



Received: 18-02-2025
Accepted: 28-03-2025

ISSN: 2583-049X

Factors Affecting Earnings Quality of Listed Companies on the Vietnamese Stock Exchange

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Abstract

This study analyzes the factors influencing the earnings quality of listed companies on the Vietnamese stock market, including financial leverage (LEV), firm size (Size), and operational efficiency (ROA). Using a Random Effects Model (REM) with robust standard errors, the results show that firm size and operational efficiency have a statistically significant negative impact on earnings quality, whereas financial leverage does not have a significant effect. These

findings suggest that large and highly efficient firms may face market pressure, leading to earnings management practices to enhance financial statement appearances, thereby reducing earnings quality. The study also provides policy implications to improve earnings quality, including strengthening internal controls, enhancing financial information transparency, and encouraging sustainable growth strategies.

Keywords: Earnings Quality, Financial Leverage, Firm Size, Operational Efficiency

1. Introduction

Financial statements play a crucial role in providing information to both internal users (such as management and the board of directors) and external users (such as investors, banks, and tax authorities). In particular, earnings information in financial statements is a key factor that directly influences important decisions made by investors and other stakeholders. In Vietnam, within the context of a rapidly developing stock market and increasing international economic integration, investors are showing a growing interest in corporate net profit figures. Net profit is regarded as a key indicator for assessing a company's profitability, operational efficiency, and future growth potential.

Listed companies on the Ho Chi Minh Stock Exchange (HOSE) and the Hanoi Stock Exchange (HNX) are required to publish quarterly and annual financial statements to comply with legal regulations and meet shareholder expectations. Among the various financial indicators, net profit is considered the most important because it directly reflects the company's operating performance during the accounting period. Investors often base their buy or sell decisions on the company's earnings results. When a company demonstrates consistent profit growth over the years, it indicates stability and growth potential, which in turn enhances investor confidence. Conversely, if a company's earnings decline or fluctuate significantly, investors may lose confidence and decide to divest.

However, in reality, profit figures in financial statements can be easily manipulated through practices such as early revenue recognition, delayed expense recognition, or using accounting techniques to inflate or deflate short-term profits. Such earnings management practices reduce the reliability of financial information, making it difficult for investors to make accurate decisions. Earnings manipulation not only distorts information but can also lead to negative consequences such as loss of market confidence, declining stock prices, or even financial crises when fraudulent information is exposed.

Earnings quality is understood as the extent to which reported earnings accurately reflect the actual performance of the company. High-quality earnings accurately represent business results without being influenced by creative accounting practices or temporary factors. In Vietnam, many companies report positive earnings figures, but the underlying earnings quality remains questionable. For example, in 2019, many companies listed on HOSE reported unusually high profits due to short-term financial investments or one-time gains from asset liquidation. However, these earnings did not reflect the core business performance, making it difficult for investors to assess the true value of these companies.

A notable example is Hoang Anh Gia Lai Joint Stock Company (HAGL). In 2017, the company reported high profits due to revenue from the sale of real estate assets and non-core investments. However, in the following years, as these sources of revenue diminished, HAGL's profits declined sharply, causing its stock price to plummet and eroding investor confidence. Similarly, on the international stage, financial scandals such as the Toshiba case—in which the company overstated its earnings by up to USD 1.2 billion over five years—and the Enron scandal in the United States have demonstrated the severe consequences of earnings manipulation. These incidents led to misguided investment decisions, significant shareholder losses, and a loss of market confidence in listed companies.

Given this context, improving earnings quality has become a pressing issue for Vietnamese companies amidst increasing competition and economic integration. To clarify the factors affecting earnings quality, this study aims to analyze the impact of factors such as audit firm size, audit tenure, auditor expertise, financial leverage, firm size, managerial ownership, and institutional ownership. Companies audited by large firms (such as the Big Four) are likely to have higher earnings quality due to strict oversight and greater transparency in the audit process. Maintaining the same audit firm over several years can help auditors develop a better understanding of the company, but it can also lead to reduced objectivity. Auditors with specialized expertise in specific industries are more capable of detecting and preventing fraudulent reporting practices, thereby improving earnings quality.

