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The Effect of Firm Size, Debt, Current Ratio, and Investment Opportunity Set on Earnings Quality: An Empirical Study in Indonesia

Rusdiah HASANUDDIN[1], Darman DARMAN[2], Muhammad Ybnu TAUFAN[3], Agus SALIM[4], Muslim MUSLIM[5], Aditya Halim Perdana Kusuma PUTRA[6]

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Abstract

The quality of earnings refers to the proportion of income attributable to the core operating activities of a business. This study analyzes the effect of the variable firm size, the leverage ratio as manifested by the debt-to-equity ratio, the liquidity ratio exemplified by the current ratio, and the investment opportunity set (IOS) on earnings quality. The study subjects are IPO companies engaged in the food and beverage sector with a study observation period using secondary data (financial statements), namely in 2016–2019, totaling 17 companies. Several stages of testing are carried out to answer statistical analysis (eg, normality test, heteroscedasticity test, multicollinearity test, *T*-test, and *F*-test) then the final testing stage is the regression test. These results of this study explain that the firm size, leverage ratio, does not contribute to earnings quality. Liquidity positively contributes to earnings quality. IOS also contributes to earnings quality. This study assumes that company management prefers to carry out earnings management to maintain their firm value. Besides, large companies make it possible to generate greater profits in the future. Thus, the market to book value of the equity ratio affects earning quality.

Keywords: Firm Size, Debt to Equity Ratio, Current Ratio, Investment Opportunity Set, Earnings Quality

JEL Classification Code: G11, G12, G53

1. Introduction

Companies use annual reports to provide important company and financial information to investors, customers, employees, and the media. An annual report is an important element of a financial communication strategy to attract and retain investors. The quality of earnings refers to the proportion of income attributable to the core operating activities of a business. Many studies explain the relationship between profit and investment decision making (Harshita et al., 2015; Sarkar & Zhang, 2020), and the methods and approaches used to determine how the earnings quality is produced by a company (Saens & Tigero, 2021; Sarkar & Zhang, 2020) In substance, in the financial statements, there are elements of the income statement that provide essential information regarding the company's amount of profit; for stakeholders and investors, earnings information is the basis for making decisions (Bae Choi et al., 2013). In connection with this (profit-loss information), many companies, especially IPO companies, strive to present the best possible financial reports, presentation methods, and financial analysis tools to deliver good quality annual reports (O'Donovan, 2002).

Kallapur and Trombley, (1999) stated that profit is considered the essential information that can determine a decision-making process by interested parties. A quality

[1]First Author and Corresponding Author. Department of Accounting, STIE YPUP, Makassar, Indonesia [Postal Address: Jl. Andi Tonro No. 88, Makassar City, South Sulawesi 90322, Indonesia] Email: rusdiah.ypup@gmail.com
[2]Assistant Professor, Department of Administration Science, Sekolah Tinggi Administrasi Bina Taruna, Gorontalo, Indonesia.
[3]Assistant Professor, Faculty of Teacher Training and Education, Universitas Tomakaka, Makassar, Indonesia.
[4]Associate Professor, Faculty of Economics & Business, Department of Islamic Economics, Universitas Muhammadiyah Makassar, Makassar, Indonesia.
[5]Assistant Professor, Department of Accounting, Faculty of Economic & Business, Universitas Muslim Indonesia, Makassar, Indonesia.
[6]Assistant Professor, Department of Management, Faculty of Economic & Business, Universitas Muslim Indonesia, Makassar, Indonesia. Email: adityatrojhan@gmail.com

earnings report helps to establish the value of a business by analyzing and reporting on detailed aspects that may not be readily identifiable to a seller, buyer, or investor in reviewing the financial statements. Dang et al. (2020) and Ball and Shivakumar (2005) emphasized that high earnings quality indicates a high level of investor interest in investing in the company in question. So that when company profits increase, the company's profits are said to be of quality and become a tool to attract investors' attention to investing their capital. The urgency regarding earnings information in the company's annual report causes managers to take various ways to prepare financial statements as effectively as possible for both internal and external parties. The urge to present excellent and quality financial reports can trigger the emergence of information asymmetry between management and principals, which is known as agency conflict (Kallapur & Trombley, 1999).

