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THE IMPACT OF INVESTMENT OPPORTUNITIES, FINANCIAL PERFORMANCE, AND INTERNAL MECHANISMS ON EARNINGS QUALITY

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Abstract: *This research aims to provide empirical evidence regarding the influence of investment opportunities, financial performance as manifested by return on assets (ROA) ratio, company size, liquidity ratio as manifested by the current ratio, growth opportunities, and internal mechanisms such as audit committee, institutional ownership on earnings quality and the relationship between these factors and earnings quality. The study utilizes a sample of non-cyclical and cyclical companies during the research period of 2020-2022. Hypothesis testing in this study employs multiple linear regression. The results of the research indicate that the factor influencing earnings quality is financial performance. Meanwhile, investment opportunities, company size, liquidity, audit committee, growth opportunities, and institutional ownership do not influence earnings quality.*

Keywords: audit committee, earnings quality, financial performance, institutional ownership, investment opportunity set

Abstrak: Penelitian ini bertujuan untuk memberikan bukti empiris mengenai pengaruh peluang investasi, kinerja keuangan yang tercermin dari rasio *return on assets* (ROA), ukuran perusahaan, rasio likuiditas yang tercermin dari rasio lancar, peluang pertumbuhan, dan mekanisme internal seperti komite audit, kepemilikan institusional terhadap kualitas laba, dan hubungan antara faktor-faktor ini dengan kualitas laba. Studi ini menggunakan sampel perusahaan *non-cyclical* dan *cyclical* selama periode penelitian 2020-2022. Pengujian hipotesis dalam penelitian ini menggunakan regresi linear berganda. Hasil penelitian menunjukkan bahwa faktor yang mempengaruhi kualitas laba adalah kinerja keuangan. Sementara itu, peluang investasi, ukuran perusahaan, likuiditas, komite audit, peluang pertumbuhan, dan kepemilikan institusional tidak mempengaruhi kualitas laba.

Kata kunci: kepemilikan institusional, kinerja keuangan, komite audit, kualitas laba, kumpulan peluang investasi

INTRODUCTION

In order to forecast future financial performance, a firm needs its financial statements, as these statements provide comprehensive information on the company's financial status for a specific accounting period. The company's financial statements will be utilized to evaluate the company's success. Financial reports serve as a source of information for individuals or entities, both internal and external to the organization, who require access to the company's financial statements (Ashma and Rahmawati 2019).

Financial statement users utilize financial statements as a tool for making decisions and can reduce errors in decision-making. The financial statements provide a means to assess the company's operational performance and evaluate its financial well-being. Therefore, financial reports must display high-quality earnings (Noviyanti and Santioso 2022).

The company's earnings can be considered of high quality if they accurately reflect its actual performance, unaffected by the biases of management or investors (Yoanita and Khairunnisa 2021). Furthermore, the assessment of quality earnings is based on the company's ability to generate maximum profits and can be utilized in making informed decisions. The financial statements must contain pertinent, trustworthy information and be capable of being compared. A corporation with consistent profitability is likewise characterized by high quality (Wulandari et al. 2021). Hence, it is imperative that the financial statements accurately depict the actual financial situation of the organization, devoid of any form of manipulation or artificial enhancement of earnings (Lusiani and Khafid 2022).

Earnings manipulation undoubtedly leads to a decline in the quality of earnings. Conversely, poor earnings quality can lead to errors in decision-making for users such as investors and creditors. However, many corporate managers still use different unethical practices to manipulate financial accounts to create the illusion of a sound firm situation. When firm management perceives that the company's state is unfavorable, they frequently employ several strategies to enhance these conditions, such as engineering or manipulating earnings information by declaring results that do not align with the company's actual state (Ashma and Rahmawati 2019).

An explicit instance of earnings manipulation can be observed in the 2018 case of PT Garuda Indonesia (GIAA). In 2018, GIAA reported a profit of USD809.85 thousand, as recognized by GIAA. Indeed, GIAA incurred a loss of USD216.5 million in the preceding year. The significant rise in profit from 2017 to 2018 can be attributed to GIAA's recognition of receivables from PT Mahata, amounting to USD239.94 million, or Rp3.5 trillion, as revenue. This amount represents an outstanding debt owed to PT Mahata that has not yet been settled. If GIAA fails to acknowledge these receivables as revenue, the company will incur a loss of USD213 million (Pratiwi 2019).

This phenomenon demonstrates that fraudulent management practices in financial reporting deviate from the company's actual state and lead to questionable profitability. If this occurrence persists, numerous users of financial statements will perceive a sense of disadvantage due to each party having a vested interest in the earnings information (Ashma and Rahmawati 2019).

This situation can also precipitate a crisis of confidence among investors, leading to a waning of their willingness to allocate their funds to the company (Lusiani and Khafid 2022). The main objective is to research the quality of earnings. Earnings quality is intricately linked to business ethics concerns, particularly regarding unscrupulous accounting methods like earnings management, which include corporations manipulating their financial accounts in a manner that lacks integrity.

