
ANALYSIS OF THE EFFECT OF THE QUALITY OF FINANCIAL STATEMENTS ON INVESTMENT DECISIONS



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Abstract

This study investigates the analysis of the effect of the quality of financial statements on investment decisions among manufacturing firms listed on the Indonesia Stock Exchange between 2020-2022. Grounded in agency theory, the research addresses the persistent issue of investment inefficiency and the mixed empirical evidence surrounding financial reporting. Using a quantitative approach and purposive sampling, data were gathered from 114 firm-year observations and analyzed through multiple linear regression. The empirical results demonstrate that profitability exerts a positive and statistically significant effect on investment decisions, highlighting the critical role of operational efficiency in resource allocation. However, the quality of financial statements does not show a statistically significant effect on investment decisions within the observed sample, indicating that financial disclosure quality alone may not be the primary driver of investment decisions in this context. These findings offer practical implications for corporate managers, investors, and policymakers, suggesting that while transparency is essential, operational profitability remains a more decisive factor in effective investment outcomes.

Keywords: Investment Decisions, Profitability, Quality of Financial Statements

INTRODUCTION

Along with the development of the world economy in the era of globalization, competition in the business world is increasingly competitive and complex. This situation requires the company's management to be able to manage their company effectively and efficiently to achieve the goals set by the company. In addition to the increasingly fierce competition, the problems that may be faced by the company do not only come from external factors, but also from internal factors of the company. A company is an institution in the form of an organization that is operated to provide goods and services to the community. Every company that operates must have a clear goal in carrying out its business operations. The main goal that all companies want to achieve is to get the maximum profit to be able to advance their company in the long term. To be able to advance his company in the long term, usually a manager will make a decision to invest.

One of the important sources of information in the capital market investment business is the financial statements provided by each company listed on the Indonesia Stock Exchange that has gone public. At first, financial statements for a company were only as a "testing tool" of the work of the bookkeeping department, but later financial statements were not only a testing tool but as a basis to be able to determine or assess the company's financial position, where with the results of the analysis interested parties made a decision. Financial statements are basically the result of an accounting process that can be used as a means of communication between financial data or activities of a company and parties interested in the company's data or activities (Munawir, 2004).

Companies need to know the development of the company's performance from time to time. One of the factors that reflects the company's performance is the financial statements presented in the annual report made by the management for the benefit of the users, including investors. Financial statements can be used as a consideration in making investment decisions and a means of accountability for company management regarding the resources entrusted to the company (Indonesian Accounting Association, 2017). Therefore, the company's management needs to improve the quality of financial statements so that investors can be interested in buying the company's shares. In addition, it can help management in identifying investment opportunities due to the reduction of information asymmetry (Salim & Kurniawati, 2016). Investing is investing in the present over a period of time to earn future payments and offset the time it is invested, the rate of inflation, as well as the uncertainty of future payments (Frank & Keith, 2012). Investment provides benefits for companies and investors, companies will get additional capital for their business activities and provide good company value if the investment increases. The advantage of investment for investors themselves is that investors will get the expected level of return on the investment. Investment is said to be efficient if investment does not occur overinvestment or underinvestment. The growth of a company is highly dependent on the policies taken by the managers in the company. A manager is required to know correctly and definitively about information that is useful for the company. However, many company managers misuse this information for their own benefit. This is due to the difference in information held between managers and shareholders.

Previous studies have identified quality of financial statements as a potential mechanism for improving investment decisions. High-quality financial reports reduce

information asymmetry and allow stakeholders to evaluate organizational performance more accurately. Nevertheless, empirical evidence remains inconsistent. Several studies report a positive association between quality of financial statements and investment decision, whereas others fail to identify a significant relationship. Similar inconsistencies appear in research examining debt maturity. These conflicting findings indicate that the relationship between corporate reporting, financing structure, and investment behavior remains insufficiently understood.

REVIEW OF LITERATURE

Agency Theory

Agency theory explains that contractual relationships between principals and agents frequently generate conflicts of interest. Managers possess superior information regarding organizational activities, while shareholders depend on disclosures provided by management (Jensen & Meckling, 1976). Information asymmetry may encourage opportunistic behavior and lead to inefficient investment decisions. High-quality financial reporting can reduce these problems by improving transparency and strengthening monitoring mechanisms. Accurate reporting enables investors to assess managerial decisions more effectively and contributes to more efficient resource allocation. Agency theory is the granting of authority by the company owner (shareholder) to the company's management to carry out the company's operations in accordance with the agreed contract, if both parties have the same interest to increase the company's value, then the management will act in accordance with the interests of the company owner (Supriyono, 2018).