In addition, larger companies tend to have better internal control systems, which help to prevent earnings manipulation. However, a high debt ratio may exert pressure on management to manipulate earnings to present better financial statements. Companies with high managerial ownership may demonstrate better earnings quality since the interests of managers are aligned with the long-term performance of the business. This study is expected to provide empirical evidence to help Vietnamese companies develop strategies to improve earnings quality, thereby enhancing investor confidence and facilitating more efficient capital mobilization in the financial market.

2. Literature review

Earnings quality has become a widely discussed topic in academic research worldwide, especially in the context of rapidly developing financial markets and increasing international integration. Dechow, Ge, and Schrand (2010)^[1] conducted a comprehensive review of the factors influencing earnings quality on a global scale. Their study synthesized data from thousands of listed companies in major markets (the United States, Europe, and Asia), highlighting that legal culture, transparency, and financial reporting standards are significant factors affecting earnings quality. However, this study was primarily theoretical and did not provide specific practical recommendations for different markets.

Chen *et al.* (2019)^[2] conducted an in-depth analysis of the relationship between corporate governance and earnings quality in Asian stock markets (Japan, South Korea, and China) during the period from 2010 to 2018. Using a Generalized Method of Moments (GMM) model, the study showed that the proportion of large shareholders and the percentage of independent board members had a positive

impact on earnings quality. These results underscore the critical role of corporate governance in improving earnings quality; however, the study did not explore the impact of macroeconomic factors or industry-specific characteristics in detail.

Nobes and Parker (2018)^[3] also conducted a meta-analysis of previous research on earnings quality in an international context. Their study demonstrated that institutional and cultural factors—such as legal traditions, investor protection, tax systems, financial regulations, and market competition—significantly influence earnings quality. The study also proposed future research directions to further clarify the impact of these factors in different contexts.

In the context of emerging markets, the study by Alvin and Yulius Kurnia Susanto (2022)^[4] in Indonesia focused on examining the factors affecting the earnings quality of listed manufacturing companies from 2014 to 2020. Using a multivariate regression model, the study found that factors such as audit firm size, audit tenure, audit specialization, firm size, and financial leverage had a positive effect on earnings quality. In contrast, factors such as investment opportunities (IOS), growth opportunities, managerial ownership, and institutional ownership did not have significant effects. This study provided important empirical evidence on the factors influencing earnings quality in the manufacturing sector in Indonesia.

In Vietnam, earnings quality has also attracted considerable attention from the academic community. Nguyen Thi Thu (2019)^[5], in her dissertation, examined the relationship between internal business factors and earnings quality among 500 listed companies on HOSE and HNX from 2010 to 2018 using a panel data regression model. The results showed that financial leverage and liquidity had a negative impact on earnings quality, while total asset turnover and firm size had a positive impact. However, this study did not consider macroeconomic factors such as the legal environment or market competition.

The study by Nguyen Thi Ngoc Trang and Bui Kim Phuong (2018)^[6] analyzed the factors influencing earnings quality among listed companies on HOSE, including profitability, financial leverage, and liquidity. The results showed that profitability and liquidity had a positive effect on earnings quality, while financial leverage had a negative effect. However, this study faced similar limitations, as it did not consider other factors such as the business environment and economic policies.

More recently, the study by Vu Thi Thanh Binh (2023)^[7] expanded the research scope with 1,218 observations from 174 listed companies in Vietnam from 2016 to 2021. The results indicated that capital intensity positively influenced earnings quality, but no significant impact of the Covid-19 pandemic on earnings quality was found during the study period. However, this study also faced limitations in that it did not explore factors such as the business environment and economic policies.

The Journal of Finance (2021) analyzed the impact of financial and non-financial factors on the earnings quality of 300 listed companies on HOSE during the period from 2015 to 2020. The results showed that state ownership positively influenced earnings quality, while financial leverage and revenue growth had a negative impact. This study provided specific recommendations regarding the role of governance and capital structure in improving earnings quality, but it did

not analyze in detail non-financial factors such as corporate culture or the business environment.

