Airlangga Journal of Innovation Management Vol. 5 No. 3 (2024): 463-476

Contents lists available at: https://e-journal.unair.ac.id
AJIM (Airlangga Journal of Innovation Management)
Journal homepage: https://e-journal.unair.ac.id/AJIM

The Effect of Third Party Funds, CFO, Debt Ratio on Earning Quality of Islamic Commercial Bank

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ARTICLE INFO

Paper Type:
Research Paper

Keywords:
Third-Party Funds, CFO, DER, Earning Quality

Article History
Received: 25 June 2024
Revised: 4 September 2024
Accepted: 14 October 2024
Available online: 14 October 2024

ABSTRACT

This study aims to analyze the factors that affect Earnings Quality. This research will offer a new and broader view on the factors that influence the profit quality of Islamic commercial banks in Indonesia. This research use quantitative study that uses multiple regression analysis methods. The data used is panel data from 2019-2022. The factors analyzed for their influence in this study are Third Party Funds, CFO, and DER. The model estimation used is multiple regression analysis with a quantitative descriptive method. The results of the study show that the CFO and DER have an impact on earnings quality, while, third third-party Funds do not affect Earnings Quality. These findings indicates that banks need to pay more attention to managing operating cash flow (CFO) and capital structure (DER) to improve earnings quality. Proper management of these two variables can help banks achieve more stable and transparent financial performance. Although Third Party Funds do not significantly affect earnings quality, their management is still important to maintain the stability of the bank's liquidity. These results also suggest that investors and other stakeholders may need to focus on CFO and DER as key indicators when assessing a bank's earnings quality.

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Cite this article as Tusa'dya, H & Wijayanti, R. (2024). The Effect of Third Party Funds, CFO, Debt Ratio on Earning Quality of Islamic Commercial Bank. *Airlangga Journal of Innovation Management, 5(3), 463-476.* https://doi.org/10.20473/ajim.v5i3.59486

Introduction

In facing global challenges and increasingly fierce business competition, companies are expected to be able to utilize various resources to achieve their financial and strategic goals (Mendo et al., 2023). The use of third-party funds as one of the components of the capital structure is an interesting aspect to study. Third-party funds, in the form of loans or debt, can play a strategic role in corporate financing, however, their impact on earnings quality requires a deeper understanding (Wardhana, 2021). In December

2022, Islamic banking deposits reached Rp620 trillion, an increase of 12.81% (yoy) compared to the previous year's position of Rp549 trillion. Although experiencing a decline in growth compared to the previous year which reached a record 15.42% (yoy), but the growth is quite stable indicating that there is still a lot of public confidence to put money in Islamic banking. The growth of deposits was driven by the current account and savings components which increased by 23.37% (yoy) and 18.52% (yoy) respectively. Current accounts increased by Rp18 trillion to Rp98 trillion and savings increased by Rp34 trillion to Rp222 trillion. (OJK, 2022). Meanwhile, the deposit component, which accounts for 48% of deposits, also continued to grow by 6.04% (yoy) from Rp281 trillion to Rp298 trillion (State of the Global Islamic Economy Report, 2023).

Third party funds (DPK) are funds obtained by banks from the public, both individuals and business entities, in the form of savings, current accounts, time deposits, certificates of deposit, and other immediate obligations. (Ghifara et al., 2022). In the context of Islamic banking, third-party funds involve account types such as wadiah demand deposits, wadiah savings, and mudharabah deposits. The source of funds used in financing involves deposits or funds from customers. Therefore, the greater the amount of third-party funds available, the more active Islamic banks will be in offering financing through the musyarakah scheme (Rahman et al., 2022). Earnings quality is a significant parameter in assessing the health condition of a bank and its effect on third party funds. (Mahyudin & Rosman, 2022). Earnings quality reflects how reliable, relevant, and able to provide an accurate picture of the health condition of banks in the Islamic banking sector. (Baihaqy, 2017) . The concept of earnings quality is multi-dimensional, where there are several aspects that must be considered to determine the extent to which earnings are considered quality. (Irwansyah et al., 2020)

