

Analysis of Factors Affecting Profit Persistency

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Abstract

Information about earnings has an important role for internal and external parties in the company's decision making. Profit that can describe the sustainability of earnings in the future is one of the characteristics of quality earnings. Investors should not only pay attention to high profits, but also pay attention to persistent earnings. This study aims to examine the factors that affect earnings persistence. The population in this study are food & beverage companies listed on the Indonesia Stock Exchange for the 2016-2020 period. The sample used purposive sampling and obtained a sample of 16 companies with a period of 5 years so that 80 samples were obtained. Earnings Persistence is proxied by Profit Before Tax ratioed to Average Total Assets. Sales Volatility is proxied by Sales in a ratio of Total Assets, and Operational Cash Flow Volatility is proxied by Total Operating Cash Flows ratioed to Total Assets. The results showed that sales volatility had a positive effect on earnings persistence and operating cash flow volatility had a positive effect on earnings persistence.

Keywords

Earnings persistence, Sales Volatility, Operating Cash Flow Volatility.

1. Introduction

One way to be able to see the company's performance can be seen from the annual profit that the company generates. If the company has a persistent profit, it can be said that the company's performance is good. Information about earnings has an important role for internal and external parties in the company's decision making. Profit that can describe the sustainability of earnings in the future is one of the characteristics of quality earnings. The purpose of the continuation of the profit is the ability of the profit to be able to survive in the future in a healthy condition. Therefore, investors must not only pay attention to high profits, but also must pay attention to persistent profits, which means that they are sustainable for the future. By looking at earnings persistence, stakeholders can evaluate events in previous, present, and future years. Earnings with a high level of persistence are very useful for predicting future earnings.

Earnings persistence can be influenced by other internal factors, namely the volatility of operating cash flows. Operating cash flow figures will vary each period according to the company's needs, so the value will be difficult to predict. If the change in the value of operating cash flow volatility is very significant in a short time, it can be indicated that the operating cash flow value has an error recorded in the financial statements, so this will affect the company in maintaining its profits. The results of research by Kusuma & Sadjiarto (2014), stated that there was a significant correlation between the volatility of operating cash flows and earnings persistence. Meanwhile, research conducted by Sulastris (2014), states that there is no significant correlation between the volatility of operating cash flows and earnings persistence.

Not only internal factors, but earnings persistence can also be influenced by external factors such as sales volatility. High sales volatility indicates that there is an estimation error in the value of sales so that profit persistence will be low. Profit can be obtained through sales so that sales are the main operating cycle for the company. High profit persistence will indicate low sales volatility, so the information has a good signal. This explanation is in line with the results of research by Kasiano & Fahrurrozie (2016) which states that sales volatility affects earnings persistence. Meanwhile, research conducted by Ariyanti, D., Ermaya, H. N. L., & Nugraheni, R. (2021) states that sales volatility does not affect earnings persistence.

Based on the description of the background above, the formulation of the problem that can be put forward is whether sales volatility and operating cash flow volatility affect earnings persistence.

2. Review Literature

This theoretical review explains the theories that support the hypothesis, understanding and measurement of each variable that can be used as an analysis of research results. This theoretical review contains signaling theory or signal theory. The variables used are sales volatility and cash flow volatility.

Signaling Theory

A signal is an action taken by the company's management that provides instructions for investors about how management views the company's prospects (Brigham and Ehrhardt, 2005). Signal theory discusses how signals of success or failure should be conveyed to owners by management. Companies have the urge to provide financial statement information to external parties arising from information asymmetry between the company and external parties.

According to Brigham and Houston, a signal is an action taken by the company to provide clues to investors about how management views the company's prospects. This signal is in the form of information about what management has done to realize the owner's wishes. The information released by the company is important, because of its influence on the investment decisions of parties outside the company. This information is important for investors and business people.

Because information essentially presents information, notes or descriptions, both for past, present and future conditions for the survival of the company and how it will affect the company.

