

Research Horizon

ISSN: 2808-0696 (p), 2807-9531 (e)

Research Horizon

Volume: 06

Issue: 02

Year: 2026

Page: 795-808

Citation:

Fitriani, A., & Setyawati, H. (2026). The effect of fraud indicators and financial reporting compliance on earnings quality and stock returns. *Research Horizon*, 6(2), 795-808.

Article History:

Received: March 21, 2026

Revised: April 13, 2026

Accepted: April 27, 2026

Online since: April 30, 2026

The Effect of Fraud Indicators and Financial Reporting Compliance on Earnings Quality and Stock Returns

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Abstract

This study addresses the increasing importance of financial reporting quality in Islamic capital markets. This study examines the effect of the depreciation index, sales general and administrative expenses index, total accruals to total assets index, leverage index, and financial reporting compliance on earnings quality and its impact on stock returns in primary consumer goods companies listed on the Indonesian Sharia Stock Index during 2020–2024. A quantitative causal approach using SEM-PLS with SmartPLS 4 was applied to 34 companies (170 observations) selected through purposive sampling. Earnings quality was measured by operating cash flow to earnings before interest and taxes, stock return by annual price change, fraud variables by Beneish indicators, and reporting compliance by a timeliness-based dummy variable. The results indicate that fraud-related indices do not significantly affect earnings quality or stock returns. However, financial reporting compliance positively affects earnings quality and stock returns, and earnings quality significantly improves stock returns. This study contributes to the literature on Islamic capital market research by providing empirical evidence on the role of financial reporting compliance and earnings quality in explaining stock return behavior.

Keywords

Earnings Quality, Financial Reporting Compliance, Fraud Indicators, Stock Returns.

1. Introduction

The development of the Islamic capital market in Indonesia has shown a continuously positive trend in recent years, particularly reflected in the performance of the Indonesian Sharia Stock Index (ISSI) as an indicator of Sharia-compliant listed companies. ISSI represents firms that operate under Islamic principles, including restrictions on non-halal income, limits on interest-based leverage, and compliance with Sharia screening criteria established by regulatory authorities (Islamic, 2025). These requirements indicate that Sharia-compliant firms are not only expected to achieve strong financial performance but also to uphold transparency, accountability, and ethical financial reporting standards (Queku, 2017; Lubis, 2023; Tarmidi & Murwaningsari, 2024; Libu & Prasetyo, 2025).

In this context, earnings quality becomes a critical construct because it reflects the reliability and representational faithfulness of reported earnings in describing a firm's actual economic condition (ElBannan & Farooq, 2019; Siladjaja et al., 2023; Siladjaja & Jasman, 2024). High-quality earnings are considered more persistent, supported by operating cash flows, and more useful for decision-making by investors (Bansal, 2020; Huang, 2020). Conversely, low earnings quality often signals earnings management or financial manipulation practices that may distort investor perception and lead to mispricing in capital markets (Dal Maso et al., 2018; Kusuma et al., 2022).

Empirical evidence suggests that various financial statement components can indicate the presence of earnings manipulation and fraud tendencies. Indices such as the Depreciation Index (DEPI), Sales, General and Administrative Expenses Index (SGAI), Total Accruals to Total Assets (TATA), and Leverage (LEVI) have been widely used as part of fraud detection models, such as the Beneish M-Score, to identify potential earnings manipulation (Tarjo & Herawati, 2021; Agugum et al., 2023; Wiraputra & Damayanti, 2025). High accrual levels, for instance, often indicate a gap between accounting profit and actual cash flow, which may reduce earnings reliability and weaken investor confidence (As'ad et al., 2021). Similarly, excessive leverage may increase financial pressure and agency conflicts between management and shareholders (Dwiyoso, 2022).

Another important determinant of financial reporting credibility is financial reporting compliance. Compliance with accounting standards and timeliness in reporting play a significant role in ensuring the integrity and usefulness of financial information (Mintz, 2019; Fox, 2021). Previous studies by Ismawati et al. (2024) also confirm that reporting timeliness is positively associated with financial statement quality and market responsiveness. Conversely, reporting delays or non-compliance may reduce investor trust and negatively affect stock market reactions.