According to LLaela (2012) mentioned that the profit of Islamic banks is higher than conventional banks. Because of the strong influence of Islamic ethical values into operational activities so as to create individual and cultural supervision mechanisms. This may indicate that investment risk in Islamic banks is not always higher than in conventional banks as the image that has been built so far. Along with this, the role of the *Chief Financial Officer* (CFO) is very important. (Budiman, 2023). CFOs have the responsibility of planning, managing, and supervising all of the company's financial activities, including the management of third-party funds. As a leader in finance, CFOs have a key role in moderating the relationship between third-party fund management and bank earnings quality (Qosim et al., 2023)(Kurnianto & Mareta, 2023). According to Ramaadhiantix et al., (2023) *Debt* ratio is also an important factor to consider. The debt ratio describes the proportion of debt in the bank's capital structure. A high debt ratio can pressure bank finances, especially in terms of interest and principal payments. A high debt ratio that was not managed properly can reduce the quality of earnings due to the loan interest.

Islamic banking is built on principles like justice, balance in financial transactions, and the prohibition of usury (Amijaya et al., 2023; Fitri & Zaimsyah, 2022; Maimun, 2022; Syarofi & Putri, 2023). Because of this, it's important to look at how third-party funds, CFO, and debt ratios affect the quality of earnings in Islamic commercial banks. This research aims to give insights to bank management on improving fund management and operational strategies, as well as helping regulators create policies that support the stability and growth of the sharia banking industry. Unlike previous studies, which focused on good corporate governance (GCG) as a moderating variable to analyze earning quality in banks, this research will offer a new and broader view on the factors that influence the profit quality of Islamic commercial banks in Indonesia.

Literature Review

Agency Theory

Agency theory explains the relationship between company management (agent) and capital owner (principal) (Anisa, 2017). In this case, the capital owner hires managers, such as the CFO, to carry out certain tasks and gives them the authority to make decisions. In this research, the CFO acts as an agent, while shareholders are principals. Agency conflicts can arise due to conflict of interests between the CFO and shareholders. For example, the CFO may have different goals than shareholders, or he or she may have more information about the company's finances than shareholders do. The CFO is responsible for planning and managing all financial activities of the company, including managing third-party funds (Audio & Serly, 2022). When these interests and information do not align, it can cause problems in decision-making and impact company performance.

Third-Party Funds

Third-party funds are money saved by the public, both individuals and companies in banks. This money is obtained through various savings products offered by banks. Research conducted by (Nur Handayani, 2020) shows that third-party funds are the largest source for banks because one of the main functions of banks is to collect funds from people who have more money. Third-party funds consist of several types of savings, such as savings used for daily needs; and checking accounts, which can be withdrawn at any time without restrictions (Wardhana, 2022). On the other hand, deposits are held for a certain period at a higher interest rate. research from (Salim, 2017) explains that third-party funds are all types of savings from the public, including current accounts, savings, and time deposits.

Earnings Quality

Earnings quality is a financial result that reflects the continuity of future earnings, which is determined by accrual elements and cash conditions that reflect the company's actual financial performance. (Elma & Nuswandari, 2020). Earnings quality refers to the extent to which the earnings generated by an entity or company are reliable, relevant, and reliable as an indicator of healthy financial performance. Good quality earnings show information about the company's financial performance in the accounting period in question without data manipulation and fraud. (Rahmawati & Aprilia, 2022). This is because more revenue and cost transactions are cash and not accruals, so revenue and cost recognition is more objective in the income statement and high-quality earnings can be realized in cash (Wijayanti et al., 2020)

Earnings quality in Islamic Commercial Banks (BUS) differs from conventional banks due to the adherence to Sharia principles, which prohibit riba (usury), gharar (uncertainty), and maysir (speculation). Financial transactions in BUS focus on profit and loss sharing and are asset-based, with income derived from activities such as profit-sharing financing (mudharabah and musyarakah), margin-based sales (murabahah), and leasing (ijarah), all of which must comply with Islamic law. Therefore, earnings quality in BUS is measured not only by the accuracy and relevance of the earnings but also by how those earnings are generated following Sharia principles. High-quality earnings in BUS must reflect justice, transparency, and honesty, and be free from practices prohibited by Sharia, such as financial manipulation. This makes earnings quality in BUS more complex as it must meet both conventional financial standards and strict Sharia regulations (Ryandono et al., 2019).