Sales Volatility

Sales volatility is an index of the distribution of sales distribution. Sales are the most important part in generating profit from the company's operating cycle. The ability of earnings to predict future cash flows is indicated by low sales volatility. A measure that shows the level of fluctuation or sales movement during a period is called sales volatility (Nina, et. al, 2014). High sales volatility indicates sales information that has a larger estimation error in sales information in the operating environment, then the company's profits are not persistent and cannot be a reference for predicting profits in the next period (Fanani, 2010).

Operating Cash Flow Volatility

According to Dechow and Dichev (2002), cash flow volatility is the degree of spread of cash flows or an index of the spread of the distribution of the company's cash flow distribution. In measuring earnings persistence, stable cash flow information is needed, which has a small volatility (Fanani, 2010). Cash flow volatility indicates high uncertainty in the operating environment indicated by high cash flow volatility. The higher the cash flow volatility, the lower the earnings persistence shown, because current cash flow information is difficult to predict future cash flows.

Cash flow volatility indicates another measure of operating environment volatility and larger deviations from use of approximations and estimates, corresponding to larger estimation errors with lower earnings quality (Dechow and Dichev, 2002).

Profit Persistence

According to Septiani (2020), earnings persistence is defined as profit that can be used as a measure of profit itself. This means that current earnings can be used as an indicator of future earnings. The more persistent earnings show the more informative profits, on the other hand if the earnings are less persistent, the profits become less informative. Understanding earnings persistence according to Penman (2003), is a profit that has the ability as an indicator of future earnings generated by the company repeatedly (repetitive) in the long term (sustainable).

This view is closely related to the company's performance which is manifested in the company's profit earned in the current year. Fanani (2010), states that persistently high profits are reflected in profits that can be sustainable for a long period. This is because earnings that are not too volatile are characteristics of persistent earnings and the quality of earnings reported by the company is good (Suwandika, 2013). In line with that, Celho, Aguiar, & Lopez (2019) stated: "Earnings persistence is one of the measures of earnings quality. Persistent earnings can be described as earnings that re-occur beyond the present time into the future of firms; mostly connected with the core operating activities of firms, management efficiency and firms' fundamental characteristics", meaning that earnings persistence is one measure of earnings quality. Persistent earnings can be described as the sustainability of corporate profits that occur in the future which are mostly related to the company's operations, management efficiency and fundamental characteristics of the company.

Hypothesis Development

The following are two hypotheses that are assumed to be true by researchers based on theoretical conclusions and the results of previous studies. The following two hypotheses will be tested by researchers based on a predetermined sample.

Effect of Sales Volatility on Profit Persistence

Based on the research of Khasanah A.U (2019), sales volatility affects earnings persistence. Sales volatility can provide information to investors about the number of sales in one period. If the sales volatility information on the company changes very significantly every period, then this can be an indication that there is an estimation error in the sales value and does not show the actual sales value. So that earnings persistence will decrease.

Based on the description above, the research hypothesis proposed is as follows:

H₁: Sales volatility has a positive effect on profit persistence.

Effect of Operating Cash Flow Volatility on Profit Persistence.

Based on the research of Saptiani & Fakhroni (2020), the volatility of operating cash flows gives a signal in the form of operating cash flow conditions each period, because the cash out or inflow will affect the company's profit. If there is a significant change in a short time in the value of the company's operating cash flows, it can be an indication that an error has occurred in the recording. The information provided is a bad signal because operating cash flows do not reflect the real situation. Then this will affect the persistence of company profits.

Based on the description above, the research hypothesis proposed is as follows:

H₂: Operational cash flow volatility has a positive effect on profit persistence.