Quality of Financial Statements

Financial statements are reports of a company's accountability in a certain period regarding the company's activities According to (Kasmir, 2015) financial statements are reports that show the company's financial condition at this time or in a certain period. Financial statements are information that describes the condition of a company's financial statements and furthermore this information can be used as an overview of the company's financial performance. Quality of financial statements is expected to improve investment decision because reliable information reduces uncertainty and enhances decision usefulness. Investors and creditors can evaluate projects more accurately when financial disclosures faithfully represent economic conditions. Profitability measured through return on assets, reflects managerial effectiveness in utilizing resources and is expected to support efficient investment behavior.

The FASB in SFAC No. 1 states that "Financial reporting includes not only financial statements but also other means of reporting information, directly or indirectly, related to the information provided by the accounting system information about economic sources, debts, periodic profits and others". The quality of financial reporting can be seen from the qualitative characteristics of financial statements. These characteristics are listed in SFAC No. 2 as follows:

- a. Relevance
- b. Reliability
- c. Comparability and Consistency
- d. Cost-Benefit Considerations

e. Materiality

Investment

According to (Tandelilin, 2017) investment is a commitment to a number of funds or other resources that are carried out at this time, with the aim of getting a number of profits in the future. According to (Abdillah & Jogiyanto, 2015) investment is a delay in current consumption to be put into productive assets over a certain period of time in the future. Based on the above definition, it can be concluded that investment is the investment of assets or funds for a certain period of time with the aim of obtaining profits in the future in order to obtain greater returns.

RESEARCH METHOD

In this study, quantitative research methods are used, according to (Sugiyono, 2014). This method is in the form of numbers and the analysis uses statistics. Based on this theory, the quantitative research method is a research in which there is data obtained from the population and samples that have been determined and analyzed according to the rules of statistical use. This study adopts a quantitative research design and employs secondary data obtained from annual reports and publicly available corporate disclosures. The population consists of manufacturing firms listed on the Indonesia Stock Exchange during the 2020-2022 period. Sample selection follows a purposive sampling approach. Firms were required to remain listed throughout the observation period, provide complete financial information, and report positive values necessary for calculating the study variables. After applying the selection criteria and removing outliers, the final sample comprised 114 firm-year observations. The data analysis technique employed in this study is multiple linear regression analysis. The multiple regression equation model formulated for this research is specified as follows:

$$ID = \alpha + \beta_1 QFS_{it} + \beta_2 ROA_{it} + \varepsilon_{it}$$

Where:

ID = Investment Decisions

α = Constant

β = Regression coefficient

QFS = Quality of Financial Statements

ROA = Profitability

ε = Error term / Residual

Research Hypothesis

The Effect of Quality of Financial Statements on Investment Decisions

Financial statements constitute a formal reporting mechanism that presents information regarding a company's current financial performance and future financial prospects. These reports are intended to provide relevant and reliable information to stakeholders, thereby supporting strategic decision-making processes. Prepared and disclosed by management, financial statements serve as a primary source of information for investors, creditors, and other decision-makers. Consequently, managers bear the responsibility of ensuring that the financial information communicated to stakeholders is of high quality and faithfully represents the company's economic condition.

Agency theory suggests that differences in interests between principals and agents may create conflicts that lead to information asymmetry. High-quality financial statements can mitigate such conflicts by enhancing transparency and reducing information gaps between management and stakeholders. Reliable financial information also limits opportunities for managerial opportunistic behavior and enables investors to monitor managerial actions more effectively. Since investors rely on financial disclosures when evaluating investment opportunities, higher quality of financial statements is expected to improve the monitoring function exercised by external stakeholders.

The quality of managerial investment decisions can be reflected in the quality of the financial information provided to stakeholders. Transparent and honest disclosure allows investors and other capital providers to assess the firm's performance and prospects more accurately, thereby facilitating more informed decision-making. According to Akasumbawa and Haryono (2021), the provision of high-quality financial information supports better evaluation of corporate resource allocation and investment activities.

Empirical evidence further supports the importance of the quality of financial statements in promoting efficient investment decisions. Houcine et al. (2021) argue that high-quality financial statements reduce information asymmetry and contribute to higher levels of efficient investment decisions. Similarly, Wang et al. (2019) demonstrate that comprehensive financial disclosure provides decision-makers with more accurate information, thereby improving investment-related judgments. Based on these arguments and prior empirical findings, the first hypothesis is formulated as follows:

**H1: Quality of Financial Statements has a positive effect on Investment Decisions.
The Effect of Profitability on Investment Decisions**

Profitability ratios reflect a company's ability to generate earnings from the resources under its control. Among the various profitability measures, Return on Assets (ROA) is widely used to assess how efficiently a firm utilizes its assets to produce profits. A higher ROA indicates that management has been more effective in converting available resources into earnings, thereby demonstrating superior operational efficiency. Since investment decisions involve the allocation of corporate resources to projects expected to generate future benefits, firms with stronger profitability performance are generally expected to exhibit greater efficient investment decisions.

