

EARNINGS QUALITY: IMPACT OF FACTORS WITH FIRM SIZE AS MODERATING VARIABLE

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Abstract: *This research objective is to obtain empirical evidence about the effect of liquidity, leverage, investment opportunity set (IOS), independent commissioner, institutional ownership, profitability, profit on earnings quality and the moderation effects of company size on interaction between profitability with earnings quality and profit growth with earnings quality. The researcher used purposive sampling method and determined 62 companies met the sampling criteria from population that is manufacturing company listed in Indonesia Stock Exchange from 2017 - 2021. The result obtained from moderated regression shows that liquidity, leverage, IOS, independent commissioner, institutional ownership, profitability, profit growth and firm size have no significant effect on earnings quality, and also company size does not moderate the effect of profitability and profit growth on earnings quality. The result shows that company size does not relevant on affecting the quality of earnings of a company.*

Keywords: earnings quality, liquidity, leverage, investment opportunity set, independent commissioner, institutional ownership, profit growth, profitability, firm size

Abstrak: Penelitian ini bertujuan untuk mendapatkan bukti empiris tentang pengaruh likuiditas, *leverage*, *investment opportunity set (IOS)*, komisaris independen, kepemilikan institusional, profitabilitas, profit terhadap kualitas laba dan efek moderasi ukuran perusahaan terhadap interaksi antara profitabilitas dengan kualitas laba dan pertumbuhan laba dengan kualitas laba. Peneliti menggunakan metode *purposive sampling* dan ditetapkan 62 perusahaan yang memenuhi kriteria sampling dari populasi yaitu perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia tahun 2017 - 2021. Hasil yang diperoleh dari regresi moderat menunjukkan bahwa likuiditas, *leverage*, IOS, komisaris independen, kepemilikan institusional, profitabilitas, pertumbuhan laba dan ukuran perusahaan tidak berpengaruh signifikan terhadap kualitas laba, serta ukuran perusahaan tidak memoderasi pengaruh profitabilitas dan pertumbuhan laba terhadap kualitas laba. Hasil penelitian menunjukkan bahwa ukuran perusahaan tidak berpengaruh terhadap kualitas laba suatu perusahaan.

Keywords: kualitas laba, likuiditas, *leverage*, *investment opportunity set*, komisaris independen, kepemilikan institusional, pertumbuhan laba, profitabilitas, ukuran perusahaan

INTRODUCTION

Started from Revolution Industry Era when many large businesses form started to do separation of ownership and control (Godfrey et al. 2010), and creating asymmetric information occurred within investors and management, financial statements are becoming important tools that should have accountability as representation of how is the controller's/management's performance. The accountability of the financial statements means that all the information can be accounted for, must be showing true and fair view presentation and comply with appropriate accounting standards. Annual reports are an important element of financial communication strategies to attract and retain investors.

Earnings quality problem in Indonesia recently occurred with the case of PT Tiga Pilar Sejahtera Food, Tbk (AISA). PT Tiga Pilar Sejahtera Food Tbk. (AISA) as a listed company, they have obligation to annually publish their annual report to be a tool for investor to see the performance of a company and make decisions. With the motives to beautify the financial statement, they allegedly inflated funds of Rp 4 trillion in the 2017 financial statements.

Joko Mogoginta and Budhi Istanto as former directors of PT Tiga Pilar Sejahtera Food, Tbk (AISA) committed violations related to the recording of financial statements. The alleged marked violations occurred on AISA Group's accounts receivables, fixed assets, and inventories. Engineering of financial statements in the management of AISA Group has been carried out since 2012. The impact of engineering or beautifying the report is that AISA's financial fundamentals at that time were contrary and not as good as they seemed in the financial statements, thus making capital market investors buy AISA shares.

LITERATURE REVIEW

Agency Theory

Agency theory argues that when principal and agent are expected to maximize their utility, there is good reason to believe that the agent may engage in opportunistic behavior at the risk of cost by the principal (Jensen and Meckling 1976). Various examples of asymmetric conflicts in the presentation of financial statements include conflicts of interest between agents.