Various examples of conflicts of asymmetry in the presentation of financial statements involve conflicts of interest between agents. For example, when financial statements are intended to attract investors, in presenting company profits, efforts are made to increase profits. While on the other hand, if the company is paying taxes to the government, efforts are made to decrease profits so that the amount of tax paid is lower (Herrmann & Inoue, 1996; Saeidi, 2012). Income smoothing is the shifting of revenue and expenses among different reporting periods to present the false impression that a business has steady earnings. Management typically engages in income smoothing to increase earnings in periods that would otherwise have unusually low earnings (Vintilă & Gherghina, 2014; Gangi et al., 2018). The conditions of volatility and uncertainty in company activities typically impact the presentation of financial statements, which also fluctuates. Therefore, the effect of differences in financial information expression related to stakeholder interests will be detrimental to potential investors or even to other stakeholders. Unreal financial reports will have a negative impact on creditors too because they are wrong in making decisions about giving credit to the company. Financial statements that tend to be exaggerated will impact investors, especially novice investors, in making their capital investment decisions.

The purpose of financial statements should be to provide tangible and verifiable information for parties interested in making decisions. One of the critical elements of financial statements is net income. Net income reported in financial statements is an essential performance evaluation criterion and determinant of company value, which is always used by many professional users such as accountants, financial managers, stock market analysts, investors, and shareholders (Broadstock et al., 2020). When the earnings listed in the financial statements do not reveal the facts, earnings' quality is doubtful. The high quality of financial information stems from the high quality of financial reports. By definition, earnings quality, also known as quality of earnings (QoE), in accounting, refers to the ability of reported earnings (income) to predict a company's future earnings (Riyani et al., 2020). The importance of earnings information is also used to assess management performance. It can also help estimate the ability of representative earnings and assess risk in an investment or credit.

Some factors that affect the quality of the company's earnings are profitability (Roy & Shijin, 2019), leverage (Alnori & Alqahtani, 2019), liquidity (Alarussi & Alhaderi, 2018); profit growth (Endri et al., 2020), and company size (Elshandidy et al., 2013; Roy & Shijin, 2019; Ullah, 2020). The company's size has a relationship with the earnings quality because large companies are considered to generate high profits and high business continuity in improving the company's financial performance. The size of the company is stated in total assets; if the total assets of a company are considered large, it is assumed that the size of the company is also getting more significant. Therefore, concerning the study's focus, this study objectively examines the effects of firm size, leverage, liquidity, and investment opportunity set on the earnings quality and investment decision making. The object of this research is to use Food and Beverages companies listed on the Indonesia Stock Exchange.

2. Literature Review and Hypothesis Development

Earnings quality refers to the reliability and credibility of a company's reported earnings. For investors, the earnings report is considered to have information to analyze the issuer's shares (Martani & Khairurizka, 2009). Quality earnings are profits that can reflect sustainable earnings in the future, which are determined by the accrual and cash components and reflects the company's actual financial performance. Earnings quality is also an indicator of the quality of financial information. The high quality of financial information stems from the high quality of financial reporting (Alarussi & Alhaderi, 2018) defines earnings quality as the ability of incomes to reflect the truth of the company's earnings and help predict future earnings, taking into account the stability and persistence of earnings. Profit is said to be of quality if the profit can reflect the financial performance (Cheng, 2014; López-Gutiérrez et al., 2015). Thus, the definition of Earnings quality above is only in the context of specific decision models. The first category includes earnings persistence, the magnitude of accruals (Zhang, 2007), residual model accrual (McNichols, 2002), earnings smoothness (Habib et al., 2011; McInnis, 2010), and timely loss recognition (Ball & Shivakumar, 2005). Earnings quality is collectively determined by the relevance of the underlying financial performance, such as

financial statements and internal control reports (Hogan & Wilkins, 2008; Krishnan & Visvanathan, 2007). Firm size is a determining factor in generating profits; investors usually have more confidence in large companies with large amounts of assets because large companies are considered capable of continuously improving their company performance and always striving to increase earnings quality (Tangngisalu et al., 2020; Abbas et al., 2020).