Chief Financial Officer (CFO)

In the organizational structure, the Chief Financial Officer is usually in the *board of directors (Board of Directors)* whose duties and responsibilities may vary from company to company, but is generally responsible for the overall finance and accounting functions (Loestefani et al., 2022). Unlike other positions in accounting and finance, the CFO is not responsible for the technical aspects of the accounting and financial reporting cycle, the Chief Financial Officer is responsible for planning, shaping, and implementing the company's strategy related to accounting and finance, in this case including financial reporting (Harymawan et al., 2023). With this responsibility, the educational background, gender, and previous experience of the CFO are important highlights in planning the quality of the company's financial statements. (Kurnianto & Mareta, 2023). Companies in the UK with female directors on the board of directors adopt earnings management practices, this study found that companies with a greater number of female CFOs tend to engage in decreased earnings than increased earnings management (Kaban, 2024).

Debt Ratio

Debt to Equity Ratio (DER) is a ratio used to assess debt with equity. This ratio is sought by comparing all debt, including current debt with all equity (Ramadhan et al., 2023). The higher this ratio indicates the higher the risk of failure that may occur in the company, and vice versa if the lower this ratio, it shows the lower the risk of failure that may occur in the company (Roni & Dewi, 2015).

The optimal use of Third-Party Funds (DPK) has a significant impact on the earnings quality of Islamic Commercial Banks (BUS). Well-managed DPK not only increases the amount of profit but also creates stable, sustainable, and reliable income. Earnings quality reflects how consistent the bank's profits are and how reliable they are as an indicator of financial health. When DPK is allocated for productive financings, such as profit-sharing (mudharabah) and murabahah, the bank can generate not only high income but also good-quality earnings (Zulaikha et al., n.d.). Conversely, an increase in profit without proper DPK management can result in temporary and fragile income, ultimately threatening the bank's financial stability. Therefore, optimal DPK management contributes to better earnings quality, providing a strong foundation for long-term growth (Beik & Aprianti, 2016). If Third Party Funds (DPK) are managed efficiently and allocated to financing that provides stable profit-sharing or income, this will result in better earnings quality. This reflects sustainable and stable profits that are not dependent on accrual manipulation, thereby supporting the concept of higher earnings quality.

Hypothesis Development

The Effect of Third-Party Funds on Earning Quality of Islamic Commercial Bank

According to Rohman & Yanti (2022) Third-party funds are one of the main components in bank operations, serving as the primary source of funding for the bank’s business activities. When the third-party funds collected by the bank increase, the bank has more funds to allocate to financing. This increase will impact the bank’s ability to generate income, either through profit-sharing in Islamic products such as mudharabah and musyarakah. The placement of positions in the form of financing can contribute to profit-sharing income, which will have a positive impact (profit) on the bank (Ryandono et al., 2020). However, if the portion of the financing is not proportional to the increase in third-party funds, this indicates that there is potential that has not been optimally utilized. In other words, banks can increase their financing further if a larger amount of third-party funds are available (Beik & Aprianti, 2020).

H1: Third Party Funds Affect the Earning Quality of Islamic Commercial Bank

The Effect of Chief Financial Officer (CFO) on Earning Quality of Islamic Commercial Bank

The Chief Financial Officer (CFO) has an important role in improving the quality of income of Sharia Commercial Banks through good decision-making and effective risk management (Nurmayanti, 2021). The CFO's job is to allocate funds to projects that can generate stable income so that the bank does not just rely on temporary income. By focusing on investments that provide positive cash flow, the CFO must ensure that reported earnings are not only large but also high quality or reliable. The CFO also plays a role in reducing possible losses that could affect revenue stability (Jiles, 2020). Additionally, it ensures that financial reports are accurate and transparent, which helps banks show their true performance (Yuszak, 2023). By driving innovation and operational efficiency, CFOs can find ways to reduce costs and increase productivity. So, the strategic role of the CFO greatly influences the quality of Sharia Commercial Banks' earnings, which provides a strong basis for long-term growth.

