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The Effect of Return on Asset, Investment Opportunity Set and Firm Size on Earnings Management

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ABSTRACT

This study aims to examine the influence of Return on Assets (ROA), Investment Opportunity Set (IOS), and firm size on earnings management in property and real estate companies listed on the Indonesia Stock Exchange (IDX) during the period 2018–2022. Earnings management refers to the deliberate actions by management to influence financial reporting outcomes to meet specific objectives, such as maintaining a favorable image among investors. Based on signaling theory, management conveys information to the market as a signal of the firm's future prospects, often represented through reported earnings. This study adopts a quantitative approach using purposive sampling, resulting in 14 selected companies and a total of 70 observation data points. The analytical method employed is multiple linear regression with classical assumption testing. The results indicate that ROA, IOS, and firm size do not simultaneously have a significant effect on earnings management. Individually, none of these independent variables significantly influence earnings management. These findings suggest that profitability, investment opportunities, and firm size are not the main factors driving earnings management practices in the property and real estate sector. Other factors outside the model may play a more dominant role in shaping managerial behavior related to earnings reporting.

Keywords: Return on Assets, Investment Opportunity Set, Firm Size, Earnings Management

1. INTRODUCTION

Every company except for non-profit companies that are established certainly aims to generate profits (profit). Profit is an important aspect in a company's financial statements as one aspect that can provide an assessment of management effectiveness. Based on this, it is possible that pressure will arise in company management so that it is often used by managers for their own benefit or as a manager's strategy to increase shareholder prosperity, this action is commonly called earnings management. Earnings management is a practice carried out by a company's management to deliberately influence the figures in the financial statements to appear more attractive to stakeholders, investors, creditors and market analysts (Nicholas et al., 2022: 3). Earnings management does not always lead to negative things if it takes advantage of the flexibility allowed by accounting standards.

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Return on Asset is intended as an analysis in a company to determine the company's ability to use its total assets to generate profits. Return on assets is the company's ability to generate profits from the assets used, the effect of return on assets on profit management if conditions decline or increase so that management takes action to save its performance in the eyes of the owner. Amertha (2013) the results of his research show that return on assets has a significant effect on profit management, this research is supported by Eksandy et al. (2023) namely that the profitability projected on return on assets has a significant effect on profit management.

A company in showing the company's future growth projections, one of which is with the investment opportunity set, the expected investment opportunity set value is high because it will reflect the company's high growth as well, but the high value contains a lot of asymmetric information that occurs between the principal and the manager due to the difficulty of seeing the growth options presented. The information provided by the company to outside parties is by showing profits in the financial statements. Earnings management is carried out by increasing profits so that it can show a high investment opportunity set and this can indicate a good company growth projection in the future. Research conducted by Jannah et al. (2020) the results of the study prove that the investment opportunity set has a positive and significant effect on earnings management. When a company's investment opportunity set increases, management needs to make good decisions to achieve the target desired by the principal, namely managing the company's profits by using and for things that are more beneficial in the long term with the aim of developing the entity itself.

Another factor that can affect earnings management is company size. According to Nagian Toni et al. (2021:33), company size is a scale that can be calculated by the level of total assets and sales which can indicate the condition of the company where larger companies will have advantages in funding sources. Rianita's research (2021) shows a significant influence between company size and earnings management. The results of this study are supported by the results of research by Lutfiyah et al. (2023).

2. LITERATURE REVIEW

Signalling Theory

Signaling theory is based on the assumption that insiders usually know the company better than outsiders. Signaling theory explains why a company provides financial report information to external parties. The motivation to provide report information is due to the asymmetry of information between the company and parties outside the company. Information asymmetry means that parties inside the company know more than outsiders (investors and creditors). Signaling Theory examines how investors react to signals received from the company in the form of various information.

Return On Asset

Corporate effectiveness in generating profits at the level of net income and assets is measured by a ratio known as return on assets. If the company's income can be obtained as much as possible, it will have an impact on the high ROA value, in other words, the profits obtained will also be large, this is what causes the stock price to increase. With the increase

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in stock value affecting the increase in company value (Ravasadewa & Fuadati, 2018).