From an agency theory perspective, the divergence of interests between managers (agents) and shareholders (principals) creates information asymmetry that can lead to opportunistic behavior such as earnings management (Dwiyoso, 2022; Nurcholisah et al., 2023). This condition becomes more complex in capital market environments where managers possess superior internal information compared to external investors. Fraud theories such as the fraud triangle and fraud pentagon further explain how pressure, opportunity, and rationalization can drive financial misreporting practices (Abdurrachman & Suhartono, 2020; Pebruary, 2020; Arrahman & Machdar, 2024).

Although previous studies have examined the relationship between leverage, accruals, reporting compliance, earnings quality, and stock returns, the findings remain inconsistent (Tresnawaty, 2021). Some studies show that leverage and financial performance significantly influence earnings quality and stock returns, while others find insignificant or mixed results (Wulan & Syahzuni, 2023; Marbun & Suhartini, 2024). Similarly, the effect of earnings quality on stock returns also varies across different sectors and market conditions (Sari & Setiyawati, 2021). This

inconsistency indicates the existence of a research gap that requires further empirical investigation.

A research gap is evident in Sharia-compliant firms, where high expectations of transparency and ethical conduct are not always aligned with actual practices, as indicated by cases of financial manipulation and reporting irregularities in Indonesia (CNBC Indonesia, 2024). This highlights a discrepancy between Islamic financial principles and corporate behavior. The urgency of this study lies in examining the determinants of earnings quality and their impact on stock returns in ISSI-listed primary consumer goods companies during 2020–2024, a period reflecting post-pandemic economic adjustments. By integrating fraud-related indices (DEPI, SGAI, TATA, LEVI) with financial reporting compliance, this study offers a more comprehensive approach than prior research. Accordingly, it aims to analyze the effects of these factors on earnings quality and its subsequent impact on stock returns, positioning earnings quality as a key link between financial reporting behavior and market performance, while contributing novel insights within the Islamic capital market context.

2. Literature Review and Hypothesis Development

2.1. Depreciation, SGAI, and Earnings Quality

Agency Theory explains the contractual relationship between principals (owners) and agents (management), where decision-making authority is delegated to management. This relationship creates agency conflicts due to differences in objectives and information asymmetry. Dwiyoso (2022) emphasizes that information imbalances enable opportunistic managerial behavior, while Indrarini and Sukartiningsih (2022) highlight that managers may prioritize personal interests, such as earnings manipulation, whereas investors focus on return maximization. These conditions increase the risk of financial reporting distortion and ultimately reduce earnings quality, reinforcing Agency Theory as a key explanation of earnings management behavior.

The literature shows that both the depreciation index and the Sales, General, and Administrative Index (SGAI) expense index influence earnings quality through managerial discretion in financial reporting. A higher depreciation index indicates greater manipulation of depreciation estimates, which reduces earnings quality by distorting the accuracy and sustainability of reported profits (Nurcholisah et al, 2023). This occurs when managers adjust depreciation to inflate income, as reducing depreciation expenses can increase operating income (Chen et al., 2020). Similarly, the SGAI expense index is negatively associated with earnings quality, as managers may engage in real earnings management by cutting discretionary SGAI costs to boost short-term performance. Such practices weaken earnings quality because reported income no longer reflects normal operational activities, with firms potentially reducing SGAI expenses to sustain last year's earnings (Gandhi, 2020). Both the depreciation index and the SGAI expense index have adverse implications for earnings quality due to opportunistic managerial behavior.

H1: Depreciation index has a positive effect on earnings quality.

H2: The sales, general, and administrative expenses index has a negative effect on earnings quality.