Frame of Thought

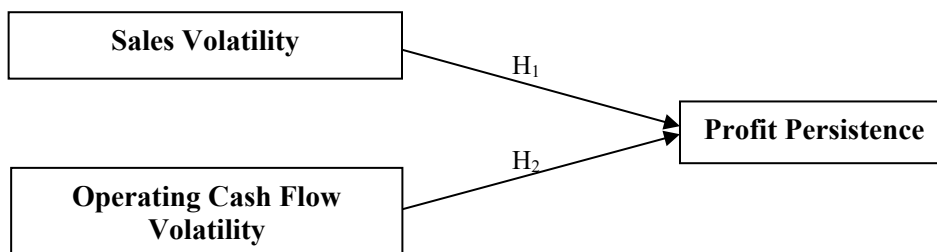


Figure 1. Frame of Thought

3. Research Methods

Types of Research and Description of the Research Population (Object)

The type of research used is quantitative research that aims to test whether or not there is a correlation between two or more variables. Quantitative research is research to test theory by emphasizing data in the form of numbers. The population in this study are food & beverage companies listed on the Indonesia Stock Exchange (IDX) in 2016-2020. The sampling technique in this research is using the purposive sampling method, where the criteria are: (1) Food & beverage companies listed on the Indonesia Stock Exchange (IDX) in 2020, (2) Food & beverage companies that consistently publish annual reports regularly in 2016-2020, (3) food & beverage companies that continue to earn profits for the 2016-2020 period, (4) food & beverage companies that have positive cash flows from operating activities for the 2016-2020 period.

Independent Variable

Sales Volatility (X₁)

Sales volatility is an index of the distribution of sales distribution. Sales are the most important part in generating profit from the company's operating cycle. The ability of earnings to predict future cash flows is indicated by low sales volatility.

$$\text{Indicator: } SV = \frac{\sigma(\text{Sales for 5 Years})}{\text{Total Assets } i}$$

Operating Cash Flow Volatility (X₂)

Operating cash flow volatility is the change that occurs in the value of operating cash flows each period. Operating cash flow volatility is useful for viewing future earnings.

$$\text{Indicator: } OCFV = \frac{\text{Total Operating Cash Flow}}{\text{Total Assets}}$$

Dependent Variable

Profit Persistence (Y)

Persistent earnings are profits that can reflect sustainable earnings in the future. The more persistent earnings show the more informative profits, on the other hand if the earnings are less persistent, the profits become less informative.

$$\text{Indicator: } EP = \frac{\text{Profit Before Tax } t+1}{\text{Average Total Assets}}$$

4. Data Collection Technique

The technique used in this research is documentation, namely collecting, recording and reviewing secondary data derived from the annual reports of food & beverage companies listed on the Indonesia Stock Exchange in 2016-2020 which can be accessed via www.idx.co.id.

Data Analysis Method

The data analysis method used the Common Effect Model (Pooled Least Square Model), Fixed Effect Model, and Random Effect Model.

Common Effect Model (Pooled Least Square Model)

The Common Effect Model or Pooled Least Square Model is an estimation model that combines time series data and cross section data using the OLS (Ordinary Least Square) approach to estimate the parameters.

Fixed Effect Model

The fixed effect model technique is a technique for estimating panel data using dummy variables to capture differences in intercepts.

Random Effect Model

The random effect model is a panel regression estimation model with the assumption that the slope coefficient is constant, and the intercept is different between individuals and over time (Random Effect).

Panel Data Regression Model Selection

Selection of Panel Data Regression Model consists of Restricted F Test (Chow Test), Lagrange Multiplier Test (LM), Hausman Test, Classical Assumption Test.

F Restricted Test (Chow Test)

The Chow test is a test to determine which fixed effect or common effect model is more appropriate to use in estimating panel data.

Lagrange Multiplier (LM) Test

Lagrange Multiplier (LM) is a test to determine whether the random effect model or the common effect model is more appropriate to use.

Hausman Test

Hausman test is a statistical test to choose whether a fixed effect or random effect model is more appropriate to use in panel data regression.