H2: *Chief Financial Officer* (CFO) Affects the Earning Quality of Islamic Commercial Bank

The Effect of Debt Ratio on Earning Quality of Islamic Commercial Bank

According to Islamic banking theory, the debt-to-equity ratio can positively influence earnings quality if managed properly. When a company uses debt for productive purposes, it can act as financial leverage, increasing the firm's capacity to invest in revenue-generating projects. For instance, debt financing enables a company to raise capital without diluting shareholder ownership as an alternative way of raising funds. Furthermore, interest payments on debt can provide a tax shield, ultimately improving the company's net income (Cedric Poretti, 2020).

Previous research studies have shown that debt can help keep company managers accountable. When a company has a lot of debt, the party lending the money (creditor) will be more careful in monitoring the company's performance, to ensure that management does not manipulate the financial reports. With pressure to pay debts, management's opportunities to commit fraud or manipulate financial reports will decrease (Kim, 2020). This is especially noticeable in countries with strong legal protections for investors, as managers fear being sued if they misreport earnings. In Islamic banking, debt must be used for real investment, because Islamic principles prohibit excessive speculation. Debt in Islamic banking must be directed to support truly growing and sustainable businesses, not for risky speculation (Cedric Poretti, 2020).

H3: Debt ratio affects the Earning Quality of Islamic Commercial Bank

Methodology

This study uses a quantitative method to investigate a particular population or sample, with panel regression analysis to test the relationship between dependent and independent variables. Panel regression was chosen because it involves time series data (2019-2022) and cross-sectional data (Islamic banks registered in OJK). In this study, the dependent variable is Earnings Quality, while the independent variables are Third Party Funds, CFO, and Debt Ratio. The goal of the panel regression model is to analyze the impact of these variables on the Earnings Quality of Islamic banks. The analysis conducted using EViews to test hypotheses and measure the significance of the independent variables' effects on earnings quality.

Operational Definition and Measurement of Variables

Dependent Variable

The dependent variable is the variable that is influenced or results from the independent variable (Sugiyono). The research model used is a modification of the model developed by Velury and Jenkins (2006) in the journal (Fatma laela, 2012) where the relationship between operating profit and future cash flows is analyzed by considering the role of the CFO

$$FCFO_{(i.t+1)} = \frac{CFO\ t+1}{TOTAL\ ASSET}$$

Independent Variable

The independent variable in this study is symbolized by X, namely third-party funds which will be related to Earnings Quality in the first hypothesis. Third-party funds are funds collected from the public which will be used for real sector funding through lending. Third-party funds are public funds collected by Islamic Banks which are then managed again by Islamic Banks to make a profit by channeling in the form of credit provided to the public (Iman et al., 2022). Third-party funds can be measured using the deposits-to-assets ratio. The deposits to assets ratio formula is as follows:

$$\textit{Deposits to Assets Ratio}\ \frac{Total\ DPK}{Total\ Asset} x\ 100\%$$

This ratio helps to show how much banks rely on customer funds to fund their operations and investment activities. The higher this ratio, the greater the proportion of the bank's assets that are funded by deposits.

CFO

In this study, CFOs were assessed based on two main variables: educational background and gender. The educational background includes the field of study pursued by the CFO, such as accounting, finance, management, or other relevant fields, as well as the level of education that has been achieved, including S1 (Bachelor’s), S2 (Master’s), and S3 (Doctorate). Researchers demonstrated that employees with higher educational backgrounds, particularly in accounting, finance, and economics, tend to be more capable of applying appropriate accounting principles and complying with Islamic regulations. This affects their ability to produce more accurate, transparent, and manipulation-free financial statements, thereby improving the earnings quality reported by Islamic banks (Abduh & Azmi Omar, 2012). Gender diversity in management, especially in the CFO position, is very important to improve the quality of income in Sharia Commercial Banks.