From the above literature review, it is evident that the factors influencing earnings quality vary depending on the context and characteristics of each market. While international studies emphasize the role of corporate governance, transparency, and legal culture, studies in Vietnam focus more on internal financial factors such as financial leverage, profitability, and firm size. This difference suggests that improving earnings quality requires a tailored approach that reflects the specific characteristics of each market. In the Vietnamese context, businesses should adopt effective governance strategies, maintain reasonable levels of financial leverage, and enhance financial reporting transparency. Additionally, macroeconomic factors such as the business environment, economic policies, and market competition should be considered to gain a more comprehensive understanding of earnings quality. Future research should focus on developing models that combine both financial and non-financial factors, including governance quality, market competition, and regulatory frameworks. Such research would provide more comprehensive insights into the mechanisms through which earnings quality can be enhanced, thereby contributing to the sustainable development of financial markets.

3. Theory and Hypotheses

Financial leverage reflects the relationship between a company's debt and its total assets. According to the capital structure theory proposed by Modigliani and Miller (1958)^[12], financial leverage can affect a company's operational efficiency and firm value through its impact on the cost of capital and financial risk. This theory suggests that using debt at a reasonable level can generate tax shield benefits, thereby improving the company's profitability. However, when debt levels increase excessively, financial risk also rises, leading to the potential risk of bankruptcy and negatively impacting earnings quality.

Empirical research on the relationship between financial leverage and earnings quality has yielded mixed results. Wati and Putra (2017)^[8] found a positive relationship between leverage and earnings quality, arguing that companies with high debt ratios are under greater pressure to maintain transparency and strengthen internal controls, which in turn improves earnings quality. In contrast, Purnamasari and Fachrurrozie (2020)^[9] reported a negative impact of leverage on earnings quality, suggesting that repayment pressure may drive management to engage in earnings management practices to present more favorable financial results. However, Murniati (2019)^[10] found no statistically significant relationship between financial leverage and earnings quality, indicating that the impact of leverage may vary depending on the context and specific characteristics of each company.

Based on the theoretical foundations and previous research findings, the following hypothesis is proposed:

H1: Financial leverage has an impact on earnings quality

Firm size is defined as the total value of a company's assets. Investors tend to have greater confidence in larger companies, as firm size reflects a company's operational

capacity and financial strength. According to the theory of economies of scale, larger companies tend to have cost advantages, stronger bargaining power, and better access to financial resources compared to smaller companies. Larger firms are also more likely to maintain operational stability, secure financial resources, and establish more effective internal control systems. Consequently, firm size can positively affect earnings quality by improving management capacity and increasing transparency in financial reporting. Empirical research on the relationship between firm size and earnings quality has produced inconsistent results. Purnamasari and Fachrurrozie (2020)^[9] found that firm size positively affects earnings quality because larger companies are better able to control business activities and implement more effective internal control measures. Conversely, Wati and Putra (2017)^[8] argued that firm size may have a negative impact on earnings quality, as larger companies may engage in earnings management to achieve short-term financial targets. However, Hakim and Naelufar (2020)^[11] found no statistically significant relationship between firm size and earnings quality, suggesting that firm size may not be the sole determinant of earnings quality.

Based on the theoretical foundations and previous research findings, the following hypothesis is proposed:

H2: Firm size negatively affects earnings quality

A company's profitability is reflected through the Return on Assets (ROA) ratio, which measures how effectively a company utilizes its assets to generate profit. According to the efficiency theory, companies with high profitability tend to have better cost control, make more effective strategic decisions, and maintain greater transparency in financial reporting. When a company has a high ROA, stable cash flow and sustainable profitability can help build trust with investors and business partners, thereby improving earnings quality. Conversely, when ROA is low, companies may face operational pressure, which could lead to financial risk and an increased likelihood of engaging in earnings management to present more favorable financial results.

Empirical research on the relationship between profitability and earnings quality has produced varying results. Wati and Putra (2017)^[8] found that ROA positively affects earnings quality, suggesting that highly profitable companies are more transparent in financial disclosure and internal control, thereby improving earnings quality. Similarly, Hakim and Naelufar (2020)^[11] argued that companies with high ROA tend to maintain better financial discipline, ensuring accuracy and integrity in financial reporting and enhancing earnings quality. However, Purnamasari and Fachrurrozie (2020)^[9] reported a negative relationship between ROA and earnings quality, suggesting that when profitability increases, management may exploit this opportunity to engage in earnings management to achieve short-term financial targets. Conversely, Murniati (2019)^[10] found no statistically significant relationship between ROA and earnings quality, indicating that the impact of profitability on earnings quality may depend on industry-specific factors and the business environment.