2.2. TATA, Leverage, Reporting Compliance, and Earnings Quality

Within this framework, earnings quality reflects how well reported earnings represent a firm's true economic performance (Thesing & Velte, 2021). Low earnings quality is associated with high accrual dependence and weak cash flow support. This study uses Total Accruals to Total Assets (TATA), depreciation index, sales general and administrative expenses index, and leverage index to capture managerial

opportunism. High total accruals to total assets indicate accrual-driven earnings and higher manipulation risk, while sales, general, and administrative expenses reflect operational efficiency, where inefficiency signals managerial weakness (Sari & Widodo, 2022). As'ad et al. (2021) show that leverage influences earnings quality through earnings persistence, as debt pressure can encourage earnings management. Thus, leverage functions both as a disciplinary mechanism and a source of agency conflict that increases opportunistic reporting. Supporting this argument, Saadah and Mustofa (2024) find that fraudulent practices contribute to firm losses, while Uwakwe and Chukwu (2024) show that fraud opportunities negatively affect earnings quality. Accordingly, this study hypothesizes that agency-related pressures reflected in accrual intensity, cost inefficiency, and leverage negatively affect earnings quality, as managers may engage in earnings management to achieve targets, maintain reputation, or avoid debt covenant violations.

Financial reporting compliance in this study refers to the level of adherence to accounting standards and capital market regulations (Rahmah & Mawardi, 2021). Videsia et al. (2022) find that reporting timeliness enhances the credibility of accounting information. High compliance signals transparency and strengthens investor confidence. In Sharia-compliant firms, compliance also reflects moral and religious obligations, including restrictions on interest-based debt and non-halal income. Mintz (2019) further states that financial reporting compliance reflects adherence to accounting standards and regulations, where timeliness and compliance are key indicators of market trust.

H3: The total accruals to total assets index has a negative effect on earnings quality.

H4: The leverage index has a negative effect on earnings quality.

H5: Financial reporting compliance has a positive effect on earnings quality.

2.3. Depreciation, SGAI, TATA, and Stock Return

Stock returns, as the final variable in this study, reflect the market's reaction to information disclosed by a company and serve as an important indicator of market performance shaped by investor perceptions of future prospects. Furthermore, Sari and Widodo (2022) find that cost structure also plays a significant role in determining stock returns, where inefficiencies in costs may signal managerial weaknesses or ineffective business strategies, ultimately reducing investor confidence.

The literature indicates that the depreciation index and the Sales, General, and Administrative Expenses Index (SGAI) influence stock returns through the signals they convey to investors. A higher depreciation index reflects managerial discretion in adjusting depreciation policies, which can inflate reported earnings and enhance short-term performance, thereby encouraging positive market reactions (Habib et al., 2022). In contrast, SGAI is negatively associated with stock returns, as reductions in SGAI expenses often stem from real earnings management that prioritizes short-term results over long-term value, signaling weaker future performance (Gandhi, 2020). Managerial discretion in these components shapes investor perceptions and market valuation.

In addition, Total Accruals to Total Assets (TATA) is a key indicator in assessing earnings quality, as a higher ratio suggests that earnings are more heavily driven by accrual components rather than actual cash flows, thereby increasing the risk of earnings manipulation and weakening market trust. Supporting this argument, As'ad et al. (2021) state that negative operating cash flows have a significant effect on stock returns, highlighting the importance of strong cash flow support in sustaining credible financial performance. These findings suggest that both earnings quality components and financial fundamentals play a crucial role in shaping investor responses in the capital market.

H6: Depreciation index has a positive effect on stock returns.

H7: The sales, general, and administrative expenses index has a negative effect on stock returns.

H8: The total accruals to total assets index has a negative effect on stock returns.

2.4. Leverage, Reporting Compliance, Earnings Quality, and Stock Return

The leverage index measures the level of debt pressure faced by a company. High leverage tends to increase financial risk and intensify agency conflicts. As'ad et al. (2021) show that leverage affects earnings quality through earnings persistence, as higher debt pressure may encourage managerial actions that influence reported performance. Financial reporting compliance in this study refers to the level of adherence to accounting standards and capital market regulations. Videsia et al. (2022) find that reporting timeliness enhances the credibility of accounting information, while high compliance serves as a positive signal to investors by reflecting transparency and strong governance. In addition, Siladjaja and Siladjaja (2025) demonstrate that stock returns mediate the relationship between compliance and earnings quality through positive market responses, reinforcing Signaling Theory that financial reporting compliance communicates firm transparency and reliability to investors. Thus, compliance not only affects earnings quality but also shapes market perception as reflected in stock returns.

