

## Effect of Profit Power, Term Commitment, Capital Structure, and Investment Opportunity on Earnings Quality

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**Abstract:** Currently the quality of earnings is a matter of great concern as an interesting issue to study related to accounting. Earnings quality and financial reporting quality are generally of concern to users of financial statements for contractual purposes and for making investment decisions. This study aims to examine the effect on earnings quality. The population in this study are manufacturing companies in the consumer goods sector that are listed on the Indonesia Stock Exchange (IDX) for 2019-2021. The sample in this study was a manufacturing company which was determined by purposive sampling method, and obtained 73 companies as a sample. Analysis of research data using multiple linear regression. Data is processed using SPSS. The results show that capital structure and investment opportunities have an effect on earnings quality, while profit power and term commitment have no effect on earnings quality. This research can be used as an evaluation material for companies to improve the quality of their earnings.

**Abstrak:** Saat ini kualitas laba merupakan hal yang sangat diperhatikan sebagai isu yang menarik untuk diteliti terkait dengan akuntansi. Kualitas laba dan kualitas pelaporan keuangan umumnya menjadi perhatian pengguna laporan keuangan untuk tujuan kontraktual dan untuk membuat keputusan investasi. Penelitian ini bertujuan untuk menguji pengaruh terhadap kualitas laba. Populasi dalam penelitian ini adalah perusahaan manufaktur di sektor barang konsumsi yang terdaftar di Bursa Efek Indonesia (BEI) tahun 2019-2021. Sampel dalam penelitian ini adalah perusahaan manufaktur yang ditentukan dengan metode purposive sampling, dan diperoleh 73 perusahaan sebagai sampel. Analisis data penelitian menggunakan regresi linier berganda. Data diolah menggunakan SPSS. Hasil penelitian menunjukkan bahwa struktur kapital dan oportunitas investasi berpengaruh terhadap kualitas laba, sedangkan daya laba dan komitmen termin tidak berpengaruh terhadap kualitas laba. Penelitian ini dapat dijadikan sebagai bahan evaluasi bagi perusahaan untuk meningkatkan kualitas labanya.



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### INTRODUCTION

Financial reports are used by companies to publish the necessary information to interested parties in the form of accountability for the performance of a company's management in making decisions. Financial reports are those that describe the

financial position and results of an accounting process during a certain period which are used as a communication tool for interested parties (Suteja, 2018). The indicator that is often considered in making decisions is profit. The importance of profit

information for its users so that every company increases its profits.

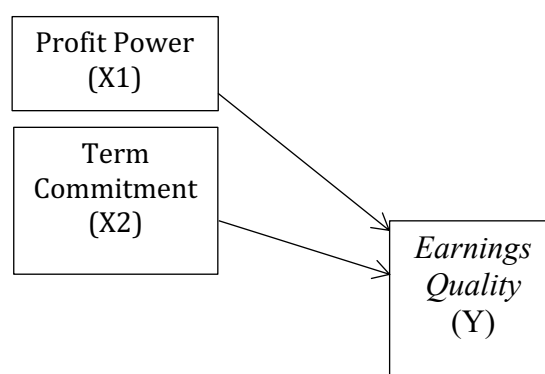
Interested parties tend to choose companies that have high profit values and experience significant profit increases from year to year. The importance of profit information for external parties results in company managers as internal parties who know more about the actual condition of the company, who are motivated to increase company profits and ignore good business practices. Besides that, there is a possibility of motivation that can encourage managers to manipulate financial data and practice earnings management, so that the manager's goal can be achieved, namely obtaining a bonus from the company. The existence of different interests between management and investors results in agency conflicts commonly referred to as agency conflicts, namely conflicts between agents (those who manage the company) and principals (shareholders) who have different and conflicting interests. Because both agents and principals are trying to increase their profits from the information they have. Therefore, there is a reason that the agent as the manager of the company tends to prioritize his own goals which can provide benefits for him compared to acting in the interests of the principal.