This study builds upon the earlier research undertaken by Hasanuddin et al. (2021) by incorporating independent factors, specifically investment opportunities, company size, and liquidity. The distinctions between this research and earlier research are as follows:

1. The previous study focused on 17 food and beverage firms on the Indonesia Stock Exchange (IDX). In contrast, this study included 255 companies from the non-cyclical and cyclical sectors listed on the IDX.
2. Prior studies utilized data from the research era 2016-2019, whereas this study employed data from 2019-2022.

3. The study conducted by Pratama et al. (2022) examines the impact of financial performance indicators, growth opportunities, and internal mechanisms such as audit committees (Sari and Kusumawati 2023) and institutional ownership (Alvin and Susanto 2022) on earnings quality. The rationale for including this variable is due to the persistently inconclusive findings of prior studies.

This study aims to gather empirical data on how investment opportunities, financial performance, firm size, liquidity ratio, growth opportunities, and internal mechanisms such as audit committees and institutional ownership impact earnings quality. This research is anticipated to yield advantages and contributions in decision-making for individuals who utilize financial statements. Furthermore, research offers valuable understanding and supplementary scholarly material for academics and researchers.

Agency Theory

Jensen and Meckling (1976) define agency relationships as contractual arrangements where a principal hires an agent to manage a company, expecting the agent to generate significant earnings. Agency theory emphasizes the significance of evaluating a firm's financial performance, specifically the earnings reported by the manager (agent) on behalf of the company owner (principal). The conflict of interest between firm management and owners necessitates that company owners have access to dependable information as a foundation for decision-making (Noviyanti and Santioso 2022). Financial reports provide earnings data frequently used as a reference point for making forthcoming business decisions. Suppose the reported earnings do not accurately represent the actual state of affairs. In that case, they cannot be considered high-quality earnings and may mislead the firm owner in decision-making. Hence, focusing on the integrity of earnings is crucial to examining the factors that can impact the reliability of a company's stated earnings (Hasanuddin et al. 2021).

Earnings Quality

Hasanuddin et al. (2021) state that earnings quality pertains to the dependability and trustworthiness of the company's declared results. Earnings can be considered of high quality if they possess three key attributes: firstly, they accurately reflect the company's current financial performance; secondly, they serve as a reliable predictor of the company's future performance; and thirdly, they serve as a benchmark for evaluating the company's overall performance. Earnings quality is a reliable measure of the accuracy and reliability of financial information.

Earnings quality refers to the stability and predictability of earnings information. It indicates its capacity to represent a company's operational success accurately and is a foundation for evaluating its future earnings and cash flows. The significance of earnings quality lies in its impact on decision-making processes and its utility as a tool for investors to evaluate a company. Producing high-quality revenue is crucial since it might significantly impact future advancements. Hence, investors are inclined to spend their funds on companies with superior earnings quality, as they perceive them to have sound financials devoid of abnormalities (Pratama et al. 2022).

Investors typically prioritize the net earnings metric when analyzing financial accounts since it aids in their investment decision-making process: the more the company's earnings, the greater the dividend for them. Indeed, the profit figure can be easily adjusted, leading to suspicions. Hence, the significance of earnings quality lies in its ability to evaluate a company's authentic revenue accurately, ultimately contributing to its longevity. Earnings quality should accurately reflect the company's financial success based on verifiable facts, without manipulation or engineering. Suppose the company consistently generates reliable and high-quality earnings. In that case, it will earn shareholders' confidence, making them more inclined to invest their funds in the company without hesitation (Ashma and Rahmawati 2019).

Conversely, if a corporation engages in earnings management, which involves manipulating profits by adjusting costs, it will diminish the reliability of its financial statements. This also leads users of financial statements to misconstrue financial accounts (Pradipta 2019). The practice of earnings management diminishes the dependability and credibility of financial statements, leading to a bias for users of financial statements who rely on manipulated figures (Sebastian and Handojo 2019). Users of financial statements may make incorrect choices due to this (Sari and Kusumawati 2023). Hence, publishing financial statements with high-quality earnings is crucial to ensuring that the earnings shown are relevant, dependable, and comparable. Furthermore, the financial statements must accurately depict the actual financial situation of the organization, devoid of manipulation or earnings management techniques.

Investment Opportunities and Earnings Quality

Hasanuddin, et al. (2021) state that investment opportunities describe the magnitude of investment opportunities for the company. Companies with high growth have high investment opportunities. Investment opportunities are used to determine the company's future growth. If the company has high growth opportunities, it will expand its operations to require more funds. Companies that have a higher growth opportunity are considered to be able to generate high returns as well (Wulandari, Situmorang, Sinaga, & Laia, 2021). Investment opportunities allow companies to determine investments that they can use. When a company has the opportunity to make investments in the future, the market value of the company's assets is assessed favorably by the company's stakeholders. This indicates the quality of the company's earnings Nurbach et al. (2019).

Investment opportunities can also affect how managers, company owners, investors, and creditors view a company. High investment opportunities are considered positive by investors, so investors will be interested in investing in companies if the investment opportunities owned by the company are high because of the possibility of obtaining higher returns (Ashma and Rahmawati 2019). The quality of earnings presented by management affects the company's investment opportunities. If investment opportunities are low, then the quality of earnings management is also low (Maulia and Handojo 2022).