The shareholders' goal is to maximize their wealth by ensuring an increase in the value of the company. Business management, on the other hand, aims to maximize personal rewards and business benefits. The cost of the agent is borne by the principle because the need to monitor the conduct of the agent, who is entrusted with the management of the company's assets, and whose interests do not coincide with the benefits of the principal (Deegan 2009). Monitoring costs may include the need to participate in an external audit function (Gaffikin 2008).

Signalling Theory

Signaling theory arises because of the asymmetry of information between agents and principals. Information asymmetry is caused by inconsistencies in information from each connected party. To overcome the existence of information asymmetry, companies need to signal investors Lestari and Khafid (2021).

According to signaling theory, company officials who have good data in the company are motivated to share that data with potential speculators, which raises the company's stock price. The good thing about the signaling hypothesis is that companies that provide good data separate them from those that don't have the "good news" by letting the store know the situation. The application of signal theory (signal theory) to the quality of revenue can be seen from the presentation of financial statements in financial statements. The quality of earnings disclosed in a company's annual financial statements could immediately arouse investors'

interest in owning a company's stock in the market.

Liquidity and Earnings Quality

The ability of a business to satisfy its present debt obligations is measured by liquidity. (Kasmir 2017b) Companies with the ability to pay short-term debt have demonstrated strong financial performance in repaying their present debt, eliminating the need for earnings management. So that the profits quality of enterprises with a high level of liquidity is high. The profit information created by the firm is a quality profit or genuine profit if the company is able to pay its short-term obligations (Fahmi 2011). Another word of liquidity also mentioned by Hasanuddin et al. (2021) which show investors and analysts how companies can maximize their working capital on their balance sheets to pay off ongoing and other liabilities.

According to the research that has been done by Murniati (2019), Salma and Riska (2019), Jaya and Wirama (2017), Ginting (2017), Sadih and Priyadi (2015), and Mulyaningsih, Surya, and Julita (2019) it has shown that there's a no significant effect of liquidity with earnings quality. Whereas the research that Hakim and Abbas (2019), Zein (2016) and Wulansari (2013) had showed positive effect on Earnings Quality.
H1: Liquidity has significant effect on Earnings Quality

Leverage and Earnings Quality

Leverage is a metric that determines how much of a company's assets are funded with debt. (Kasmir 2017b) When a firm uses debt to support its business activities instead of utilizing its own capital, this is referred to as leverage. According to the research that has been done by Hasanuddin et al. (2021) and Mulyaningsih, Surya, and Julita (2019) and Hakim and Abbas (2019) it has shown that there's a no significant effect of leverage on earnings quality. Wulansari (2013), Sadih (2015) and K. A. Zein, Surya, and Silfi (2016) has also done research which result to a negative and not significant effect of

leverage with earnings quality. It means that the leverage will has a negative and non-significant effect on a company's earnings quality.

While the research from Salma and Riska (2019), Lestari and Khafid (2021) shown that there is positive and significant effect of leverage with earnings quality. Then there's also research that is done by Al-Vionita and Asyik (2020) and Anggrainy and Priyadi (2019) which resulted to negative effect. Negative effect of Leverage on Earnings Quality means the higher leverage of a company, it decreases the quality of earnings of a company. It can be concluded that leverage has no significant effect on earnings quality.

H2: Leverage has significant effect on Earnings Quality

Investment Opportunity Set and Earnings Quality

Myers (1977) was the first to suggest the Investment Opportunity Set, describing the firm as a combination of existing assets (assets in place) and future investment choices (Myers 1977). The Investment Opportunity Set (IOS) reflects the breadth of investment options or prospects for a firm in general, but it truly depends on the company's decision of future interests spending. When a company's IOS value is high, it means the company's worth is likewise high, and vice versa (Fathussalmi, Darmayanti, and Fauziati 2019a).