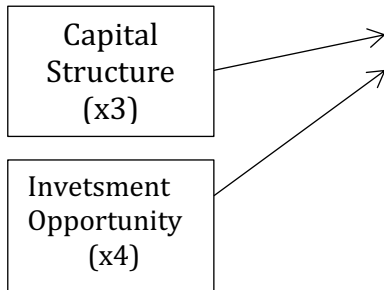
An example of a case of financial statement manipulation that occurs in a manufacturing company engaged in the production of consumer goods is PT Tiga Pilar Sejahtera (AISA) or TPS Food. Initially, the discovery of its subsidiary, PT Indo Beras Unggu (IBU), caused AISA's shares to drop significantly and made the company try to manipulate the 2017 financial statements. The case was investigated and found allegations of overstatement, flow of funds, and no disclosures to stakeholders. thereby violating the Decree of the Chairman of the Capital Market and Financial Institution Supervisory Agency No. KEP-412/BL/2009 concerning Affiliated Transactions and Conflicts of Interest in Certain Transactions. The engineering of financial statements carried out by AISA Group has caused many losses, including providing false information to investors, diminishing company credibility and a bad corporate image from the public.

Based on the losses in this case, it can be said that the quality of the financial reports that are expected to provide information is doubtful. Earnings quality and financial reporting quality are a concern for users of financial statements for contractual purposes and for making investment decisions. Every company needs to have good earnings quality. The profit contained in the financial statements is a reflection of the company's actual financial performance.

The first factor that can affect the quality of earnings is profitability. Companies with growing profits will have a large number of assets so that they can provide opportunities to generate profit power. Growing companies are companies that have high margin, profit and sales growth (Hamid, 2001). The second factor that can affect the quality of earnings is liabilities. Liability shows the company's ability to pay its maturing short-term debt. Companies with high liabilities will have a small risk that will make creditors confident in giving loans and investors are interested in investing their funds because they believe the company can survive. The third factor that can affect earnings quality is leverage. Leverage measures the proportion of debt used by a company to finance its assets. The greater the level of leverage, the lower the quality of a company's earnings. The fourth factor that can affect the quality of earnings is investment opportunity. The investment opportunity of a company can affect the perspective of managers, investors, and creditors towards the company.

This research is a combination of previous research with the object of research on manufacturing companies in the consumer goods sector. Research on the impact on earnings quality has been carried out by several people and the main reference in this research is Kepramareni, Pradnyawati, and Swandewi (2021) who conducted research on earnings quality and the influencing factors.





**Figure 1.** Research Model

Profit power is a company's ability to generate profits through assets. An indicator that can be used to measure a company's profit power is ROA (Return On Assets). ROA is a measure of a company's ability to generate net profit with a certain level of sales, assets and share capital. The higher the level of profit power of the company, the better the signal for investors to maintain their shares in the company. The higher the company's profit power, the stronger the quality of earnings. This is evidenced by Kepramareni, et al (2021), Safitri, et al (2021), Santoso, et al (2021) which show that profit power affects earnings quality.

Based on this description, the hypothesis can be formulated:

H1: Profit power affects earnings quality.

Term commitment is the company's ability to pay its short-term obligations using its current assets at maturity. High Term commitment cause companies to tend to disclose earnings information widely to external parties and this will illustrate good value for investors. The higher the value of the liability, the higher the quality of earnings. Research conducted by Kepramareni, et al (2021), and Mulyati, et al (2021) shows that term commitment affect earnings quality.

Based on this description, the hypothesis can be formulated:

H2: Term commitment affect earnings quality.

Capital structure is the relationship between the company's debt to the

company's capital and assets. If the company's assets are financed by debt rather than its own capital, the role of investors decreases. Therefore, the higher the capital structure level of a company, the lower the quality of the company's earnings. The results of research by Safitri and Titisari (2021), Mulyati, et al (2021), Kepramareni, et al (2021) state that sapital structure has an effect on earnings quality. These results indicate that the greater the company's leverage, the lower the quality of the profits generated.

Based on this description, the hypothesis can be formulated:

H3: Capital Structure affects earnings quality.