Earnings quality, as the final variable in this study, reflects the market's response to firm-disclosed information and serves as a key indicator of company prospects. According to signaling theory, high-quality earnings signal firm stability and growth, leading to higher stock returns as investors respond positively (Marbun & Suhartini, 2024). Marbun and Suhartini (2024) show that earnings quality significantly influences stock returns by signaling firm stability. However, prior studies present mixed findings regarding the relationship between financial reporting indicators and earnings quality. As'ad et al. (2021) identify a specific effect of leverage on earnings quality, while Sari and Widodo (2022) emphasize its role in enhancing stock value and returns. Meanwhile, Abdurrachman and Suhartono (2020) and Arrahman and Machdar (2024) indicate that earnings quality may both strengthen and weaken the impact of fraud-related indicators. These inconsistencies highlight the need for an integrated model that combines multiple indicators to better explain the relationships among leverage, compliance, earnings quality, and market response.

H9: The leverage index has a negative effect on stock returns.

H10: Financial reporting compliance has a positive effect on stock returns.

H11: Earnings quality has a positive effect on stock returns.

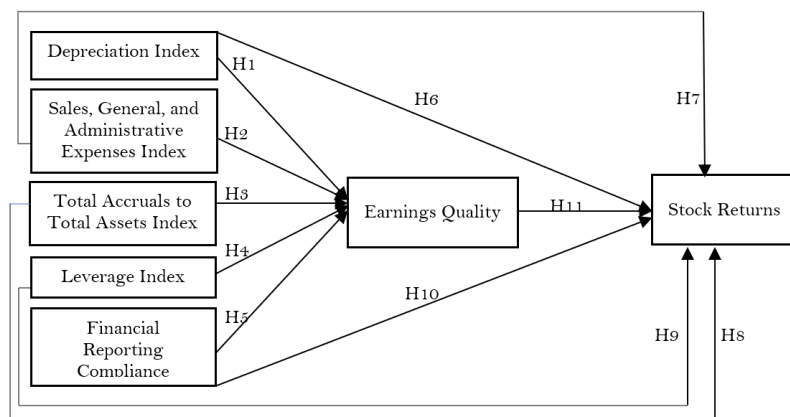


Figure 1. Research Framework

Figure 1 illustrates the conceptual framework of this study, integrating DEPI, SGAI, TATA, LEVI, financial reporting compliance, earnings quality, and stock returns in a unified model. The framework shows that Beneish indicators represent fraud risk and earnings management that may reduce earnings quality, while compliance improves it through transparency and regulatory adherence (Dwiyoso, 2022; Videsia et al., 2022). Earnings quality influences stock returns, which reflect market responses to financial information (Marbun & Suhartini, 2024).

Grounded in Agency Theory and Signaling Theory, the model explains how information asymmetry and conflicting interests can impair reporting quality, while compliance serves as a positive market signal that enhances investor confidence (Indrarini & Sukartiningsih, 2022; As'ad et al., 2021; Ramadina & Hidayah, 2025). The framework highlights both direct and indirect effects of financial behavior and governance mechanisms on stock returns through earnings quality as the central channel.

3. Methods

This study adopts a quantitative approach with a causal design to examine the effects of the depreciation index, sales general and administrative expenses index, total accruals to total assets index, leverage index, and financial reporting compliance on earnings quality and its impact on stock returns, with earnings quality positioned as an intervening variable (Santosa, 2018; Nugroho et al., 2023). The data used are secondary data derived from annual financial reports of companies in the Primary Consumer Goods sector listed on the Indonesian Sharia Stock Index (ISSI) during the 2020–2024 period, obtained from the official Indonesia Stock Exchange (IDX) website and other relevant public sources.

From a population of 46 companies, 34 companies were selected as samples using purposive sampling based on predetermined criteria, resulting in 170 observations. The analysis employs the Structural Equation Modeling–Partial Least Squares (SEM-PLS) technique using SmartPLS 4 to assess both direct and indirect relationships among variables. Model evaluation is conducted through outer and inner model assessments, while hypothesis testing is performed using a bootstrapping procedure based on t-statistics and p-values.