According to the research that has been done by Hasanuddin et al. (2021), Al-Vionita and Asyik (2020), (Sadih and Priyadi 2015) and Murniati (2019) showed there is positive and significant effect on earnings quality. Whereas another research that has been done by Hakim and Abbas (2019), Wulansari (2013) and Fathussalmi, Darmayanti, and Fauziati (2019) showed on the contrary that there is no significant effect on earnings quality.

H3: Investment Opportunity Set has significant effect on Earnings Quality

Independent Commissioners and Earnings Quality

An independent commissioner is a commissioner who is not a director, controlling shareholder, officer, or officer who is directly or indirectly related to the controlling shareholder of the company that oversees the management of the company. The role of the Independent Commissioner is to exercise the role of oversight to enable the Commissioner to perform its duties more objectively. Due to the role of the board of directors in carrying out the oversight function of the company's activities by management, the composition of the board of corporate auditors can effectively contribute to the outcome of the quality report preparation process or the potential for financial disruption (Arisanti 2019).

According to the research that has been done by Arisanti (2019), Murniati (2019), Aurelia, Diah, and Tiswiyanti (2020), Nanang and Tanusdjaja (2019), Fathussalmi, Darmayanti, and Fauziati (2019) and Budiono (2015) resulted that independent commissioner has no significant effect on earnings quality. While research that has been done by Yushita (2013) showed contradict result that independent commissioner has positive and significant effect on earnings quality.

H4: Independent Commissioners has significant effect on Earnings Quality

Institutional Ownership and Earnings Quality

Institutional ownership is the ownership of a company's shares by a party outside the company such as institutions or companies owned by non-bank financial institutions such as insurance companies, investment companies, investment trust companies, leasing companies, and pension funds. Institutional ownership can reduce agency issues and have a positive impact on the company. The presence of oversight from outside parties ensures that financial statements are available to all involved parties and that no harm is done to them (Murniati and Murniati 2019c).

According to the research that has been done by Nanang and Tanusdjaja (2019), Aurelia, Diah, and Tiswiyanti (2020) and Murniati (2019) resulted that institutional ownership has no significant effect on earnings quality. While research that has been done by Mergia, Sulistyo, and Setiyowati (2021) showed contradict result that institutional ownership has negative and significant effect on earnings quality. Another research done by Indrawati and Yulianti (2010) resulted that institutional ownership has positive and significant effect on earnings quality.

H5: Institutional Ownership has significant effect on earnings quality

Profitability and Earnings Quality

The ability of a corporation to earn profits in relation to sales, total assets, and own capital is referred to as profitability (Hakim and Abbas 2019a). A measure of return on assets (ROA), which is the ratio of net income to total assets, is one of the profitability ratios. Return on Assets (ROA) measures a company's efficiency in managing assets, both with its own money and borrowed money. Investors may assess how efficient a company is at managing assets.

According to the research that has been done by Hakim and Abbas (2019), Ginting (2017) and Aurelia, Diah, and Tiswiyanti (2020) resulted that profitability has no significant effect on earnings quality. While research that has been done by Mulyaningsih, Surya, and Julita (2019) and Mergia, Sulistyo, and Setiyowati (2021) showed contradict result that profitability has significant effect on earnings quality.

H6: Profitability has significant effect on Earnings Quality

Profit Growth and Earnings Quality

Profit growth is defined as a ratio that is used to assess the percentage rise in profit numbers that a company has experienced. Profit growth is a variable that explains the company's future growth potential (Ziman and Nur Azlina 2015).

Profit growth refers to a company's ability to increase net profit in the current year over the prior year. Profit growth is one metric that may be used to assess a company's success (Septiyani, Rasyid, and Tobing 2017). If a company's annual profit growth is positive and there is no fall, the company is deemed to be performing well. In order for users of the company's financial statements to be able to make informed investment decisions. (Al-Vionita and Asyik 2020a)

According to the research that has been done by Lestari and Khafid (2021), Mulyaningsih, Surya, and Julita (2019), Al-Vionita and Asyik (2020), and Anggrainy and Priyadi (2019) resulted that profit growth has no significant effect on earnings quality. While research that has been done by K. A. Zein, Surya, and Silfi (2016), and Eka Irawati (2012) showed contradict result that profit growth has significant effect on earnings quality.