Smith and Watts (1992) in Januarta (2017) investment opportunity set can have implications for the value of assets and the value of the company's opportunity to grow in the future. Companies with a high level of investment opportunity set tend to have high growth prospects for the company in the future. The existence of growth opportunities which are marked by the investment opportunity set will cause future company profits to increase. The results of research by Fauzi (2015), Fahlevi (2016), Januarta (2017) and Dewi (2018) state that the investment opportunity set has a positive effect on earnings quality

Based on this description, the hypothesis can be formulated:

H4: Investment Opportunity affects earnings quality.

## METHODS

The population in this study are consumer goods manufacturing companies listed on the Indonesia Stock Exchange. The form of this research is quantitative research in the form of annual reports with a sample of manufacturing companies listed on the Indonesia Stock Exchange for the 2019-2021 period. The data in this study is secondary data obtained through the documentation method on the official website of the

Indonesia Stock Exchange (www.idx.com) and the official website of each company. The purposive sampling method in this study was used as the sampling method. The criteria for selecting the sample include companies that publish annual reports and experience no losses during the research year. It was found that 73 companies passed the criteria for 3 years of research and after the outlier data.

**Operational Variable Measurement**

**Table 1.** Operational Variable Measurement

Variable	Indicator
X1	$ROA = \frac{\sum \text{Net income}}{\sum \text{Total assets}}$
X2	$CR = \frac{\sum \text{Current assets}}{\sum \text{Current liabilities}}$
X3	$DER = \frac{\sum \text{Total debt}}{\sum \text{Total assets}}$
X4	$MBVE = \frac{\sum \text{Shares outstanding x closing price}}{\sum \text{Total equity}}$
Y	$QER = \frac{\sum \text{Operating cash flow}}{\sum \text{Net income}}$

The analytical technique used in this case research is descriptive statistical analysis, classical assumption test, multiple linear regression analysis, coefficient of determination test and hypothesis test. To test the variables of profitability, liability, leverage and investment opportunity on earnings quality.

The multiple linear regression model is shown in the following equation:

$$QER = \alpha + X1ROA + X2CR + X3DER + X4MBVE + e$$

Where :

- QER : Profit Quality
- $\alpha$  : Constant Value
- X1, X2,..., X5 : Regression Coefficient
- ROA : Profitability

- CR : Liability
- DER : Leverage
- MBVE : Opportunity Investment
- e : Residual

**RESULTS AND DISCUSSION**

Based on the sample collection criteria, the number of samples obtained was 73 data. Data processing in this study used SPSS version 22. Based on the results of tests conducted by researchers, the following are descriptive statistics for each research variable.

**Table 2.** Statistical Test Results

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	7	.01	.35	.1079	.06749
CR	7	.61	13.31	3.2611	2.62099
DER	7	.11	.77	.3518	.14997
MBVE	7	.40	56.79	3.9280	7.64960
QE	7	-2.69	4.52	1.1603	1.14718

Source : SPSS Output Result, 2023

Table 2 presents descriptive statistics with a sample size of 73. Profit power (ROA) has a minimum value of 0.010 and a maximum value of 0.350 with a mean of 0.1079. The standard deviation value of ROA is 0.06749 (below the average), meaning that ROA has a low level of data variation. Term commitment (CR) shows a minimum value of 0.610 and a maximum value of 13.310 with a mean of 3.2611. The standard deviation value of CR is 2.62099 (below the average), meaning that CR has a low level of data variation. Capital structure (DER) has a minimum value of 0.110 and a maximum value of 0.770 with a mean of 0.3518. The standard deviation value for DER is 0.14997 (below the average), meaning that DER has a low level of data

variation. Investment opportunity (MBVE) has a minimum value of 0.400 and a maximum value of 56.790 with a mean of 3.9280. The standard deviation value for MBVE is 7.64960 (above the average), meaning that MBVE has a high level of data variation. Earnings Quality (QER) has a minimum value of -2.690 and a maximum value of 4.520 with a mean of 1.1603. The standard deviation value for QER is 1.14718 (below the average), meaning that QER has a low level of data variation.