The total assets measure the size of the company in this study. Real assets can describe the company's size by the reflection of the assets. Real assets more significant the investments decision making (Dang et al., 2018). Companies with good financial performance do not need to manipulate the earnings presented in the financial statements. Reducing the practice of profit manipulation will result in the profit shown in quality financial statements. Research conducted by Davidson and Neu (1993) proved that firm size affects earnings quality. Large companies have greater returns and information. Besides, large companies are considered to disclose more information to investors than small companies. Based on the signal theory, company size provides a positive signal for investors regarding disclosing information in financial statements (Morris, 1987). The size of a business unit means the size of a business firm. It means the scale or volume of operation turned out by a single firm. By definition, firm size is the average total net sales for the year (Dang et al., 2018). In this case, if sales of the company is higher than the variable costs and fixed costs, the company will earn profits. Conversely, if sales are smaller than the variable costs and fixed costs, the company will suffer losses. Company size is a scale in which the company's size can be classified according to various ways, including total assets, stock market value, number of employees, etc. Company size is divided into three categories: large firm, medium-firm size, and small-firm size. Investors usually have more confidence in large companies. This is because large companies are considered capable of improving their performance through good earnings. Large companies are also considered to have more information than small companies. The larger the company's assets the more stable wll be the financial condition of the company so that it will be easier to obtain capital than companies with smaller assets.

Another latent variable in this study is leverage, which refers to the amount of debt a firm uses to finance assets. Leverage shows the level of the company's dependence on debt in financing the company's operational activities (Mardani & Fallah, 2018). Leverage is an investment strategy of using borrowed money—specifically, the use of various financial instruments or borrowed capital—to increase the potential return of an investment. This leverage ratio is the information needed by creditors or lenders. By knowing the leverage ratio, creditors can determine how high the debt risk of the company will be. Based on the signal theory, the debt ratio will signal investors how much the company's assets are funded by debt. The use of debt to measure Earnings quality is because information about the high amount of debt causes earnings' rate and quality to decrease. Companies with high levels of leverage cause investors to lack confidence in earnings information published by the company. This is because investors think that companies prioritize debt payments to debtholders rather than dividend payments (Koudijs & Voth, 2016). The different types of leverage measurement are debt ratio, debt to equity ratio, time interest earned ratio, fixed charge coverage, and debt service coverage. The company to attract investors take various efforts; the company's management sometimes takes action by increasing the profits presented in the financial statements. Management's actions to manipulate earnings like this will cause financial statement users to experience errors in decision making.

The next latent variable in this study is liquidity, which is the ratio used to measure a company's ability to meet its short-term obligations. The current ratio is a liquidity ratio that measures a company's ability to cover its short-term obligations with its current assets. The current ratio is a liquidity ratio that measures a company's ability to pay short-term obligations or those due within one year. It tells investors and analysts how a company can maximize the current assets on its balance sheet to satisfy its current debt and other payables (Smith Jr & Watts, 1992). Types of measurement for liquidity ratios are current ratio, quick ratio, and cash ratio. In this study, the indicator used is the quick ratio; the reason is that it can measure the total assets of the company and the amount of liquid money available in the company both for operations and to pay the short-term debt (Al Nimer et al., 2011). Ideally, the ratio between current assets and current debt is two to one. With the availability of current assets, the company can pay off its current debt and still has current assets for its business sustainability. Thus, when published, the company gives a positive signal to investors and creditors regarding earnings information. Based on the signal theory, liquidity becomes essential information for investors and creditors before making decisions based on the earnings information presented. Because the company's financial performance is better, the less likely it is for the company to practice earnings management. Reduced earnings management practices will result in higher quality profits.

The Investment Opportunity Set describes the breadth of investment opportunities for companies. Companies with high growth are often said to have high investment opportunities (IOS). This motivates the managerial side to reinvest in large amounts. IOS is used as the basis for determining future company growth. The value of IOS depends on future discretionary expenditure (Kallapur & Trombley, 1999). IOS can also affect how managers, owners,

investors, and creditors view the company. Companies that have high growth opportunities are considered to be able to generate high returns. Riyani et al (2020) stated that high IOS is directly proportional to the discretionary accruals. IOS and discretionary accruals indicate that managers of companies with high investment opportunities tend to manipulate discretionary accruals, as such, the earnings quality is low. Siahaan (2013) stated that IOS has a positive effect on earnings quality. Therefore, if the company has a high opportunity to grow with IOS, in that case, this can increase its profit so that the market will significantly respond to the company.

3. Research Methods and Materials

3.1. Sample Criteria

This study's sample is food and beverage companies listed on the Indonesia Stock Exchange (IDX) in 2016–2019. The company's population is 25 companies, while the number of food and beverage companies that have complete financial reports is 17 companies. The sample in question is described in Table 1. The data uses secondary data, which comes from financial statements.