H7: Profit growth has significant effect on earnings quality.

Profitability and Earnings Quality with Company Size as Moderating Variable

High profits indicate that the company is in good shape and has good business opportunities in the future. This shows that companies have good revenue quality. Good Corporate profitability shows that the enterprise has top possibilities withinside the destiny in order that it shows top income quality. For big company, there's a mechanism associated with inner manipulate which has a tendency to be higher than small agencies. It will inspire the enterprise to constantly perform nicely and optimally a good way to meet the wishes of numerous fascinated parties, one in every of that is the owner. Large agencies will attempt to hold top enterprise practices in order that the earnings generated are maximized and according with relevant accounting provisions. The higher the rate of return, the better the quality of the company's profits (Lestari and Khafid 2021). The research

that is conducted by Lestari and Khafid (2021) shown that company size does not moderates the effect of profitability and earnings quality. Therefore, regarding to the explanation, the hypothesis can be developed as follows.

H8: Company Size moderates the effect of profitability on earnings quality.

Profit Growth and Earnings Quality with Company Size as Moderating Variable

Earnings growth is an increase or decrease in profits, and an increase in corporate profits affects an increase in profit growth. In signal theory, an increase in a company's profits can give a positive signal to the market and explain the company's future growth prospects. Especially for large companies, the revenue growth rate can be as high as their size. This is because the company's total assets are large, which makes the company's business continuity safer and gives it more opportunities to make a profit. As a company's earnings continue to grow, earnings information will make it more attractive for investors to invest their capital. Research that has been done by Lestari and Khafid (2021) resulted that company size does not moderate the effect of profit growth on earnings quality. Therefore, regarding to the explanation, the hypothesis can be developed as follows.

H9: Company Size moderates the effect of profit growth on earnings quality.

RESEARCH METHOD

The population used in this research are manufacturing companies listed in Indonesian Stock Exchange (IDX) from the period of 2017-2021. Meanwhile, the sample used are listed manufacturing companies selected using purposive sampling method with criteria in the table 4.1 shown below

Table 4. 1 Sample Selection Procedure

Criteria Description	Total Companies	Total Data
Manufacturing companies constantly listed in Indonesia Stock Exchange (IDX) from 2017 – 2021	157	785
Manufacturing companies that not consistently used IDR Currency in Financial Statements in from 2017 – 2021	(38)	(190)
Manufacturing companies that not consistently published financial statement as of 31 December from 2017 – 2021	(2)	(10)
Manufacturing companies that not consistently earned profit from 2017 – 2021	(50)	(250)
Manufacturing companies that not have institutional ownership in their financial statement from 2017 – 2021	(5)	(25)
Number of Samples Firms Used	62	310

Source: Data is obtained from IDX's Website

The earnings quality ratio, sometimes referred to as the quality of income ratio, is calculated by dividing the net cash provided by the business by the company's net revenue (Hasanuddin et al. 2021b). The earning quality ratio shows the relationship between cash flow and net income. Therefore, the higher the ratio, the higher the earnings quality because the greater the operating profit portion is realized in cash and not on an accrual basis (Murniati 2019).

$$\text{Earning Quality} = \frac{\text{Cash Flow From Operating Activity}}{\text{Net Income}}$$

A financial ratio that measures how a company's ability to face its debt obligations in a short amount of time is known as Liquidity. The liquidity ratio looks at the company's current assets against current debt/liabilities (Subramanyam, 2014, 9). This variable is measured by Current Ratio.