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

Investment Opportunity Set

Investment Opportunity Set (IOS) is a company value whose size depends on the level of expenditure set by management in the future, and is an investment that is expected to produce higher results. Astriani (2017) in general IOS describes the breadth of investment opportunities for a company, but is highly dependent on the company's expenditure for future interests. The selection of proxies refers to Ningrum's research (2011). In general, it can be said that IOS describes the breadth of investment opportunities for a company, but is highly dependent on the company's choice of expenditure for future interests. Thus, IOS is unobservable, so it is necessary to choose a proxy that can be linked to other variables in the company.

Firm Size

Company Size is a measure, scale or variable that describes the size of a company based on several provisions, such as total assets, log size, market value, total sales, shares, income, capital and others. Company size in this study is measured through the company's total assets. Companies that have large amounts of assets will increase the company's value so that management will pay more attention to the company's profits and will take profit management actions. Profit management actions can also be taken for companies with small assets because management wants the company's assets to be seen in large amounts. at the time of reporting.

Earnings Management

Earnings management is a choice of actions or accounting policies carried out by managers to influence profits in financial statements to achieve certain profit goals. (Scott, 2015) Motivations that drive company managers to carry out earnings management can be in the form of bonus motivation, long-term debt contracts, political motivation, tax motivation, change of Chief Executive Officer (CEO), Initial Public Offering (Sulistyanto, 2018) Based on empirical models, there are several models used to detect earnings management, namely the Healy model, the De Angelo model, the Jones model, the modified Jones model. In this study, earnings management is proxied by Discretionary Accruals (DAC) using the modified Jones model calculation. (Sulistyanto, 2018).

Hypothesis Development

Return on Asset (ROA) is a profitability ratio that measures a company's ability to generate profits from its total assets. The higher the ROA, the more efficient the company is in utilizing its assets to make a profit. In the context of earnings management, companies with high ROA may have an incentive to maintain or improve their accounting performance in order to remain attractive to investors, creditors, or other stakeholders.

Earnings management itself is an action taken by management to influence financial statements within certain limits according to accounting standards in order to achieve certain goals, such as meeting profit targets or influencing market perception. High ROA can be a positive signal to the market. Therefore, management tends to carry out earnings management to maintain or strengthen this signal.

H1 : ROA influences earnings management

Investment Opportunity Set (IOS) is a collection of investment

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options available to a company that can create future value. IOS is often measured using financial ratios that reflect growth opportunities, such as market-to-book ratio, capital expenditure to total assets, or growth ratio

Companies with high IOS are usually in the growth stage and have high expectations from the market. Therefore, companies in this category are often under pressure to maintain or improve their financial performance, so they have a greater potential.

Companies with high IOS seek to send positive signals to the market regarding their future prospects, and are thus encouraged to improve their performance outlook through earnings management.

H2 : Investment Opportunity Set influences earnings management

Company size is an important indicator in assessing the market position and economic strength of a business entity. This measure can reflect the level of influence of the company in the industry, its ability to access resources, and public expectations of its performance. The larger the company, the greater the attention from investors, regulators, and the media. Company size is an important indicator in assessing the market position and economic strength of a business entity. This measure can reflect the level of influence of the company in the industry, its ability to access resources, and public expectations of its performance. The larger the company, the greater the attention from investors, regulators, and the media.

In the context of earnings management, large companies have strong incentives to maintain a positive image and perception in the eyes of the public and investors through the presentation of stable and profitable financial statements. Signaling theory explains that company management provides signals to the market through financial statements to show the company's future performance and prospects. One way to provide such signals is by showing consistent or increasing profits.

Large companies, because they have higher market expectations, tend to be more active in sending positive signals to investors. One form of this signal can be realized through earnings management, such as increasing profits to make them look stable or growing over time.