Earnings quality is measured using the ratio $EQ = \text{Cash Flow from Operating Activities} / \text{Earnings Before Interest and Taxes (EBIT)}$. The depreciation index is calculated as $DEPI = (\text{Depreciation } t-1 / (\text{Depreciation } t-1 + \text{PPE } t-1)) / (\text{Depreciation } t / (\text{Depreciation } t + \text{PPE } t))$. The sales, general, and administrative expenses index is measured as $SGAI = (\text{SGA Expenses } t / \text{Sales } t) / (\text{SGA Expenses } t-1 / \text{Sales } t-1)$.

The total accruals to total assets index is calculated as $TATA = ((\text{Change in Working Capital } t - \text{Change in Cash } t - \text{Change in Tax Payable } t - \text{Depreciation \& Amortization Expense } t) / \text{Total Assets } t)$. The leverage index is measured as $LEVI = ((\text{Long-Term Debts } t + \text{Current Liabilities } t) / \text{Total Assets } t) / ((\text{Long-Term Debts } t-1 + \text{Current Liabilities } t-1) / \text{Total Assets } t-1)$. Financial reporting compliance is measured using a dummy variable, where a value of 1 indicates companies that submit financial reports on time through the IDX website, and 0 indicates non-compliance or late submission. Stock return is calculated as $RS = (\text{Stock Closing Price} - \text{Stock Initial Price}) / \text{Stock Initial Price}$.

The data analysis technique in this study uses SEM-PLS with SmartPLS 4. Analysis begins with descriptive statistics, followed by structural model evaluation using R-square to assess explanatory power and Q-square to test predictive relevance. Effect size is examined using F-square to determine each exogenous variable's contribution, while multicollinearity is tested using VIF. Hypothesis

testing is conducted through bootstrapping to evaluate the significance of path coefficients (Sekaran & Bougie, 2017).

4. Results

Based on the results of data analysis utilizing the SEM-PLS technique with SmartPLS 4, the study's findings are given. An extensive review of structural model evaluation, hypothesis testing, and descriptive statistics is given in this section. The results are methodically examined to clarify the connections between the variables in the study model, such as how financial reporting compliance and fraud indicators affect stock returns and earnings quality.

Table 1. Descriptive Statistical Results

Variable	Mean	Max	Min	Std. Dev
Earnings Quality	0.741	9.900	-7.381	1.698
Depreciation Index	1.456	42.331	0.015	4.239
Sales General and Administrative Expenses Index	1.018	2.568	0.179	0.279
Total Accruals to Total Assets Index	-0.014	5.154	-5.271	0.608
Leverage Index	1.009	3.146	0.163	2.688
Financial Reporting Compliance	0.98	1	0	0.132
Stock Return	0.027	4.158	-0.996	0.511

Table 1 presents the descriptive statistical results of the study variables. Earnings quality shows an average value of 0.741, indicating that earnings are generally supported by adequate operating cash flows. However, the wide range between the minimum -7.381 and maximum 9.900 values reflects substantial fluctuations in firms' ability to convert earnings into cash, indicating heterogeneous financial performance across companies and time periods.

For the explanatory variables, depreciation index averages 1.456, suggesting a tendency toward lower depreciation expense relative to fixed assets. Sales general and administrative expenses index averages 1.018, indicating slightly higher growth in operating expenses compared to sales. The total accruals to total assets index shows an average of -0.014, reflecting a relatively conservative accrual structure dominated by cash flows. Leverage index is 1.009, indicating a relatively stable leverage level despite cross-firm variation. Financial reporting compliance is very high, with a mean of 0.98, reflecting strong adherence to timely reporting obligations. Meanwhile, stock returns average 0.027 (2.7%), but with high volatility ranging from -0.996 to 4.158, indicating heterogeneous investor responses to firm performance and financial conditions.