Hasanuddin et al. (2021) show that investment opportunities positively affect the quality of earnings. This is due to the positive effect of the ratio market to book value of equity on earnings quality. So, it can be concluded that investment opportunities affect the quality of earnings. Hasanuddin et al. (2021) revealed that investment opportunities can affect the quality of earnings because investment opportunities become the basis for determining the company's future growth. When a company has the opportunity to make investments in the future, the market value of the company's assets is assessed favorably by the company's stakeholders. This bodes well for the quality of the company's earnings. In addition, large companies make it possible to make greater earnings in the future. Thus, the market-to-book value of equity affects the quality of earnings.

However, the results are inversely proportional to the research conducted by Nurbach et al. (2019), which shows that investment opportunities negatively affect the quality of earnings. The companies with high investment opportunities indicate that management tends to take earnings management actions, so company earnings are low. Management tries to convince investors and make them interested in investing their money in the company by performing earnings management actions. This earnings management action shows low earnings quality.

Other studies show that there is no relationship between investment opportunities and the quality of earnings made by Anam (2023), Alvin and Susanto (2022), Maulia and Handojo (2022), Noviyanti and Santioso (2022), Wulandari et al. (2021) and Ashma and Rahmawati (2019). Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_1: Investment opportunities affect the quality of earnings.

Financial Performance and Earnings Quality

According to Pratama et al. (2022), financial performance can be seen in how the company maximizes its earnings by controlling its operational activities. Companies with good financial performance do not need to manipulate earnings reported in financial statements. Without earnings manipulation, earnings reported in financial statements are highly quality (Hasanuddin et al. 2021). Investors, managers, and the board of directors see earnings as a fundamental indicator in assessing a company's financial performance and has a direct impact on the distribution of wealth among various stakeholders such as shareholders or creditors, management, and the board of directors because it can also determine the compensation and bonuses management receives.

Therefore, accountants care about financial performance, which is considered necessary in financial statements to measure the effectiveness and efficiency of company management and can be used to predict future earnings and as a basis for making financial decisions related to company management (Alrjoub et al. 2021). The company's financial performance can be seen from its earnings ability. The higher the earnings ability value, the better the company manages its assets to maximize earnings (Wulandari et al. 2021).

Research that supports the hypothesis that financial performance has a positive effect on earnings quality is research from Lusiani and Khafid (2022), Krisnawati et al. (2021), and Sebastian and Handojo (2019). Financial performance shows a company's ability to generate earnings by utilizing its assets. Companies that can carry out their business activities well can be considered capable of working optimally to obtain maximum earnings. The higher the Return on Assets of a company, the greater the level of earnings the company achieves, so the quality of earnings will increase. For investors, companies that generate high earnings are considered capable of generating maximum earnings so that they will improve the quality of earnings. In accordance with agency theory which states that management (agents) are entrusted by company owners (principals) to manage the company in order to get high bonuses. If management manages the company well and produces good financial performance, it will generate high earnings. High company earnings indicate that the quality of earnings in the company is also high.

Instead, Sari and Kusumawati (2023), Alrjoub et al. (2021), Florencia and Susanty (2019), Pradipta (2019), and Soly and Wijaya (2017) provide empirical evidence that financial performance negatively affects the quality of earnings which means financial performance reduces the quality of earnings. A high level of profitability does not mean that earnings are high quality. After all, it does not rule out the possibility that the earnings presented in the financial statements are the results of management's earnings management to attract investors. Earnings management makes the quality of earnings low.

Meanwhile, research conducted by Pratama et al. (2022) and Wulandari et al. (2021) provides a statement that financial performance does not affect the quality of earnings. Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_2: Financial performance affects earnings quality.

Company Size and Earnings Quality

According to Hasanuddin et al. (2021), the company's size indicates the business's size. Company size is a scale that can be used to classify company size in various categories, such as total assets, stock market value, number of employees, etc. According to its size, companies are divided into three categories: large enterprises, medium-sized enterprises, and small enterprises. Investors generally trust large companies more because they are considered to be able to improve their performance through earnings. They also assume that large companies have significant assets as well. The greater the assets owned by the company, the more stable its financial condition will be, so it will be easier to get a return on capital compared to companies with smaller assets. In addition, large companies are considered to be able to disclose more information to investors than small companies. Large companies have greater returns because they are considered capable of constantly improving the performance of their companies and striving to improve the quality of earnings (Hasanuddin et al. 2021).

Research supports the hypothesis that company size positively affects earnings quality (Alvin and Susanto 2022; Maulia and Handojo 2022; Yoanita and Khairunnisa 2021). Large companies tend to have the convenience of obtaining more extensive funding and better financial performance to generate higher earnings quality than small companies. Large-sized companies have an enormous asset value, and companies with an enormous asset value can manage their assets for company operations that generate large amounts of earnings. The company's ability to manage its assets to generate earnings also signifies good management performance. Management no longer needs to practice earnings manipulation on financial statements to make them attractive to investors. That indicates that the company's size, which is getting bigger, can generate high earnings quality.