Classic Assumption Test

The Eviews 10 statistical method does not require a normality test, if in determining the selected model is a random effect model, the classical assumption test is ignored and if the selected model is a common effect model or a fixed effect model, the assumption test carried out is the Multicollinearity test and the Heteroscedasticity test.

Hypothesis Test

Hypothesis testing aims to test the hypothesis between variables on the integrity of financial statements. The models used are Coefficient of Determination (RSquare), Simultaneous Significance Test (F Statistics Test), Individual Parameter Significance Test (T Statistical Test), and Regression Equation.

Coefficient of Determination (R Square)

This is to see how much influence the independent variable has on the dependent variable partially. The coefficient of determination is the square of the correlation coefficient as a measure to determine the ability of each variable used.

Simultaneous Significance Test (F Statistics Test)

The F statistic test is a regression model suitability test to determine whether the results of the research model are feasible or not. The F statistic test used a significance level of 0.05.

Individual Parameter Significance Test (T Statistical Test)

Partial T-test was used to test the regression coefficients individually. The test is carried out on the population regression coefficient, is it equal to zero, which means that the independent variable has no significant effect on the dependent variable or is not equal to zero, which means that the independent variable has a significant effect on the dependent variable.

Regression Equation

Multiple linear regression analysis is a linear relationship between two or more independent variables ($X_1, X_2 \dots X_n$) and the dependent variable (Y). This analysis is to determine the direction of the relationship between the independent variable and the dependent variable, whether each independent variable is positively or negatively related.

5. Results and Discussion

Descriptive Statistical Analysis

Table 1 Descriptive Statistics Test Results

	X1	X2	Y
Mean	1.129500	0.156125	0.147500
Median	1.075000	0.135000	0.120000
Maximum	3.100000	0.550000	0.740000
Minimum	0.120000	0.010000	0.020000
Std. Dev.	0.548224	0.108505	0.127860
Observations	80	80	80

Sales Volatility (X_1) in Table 1 has a minimum value of 12%, while the maximum value is 310%, with an average value of 112,95% and a standard deviation of 54,8224%. Operating Cash Flow Volatility (X_2) in Table 1, has a minimum value of 1%, while the maximum value is 55%, with an average value of 15,6125% and a standard deviation of 10.8505%. Earnings persistence (Y) in Table 1 has a minimum value of 2%, while the maximum value is 74%, with an average value of 14,75% and a standard deviation of 12,786%. Observations in Table 1 descriptive statistics have a value of 80, meaning that the amount of data used in this study amounted to 80 samples of companies.

Panel Data Regression Model Selection

Table 2 CEM (Common Effect Model) Test Results

Variable	Coefficient
C	-0.041904

X1	0.040543
X2	0.909668
R-Squared	0.640250

Source: Data processed with Eviews 10, 2022

From the regression results in Table 2 of the common effect model above, it is found that the coefficient value on Sales Volatility (X_1) = 0.040543 and Operating Cash Flow Volatility (X_2) = 0.909668 with an R-squared of 0.640250.

Table 3 FEM (Fixed Effect Model) Test Results

Variable	Prob.
C	0.0573
X1	0.0007
X2	0.0001
R-Squared	0.832099
F-Statistic	18.07444
Prob(F-Statistic)	0.000000

Source: Data processed with Eviews 10, 2022

From Table 3 above on the fixed effect model, it can be seen from the probability which shows that the two variables, namely Sales Volatility (X_1) with a value of 0.0007 and Operating Cash Flow Volatility (X_2) with a value of 0.0001, show significant results because < 0.05 . R-squared shows a value of 0.832099, while the F-statistic value is 18.07444 and the probability (F-statistic) is 0.000000 which means that the model is very significant.