Table 2. R-Square & Q-Square

Endogenous Variable	R ²	R ² Adjusted	Q ² Predictive
Earnings Quality	0.113	0.113	0.583
Stock Return	0.333	0.333	0.300

The structural model evaluation results are shown in Table 2. The depreciation index, sales general and administrative expenses index, total accruals to total assets index, leverage index, and financial reporting compliance together account for 11.3 percent of the variation in earnings quality, while other factors outside the model account for the remaining 88.7 percent, according to the coefficient of determination, which indicates that earnings quality has an R-square value of 0.113. This implies that the model's ability to explain earnings quality is quite constrained.

With an R-square value of 0.333 for stock return, the depreciation index, sales general and administrative expenses index, total accruals to total assets index,

leverage index, financial reporting compliance, and earnings quality account for 33.3% of the variation in stock return, with other factors outside the model influencing the remaining 66.7%. This suggests that the explanatory power of stock return is moderate. Furthermore, the predictive relevance test reveals that stock return has a Q^2 value of 0.300 and earnings quality has a Q^2 value of 0.583. It is possible to conclude that the structural model has predictive significance and can accurately anticipate the observed data because both values are greater than zero.

Table 3. VIF Test

Endogenous Variable	Earnings Quality	Stock Return
Depreciation Index	1.017	1.017
Financial Reporting Compliance	1.004	1.013
Earnings Quality		1.014
Leverage Index	1.018	1.018
Sales General and Administrative Expenses Index	1.006	1.008
Total Accruals to Total Assets Index	1.002	1.002

The multicollinearity test results utilizing the Variance Inflation Factor (VIF) are displayed in Table 3. The VIF values for every variable, including the depreciation index, sales general and administrative expenses index, leverage index, total accruals to total assets index, financial reporting compliance, and earnings quality, are significantly below the threshold of 10. This shows that each predictor in the structural model is sufficiently independent and does not show substantial intercorrelation that could skew the estimation results, indicating that there is no multicollinearity issue among the independent variables.

Table 4. F-Square Test

Influence	F-Square	Remarks
Depreciation Index → Earnings Quality	0.010	Small Effect
Sales General and Administrative Expenses Index → Earnings Quality	0.013	Small Effect
Total Accruals to Total Assets Index → Earnings Quality	0.014	Small Effect
Leverage Index → Earnings Quality	0.005	Small Effect
Financial Reporting Compliance → Earnings Quality	0.150	Medium Effect
Depreciation Index → Stock Return	0.015	Small Effect
Sales General and Administrative Expenses Index → Stock Return	0.012	Small Effect
Total Accruals to Total Assets Index → Return of Shares	0.015	Small Effect
Leverage Index → Stock Return	0.002	Small Effect
Financial Reporting Compliance → Stock Return	0.166	Medium Effect
Earnings Quality → Stock Return	0.160	Medium Effect

Table 4 presents the results of the effect size analysis. The depreciation index, sales general and administrative expenses index, total accruals to total assets index, and leverage index show a very small effect on both earnings quality and stock return, indicating that their individual contribution to the model is relatively weak. In contrast, financial reporting compliance demonstrates a moderate effect on earnings quality and stock return, while earnings quality itself also shows a moderate effect on stock return. These results indicate that financial reporting compliance and earnings quality are more influential determinants in explaining variations in stock return compared to the other financial ratio-based indicators in the model.