Based on the theoretical foundations and previous research findings, the following hypothesis is proposed:

H3: Profitability has an impact on earnings quality

4. Data and methodology

Research subject: The impact of earning quality on corporate performance in non-financial enterprises.

Research scope: Data is sourced from Fiin Group JSC.

In terms of geography: Non-financial companies listed on the Vietnamese stock market are identified, excluding financial companies such as insurance, securities, and banks. These entities are considered to have their own corporate governance rules and financial reporting standards, which may affect the research results (Davidson, Goodwin-Stewart, & Kent, 2005).

A linear regression model is employed to test the impact of earnings quality on dependent variables. A general model can be expressed as follows:

$$EQ_i = \beta_0 + \beta_1 LEV_i + \beta_2 Size_i + \beta_3 ROA_i + \epsilon_i$$

Where:

- EQ = Earnings Quality
- LEV_i = Financial Leverage
- Size_i = Firm Size
- ROA_i = Profitability

5. Results and discussion

5.1 Examining the research model

Statistical data on the factors in the research model are as follows:

Table 1: Descriptive statistics of variables

Variable	Obs	Mean	Std. dev.	Min	Max
STT	3,779	291.6107	153.7567	1	550
MA	0				
NAM	3,779	2018.001	2.581852	2014	2022
TEN	0				
SAN	0				
ROA	3,360	.0651104	.0802338	-.6246	.7219
Size	3,360	12.12334	.7254189	10.18013	14.76148
LEV	3,360	.477714	.2218299	.0026735	1.294471
EQ	3,360	30.77523	478.2864	-24539.27	9384.433
ma_num	3,779	210.4557	121.2447	1	420
san_num	3,779	1.733263	.4423124	1	2

The correlation between variables is shown in Table 2. This table shows that the correlation coefficient between the independent variables in the model has no pair greater than 0.5. Therefore, there is little possibility of multicollinearity among the independent variables in the model.

Table 2: Correlation coefficient matrix

	EQ	ROA	Size	LEV
EQ	1.0000			
ROA	-0.0309	1.0000		
Size	-0.0233	-0.1015	1.0000	
LEV	-0.0025	-0.3251	0.3526	1.0000

The study examines the multicollinearity of variables in the research model based on the acceptable threshold of the variable (Tolerance) and the VIF coefficient. The results of the regression analysis show that the variance exaggeration factor VIF is less than 5, so it is possible to reject the hypothesis that the model has multicollinearity (Table 4).

Table 3: Multicollinearity test result

Variable	VIF	1/VIF
LEV	1.26	0.791117
Size	1.14	0.875497
ROA	1.12	0.894119
Mean VIF	1.17	

However, there is evidence of heteroscedasticity.

H0: Constant variance

chi2(1) = 121.40

Prob > chi2 = 0.0000

Table 4: Linear Regression Results

Linear regression	Number of obs	=	3,360
F(3, 3356)	=	13.09	
Prob > F	=	0.0000	
R-squared	=	0.0017	
Root MSE	=	478.1	
Robust			
EQ	Coefficient	std. err.	t P> t [95% conf. interval]
ROA	-208.9402	53.6183	-3.90 0.000 -314.0681 -103.8124
Size	-16.53108	4.293648	-3.85 0.000 -24.94952 -8.112654
LEV	-10.79038	55.84862	-0.19 0.847 -120.2912 98.71038
_cons	249.9462	48.95801	5.11 0.000 153.9556 345.9367

The regression results show that ROA and Size have a negative and statistically significant impact on earnings quality (EQ), with p-values less than 0.01. In contrast, LEV is not statistically significant (p = 0.847), indicating that financial leverage does not have a clear impact on earnings quality. The overall model is statistically significant (p < 0.01), but the R-squared value is very low (0.0017), suggesting that the model explains only a small portion of the variation in earnings quality.

The study tests to choose an appropriate regression model between OLS and FEM by employing the F test and the Hausman test before analyzing factors affecting the truthfulness of financial reporting. As a result, the FEM model was selected for further tests. The results are shown in Table 5.