H3: Firm size influences earnings management

3. RESEARCH METHOD

The population of this study is property and real estate companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. The sampling method is purposive sampling, so that 14 companies were identified and the total sample data collected was 70 from 2018 to 2022. Multiple regression analysis was used as a data analysis method.

Table 1 Sample Selection Criteria

No	Sample Criteria	Total
1	Property and real estate companies, which are consistently listed on the IDX during the 2018-2022 research period.	**92**
2	Property and real estate companies, which did not publish annual reports and financial reports in 2018-2022.	**(36)**

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3	Property and real estate companies that do not present financial reports using the rupiah currency	**(0)**
4	Property and real estate companies in 2018-2022 that did not experience profits.	**(40)**
5	Property and real estate companies that do not have complete data on the variables studied.	**(2)**
Total research sample		**14**
Observation Period		**5**
Total Observations		**70**

4. RESULT AND DISCUSSION

Normality Test

Table 2 Normality Test

	Unstandardized Residual
Kolmogorov-Smirnov Z	.568
Asymp. Sig. (2-tailed)	.903

Based on the output in table 2, it shows a significance value of 0.903 above 0.05 so it can be concluded that the data is normally distributed.

Anova

Table 3 ANOVA

	Sum of Squares	**Mean Square**	**F**	**Sig.**
Regression	.003	.001	.972	.412[b]
Residual	.061	.001		
Total	.064			

Based on table 3, it shows that the model has a calculated F value of 0.972 with a significance value of 0.412. Because the significance value is greater than 0.05, it can be concluded that simultaneously the variables return on assets, investment opportunity set and firm size do not have a significant effect on earnings management.

Regression Analysis

Table 4 Regression Results and Hypothesis Testing

Variabel	**B**	**Std Error**	**t**	**Sig.**
(Constant)	.123	.123	1.004	.319
Return On Asset	.011	.037	.299	.766
Investment Opportunity Set	.020	.014	1.480	.144
Firm Size	-.005	.004	-.096	.277

Based on the results in table 4 above, it can be explained as follows::

1. The obtained t-value result is 0.011 <t table 1.669 with a significance value of 0.766> 0.05, so hypothesis 1 is rejected. The results of the hypothesis indicate that the return on asset variable does not affect earnings management. The results of this study are in line with research conducted by Damayanti & Kawedar (2018) and research conducted by Suhartanto (2018) which shows that ROA has no effect on earnings management. This shows that when the Company has good or bad performance, it does not affect earnings management. Thus, the Company's profitability as reflected in the ROA ratio is not one of the reasons managers carry out earnings management, this is because the Company's profitability as reflected through ROA has become the main

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concern of stakeholders so that there is little room for managers to be able to practice earnings management.

2. The t-value obtained is 0.020 <t table 1.669 with a significance value of 0.144> 0.05, so hypothesis 2 is rejected. The results of the hypothesis indicate that the investment opportunity set variable has no effect on earnings management. The results of this study are in line with research conducted by Widiasari (2023) and research conducted by Maulia (2022) which states that investment opportunities have no effect on earnings management. This indicates that the investment opportunities owned by the company do not affect the management actions taken by a company. Companies with high investment opportunities often attract investors who are oriented towards future growth, not solely on current profits. This reduces management's incentive to manipulate earnings, because the market pays more attention to business strategy and expansion than short-term profit figures.
3. 3. The obtained t-value result is -0.05 <t table 1.669 with a significance value of 0.277> 0.05, so hypothesis 3 is rejected. The hypothesis results show that the firm size variable does not affect earnings management. The results of this study are in line with research conducted by Fitriana & Febrianto (2017) which shows that firm size does not affect earnings management. This indicates that the relationship between company size and earnings management is also greatly influenced by industry characteristics. In some sectors, company size is not directly related to the intensity of competition, profit margins, or external pressures, so its influence on earnings management is weak or invisible in statistical analysis.

5. KESIMPULAN

The conclusion of this study is:

a. Simultaneously return on asset, investment opportunity set and firm size do not affect earnings management.
b. Partially shows that both return on asset, investment opportunity set and firm size do not have a significant effect on earnings management.

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