**Table 3.** Normality test results

		Unstandardized Residual
N		73
Normal Parameters <sup>a,b</sup>	Mean	.000000
	Std. Deviation	1.06426812
Most Extreme Differences	Absolute	.100
	Positive	.076
	Negative	-.100
Test Statistic		.100
Asymp. Sig. (2-tailed)		.070 <sup>c</sup>

Source : SPSS Output Result, 2023

In Table 3 it can be seen that the results of the One Sample Kolmogorov-Smirnov test obtained the Asymp Sig value. (2-tailed) of 0.070 where the value is greater than 0.05. So it can be concluded that the data has been normally distributed.

**Tabel 3.** Multikolinearitas test results

Model	Collinearity Statistics	
	Tolerance	VIF
1(Constant)		
ROA	.355	2.815
CR	.602	1.661
DER	.351	2.846
MBVE	.306	3.265

Source : SPSS Output Result, 2023

The multicollinearity test results for the regression equation model show inflation factor values (VIF) between 1.661-3.265 and tolerance values between 0.306-0.602, this illustrates that there is no multicollinearity problem in the regression equation.

**Table 4.** Autocorrelation results

Model	Durbin-Watson
1	1.643

Source : SPSS Output Result, 2023

It can be seen that the significance value of the Durbin Watson autocorrelation results is 1.645, where the DW number is between -2 to 2. So it can be concluded.

**Table 5.** Heterokedastisitas test results

Variab le	Signifiance	Description
ROA	0,694	There is no heteroscedasticity
CR	0,447	There is no heteroscedasticity
DER	0,451	There is no heteroscedasticity
MBVE	0,945	There is no heteroscedasticity

Source : SPSS Output Result, 2023

The results of the heteroscedasticity test with the Spearman rho test show that the significance value of each research variable is above 0.05 and there is no heteroscedasticity problem in the regression equation of this study.

**Table 6.** Multiple Linear Regression Test Results

Var iab le	B	t- value	Significan ce	Descripti on
ROA	-5,982	-	0,067	H <sub>1</sub>
A		1,865		Rejected

CR	-0,017	-	0,793	H <sub>2</sub>
		0,263		Rejected
DE	-4,043	-	0,007	H <sub>3</sub>
R		2,785		Accepted
MB	0,071	2,316	0,024	H <sub>4</sub>
VE				Accepted

Source : SPSS Output Result, 2023

$$QER = -5.982 - 0.017 - 0,4043 + 0,071 + e$$

Based on the results of analysis testing that has been carried out through descriptive statistical analysis and hypothesis testing shows that profit power not affects the earnings quality. Profit power has a regression coefficient of -5.982 with a significance of 0,067 profit power greater than 0.05 and **H<sub>1</sub> is rejected**. This finding is different from research by Kepramareni, et al (2017) which states profit power affects the disclosure of earning quality. The high value of ROA illustrates a large profit level that will attract investors to invest their capital. However, in this case the power of earnings cannot trigger a market response to earnings quality so that it cannot contribute to investors in assessing market conditions

Term commitment has a regression coefficient of -0,017 with a significance of 0.793 gender diversity greater than 0.05 and **H<sub>2</sub> is rejected**, meaning that term commitment does not affect the disclosure of earnings quality. The results of this study are in line with Ginting (2017). The high or low levels of term commitment indicate a company's ability to pay short-term debt which does not affect the quality of earnings presented by management in the company. Management is not encouraged to report earnings quality or earnings that reflect the actual condition of the company, but must face liquidity solutions in the future.

Capital structure has a regression coefficient of -4,043 with a significance of 0,007 which is less than 0.05, then **H<sub>3</sub> is accepted**. Based on the results of this test, it can be concluded that capital structure

affects the disclosure of earnings quality. Capital structure that is used effectively and efficiently will generate large profits. Companies with high levels of leverage do not describe low earnings quality because they are able to manage their debts well and do not need earnings management. The results of this study are in line with Kepramareni, et al (2021), and Mulyati, et al (2021) that capital structure affects earnings quality.

Investment opportunities has a regression coefficient of 0,071 with a significance of 0,024 which is less than 0.05, then **H<sub>4</sub> is accepted**. Based on the results of this test, it can be concluded that investment opportunities affects of earnings quality. The market will respond better to companies that have growth opportunities. The existence of a set of investment opportunities will increase the company's growth prospects and cause the company's profits to increase in the future. This means that the greater the company's investment opportunities, the better the company is and the company's profit information increasingly indicates the company's actual profit. This is not in line with research from Kepramareni, et al (2021), Santoso and Handoko (2021) where investment opportunities have no effect on earnings quality.