Women in managerial positions are usually more thorough and careful in managing finances, which helps ensure better corporate governance and transparency of financial reports (Wijayanti, n.d.). In BUS, the presence of women can reduce the practice of income manipulation, thereby increasing the accuracy of income reports. Additionally, women focus more on long-term interests, helping to align the goals of managers and shareholders. Gender diversity also improves a company's reputation with investors and consumers, which is important for financial performance (Irwansyah et al., 2020). In this study, female CFOs will be given a value of 1, while male CFOs will be given a value of 0.

Debt Ratio

Debt ratio is a ratio that can measure the solvency level of the company, by measuring the ratio between total debt and total assets. The greater the likelihood that the company will not be able to pay off its debts when the debt ratio is high. (Alma’uunah & Mukaram, 2021)

$$\textit{Debt Ratio:}\ \frac{Total\ Debt}{Total\ Asset}$$

The following is the research analysis model based on the hypotheses that have been developed

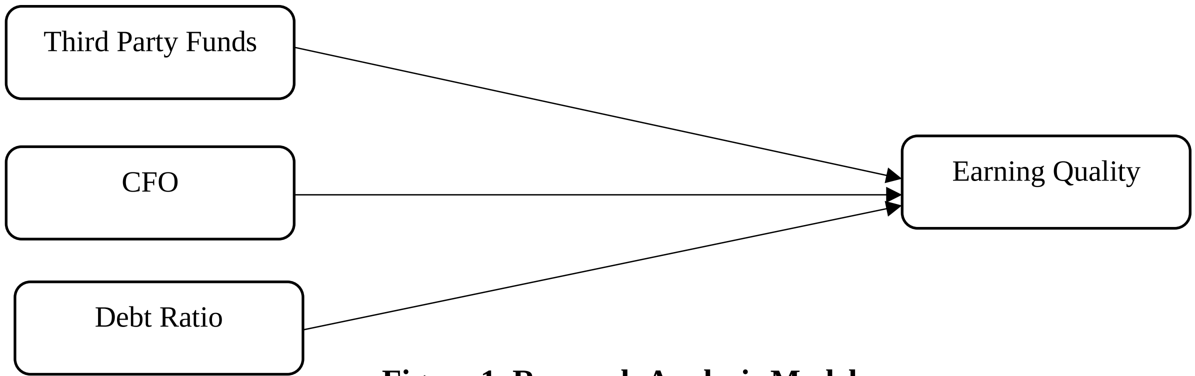

Figure 1. Research Analysis Model

Source: Author (2024)

Result and Discussion

Results

Descriptive statistics are needed to explain the samples tested in the study. Statistics contain the number, minimum value, maximum value, average, and standard deviation. This study observed the effect of Third-Party Funds on the Quality of Financial Statements, and the existence of CFO as a moderating variable between the two variables. These variables can be obtained through financial reports which are then processed and expressed in percentage form.

Table 1. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Standard Deviation
DPK	52	0,024258	0,959700	0,0700561	0,188878
KL	52	0,001478	0,034,400	172.9112	1221,056
CFO	52	1,000000	3,000000	2,080000	0,751597
DER	52	0,025695	2,443613	0,745183	0,038853

Source: EViews 12 Output

DPK = Third Party Funds

KL = Earnings Quality

CFO = *Chief Financial Officer*

DER = *Debt Ratio*

The Chow Test, Lagrange Multiplier (LM), and Hausman Test are statistical tests used to figure out the best model for estimating panel data. The Chow Test helps choose between the Common Effect Model (PLS) and the Fixed Effect Model (FE). The result showed a Prob < F value of 0.0005, which means the Fixed Effect Model (FEM) is a better fit. The LM Test helps decide whether to use PLS or the Random Effect Model (RE). In this study, the Prob < chibar2 value was 0.0301, indicating that the Random Effect Model (REM) is more suitable. The Hausman Test helps choose between RE and FE. The result showed a Prob < F value of 0.0004, so the Fixed Effect Model (FEM) is the way to go. The Classical Assumption Test checks if the regression assumptions are met. According to (Napitupulu et al., 2021), this study used the Random Effect Model approach, so there's no need for the classical assumption test. Based on all the tests, the chosen model is the Fixed Effect Model (FEM).