Table 4 Chow Test Results

Effects Test	Statistic	d.f.	Prob.
Cross-Section F	4.722896	(15,62)	0.0000
Cross-Section Chi-Square	60.962955	15	0.0000

Source: Data processed with Eviews 10, 2022

From Table 4, the Chow Test, Cross-Section F and Cross-Section Chi-Square show a probability level of 0.0000 where the value is < 0.05 , which means that hypothesis testing refuses to use the Common Effect Model, so the test is more appropriate to do with the Fixed Effect Model.

Table 5 REM Test Results (Random Effect Model)

Variable	Prob.
C	0.1607
X1	0.0040
X2	0.0000
R-Squared	0.468824
F-Statistic	33.98066
Prob(F-Statistic)	0.000000

Source: Data processed with Eviews 10, 2022

From Table 5 above, the random effect model shows that the probability of the variable, namely Sales Volatility (X_1) of 0.0040, Operating Cash Flow Volatility (X_2) of 0.0000 shows significant results because < 0.05 . R-squared shows 0.468824 and F-statistics of 33.98066 and Prob (F-statistics) 0.000000 which means the data is very significant.

Table 6 Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. D.F.	Prob.
Cross-Section Random	11.720164	2	0.0029

Source: Data processed with Eviews 10, 2022

From Table 6, in the Hausman Test, Cross-Section Random shows a probability level of 0.0029 where the value is < 0.05 , which means that the hypothesis testing refuses to use the Random Effect Model, so the test is more appropriate to do with the Fixed Effect Model.

Classic Assumption Test

The Eviews 10 statistical method does not require a normality test, if in determining the selected model is the Random Effect Model then the classical assumption test is ignored and if the model chosen is the Common Effect Model or Fixed Effect Model then the assumption tests carried out are:

Table 7 Multicollinearity Test Results

	X1	X2
X1	1.000000	0.051708
X2	0.051708	1.000000

Source: Data processed with Eviews 10, 2022

Multicollinearity test results in Table 7 above are < 0.8 , which means that there is no multicollinearity.

Table 8 Heteroscedasticity Test Results

Variable	Prob.
C	0.0008
X1	0.1414
X2	0.1301

Source: Data processed with Eviews 10, 2022

From the results of the Heteroscedasticity test as shown in Table 8, namely for Sales Volatility (X_1) with a probability of 0.1414 and Operating Cash Flow Volatility (X_2) with a probability of 0.1301 is > 0.05 , thus in the regression model there is no heteroscedasticity.

Hypothesis Test

The Result of the Coefficient of Determination Based on the Estimated Fixed Effect Model

Table 9 Regression Line Feasibility Test (R-squared)

R-squared	0.832099
Adjusted R-squared	0.786062
S.E. of regression	0.060529
Sum squared resid	0.227150
Log likelihood	121.0518
F-statistic	18.07444
Prob(F-statistic)	0.000000

Source: Data processed with Eviews 10, 2022

Table 9 above shows the estimation results: R-squared is 0.832099. This means that the independent variables X_1 and X_2 contribute to the influence of the dependent variable Y by 83.2%, where the contribution is in a very strong relationship level.

F Test Results Based on Fixed Effect Model Estimation

Table 10 Model Feasibility Test (F Test)

R-squared	0.832099	Mean dependent var	0.143000
Adjusted R-squared	0.786062	S.D. dependent var	0.130863
S.E. of regression	0.060529	Akaike info criterion	-2.576296
Sum squared resid	0.227150	Schwarz criterion	-2.040340
Log likelihood	121.0518	Hannan-Quinn criter.	-2.361415
F-statistic	18.07444	Durbin-Watson stat	1.699394
Prob(F-statistic)	0.000000		

Source: Data processed with Eviews 10, 2022

Table 10 above shows the estimation results: Prob(F-statistic) is 0.000000. This shows that the independent variable is appropriate in explaining the dependent variable because the significant value of $F < 0.05$, so that the regression model suitability test to determine the results of the research model is feasible.