3.2. Measurement

The test variables include company size, leverage, liquidity, investment opportunity set, and income ratio quality. The size of the company is measured according to the log size of the total assets as shown in the following formula:

$$\text{Firm Size} = \text{Ln (Total Asset)} \quad (1)$$

Furthermore, leverage describes the relationship between the company's liabilities to capital and total assets. In this study, the Debt to equity ratio (DER) is used as the leverage ratio with the following formula:

$$\text{DER} = \frac{\text{Liabilities}}{\text{Total Asset}} \quad (2)$$

The third independent variable is the liquidity ratio, which is a ratio that describes the company's ability to meet short-term liabilities. In this study, the current ratio is used as the liquidity ratio with the following formula:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} \quad (3)$$

Table 1: Data Description of Food and Beverage Companies in Indonesia

No	Code	Firm Size				DER				Current Ratio			
		2016	2017	2018	2019	2016	2017	2018	2019	2016	2017	2018	2019
1	ADES	26.51	26.67	26.76	26.76	99	1.00	99	91	1.39	1.63	1.20	1.48
2	ALTO	27.80	27.78	27.73	27.72	1.33	1.42	1.65	1.85	1.58	75	1.07	1.17
3	BTEK	26.93	29.22	29.30	29.32	5.20	2.23	1.67	1.03	48	60	1.01	2.16
4	BUDI	28.81	28.71	28.71	28.81	1.95	1.52	1.46	1.71	1.00	1.00	1.00	1.00
5	CEKA	28.03	27.99	27.96	27.82	1.32	61	54	32	1.53	2.19	2.22	3.40
6	DLTA	27.67	27.81	27.92	27.97	22	18	17	19	6.42	7.60	8.64	7.28
7	ICBP	30.91	30.99	31.08	31.15	62	56	56	54	2.33	2.41	2.43	2.02
8	IIKP	26.53	26.60	26.47	26.45	4	30	9	9	1.01	68	82	1.05
9	INDF	32.15	32.04	32.11	32.20	1.13	87	88	98	1.70	1.51	1.50	1.13
10	MLBI	28.37	28.45	28.55	28.59	1.74	1.77	1.36	2.12	58	68	83	64
11	MYOR	30.06	30.19	30.33	30.52	1.18	1.06	1.03	1.29	2.36	2.25	2.39	2.84
12	PSDN	27.15	27.21	27.26	27.29	91	1.33	1.31	1.58	1.21	1.06	1.16	1.20
13	ROTI	28.63	28.70	29.15	29.09	1.28	1.02	62	51	2.05	2.96	2.26	2.71
14	SKBM	29.67	27.63	28.12	28.12	1.22	1.72	59	56	1.15	1.11	1.64	1.63
15	SKLT	26.66	27.07	27.18	31.91	1.48	92	1.07	1.20	1.19	1.32	1.26	1.26
16	STTP	28.28	30.78	28.57	28.57	90	1.00	69	61	1.58	1.65	2.64	2.64
17	ULTJ	28.90	29.08	29.28	29.35	27	21	23	19	3.75	4.84	4.19	5.07
∑ Mean		28.50	28.62	28.62	28.92	1.28	1.04	0.88	0.92	1.84	2.01	2.13	2.28

The fourth independent variable is the investment opportunity set, which means choosing future investment opportunities that can affect the growth of company or project assets that have positive net present value (NPV). The IOS proxy is based on the assumption that the company's growth prospects are partially expressed in share prices. A growing company will have a relatively higher market value for its assets than a company that is not growing. The IOS with a formula using the Market Value to Book of Assets is as follows:

$$\text{Market Value to Book of Assets} = \frac{\text{Market Capitalization}}{\text{Book Value}} \quad (4)$$

The dependent variable in this study is Earnings quality. The quality of earnings ratio, sometimes referred to as the quality of income ratio, is calculated by dividing the net cash provided by operating activities by the net income of the business as shown in the following formula:

$$\text{Earnings Quality} = \frac{\text{Cash flow from Operating Activities}}{\text{Net Income}} \quad (5)$$

The results of calculations using the formulas described above are summarized in Table 1. Furthermore, in analyzing the data, this study uses a linear regression approach. The stages in testing are Illustration description of variable data calculation, normality and multicollinearity testing, and linear regression testing with the following formula:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \mu \quad (6)$$

Information:

Y = Earnings quality
X_1 = Firm Size
X_2 = Debt to Equity Ratio
X_3 = Current Ratio
X_4 = IOS
α = Constant
$\beta_{1,2,3,4}$ = Regression coefficient
μ = Standard error

4. Results and Discussion

4.1. Data

Based on the table above, it can be seen that the average Firm Size has increased every year. In 2016 the firm-size average was 28.50, then increased to 28.62 in 2017 and 28.92 in 2018. Although the firm size has grown each year, it can be seen in Table 1 that the firm size of several companies is unstable every year. The highest firm size during the study period was INDF at 32.20 in 2019, while ADES had the lowest firm size at 26.51 in 2016. Furthermore, the average value of the variable debt to equity ratio (DER) was 1.28 in 2016 then decreased in 2017 to 1.04, 0.88 in 2018, and 0.92 in 2019. The debt-to-equity ratio, which has reduced and improved each year, shows that several companies' debt-to-equity ratio is unstable every year. This also applies to the average value of the current ratio of each company that also experiences volatility.

Table 2 explains that the average total asset turnover has decreased and increased each year. In 2016 the average market-to-book value of equity ratio was 29289.87, then reduced in 2017 to 23878.45, 19507.73 in 2018, and increased to 20808.76 in 2019. The average total market to book value of equity ratio that has increased and decreased each year shows that the market to book value of equity ratio in several companies is unstable. The average total market to book value of equity ratio that has increased and decreased each year shows that the market to book value of equity ratio in several companies is unstable.

4.2. Statistical Results

Table 3 describes the results of the statistical analysis. The first stage is data normality testing; The results obtained using the Kolmogorov-Smirnov method at the asymp-sig value of 0.052 > 0.05 can be interpreted as normal (parametric). The second stage is multicollinearity testing; it can be stated that there is no multicollinearity if the VIF value is <10. The results described in Table 2 show the overall VIF values <10, so it can be concluded that the data does not have multicollinearity. The third stage in this research is heteroscedasticity testing, in which the variants of the observation residuals between variables must have different variants or the observational data is heterogeneous. The Heteroscedasticity test here uses the Spearman rank correlation between the residuals and all independent variables. The results of the heteroscedasticity test analysis show that the variable Firm Size = 0.385, Leverage ratio / DER = 0.288, Liquidity ratio / Current Ratio = 0.667, and Investment Opportunity = 0.147, do not have a significant correlation between residuals and independent variables, where the significance value of each variable > 0.05. Since all variables do not have a significant correlation, the results of this analysis can be concluded that there is no heteroscedasticity. The *R*-Square value also shows a value of 0.571; This means that the firm size, DER, Current Ratio, and IOS variables have a close relationship with earnings quality, and 57.1% of the variance in the earnings quality

Table 2: Resume on the Calculation Result of Market to Book Value of Equity and Earning Quality

No	Code	Market to Book Value of Equity				Earning Quality			
		2016	2017	2018	2019	2016	2017	2018	2019
1	ADES	188.63	153.46	123.41	112.61	0.59	1.93	1.71	2.09
2	ALTO	142.96	153.04	202.68	226.48	0.29	1.40	0.08	0.17
3	BTEK	453.44	1157.28	772.41	674.13	139.79	59.36	3.90	14.00
4	BUDI	25.64	33.60	35.40	35.21	1.86	5.45	1.14	0.36
5	CEKA	62.76	90.46	85.00	83.77	1.19	0.62	1.46	2.33
6	DLTA	490033.17	395436.39	321062.32	344022.36	0.99	0.79	0.93	0.87
7	ICBP	479.48	540.52	510.67	536.69	0.87	0.92	0.99	0.72
8	IIKP	3869.10	3009.48	3838.17	2939.38	0.16	0.05	0.22	0.05
9	INDF	105.37	158.36	143.19	131.05	0.85	0.97	0.85	0.80
10	MLBI	225.41	3017.48	2705.71	2887.45	1.36	0.95	0.75	0.88
11	MYOR	525.13	587.05	614.12	685.74	1.42	0.36	0.58	0.19
12	PSDN	54.17	62.68	123.09	113.83	0.69	2.41	0.46	0.82
13	ROTI	538.75	561.35	279.70	254.51	1.47	1.12	1.99	0.63
14	SKBM	257.21	164.71	120.61	115.28	1.16	1.02	3.11	2.67
15	SKLT	168.09	71.84	247.04	305.42	1.08	0.06	0.08	0.37
16	STTP	391.52	357.63	412.46	298.38	0.84	0.76	1.04	0.75
17	ULTJ	407.04	29.08	355.48	326.65	0.96	0.84	1.05	0.61
∑ Mean		29289.87	23878.45	19507.73	20808.76	9.15	4.65	1.20	1.67

is influenced by firm size, DER, Current Ratio, and IOS variables.