Tables 5: F test and Hausman test results

Overall model	Inspection results	Conclusion
Step 1: Comparison between OLS and FEM	F(3, 419) = 2.42, Prob > F = 0.0658	FEM model selection
Step 2: Comparison between OLS and REM	Wald chi2(3) = 5.64, Prob > chi2 = 0.1304	REM model selection
Step 3: Comparison between FEM and REM (Hausman test)	chi2(3) = 4.72, Prob > chi2 = 0.1934	REM model selection

The selected REM model appears to have defects of the research model, such as the variance of the error change. However, the Wooldridge test shows that there is no series correlation in the model. Thus, the study uses the robust standard error correction in the random effects model (REM) to solve the above defect and ensure that the obtained estimate is stable and efficient.

5.2 Testing Hypotheses

The researcher performed a random-effects model (REM) with robust standard errors for the overall model, with the results shown in Table 6.

Table 6

Random-effects GLS regression		Number of obs =	3,360			
Group variable: ma_num		Number of groups =	420			
R-squared:		Obs per group:				
Within = 0.0023		min =	8			
Between = 0.0032		avg =	8.0			
Overall = 0.0017		max =	8			
corr(u_i, X) = 0 (assumed)		Wald chi2(3) =	23.76			
		Prob > chi2 =	0.0000			
(Std. err. adjusted for 420 clusters in ma_num)						
EQ	Coefficient	Robust std. err.	z	P> z	[95% conf. interval]	
ROA	-208.9562	61.4728	-3.40	0.001	-329.4407	-88.47176
Size	-16.53109	5.273901	-3.13	0.002	-26.86775	-6.194439
LEV	-10.78981	52.20238	-0.21	0.836	-113.1046	91.52498
_cons	249.947	62.32339	4.01	0.000	127.7955	372.0986
sigma_u	2.1790413					
sigma_e	477.97103					
rho	.00002078	(fraction of variance due to u_i)				

The selected REM model appears to have defects of the research model, such as the variance of the error change. However, the Wooldridge test shows that there is no series correlation in the model. Thus, the study uses the robust standard error correction in the random effects model (REM) to solve the above defect and ensure that the obtained estimate is stable and efficient.

5.3 Testing Hypotheses

The researcher performed a random-effects model (REM) with robust standard errors for the overall model, with the results shown in Table 7.

Table 7

S. No	Variables	Expected	Results
1	LEV	+	Not significant
2	Size	-	-
3	ROA	+	-

Based on the REM regression results with robust standard errors, this study provides deeper insights into the impact of financial leverage (LEV), firm size (Size), and return on assets (ROA) on earnings quality (EQ).

According to Hypothesis H1, LEV was expected to have a positive impact on earnings quality. However, the regression coefficient for LEV is -10.78981 with a p-value of 0.836, indicating that the effect is statistically insignificant. This suggests that financial leverage does not have a direct or significant influence on earnings quality.

Regarding Hypothesis H2, the regression coefficient for Size is -16.53109 with a p-value of 0.002, confirming a statistically significant negative impact on earnings quality. This result contradicts expectations, suggesting that larger firms may face greater complexity in financial reporting and increased pressure to manage earnings, which could reduce the perceived quality of earnings.

Finally, Hypothesis H3 on the effect of ROA is also supported, with a regression coefficient of -208.9562 and a p-value of 0.001, indicating a statistically significant negative impact on earnings quality. This finding implies that firms with higher profitability may focus on short-term performance rather than maintaining stable and transparent earnings quality.

These findings underscore that while financial leverage does not significantly influence earnings quality, firm size and profitability may have negative effects. Larger firms and highly profitable firms may face increased complexity and strategic pressures, which could reduce the consistency and transparency of reported earnings.

6. Research Findings and Policy Implications

6.1 Research Findings

The research findings provide important insights into the relationship between earnings quality (EQ), financial leverage (LEV), firm size (Size), and operational efficiency (ROA). One of the key findings is that financial leverage does not have a significant effect on earnings quality, which contrasts with initial expectations. The regression coefficient for LEV is -10.78981 with a p-value of 0.836, indicating that this relationship is not statistically significant. This suggests that financial leverage does not directly influence earnings quality, possibly because companies with high debt ratios often face greater financial pressure in terms of debt repayment and maintaining cash flow. This financial pressure may lead to strategic earnings management practices. The lack of statistical significance indicates that the impact of financial leverage on earnings quality may depend on other contextual factors, such as the company's capital structure and market conditions.