T Test Results Based on Fixed Effect Model Estimation

Table 11 Independent Variable Significance Test (T Test)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.087214	0.045017	-1.937334	0.0573
X1	0.133293	0.037218	3.581396	0.0007
X2	0.524145	0.123636	4.239412	0.0001

Source: Data processed with Eviews 10, 2022

Table 11 shows that the population regression coefficient of -0.087214 is not the same as 0, which means that the independent variable has a significant effect on the dependent variable. Sales Volatility (X_1) variable with probability value of 0.0007 and Operating Cash Flow Volatility (X_2) with probability value of 0.0001 and t-Statistic (X_1) of 3.581396 and t-Statistic (X_2) of 4.239412, then the variables (X_1) and (X_2) has a positive effect on the Profit Persistence variable (Y), so the hypothesis is accepted.

Discussion of Research Results

Effect of Sales Volatility on Profit Persistence

Sales volatility has a significant positive effect on earnings persistence. These conditions indicate that if sales volatility changes significantly, it will affect earnings persistence. The high level of sales reflects the company's performance in marketing and selling products or services is also high. Investors prefer sales levels that are relatively stable or have low volatility. Low sales volatility will affect company profits where low sales volatility will be able to show high profit ability in predicting cash flow generated from sales in the future so that the profits generated are more persistent. This study is in line with the results of research by Kasiano & Fahrurrozie (2016) which states that sales volatility affects earnings persistence. This shows that the higher sales volatility will have an impact on the lower the company's chances of obtaining profit persistence in the future. However, this study is not in line with research conducted by Ariyanti, D., Ermaya, H. N. L., & Nugraheni, R. (2021) which states that sales volatility does not affect earnings persistence.

Effect of Operating Cash Flow Volatility on Profit Persistence

Operating cash flow volatility has a significant positive effect on earnings persistence. This condition indicates that if the operating cash flow volatility changes significantly, it will affect earnings persistence. In a business activity, cash flows will show different numbers each period, but these numbers cannot be far apart in a short period. If there is an event where the operating cash flow of a company changes drastically in a short time continuously, then this can be an indication that the cash flow does not reflect the actual operating conditions. This will also have an impact on the company's profit, which means that the company's profit also does not show the actual situation and cannot be used as a basis for predicting the company's profit in the future period. It can be observed that if there is high uncertainty in the operating environment, the volatility of operating cash flows will show a high level as well. With high uncertainty and causing high cash flow volatility, the persistence of earnings will be lower, or the accuracy of earnings will be increasingly questioned. This study is in line with the results of research by Kusuma & Sadjarto (2014) which states that there is a significant correlation between operating cash flow volatility and earnings

persistence. Meanwhile, research conducted by Sulastri (2014), states that there is no significant correlation between the volatility of operating cash flows and earnings persistence.

6. Conclusion and Suggestions

Conclusions

This study examines the factors that affect profit persistence in Food & Beverage companies listed on the Indonesia Stock Exchange in 2016-2020. The sample used purposive sampling and obtained a sample of 16 companies with a period of 5 years so that 80 samples were obtained. The conclusions obtained from this study are as follows: (1) Sales volatility has a positive effect on profit persistence. These conditions indicate that if sales volatility changes significantly, it will affect profit persistence. (2) Operational cash flow volatility has a positive effect on profit persistence. These conditions indicate that if the volatility of operating cash flows experiences a significant change, it will affect the persistence of profit.

Suggestions

Based on the conclusions above, some suggestions can be put forward as follows: (1) For further researchers, it is expected to add other independent variables that are indicated to influence profit persistence, such as funding cash flows and investment cash flows. (2) Future researchers are expected to take a longer period and more samples from this study to give good results. The time span used in this study is only 5 years, namely from the 2016-2020 period. The addition of a longer period is expected to provide a clearer picture of the relationship that affects profit persistence. (3) For potential investors to pay more attention to the persistent profit factor to predict the earnings quality of a company to avoid losses.

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