**Table 7.** F test results

Model		F	Sig.
1	Regression	2.752	.035 <sup>b</sup>
	Residual		
	Total		

Source : SPSS Output Result, 2023

Based on the results of the table test, the regression results were obtained from the F count of 2.752. The statistical value shows a significance value of 0.035 with a value of  $\alpha = 0.05$ ; so that  $0.035 < 0.05$  it can be concluded that the regression model is fit.

**Table 8.** The Results Of The Analysis Of The Coefficient Of Determination (R<sup>2</sup>)

Model	R	R Square	Adjusted R Square
1	.373 <sup>a</sup>	.139	.089

Source : SPSS Output Result, 2023

The results of the table test show that the coefficient of determination or Adjusted R<sup>2</sup> is 0.089. This shows that 8.9% of the quality of earnings in manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2021 period can be explained by the variables of profit power, term commitment, capital structure, and investment opportunities, while 91.1% is influenced by other variables not analyzed in research outside of this regression model.

## CONCLUSION

### 1. Effect of Profit Power on Earnings Quality

Based on the results of the tests performed, it showed a significance value of 0.067 (0.067 > 0.05), so it can be concluded that profit power does not affect earnings quality. This is in line with research conducted by Ginting (2017) that profit power or profitability does not affect earnings quality. The high value of ROA illustrates a large profit level that will attract investors to invest their capital. However, in this study, earnings power cannot trigger a market response to earnings quality, so it cannot contribute to investors in assessing market conditions. However, this research is not in line with the research of Kepramareni, et al (2017), Safitri and Titisasi (2021), Santoso and Handoko (2022) that profit power affects earnings quality.

### 2. Effect of Term Commitment on Earnings Quality

Based on the results of the tests performed, it showed a significance value of 0.793 (0.793 > 0.05), so it can be concluded that term commitment has no effect on earnings quality. This is in line with the research conducted by Ginting (2017) and Safitri and Titisari (2021), but this research is not in line with the research by Kepramareni,

et al (2021) and Mulyati, et al (2021) where term commitment affect earnings quality. The level of term or liquidity commitments shows the company's ability to pay its short-term obligations which does not affect the quality of earnings presented by management in the company. Management is not encouraged to report earnings or profit quality that reflects the actual condition of the company, but must focus on solving liquidity in the future.

### 3. Effect of Capital Structure on Earnings Quality

Based on the results of the tests performed, it shows a significance value of 0.007 (0.007 < 0.05), so it can be concluded that capital structure affects earnings quality. Capital structure that is used effectively and efficiently will generate large profits. Companies with high levels of leverage do not mean they have low earnings quality because they are able to manage their debts well and do not need earnings management. This is in line with the research of Kepramareni, et al (2021), and Mulyati, et al (2021) that capital structure has an effect on earnings quality.

### 4. Effect of Investment Opportunity on Earnings Quality

Based on the results of the tests performed, it shows a significance value of 0.024 (0.024 < 0.05), so it can be concluded that investment opportunities have an effect on earnings quality. The market will respond better to companies that have growth opportunities. The existence of a set of investment opportunities will increase the company's growth prospects and cause the company's profits to increase in the future. This means that the greater the company's investment opportunity, the better the company is and the company's profit information increasingly indicates the company's actual profit. This is not in line with research from Kepramareni, et al (2021), Santoso and Handoko (2021) where investment opportunities have no effect on earnings quality.

## SUGGESTION

Based on the results of data analysis and discussion of the effect of earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2019 to 2021, it can be concluded that capital structure and opportunities investment affect of earnings quality. For profit power and term commitment, it has no effect of earnings quality. The research results obtained in this study still have limitations caused by limitations. This research still uses short-term observations and special reviews about the impact of a pandemic that may also occur in the operationalization of manufacturing companies and the company's of earnings quality. Therefore, it is still possible to do research in medium and long term periods and it is possible to use other variables such as company size, profit growth, corporate social responsibility.

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