Table 3 also shows the statistical interpretation of the regression test results; the constant value of 13.624 indicates that for the variables company size, Leverage ratio / DER, Liquidity / Current Ratio, and IOS, the coefficient is zero or constant. Then the earnings quality is reduced/ decreased by 13,624. The regression coefficient value of company size is 0.866 and is positive, indicating a linear change between company size and earnings quality as the dependent variable; it is assumed that if the company size increases by one unit, earnings quality will increase by 0.866. Conversely, if the size of the company decreases by one unit, the company's earnings quality will also reduce by 0.866, assuming the variables leverage ratio / DER, liquidity ratio / Current Ratio, and IOS are constant. Furthermore, the Leverage / DER ratio's regression coefficient value is 0.057. It is negative, which means an indirect relationship or an opposite relationship between the leverage / DER ratio on earnings quality as the dependent variable. This means that if the leverage / DER ratio increases by one unit, the earnings quality will decrease by 0.057. Likewise, if the leverage / DER ratio decreases by one unit, the earnings quality will increase by 0.057, with the assumption that other dependent variables regression coefficient is constant. The regression coefficient value of the Liquidity ratio / Current Ratio, is 1.671 and is positive, and shows a direct change between liquidity / current ratio and earning quality as the dependent variable. This means that if the liquidity ratio / Current Ratio increases by one unit, the earnings quality will also increase by 1.671. Conversely, if the liquidity ratio / Current Ratio decreases by one unit, income quality will also reduce by 1.671, assuming all other independent variables regression coefficients are constant. Finally, the regression coefficient value of the IOS variable is 0.040 and is negative, and shows an indirect relationship or an opposite relationship between IOS and earnings quality. This means that if the IOS increases by one unit, the income quality will decrease by 0.046 and if the IOS decreases by one unit, the income quality will increase by 0.046, assuming that all regression coefficient values from other independent variables are constant.

The fifth stage of this study is the simultaneous test / *F*-test. The *F*-test analysis (model fit test), shows significant results. It can be concluded that the multiple regression analysis tools used as an analysis tool is suitable or can be used as an analytical tool with a significant level of 0.000. It can be

Table 3: Statistical Result

Normality and Multicollinearity Test					
Measurement			**Model**	**Collinearity Statistics**	
N		**60**		**Tolerance**	**VIF**
Normal Parameters[a,b]	Mean	28.7933	Firm Size	0.921	1.086
	Std. Deviation	1.59472	DER	0.947	1.056
Most Extreme Differences	Absolute	0.114	Current Ratio	0.154	6.473
	Positive	0.114	IOS	0.159	6.284
	Negative	–0.073	*R* = 0.755; *R*-Square = 0.571; Sig *F* = <0.01		
Test Statistic		0.114			
Asymp. Sig. (2-tailed)		0.052[c]			

Heteroscedasticity Test			
Spearman's rho	Unstandardized Residual	Correlation Coefficient Sig. (2-tailed) *N*	1.000 60
	Firm Size	Correlation Coefficient Sig. (2-tailed) *N*	–0.114 0.385 60
	DER	Correlation Coefficient Sig. (2-tailed) *N*	0.140 0.288 60
	CR	Correlation Coefficient Sig. (2-tailed) *N*	0.057 0.667 60
	IOS	Correlation Coefficient Sig. (2-tailed) *N*	–0.189* 0.147 60

Regression Test						
Model	**Unstandardized Coefficients**		**Standardized Coefficients**	***t***	**Sig**	**Info**
	B	**Std. Error**	**Beta**			
(Constant)	–13.624	32.236		–0.423	0.674	
Firm Size	0.866	1.118	0.071	0.775	0.442	Not Support
DER	–0.057	0.050	–0.102	–1.128	0.264	Not Support
Current Ratio	1.671	0.201	1.867	8.304	0.000	Support
Investment Opportunity	–0.040	0.005	–1.699	–7.670	0.000	Support