These results are inversely proportional to the research by Noviyanti and Santioso (2022), which states that the company's size negatively affects the quality of earnings. Large companies are more likely to manage earnings than small ones. Earnings management is done to avoid losses in reporting and can make investors interested in investing their money in the company. That resulted in earnings generated by low quality.

Instead, Lusiani and Khafid (2022), Pujiati et al. (2022), Alrjoub et al. (2021), Santioso and Daryatno (2021), Hasanuddin et al. (2021), Wulandari et al. (2021), Florencia and Susanty (2019), Pradipta (2019), Sebastian and Handojo (2019), Soly and Wijaya (2017) and Sarawana and Destriana (2015) provide a statement that the size of the company does not affect the quality of earnings. Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_3: There is an effect of company size on earnings quality.

Liquidity and Earnings Quality

Liquidity is a ratio that measures a company's ability to meet its short-term obligations. Liquidity ratios use current ratios that measure a company's ability to cover its current liabilities with its current assets (Hasanuddin et al. 2021). A company's high liquidity means that the value of current assets is higher than its current liabilities. The company can pay its current liabilities with its assets. A good company is a company that can pay short-term obligations so that the company's operations run smoothly and achieve earnings. Liquidity can describe the financial condition of the company. Companies with high liquidity describe the company's financial condition as good, meaning it can pay its short-term obligations on time (Wulandari et al. 2021).

Companies with high liquidity have relatively low risk, making lenders confident in lending to companies and businesses. Investors are interested in investing in the company because investors believe that the company can survive and does not need to be liquidated (Krisnawati et al. 2021). Liquidity is also important information for investors and lenders before making decisions based on the earnings information presented. The better the company's financial performance, the less likely the company is to engage in earnings management practices. Earnings quality becomes higher if free from earnings management practices (Hasanuddin et al. 2021).

Research that supports the hypothesis of liquidity having a positive effect on earnings quality is research from Anam (2023), Sari and Kusumawati (2023), Pratama et al. (2022), Hasanuddin et al. (2021) and Krisnawati et al. (2021). Liquidity is a ratio that measures the company's ability to meet all obligations that must be paid in the short term. A high liquidity ratio illustrates that the company can pay short-term debt. A good company is a company that can pay short-term obligations so that the company's operations run smoothly and achieve earnings. A high liquidity ratio also illustrates that the company can manage its current assets as much as possible and indicates the good financial performance of the company that can generate high earnings quality. A company's high liquidity means that the value of current assets is higher than its current liabilities. The company has good financial performance because it can pay its current liabilities with its assets without manipulating earnings. So, that higher liquidity indicates that the earnings generated by the company are of high quality.

Instead, Putra and Dewi (2023) state that liquidity negatively affects earnings quality. Companies with significant liquidity are considered less able to manage their current assets, allowing earnings manipulation.

While Noviyanti and Santioso (2022), Pujiati et al. (2022), Mappadang (2021), Wulandari et al. (2021), Yoanita and Khairunnisa (2021), Soly and Wijaya (2017) provide a statement that liquidity does not affect the quality of earnings. Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_4: There is an effect of liquidity on earnings quality.

Audit Committee and Earnings Quality Committee

Sari and Kusumawati (2023) state that the Audit Committee is tasked with reviewing accounting policies implemented by the company, assessing internal controls, reviewing external reporting systems, and regulatory compliance. In carrying out its duties, the committee assists independent commissioners in supervising the preparation of financial statements and improving the quality of internal and external audits. The board of commissioners forms the audit committee and is responsible for assisting with the duties and roles of the board of commissioners. The task of the audit committee is to examine all information in the financial statements, especially financial information. In addition, the audit committee can provide opinions independently, which can reduce agency conflicts between owners and management (Pujiati et al. 2022). The audit committee can improve the integrity and credibility of financial reporting by overseeing the reporting and audit processes. In principle, the audit committee plays an essential role in its work, which aims to provide relevant and reliable information for shareholders (Sarawana and Destriana 2015).

Audit Committee Regulations in Indonesia stipulate that a company's minimum number of members is three people, selected from independent commissioners and external parties. If the audit committee size is large enough, it can better control and detect misstatements in financial statements. That way, the information presented is of higher quality (Pujiati et al. 2022).

Research that supports the hypothesis that the audit committee has a positive effect on earnings quality is research from Pujiati et al. (2022), Hamdan (2020), and Sebastian and Handojo (2019). The board of commissioners forms the audit committee to assist the board of commissioners in monitoring the process of preparing financial statements to increase the credibility of financial reporting. The number of members of the audit committee affects the effectiveness of monitoring. An influential monitoring audit committee can assure stakeholders that the quality of the company's earnings is also good. The audit committee formed by the board of commissioners is expected to reduce errors in making financial statements. An audit committee in the company can improve the quality of company earnings. A large number of audit committee memberships can result in tighter supervision of the company during the preparation of financial statements, which will then lead to better earnings quality because the number of audit committee memberships can guarantee the company can generate higher earnings quality because supervision of the preparation of financial statements is more effective.