Table 2. Multiple Regression Test

Variables	Coefficient	St. Error	t-Statistic	Prob
C	-1.908167	1.239255	-1.539770	0.1496
DPK	1.932550	1.539923	1.254966	0.2334
CFO	0.196482	0.141562	1.387964	0.01904
DER	0.0459902	0.205177	2.241489	0.0447
R-Square				0.453696

Source: Eviews 12 Output

Based on the panel data regression results above, the following equation is obtained.

Ykl= -1.908 + 1.932 DPK + 0.196 CFO + 0.459 DER

The above equation can be explained that the constant -1.908 is the bias required in the regression model to ensure that the average Ykl is 0. The coefficient of 1.9321 for DPK shows that every increase in DPK by 1 unit will increase Ykl by 1.932 units, while the coefficient of 0.1960 for CFO and 0.4590.459 for DER shows that every increasing point of CFO and DER by 1 unit will increase Ykl by 0.196 units and 0.459 units respectively. Based on the table above, the coefficient of determination (adjusted R2) is 0.453696 or 45.37%. It can be seen that the score of earnings quality, 45.37%, can be explained by DPK, CFO, and DER. On the other hand, the score of 54.63% is explained by variables outside the independent variables of this study.

Hypothesis 1 states that third-party-funds did not affect earning quality. Then Hypothesis 2 states that CFO affects Earnings Quality. Based on the test results on each third-party fund variable, the prob value of 0.2334 is greater than 0.05. So, it can be concluded that H1 is rejected. The CFO variable obtained a result of 0.01904 is smaller than 0.05 which indicates that H2 is accepted. Variable DER based on testing obtained a prob value of 0.0447 smaller than 0.05. It can be concluded that H3 is accepted. Then testing the R square produces a value of 0.4536 or 45.36%. The coefficient of determination shows that the independent variables consisting of Third Party Funds, CFO, and DER explain the Earnings Quality performance variable by 45.36%, while the rest can be influenced or explained by other variables not included in this research model.

Discussion

The Effect of Third-Party Funds (DPK) on Earning Quality of Islamic Commercial Bank

The first hypothesis in this study states that third-party funds (DPK) influence the company's earnings quality. However, after hypothesis testing, it was found that the third-party fund variable had no significant effect on earnings quality, so the first hypothesis (H1) was rejected. This means that third-party funds do not have a significant impact on the company's earnings quality. Several reasons can explain this finding. First, the analysis period covers 2019 to 2021, which is the period of the Covid-19 pandemic. This pandemic has caused financial statement instability in many companies, including banks, which in turn may affect the relationship between deposits and earnings quality (Pangaribuan & Asmalidar, 2022). Firms may face difficulties in managing third-party funds effectively during this period, given the economic uncertainty and significant operational challenges.

In 2020, there was a merger of several Islamic Commercial Banks which resulted in changes to their financial reporting systems (Biasmara & Srijayanti, 2021). These mergers may lead to inconsistencies in financial data and change the dynamics of how deposits are reported and managed in the financial statements of these banks. These changes may obscure the potential influence of DPK on Earnings Quality in the short term, making the relationship between these two variables unclear in the analysis. Overall, the results of this study indicate that third-party funds do not significantly influence earnings quality during the period analyzed. External factors such as the *COVID-19* pandemic and corporate restructuring through mergers may play an important role in this result, suggesting that economic conditions and structural changes in the banking industry need to be considered when analyzing the relationship between DPK and Earnings Quality. DPK may not have a significant impact on the earnings quality of Islamic banks for several reasons.