$$\text{Current ratio} = \frac{\text{Current Asset}}{\text{Current Liability}}$$

Leverage represents the relationship between a company's capital and liabilities and

the total balance sheet (Hasanuddin et al. 2021b). The objective of Leverage is to describe the company's ability to use assets and sources of funds to increase the returns to the owners. The higher the company's leverage indicates that the company uses more liabilities in their capital structure. Leverage is measured using Debt to Equity Ratio (DER) which compares the total liabilities with total equity of a company for a certain period (Sukmawati, Agustina, and Kusmuriyanto 2014).

$$\text{DER} = \frac{\text{Total Liability}}{\text{Total Equity}}$$

An Investment Opportunity Set is selection of future investment opportunities that may impact the growth of a company or project asset with a net present value (NPV). IOS proxies are based on the assumption that the stock price reflects part of the company's growth prospects. Growing companies have a relatively higher market value for their assets than non-growing companies.(Hasanuddin et al. 2021b) IOS using a formula that uses the market value to record the value of an asset is:

Market Value to Book Value of Net Assets =

$$\frac{\text{Market Capitalization}}{\text{Book Value of Net Assets}}$$

According to previous researcher Murniati (2019), to measure an independent commissioner, researchers use a ratio that represents the ratio of the number of independent committees compared to the committee. A large percentage indicates that the percentage of independent commissioners is increasing. Based on the decision of the Directors of PT Jakarta Stock Exchange No. Kep305 / BEJ / 072004, the number of members of the Independent Committee that a public company must own is at least 30% of the total number of members of the Committee. The following is the formula used to measure the number of independent commissioners:

Independent Commissioner =

$$\frac{\text{Number of Independent Commissioners}}{\text{Total Members of The Board of Commissioners}}$$

A proportion of shares held by institutions or companies owned by non-bank financial institutions such as insurance companies, investment companies, mutual fund companies, leasing companies, pension funds companies, and many other more is also known as Institutional Ownership. The institutional ownership can be calculated using the following formula:

Institutional Ownership =

$$\frac{\text{Number of Shares Owned by Institutional}}{\text{Total Outstanding Shares}}$$

Profitability is the ability of a company to make a profit in relation to sales, total assets, and its own capital. In this study profitability was measured using ROA (Return on Asset), which is a comparison of net income with total assets.

Where this ratio measures the company's ability to manage the assets it controls to generate income. (Mulyaningsih, Surya, and Julita 2019)

$$\text{Return on Asset (ROA)} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Profit Growth explain the ability of the company's growth in the future (Lestari and Khafid 2021). Profit growth is an increase in profit or decrease in profit per year which is expressed as a percentage. The profit amount that is used in this research is the profit after tax and can be computed as follows (A. K. Zein 2016).

$$\Delta Y_{it} = \frac{Y_{it} - Y_{it-1}}{Y_{it-1}}$$

ΔY_{it} = Profit Growth at current period

Y_{it} = Profit of company i in period t

$Y_{(it-1)}$ = Profit of company i in period t-1

Moderating Variable

Assets are assets or resources owned by a company. The larger the assets owned, the company can invest well and meet product demand. This further expands the market share achieved and will affect the company's profitability. Company Size is the scale of the company from the total assets of the company at the end of the year (Lestari and Khafid 2021).

Size = Ln. Total Asset

RESULT AND DISCUSSIONS

The result from descriptive statistics that have been done is summarized as follows:

Table 4.2 Descriptive Statistic Result

Variable	N	Minimum	Maximum	Mean	Std. Deviation
EQ	310	-116.66353	177.06363	2.7880740	18.212915
CR	310	0.6141	312.7882	6.725708	28.8478330
DER	310	0.0035	5.4426	0.807943	0.7597314
EP	310	0.0857	13.8409	1.582573	2.0108500
IC	310	0.2000	0.8333	0.414429	0.1044347
IO	310	0.0445	0.9971	0.707795	0.1941789
Yit	310	-3.9979	28.8474	0.543252	2.3567297
ROA	310	0.0003	0.9210	0.091028	0.1059306
Size	310	25.7957	33.5372	28.923665	1.5735264

Source: Statistic Output Data SPSS 25

The t-Test result is shown in the table below.