While Mappadang (2021) indicates that the audit committee negatively affects the audit quality, this is because the audit committee was formed to assist the board of commissioners in monitoring the process of preparing financial statements to increase the credibility of financial reporting. However, management can act opportunistically by conducting earnings management if the performance of financial statements declines. Audit committees in some companies in Indonesia also do not perform their roles properly. The board of commissioners forms the audit committee only to comply with regulations required by the Financial Services Authority. In addition, instead of professional competence and expertise, the appointed members of the audit committee are people close to management. So, many audit committee members will not effectively conduct supervision. Therefore, a large number of audit committee members is not a guarantee that earnings management will decrease. With this earnings management, earnings are generated by low-quality.

While Sari and Kusumawati (2023), Alvin and Susanto (2022), Florencia and Susanty (2019), Sarawana and Destriana (2015), and Nelliyana (2015) provide a statement that the Audit Committee does not affect the quality of earnings. Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_5: The audit committee affects earnings quality.

Growth Opportunities and Earnings Quality

Growth opportunity is a concept that refers to the company's growth potential in the future (Rizqi et al. 2020). Growth opportunities create the potential to increase company revenue. By taking growth opportunities, companies can increase sales and revenue over time. The opportunities to grow the business, expand the market share, introduce new products or services, or make investments that can increase a company's revenue and profitability. If companies take advantage of this opportunity, their revenue can increase, which can also increase earnings.

Growth opportunities can be a source of value for a company, and continued growth can create positive expectations among investors. The level of growth opportunity can influence a company's financial policies, including dividend policy, debt management, and investment decisions. Companies with growth opportunities may be more likely to retain most of their earnings for reinvestment in the business rather than paying dividends to shareholders. The advantage of growth opportunities is that companies may need to invest and reduce current earnings due to investment costs. However, it is expected to generate higher returns (Alvin and Susanto 2022).

Research that supports the hypothesis of growth opportunities positively affecting the quality of earnings is research from Yulianti et al. (2020). The company has the convenience of attracting capital, which is a source of growth if it continues to grow (Yulianti et al. 2020). Good growth opportunities can contribute positively to earnings quality. When the company has real growth opportunities, it is less likely to engage in dishonest earnings management practices. Earnings quality may improve as higher revenues are appropriately reflected in financial statements.

Rizqi et al. (2020) show that growth opportunities negatively affect the quality of earnings. Companies with high growth opportunities tend to retain most of their earnings for reinvestment in the business rather than paying dividends to shareholders. In addition, companies invest to take advantage of growth opportunities. That may reduce current earnings due to investment costs, but it is expected to generate higher returns in the future (Rizqi et al. 2020).

Instead, Alvin and Susanto (2022) Provide a statement that the opportunity for growth does not affect the quality of earnings. Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_6: Growth opportunities affect the quality of earnings.

Institutional Ownership and Earnings Quality

Institutional ownership refers to the ownership of shares in a company by large financial institutions such as pension funds, investment funds, insurance companies, and other institutional investors (Maulia and Handojo 2022). These holdings can be passive, with a long-term investment objective, or active, attempting to influence company policy. Institutional ownership can have a significant role in governing a company. Institutional shareholders are incentivized to oversee the company's practices and ensure that the company operates appropriately and complies with regulations (Santioso and Daryatno 2021). Institutional shareholders often participate in critical corporate decision-making, including the election of board members and other strategic issues.

Significant institutional ownership can provide external control over the company's management and reduce conflicts of interest between management and shareholders, so institutional ownership can be a tool to reduce agency conflicts that occur within the company (Santioso and Daryatno 2021). In addition, active institutional shareholders can influence a company's accounting practices to improve the quality of financial reporting. Institutional investors often have a long-term focus and can encourage companies to manage risk well, affecting the quality of earnings in the long run.

Research that supports the hypothesis that institutional ownership has a positive effect on earnings quality is research from Zagita and Bangun (2020). Institutional investors are often vested in ensuring companies operate properly and implement transparent management practices. Extensive institutional holdings can provide effective external oversight, improving the quality of financial reporting and preventing dishonest earnings management practices. In addition, institutional investors often focus long-term on their stock holdings. Institutional investors may be more likely to support sustainable policies and positively impact earnings quality in the long run. Significant institutional ownership can affect corporate structure and governance. Institutional shareholders often promote transparency, accountability, and good governance, which can improve the quality of financial reporting (Zagita and Bangun 2020).

Alvin and Susanto (2022), Maulia and Handojo (2022), Santioso and Daryatno (2021), and Florencia and Susanty (2019) show that institutional ownership negatively affects audit quality. High institutional ownership can create conflicts of interest between management and shareholders, leading to dishonest earnings management practices. Management can feel pressured to meet institutional investor expectations, whereas their focus is only on current earnings, and they cannot oversee earnings management actions (Florencia and Susanty 2019). With this, it shows that the presence of institutional investors does not affect the quality of earnings.