First, during the COVID-19 pandemic period, economic uncertainties and operational challenges may have impacted banks' ability to manage third-party funds effectively, thus obscuring the relationship between third-party funds and earnings quality. In addition, Islamic banks may face limitations in Shariah-compliant investments, which may affect how funds are managed and reported (Yunus, 2021). External factors such as changes in regulations and market conditions may also affect banks' financial performance and reduce the direct relationship between deposits and earnings quality (Pratiwi et al., 2022).

The Effect of CFO on Earning Quality of Islamic Commercial Bank

In the study by (Sudirgo et al., 2021), it is revealed that CFOs who are involved in the company through stock ownership or other managerial roles are more motivated to maintain earnings quality, as they have a direct stake in the company's success. Therefore, active CFOs with greater control within the company tend to encourage the implementation of more transparent and accountable governance, which in turn enhances the quality of reported earnings (Wardhana & Ratnasari, 2022). This aligns with the principle that good governance and effective management involvement can minimize earnings manipulation and improve the integrity of financial reporting. It is stated that although there are no rules that require a CFO to have a certain educational degree, a CFO's work experience is a factor that greatly influences their performance in making decisions regarding earnings quality (Firk et al., 2023; Schmid & Altfeld, 2018). Thus, both formal education and work experience play an important role in determining the effectiveness of a CFO in improving the quality of corporate earnings. Based on these findings, H2 is accepted, as CFO involvement through stock ownership or other managerial roles enhanced corporate earnings quality.

The Effect of DER on Earning Quality of Islamic Commercial Bank

This study reveals that the Debt-to-Equity Ratio (DER) variable has a significant positive effect on the quality of corporate earnings. This finding indicates that the third hypothesis (H3) is accepted. DER, which represents the ratio between a company's total debt and its equity, is an important financial indicator in assessing a company's financial health. A higher DER, when managed effectively, can help improve the quality of earnings reports. Companies that can maintain a healthy debt ratio tend to have the ability to meet their financial obligations without sacrificing the reported earnings quality (Ryandono et al., 2022).

Furthermore, research conducted by (Christy Kurniawan & Rosita Suryaningsih, 2017) reinforces that companies with efficient debt management tend to maintain financial stability more effectively. Their study found that companies that manage their debt well are not only able to fulfill their financial obligations promptly but are also able to sustain higher earnings quality. Good debt management ensures that companies remain liquid and solvent, thereby enhancing the integrity of their financial reports. This sends a positive signal to investors about the company's stable and sustainable financial condition, ultimately fostering trust among investors and shareholders who see the company as capable of maintaining long-term financial performance (Wardhana et al., n.d.).

Conclusion

Based on the result above, this study concluded that the most influential variables in improving the quality of the company's earnings are CFO and DER. The role of Islamic banking is expected through this research so that Islamic banking can actively participate in the development of Islamic finance. The limitations of this study include only using three independent variables, namely Third-Party Funds, CFO, and DER to improve the company's earnings quality. Therefore, future research needs to consider adding other variables that are thought to affect earnings quality to obtain more comprehensive results.

Author Contribution

Halima Tusa'dya contributed to developing the research idea, collecting and analyzing data, and writing the manuscript. Rahma Wijayanti, as the supervising lecturer, gave direction, academic guidance, and input at every stage of the research and writing of this article.

Acknowledgments

I would like to thank myself first, followed by my parents, family, and friends who have consistently provided moral support. This success is also the result of their continuous prayers and positive encouragement. I also want to express my gratitude to all those who have assisted me in this research by offering knowledge and help in various areas, which greatly supported me in preparing this manuscript. Additionally, thanks to the Editorial Team of AJIM UNAIR for their valuable input that has helped refine this manuscript.

Declaration of Competing Interest

The author declares that the research was conducted in the absence of any commercial or financial relationships that could be construed as a potential conflict of interest.

Funding

This study did not receive any funding.

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