***F*-Test**						
Model	**Sum of Squares**	**DF**	**Mean Square**	***F***	**Sig**	
Regression	12615.462	4	3153.865	18.273	0.000	
Residual	9492.581	55	172.592			
Total	22108.043	59				

[a]Test distribution is Normal; [b]Calculated from data; [c]Lilliefors Significance Correction.

seen that *F* count = 18.273 with Sig. 0.000 < 0.05, which is significantly positive, which means changes in the four variables (e.g., company size, Leverage / DER ratio, Current Ratio, and Investment Opportunity) can explain changes in earnings quality variables as the dependent variable. The value of *R*-Square = 0.571 or 57.1% while the difference value is 42.9%, which demonstrates that all independent variables in this study can interpret the dependent variable well, while other variables outside of this study influence the remaining 42.9% of the dependent variable.

4.3. Discussion

Firm size does not have a significant effect on earnings growth. Company size is a scale in which the company's size can be classified according to total assets, stock market value, and others. This study's results indicate the inability of company size to influence profit growth; because companies that are specifically engaged in the food and beverage sector in Indonesia in this study period are assumed not to move their company assets to increase profits earned by companies to generate positive market responses and investors. Companies prefer to maintain rather than increase their ability to generate profits. Therefore, total assets do not affect profit growth. The leverage variable that is proxied by the debt-to-equity ratio also does not significantly affect the earnings quality. This can be seen from the resulting significance level of 0.264 > 0.05. The debt-to-equity ratio is the ratio of debt used to assess debt to equity. The debt-to-equity ratio's inability to affect the earnings quality due to a high debt to equity ratio (DER ratio > 1) indicates that its capital or profit is smaller than its liabilities. When examined comprehensively, the company has a high debt to equity ratio, which indicates that the company's dependence on funds comes from external parties. Dependence of funds from outsiders will result in higher interest expenses paid. With this, if the company gets a profit, the profit is used to pay debt and interest expenses, resulting in the company earning low profits. Thus, if the company receives low yields, it can affect its profit quality. Therefore, the debt-to-equity ratio does not affect profit growth and earnings quality.

The liquidity variable as proxied by the current ratio has a positive and significant effect on profit growth. The current ratio shows the company's ability to pay short-term financial obligations on time. The current ratio is a comparison of current assets to current liabilities, calculated by dividing the current assets by the current liabilities. If the level of liquidity is good, the company will be able to generate profits, which shows that the company's performance has increased, as such, investors would want to invest in the company. This is because liquidity is related to creditors' trust in the company, meaning that the higher the liquidity, the higher the creditor's confidence in the company. In this study, several companies were considered less capable of fulfilling their short-term debt because the current ratio's ideal limit was 1.5–3%. The positive value of liquidity on the earnings quality is assumed to be a relationship between the use of large external (investor) capital to increase the company's total assets and operations.

The market to book value of the equity ratio has a positive and significant effect on profit growth. So, it can be concluded that the investment opportunity set (IOS) has an indirect impact on earnings quality. Our study results reveal that IOS can influence the earnings quality because it serves as the basis for determining future company growth. IOS depends on future discretionary expenditure. This study assumes that company management prefers to carry out earnings management to maintain their firm value. Besides, large companies make it possible to generate greater profits in the future. Thus, the market to book value of the equity ratio affects earning quality.

5. Conclusion

Based on the research done and the discussion of previous study results, it can be concluded that company size does not contribute to earnings quality in food and beverage companies listed on the Indonesia Stock Exchange. The high value of total assets should be accompanied by better governance to encourage market response and be used to increase revenue which will later be able to generate optimal profits. Second, the leverage ratio does not contribute to earnings quality at food and beverage companies listed on the Indonesia Stock Exchange. The high level of leverage that is proxied in the debt-to-equity ratio is because the debt owed by food and beverage companies is higher than the equity or profits received. Suppose the debt level is too high and the company does not use it to support operational activities, in that case, the company will continue to pay the debt burden, as such, it cannot optimize quality profits. Therefore, the company should be able to utilize debt to support operational activities to generate profits. Third, liquidity contributes to earnings quality at food and beverage companies listed on the Indonesia Stock Exchange. If the company has high activity, the company will get quality profits. Fourth, IOS contributes to earnings quality in food and beverage companies listed on the Indonesia Stock Exchange. If the company has a low investment opportunity set, the company will get quality profits.

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