Tarmidi et al. (2023) show that institutional ownership does not affect the quality of earnings. Based on the inconsistencies in the results of the above research, the research hypothesis is:

H_7: Institutional ownership affects the quality of earnings.

RESEARCH METHODS

Method Sample Selection and Data Collection

The research objects used in this study are companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2022 period. The research data was from the Indonesia Stock Exchange (IDX) website. The sample used for this study used purposive sampling techniques with sampling criteria as listed in Table 1.

Table 1. Sample Selection Results

Sample Criteria	Number of Companies	Amount of Data
Non-cyclical and cyclical companies are consistently listed on the Indonesia Stock Exchange (IDX) during 2019-2022.	192	576
Non-cyclical and cyclical companies did not consistently publish financial statements during 2019-2022.	(11)	(33)
Non-cyclical and cyclical companies which inconsistently ended the financial reporting period as of December 31	(3)	(9)
Non-cyclical and cyclical companies that do not consistently use rupiah currency to present their financial statements during 2019-2022.	(13)	(39)
Non-cyclical and cyclical companies were suspended during the period 2020-2022.	(3)	(9)
Total research sample	**162**	**486**

Source: Research Sample Criteria

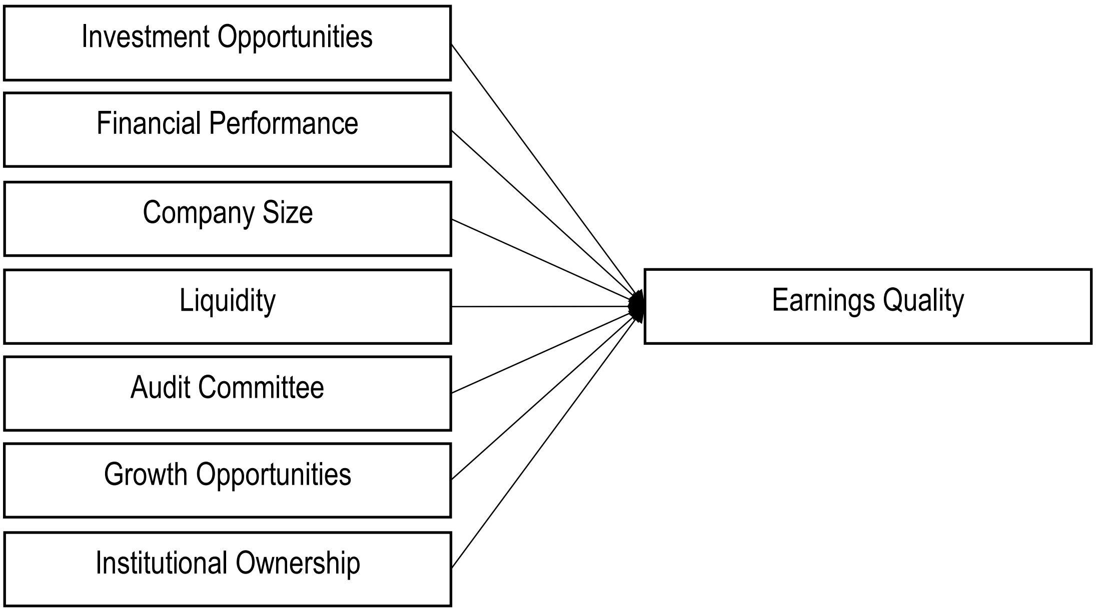

Figure 1. Research Model

Operational Definition and Variable Measurement

Earnings Quality

Earnings quality refers to the reliability and credibility of earnings a company reports (Hasanuddin et al. 2021). This study uses the absolute value of DAC as a proxy for earnings quality consistent with previous research (Mousa and Desoky 2019). To calculate the absolute value of this DAC using the model Jones (1991) has been modified by Dechow et al. (1995). The company's total accrual (TAC) in the current year is calculated as the difference between revenue and cash flow from operations (CFO) as follows:

$$\mathrm{TACit} = \mathrm{EARNINGSit} - \mathrm{CFOit} \qquad (1)$$

After that, TAC is regressed to its components and errors as follows:

$$\frac{\mathrm{TAC_{it}}}{\mathrm{TASS_{it-1}}} = \left(\frac{1}{\mathrm{TASS_{it-1}}}\right) + \frac{(\Delta\mathrm{REV} - \Delta\mathrm{REC})}{\mathrm{TASS_{it-1}}} + \frac{\mathrm{PPE}}{\mathrm{TASS_{it-1}}} + \mathrm{e} \qquad (2)$$

Next, the DAC is calculated through the use of the regression coefficient to calculate the normal accrual (NAC), which is subtracted from the total accrual by using the following equation:

$$|\mathrm{DAC_{it}}| = \mathrm{TAC_{it}} - \mathrm{NAC_{it}} \qquad (3)$$

Information:
TAC_{it}= Total accrual of company i in year t
$EARNINGS_{it}$= Current year earnings of company i in year t
CFO_{it}= Operating Cash Flow of Company i in year t
$TASS_{it}$= Total assets of the company i in year t
ΔREV= Company's revenue in year t minus company revenue i in year t-1
ΔREC= company i receivables in year t minus company i receivables in year t-1
PPE= PPE of the company i in gross in year t
$|DAC_{it}|$= Absolute discretionary accruals company i in year t
NAC_{it}= Normal accrual/non-discretionary accruals company i in year t
e= error