Strong profitability performance may also encourage higher-quality corporate disclosures and enhance stakeholders' confidence in managerial decision-making. Firms with favorable financial performance generally possess greater incentives to communicate their achievements transparently through financial statements. Such transparency can improve information availability for investors and facilitate more accurate assessments of investment opportunities. Empirical evidence provided by Wang et al. (2019) and Raharjo (2017) indicates that profitability performance contributes to more efficient investment decisions by strengthening financial conditions and improving the quality of information available to market participants. Based on these arguments, the following hypothesis is proposed:

H2: Profitability has a positive effect on Investment Decisions.

RESULTS AND DISCUSSION

Table 1 presents the results of the descriptive statistical analysis, as follows:

Table 1
Descriptive Statistic

	N	Min.	Max.	Mean
Investment	114	0.025	5.74	0.523
Quality of Financial Statements	114	0.067	31.957	3.725
Profitability	114	0.003	1.572	0.097

Source: Processed Data (2025)

For the investment decision, the mean value is 0.523. The maximum value obtained is 5.74, while the minimum value obtained is 0.025 which this average indicates that the level of efficient investment decisions among the sampled companies in this study is relatively high. For the Quality of Financial Statements, the mean value is 3.725. The maximum value reached is 31.957, and the minimum value is 0.067. This average implies that the quality of financial statements of the sampled companies is good, as their operating cash flows generally stand above their pre-tax operating profits. Lastly, the Profitability shows a mean value of 0.097. The maximum value obtained is 1.572, whereas the minimum value is 0.003. Given that the average profitability remains under 10%, it can be concluded that the overall condition of the sampled firms falls below the established corporate benchmark of 20%.

The results of the distribution normality test were obtained using the One Sample Kolmogorov-Smirnov test.

Table 2
Normality Test

One-Sample Kolmogorov-Smirnov Test		
	Unstandardized Residual	Decision
Asymp. Sig. (2-tailed)	0.162	Normally Distributed

Source: Processed Data (2025)

The Kolmogorov-Smirnov test yielded a significance value of 0.162 (> 0.05), indicating no significant difference between the empirical data and the standard normal distribution. Consequently, it can be concluded that the data is normally distributed.

Table 3
Multicollinearity Test

	Tolerance	VIF	Decision
Quality of Financial Statements	0.193	5.472	No Multicollinearity
Profitability	0.962	1.113	No Multicollinearity

Source: Processed Data (2025)

The multicollinearity test aims to determine whether there is a high or perfect correlation among the independent variables within the regression model. A good regression

model should not exhibit any multi-correlation among its independent predictors. The assumption of non-multicollinearity is satisfied if the Tolerance value is greater than 0.10 (>0.10) and the Variance Inflation Factor (VIF) value is less than 10 (<10). Based on the statistical output presented in Table 3, the results are Quality of Financial Statements variable shows a tolerance value of 0.193 and a VIF value of 5.472 and profitability shows a tolerance value of 0.962 and a VIF value of 1.113. The empirical results demonstrate that all independent variables have a tolerance value exceeding 0.10 and a VIF value well below 10. Therefore, it can be concluded that there is no multicollinearity problem among the independent variables in this regression model, confirming its readiness and validity for further statistical analysis.

Table 4
Autocorrelation Test

DL	DW	DU	Decision
1.752	2.000	1.804	No Autocorrelation

Source: Processed Data (2025)

The autocorrelation test is performed to evaluate whether there is a correlation between the residuals of a specific period and those of previous periods within the linear regression model. A robust regression model requires the absence of autocorrelation disturbances among its residuals. To assess this classical assumption, the Durbin-Watson (DW) statistical test is utilized, where the calculated DW value is systematically compared against the critical table thresholds, namely the Durbin-Lower and Durbin-Upper bounds.

Based on the empirical findings presented in Table 4, the statistical analysis yields a Durbin-Watson (DW) value of 2.000, alongside a lower bound of 1.752 and an upper bound of 1.804. The diagnostic decision rule establishes that a model is entirely free from autocorrelation.

Hypothesis Test

In this study, the Adjusted R^2 is 32.7%, implying that approximately 32.7% of the variability in the investment decision is collectively accounted for by the variables. The remaining 67.3% indicates the presence of other external factors affecting investment decisions that were omitted from the current empirical model.