In contrast, firm size has a negative and statistically significant effect on earnings quality. The regression

coefficient for Size is -16.53109 with a p-value of 0.002, indicating that this relationship is statistically significant and negative in direction. This finding contradicts the initial expectation that larger companies would have better internal control systems and more transparent financial reporting processes, thereby improving earnings quality. However, the negative impact of firm size on earnings quality may reflect the complexity of financial operations in larger firms, which increases opportunities for earnings management and reduces the transparency of financial reports. Moreover, the pressure to meet market expectations and maintain competitive positions may drive larger companies to engage in earnings management practices, thereby reducing earnings quality.

Furthermore, operational efficiency (ROA) also has a negative and statistically significant effect on earnings quality. The regression coefficient for ROA is -208.9562 with a p-value of 0.001, suggesting that more profitable companies tend to report lower earnings quality. This result implies that highly profitable companies may focus on short-term profit maximization rather than maintaining long-term financial stability and transparency. Profit-maximizing strategies, such as income smoothing or early revenue recognition, can weaken earnings quality by reflecting a trade-off between short-term profitability and long-term financial stability.

These findings indicate that while financial leverage does not directly affect earnings quality, firm size and operational efficiency have significant negative impacts. This highlights the need to maintain a balanced financial management approach, considering both the short-term and long-term effects of operational efficiency and firm size on earnings quality.

6.2 Policy Implications

Based on the research findings, several important policy implications can be proposed to improve earnings quality and enhance the financial transparency of companies:

First, improving earnings quality while maintaining financial flexibility. Although high earnings quality can improve transparency and reduce financial risk, companies should avoid overly conservative accounting policies that may limit their ability to raise capital and take advantage of growth opportunities. Regulatory agencies should develop accounting standards that balance transparency with financial flexibility, ensuring that earnings quality is not achieved at the expense of a company's growth potential. Additionally, companies should implement strong internal financial controls to prevent earnings management practices and ensure that financial strategies are executed consistently and transparently.

Second, strengthening oversight mechanisms and financial transparency. Since firm size has a negative impact on earnings quality, larger companies should establish more rigorous internal control mechanisms to mitigate the risk of earnings management practices. Regulatory bodies should require companies to provide more detailed financial disclosures and strengthen the supervision of financial reporting activities, especially for large firms. The adoption of International Financial Reporting Standards (IFRS) and mandatory independent audits can help improve the quality of financial reporting and increase investor confidence.

Third, encouraging sustainable growth strategies. Although financial leverage does not have a direct effect on earnings

quality, companies should manage debt carefully to avoid excessive financial pressure that could lead to earnings management practices. Corporate debt management policies should focus on maintaining a balanced debt-to-equity ratio, ensuring that debt usage creates value for the company without compromising financial transparency. Companies should prioritize more conservative capital allocation strategies to maintain long-term financial stability rather than focusing solely on short-term profit maximization.

Fourth, improving corporate governance and disclosure standards. Since operational efficiency negatively affects earnings quality, companies should implement stronger internal control measures to prevent earnings management and ensure that financial reports accurately reflect business performance. Regulatory bodies should encourage independent supervision of financial reports, especially for highly profitable companies, to prevent opportunistic behavior. Companies should also adopt more transparent disclosure policies to provide stakeholders with a clearer view of the drivers of financial performance and earnings quality.

Fifth, supporting small and medium-sized enterprises (SMEs). Since large firms have an advantage in raising capital and accessing financial resources, government policies and financial institutions should create favorable conditions for small and medium-sized enterprises (SMEs) to access capital, improve corporate governance systems, and increase competitiveness in the market. Financial support and improved market access will help SMEs enhance earnings quality and maintain sustainable long-term growth.

7. Acknowledgments

This paper was conducted with the research support of the project "Factors Affecting Earnings Quality of Listed Companies on the Vietnamese Stock Exchange" project code 2025.TĐHHN.06.16, led by Hanoi University of Natural Resources and Environment.

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