Investment Opportunities

Hasanuddin et al. (2021) state that investment opportunities describe the magnitude of investment opportunities for the company. Companies with high growth have high investment opportunities. The market value to book of equity ratio reflects how much the market assesses that the company can utilize its capital in running the business to meet company goals. The greater the company can manage its capital well, the higher its opportunity to grow and attract investors to give funds. So, the bigger the market value to the book of equity ratio Then, the greater the company can manage its capital well, and the company's opportunity to grow will be higher and can attract investors.

The measurements used for this model are measurements used in research by Hasanuddin et al. (2021) that is:

$$\mathrm{MVBE} = \frac{\text{Market Capitalization}}{\text{Book Value of Equity}}$$

Information:
Market capitalization = Share price x number of shares outstanding
Number of shares outstanding = number of shares outstanding at the end of the year
Stock price = Year-end stock selling price
Book value = Total equity

Financial Performance

According to Pratama et al. (2022), financial performance can be seen in how the company maximizes its earnings by controlling its operational activities. This study's measurement of financial performance refers to Pratama et al. (2022), where financial performance is proxied by the profitability ratio (ROA).

$$\mathrm{ROA} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

Company Size

According to Hasanuddin et al. (2021), the size of the company indicates the size of a company's business venture. Company size is a classification scale using various categories, such as total assets, stock market value, number of employees, etc. The measurements used in this study refer to Hasanuddin et al. (2021) that is:

$$\text{Firm Size} = \text{Log n (Total Asset)}$$

Liquidity

Liquidity is a ratio that measures a company's ability to meet its short-term obligations. Liquidity ratios use current ratios that measure a company's ability to cover its current liabilities with its current assets (Hasanuddin et al. 2021). In this study, liquidity measurement refers to Hasanuddin et al. (2021) as follows:

$$\mathrm{CR} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Audit Committee

Sari and Kusumawati (2023) state that the Audit Committee is tasked with reviewing accounting policies implemented by the company, assessing internal controls, examining external reporting systems, and regulatory compliance. The measurements used in this study refer to Sari and Kusumawati (2023) that is:
KA = Number of audit committee members

Growth Opportunities

Growth opportunity is a concept that refers to the company's growth potential in the future. With growth opportunities, companies can increase sales and revenue over time (Rizqi et al. 2020).

In this study, the measurements used refer to Alvin and Susanto (2022) that is:

$$\mathrm{GO} = \frac{(\mathrm{Sales}_t) - (\mathrm{Sales}_{t-1})}{\mathrm{Sales}_{t-1}} \times 100\%$$

Institutional Ownership

Institutional ownership refers to the ownership of shares in a company by large financial institutions such as pension funds, investment funds, insurance companies, and other institutional investors (Maulia and Handojo 2022). Institutional shareholders oversee the company's practices and ensure that the company operates appropriately and complies with regulations (Santioso and Daryatno 2021). In addition, active institutional shareholders can influence a company's accounting practices to improve the quality of financial reporting. Institutional investors often have a long-term focus and can encourage companies to manage risk well, affecting the quality of earnings in the long run.

In this study, institutional ownership refers to Alvin and Susanto (2022) that is:

$$\mathrm{IO} = \frac{\text{Shares owned by the institution}}{\text{Total outstanding shares}} \times 100\%$$

This study tested the research hypothesis using multiple regression analysis. Multiple regression analysis can show the relationship of each independent variable to the dependent variable (Sekaran and Bougie 2016, 314). The regression equation model is as follows:

EQ = α + β1PI + β2KI + β3UKP + β4LIK + β5KA + β6GO + β7IO + e

Information:
EQ= Earnings Quality
α= Constant value
β1-β7= Regression coefficient
PI= Investment Opportunities
KI= Financial Performance
UKP= Company size
LIK= Liquidity
KA= Audit Committee
GO= Growth Opportunity
IO= Institutional Ownership
e= error

RESEARCH RESULTS

Table 2 displays the descriptive statistics results for the entire dataset used in this study, consisting of 486 data points from 2020 to 2022. The study's data indicates that the earnings quality variable (EQ) has an average value of 0.155412 and a standard deviation of 0.336992. The investment opportunity variable (PI) has a mean value of -0.544610 and a standard deviation of 84.260282. The financial performance variable (KI) has a mean value of -0.032979 and a standard deviation of 0.469198. The variable representing the firm's size (UKP) has an average value of 28.335398 and a standard deviation of 1.703975. The liquidity variable (LIK) has a mean value of 3.697343 and a standard deviation of 11.657571. The audit committee variable (KA) has a mean value of 3 and a standard deviation of 0.307942. The growth opportunity variable (GO) has a mean value of 0.640370 and a standard deviation of 10.009530. The variable representing institutional ownership (IO) has a mean value of 0.655346 and a standard deviation of 0.226735.