The F-test was employed to assess the overall goodness-of-fit of the regression model relative to the empirical data, as well as to evaluate the simultaneous statistical significance of the independent variables on the dependent variable. The statistical output reveals an F-statistic with a corresponding probability (p-value) of 0.000, evaluated at a 5% alpha level. Given that the significance value of the F-statistic is well below the 0.05 threshold ($p < 0.05$), the null hypothesis (H_0) is rejected in favor of the alternative hypothesis (H_1). This strongly confirms that the independent variables simultaneously exert a statistically significant effect on investment decisions.

The following are the results of the t-test conducted in this study to evaluate the proposed hypotheses:

Table 5
t-statistic Test

	B	Sign.	Decision
Quality of Financial Statements	0.007	0.134	H1 Not Supported
Profitability	2.215	0.000	H2 Supported

Source: Processed Data (2025)

The Effect of Quality of Financial Statements on Investment Decisions

The empirical findings of this study demonstrate that the quality of financial statements does not exert a statistically significant effect on investment decisions, thereby failing to support the first hypothesis (H1). This outcome directly contradicts the core premise of agency theory, which posits that high-quality financial reporting serves as a robust mechanism to enhance transparency, mitigate information asymmetry, and subsequently drive efficient resource allocation. The absence of a significant relationship between quality of financial statements and investment decisions suggests that the selected reporting quality proxy may not fully capture the informational characteristics valued by investors. Although agency theory predicts that transparent reporting should reduce information asymmetry, the operating cash flow to earnings ratio may provide only a limited representation of reporting quality. Investors may rely on broader information sources when evaluating investment opportunities. Furthermore, this result diverges from the empirical evidence documented by Houcine et al. (2021), who argued that comprehensive financial disclosures improve managerial investment judgments by limiting opportunistic behaviors. Several plausible factors may explain this insignificant relationship. First, the lack of statistical significance suggests that a high level of quality of financial statements does not automatically insulate an organization from managerial opportunism or deep-seated agency conflicts. Second, this phenomenon may be influenced by the specific proxi used to measure quality of financial statements. This specific metric may be inadequate to capture the true, multi-dimensional economic substance of financial disclosures required by market participants to evaluate efficient investment decisions. Consequently, improvements in this specific measure may not necessarily translate into more efficient investment decisions. Notably, this finding aligns with Perdana (2019), who similarly concluded that variations in quality of financial statements reporting do not significantly dictate efficient investment decisions.

The Effect of Profitability on Investment Decisions

The empirical results of this study confirm that profitability has a positive and statistically significant effect on investment decisions, thereby supporting the second hypothesis (H2). This finding indicates that a firm's ability to generate earnings from its asset base is a critical determinant of efficient investment decisions. This result is consistent with the findings of Riani and Maulani (2021), who also identified a positive association between profitability and the efficiency of corporate investment. The rationale behind this relationship lies in the nature of the profitability ratio, which effectively captures a firm's managerial effectiveness in utilizing its resources to produce net income. A higher profitability signifies superior operational efficiency, demonstrating that the firm is successfully optimizing both tangible and intangible assets to generate economic value. When firms exhibit strong profitability, they are generally perceived as having better control over their internal operations, which provides management with the necessary resources and strategic

confidence to pursue efficient investment projects. Furthermore, firms with robust financial performance often possess stronger incentives to maintain transparent disclosures, thereby increasing stakeholder confidence in managerial decision-making and facilitating more accurate assessments of future investment opportunities.

CONCLUSION

This study empirically investigated the effect of the quality of financial statements on investment decisions among manufacturing firms listed on the Indonesia Stock Exchange between 2020 and 2022. Based on the statistical analysis performed on 114 firm-year observations, the study draws conclusions confirming that while profitability significantly affects investment decisions, the quality of financial statements does not exert a statistically significant influence within this sample. This finding suggests that, within the observed sample, high-quality financial reporting alone is insufficient to guarantee efficient investment behavior or to fully mitigate managerial opportunism. Meanwhile, profitability has a positive and significant effect on investment decisions. This confirms that firms with superior operational efficiency and higher earnings-generating capability are better positioned to execute effective investment policies.

These findings offer valuable insights for various stakeholders. For corporate managers, the results underscore the critical importance of operational efficiency as a primary driver of investment efficacy. For investors and policymakers, this study highlights that while quality of financial statements is a fundamental component of transparency, it may not be the sole predictor of efficient investment outcomes within this specific sample, suggesting the need for more rigorous, multi-faceted analysis when assessing investment potential.

This study acknowledges certain limitations, particularly regarding the proxy used to measure quality of financial statements, which may not capture the full economic substance of corporate disclosures. Furthermore, the scope was limited to the 2020–2022 period and the manufacturing sector. Future research is encouraged to incorporate a longer observation period, a broader range of industrial sectors, and more comprehensive proxies to further validate these relationships and enhance the explanatory power of the investment decision model.

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