Table 4.3 t-Test Result

Variable	Coefficients	Significance	Decision	Conclusion
Constant	47.870			
CR	-0.007	0.852	H ₁ Rejected	No Influence
DER	-0.560	0.696	H ₂ Rejected	No Influence
EP	0.361	0.615	H ₃ Rejected	No Influence
IC	15.960	0.150	H ₄ Rejected	No Influence
IO	-6.716	0.237	H ₅ Rejected	No Influence
ROA	-159.276	0.503	H ₆ Rejected	No Influence
Yit	-2.715	0.103	H ₇ Rejected	No Influence
Size	-1.588	0.124	H ₉ Rejected	No Influence
ROASize	4.781	0.574	H ₈ Rejected	No Influence
YitSize	0.099	0.114	H ₉ Rejected	No Influence

Source: Statistic Output Data SPSS 25

The adjusted R² result is shown in the table below.

Table 4.4 Coefficient of Determination Analysis

No.	Model	Adjusted R ²
1	CR, DER, EP, IC, IO, Yit, ROA, Size, YitSize, ROASize	0.001

Table 4.4 shows that the adjusted R-square value is 0.001 which means that 0.1% of dependent variable variation (earnings quality) can be explained by

independent variable variations (liquidity, leverage, investment opportunity set, independent commissioner, institutional ownership, profit growth, profitability, firm size,

profit growth with moderation of firm size, and profitability with moderation of firm size). While the remaining 99.9% can be explained by other factors not included in the model.

Liquidity (CR) has significance value of 0.852, higher than alpha 0.05. H1 is rejected which means that liquidity has no significant effect on earnings quality. Leverage (DER) has significance value of 0.696, higher than 0.05. H2 is rejected which means that leverage has no significant effect on earnings quality. Investment Opportunity Set (PE) has a significance value of 0.615 higher than 0.05. H3 is rejected which means that Investment Opportunity Set proxied by Market Value to Book Value of Net Assets has no significant effect on earnings quality. Independent Commissioners (IC) has a significance value of 0.159, higher than 0.05. H4 is rejected which means that Independent Commissioners (IC) has no significant effect on earnings quality.

Institutional Ownership (IO) has significance value of 0.237, higher than 0.05. H5 is rejected which means that Institutional Ownership has no significant effect on earnings quality. Profitability has significance value of 0.503, higher than 0.05. H6 is rejected which means that profitability has no significant effect on earnings quality. Profit Growth has significance value of 0.103, higher than 0.05. H7 is rejected which means that Profit Growth has no significant effect on earnings quality. Company size moderating Profitability (ROASize) has significance value of 0.574, higher than 0.05. H8 is rejected which means that company size does not moderate the effect of profitability on earnings quality. Company size moderating Profit Growth (YitSize) has significance value of 0.114, higher than 0.05. H9 is rejected which means that company size does not moderate the effect of profit growth on earnings quality.

CONCLUSIONS

The conclusion of this research is that all hypotheses are rejected which states that liquidity, leverage, investment opportunity set, independent commissioner, institutional ownership, profitability, and profit growth have no significant effect on earnings quality. This research also conclude that company size does not moderates the effect or interaction of profitability and profit growth on earnings quality.

There are several limitations in this research which are: The research population is limited only around manufacturing sector company listed in Indonesia Stock Exchange (IDX), There is multicollinearity problem in several independent variable in this research which are profit growth, profitability, profit growth moderates with firm size, and profitability moderates with firm size. There is heteroscedasticity problem in several independent variable in this research which are institutional ownership, profit growth, firm size, and profit growth with firm size as moderating variable, The adjusted R-Square of this research is only 0,1% of dependent variables variation which can be explained by independent variables.

To solve the limitations mentioned prior, these are the recommendations for further research. Further research is suggested to apply another research population other than manufacturing companies, to solve multicollinearity problem by performing transformation procedures, to solve heteroscedasticity problem by performing transformation procedures, to add more independent variables to have more ability in explaining the dependent variable, or to use another proxy of dependent variable.

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