Table 2. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Standard Deviation
EQ	486	0,000151	5,561597	0,155412	0,336992
PI	486	-1848,308155	56,791898	-0.544610	84,260282
KI	486	-7.592138	0,599025	-0.032979	0,469198
UKP	486	22,937382	32,826382	28,335398	1,703975
LIK	486	0,010758	140,245199	3,697343	11,657571
KA	486	1	5	3	0,307942
GO	486	-0.985299	219,295184	0,640370	10,009530
IO	486	0	0,999584	0,655346	0,226735

Source: Data Processing Results

Table 3. t test Results

Variable	β	Sig.	Conclusion
(Constant)	-0,067	0,721	
PI	-0,000050	0,643	H_1 not accepted
KI	-0,588	0,000	H_2 accepted
UKP	0,005	0,386	H_3 not accepted
LIK	0,000	0,883	H_4 is not accepted
KA	0,015	0,658	H_5 not accepted
GO	0,001	0,244	H_6 not accepted
IO	0,021	0,609	H_7 not accepted

The result test F indicates a sig. value of 0.000 < 0.05 means that the model in this study is fit or suitable for use—the value of Adj. R2 (coefficient of determination) indicates the number 0.644, which shows that the magnitude of the dependent variable of earnings quality that can be explained by variations in the independent variables of investment opportunity, financial performance, company size, liquidity, audit committee, growth opportunity, and institutional ownership is 64.40%. The remaining 35.60% is explained by other variables not included in the regression model.

The results of the t-test in Table 3 obtain the results that investment opportunities (PI) have a significance value (sig.) of 0.643 > 0.05. H_1 is not accepted, meaning the investment opportunity does not influence earnings quality. Investment opportunities are not the main focus of investors when making investment decisions. Investors do not pay much attention to the value of the company's investment opportunities but pay more attention to the company's earnings (Yulianti et al. 2020).

Financial performance (IP) has a significance value (sig.) of 0.000 < 0.05. H_2 is acceptable, meaning financial performance influences the quality of earnings. The unstandardized coefficient (β) value of -0.588 indicates a negative relationship between financial performance and earnings management. Therefore, financial performance has a positive relationship with earnings quality. Profitability can measure a company's effectiveness in generating earnings by utilizing its assets. The higher the profitability value, the better the company's performance and the higher the shareholders' earnings. Likewise, management does not do earnings management because management will get high earnings. The lower earnings management indicates that the earnings quality will increase (Sari and Kusumawati 2023).

Company size (UKP) has a significance value (sig.) of 0.386 > 0.05. H_3 is not accepted, meaning the company's size does not influence the quality of earnings. The company's size does not affect the quality of earnings because it does not use its assets to increase earnings. Therefore, total assets do not affect earnings quality (Hasanuddin et al. 2021).

Liquidity (LIK) has a significance value (sig.) of 0.883 > 0.05. H_4 is not accepted, which means that liquidity does not influence earnings quality. This is because, to pay short-term obligations, companies must do various things, such as withdrawing their assets by selling inventory, collecting receivables, and selling securities. Companies are more focused on choosing various settlement methods that must be implemented to overcome liquidity problems. Liquidity problems do not allow management to report earnings that do not reflect the actual condition of the company, which results in low earnings quality. Instead, management focuses more on addressing liquidity issues (Murniati 2019).

The audit committee (KA) has a significance value (sig.) of 0.658 > 0.05. H_5 is not accepted, meaning the audit committee does not influence the quality of earnings. The audit committee members can be selected on the recommendation of the controlling shareholder, not based on the ability and expertise of prospective audit committee members. So, an audit committee does not affect the quality of earnings (Sari and Kusumawati 2023).

The opportunity to grow (GO) has a significance value (sig.) of 0.244 > 0.05. H_6 is not accepted, meaning the opportunity to grow does not affect the quality of earnings. Growth opportunities are not the main focus of investors when making investment decisions. Companies with significant growth opportunities are more focused on expansion and investments that can generate unstable earnings or experience significant changes from period to period (Alvin and Susanto 2022).

Institutional ownership (IO) has a significance value (sig.) of 0.609 > 0.05. H_7 is not accepted, which means that institutional ownership does not influence the quality of earnings. Institutional shareholders who own shares in the company do not have control over what management reports in the financial statements, so institutional shareholders do not affect the quality of earnings (Murniati 2019).

CONCLUSION

Based on the research that has been done, it can be concluded that financial performance has a positive effect on the quality of earnings. Meanwhile, investment opportunities, company size, liquidity, growth opportunities, and internal mechanisms such as audit committees and institutional ownership do not influence the quality of earnings.

The implications of this research are related to understanding various parties, especially investors, of financial performance that can improve earnings quality. Companies with good financial performance do not need to manipulate earnings reported in financial statements. Without earnings manipulation, earnings reported in financial statements are of high quality. Investors can pay attention to one company's earnings quality in decision-making before investing capital.

The limitation of this study is that the research period used from 2020 to 2022 is relatively short. Recommendations can be considered to support future research using more than three years of research.

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