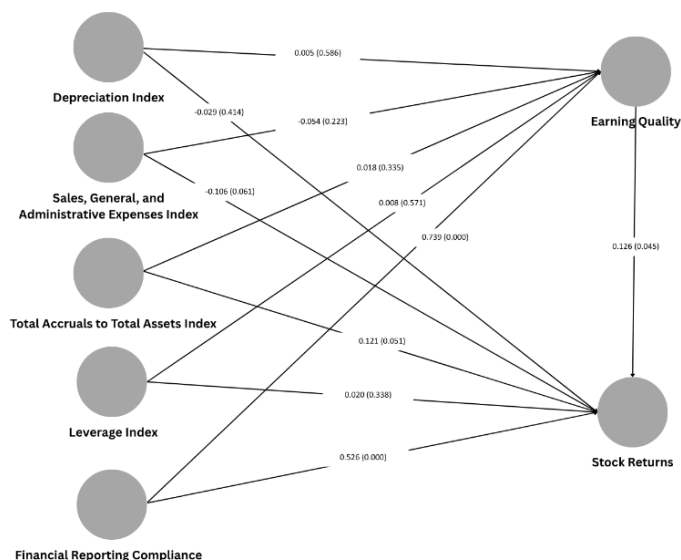


Figure 2. Path Diagram SEM-PLS

Table 5. Bootstrapping Results

Path Coefficients	Original Sample	t-statistics	P-value	Remarks
Depreciation Index → Earnings Quality	0.005	0.085	0.586	No effect
Sales General and Administrative Expenses Index → Earnings Quality	-0.054	-0.618	0.223	No effect
Total Accruals to Total Assets Index → Earnings Quality	0.018	0.122	0.335	No effect
Leverage Index → Earnings Quality	0.008	0.092	0.571	No effect
Financial Reporting Compliance → Earnings Quality	0.739	5.116	0.000	Significant
Depreciation Index → Stock Return	-0.029	-0.322	0.414	No effect
Sales General and Administrative Expenses Index → Stock Return	-0.106	-1.877	0.061	No effect
Total Accruals to Total Assets Index → Return of Shares	0.121	1.901	0.051	No effect
Leverage Index → Stock Return	0.020	0.128	0.338	No effect
Financial Reporting Compliance → Stock Return	0.526	4.816	0.000	Significant
Earnings Quality → Stock Return	0.126	2.016	0.045	Significant Impact

Figure 2 and Table 5 present the results of the bootstrapping analysis for hypothesis testing. The findings indicate that the depreciation index, sales general and administrative expenses index, total accruals to total assets index, and leverage index do not have a significant effect on earnings quality and stock return ($p > 0.05$), leading to the rejection of the related hypotheses. In contrast, financial reporting compliance has a positive and significant effect on earnings quality ($\beta = 0.739$; $p < 0.001$) and stock return ($\beta = 0.526$; $p < 0.001$). In addition, earnings quality has a positive and significant effect on stock return ($\beta = 0.126$; $p = 0.045$). These results show that financial reporting compliance and earnings quality are the dominant factors in influencing stock return compared to the other financial ratio indicators in the model.

5. Discussion

The results of this study indicate that the depreciation index does not have a significant effect on earnings quality or stock returns. This suggests that depreciation policies are not a key determinant of financial reporting outcomes or market responses in companies within the Primary Consumer Goods sector listed on ISSI. These findings are consistent with Aguguum et al. (2023) and Lutfi and Endri (2024), but contradict Reynata et al. (2024) and Samosir et al. (2025). From an agency theory perspective, depreciation adjustments are relatively constrained by governance mechanisms and Sharia principles, limiting managerial opportunism. Similarly, signaling theory explains that depreciation is perceived as a weak signal because it does not reflect real cash-generating performance, leading investors to largely ignore its variation.

The sales, general, and administrative expenses index also shows no significant effect on both earnings quality and stock returns. This indicates that variations in operational costs are not interpreted as indicators of managerial opportunism or firm value changes. These results are consistent with Prasetyo et al. (2025) but differ from Arrahman and Machdar (2024). In agency theory terms, cost management is likely well-controlled through governance systems, reducing the possibility of manipulation. From a signaling perspective, these expenses are considered routine operational information and therefore do not carry strong informational value for investors in forming expectations.

Similarly, the total accruals to total assets index does not significantly affect earnings quality or stock returns. This finding indicates that accrual levels do not play a dominant role in shaping either reporting quality or market reactions. The results are consistent with Abdanadillah et al. (2022), but contrary to Uwakwe and Chukwu (2024) and Reynata et al. (2024). In agency theory, although accruals can be used for earnings management, the results suggest that strong governance and the characteristics of the ISSI market reduce such opportunistic behavior. From a signaling perspective, accrual-based earnings are not considered strong signals compared to cash-based performance indicators, making their impact on investor decisions limited.

The Leverage Index also shows no significant effect on earnings quality and stock returns. This suggests that debt levels are not a dominant factor influencing either financial reporting behavior or investor response. These findings are consistent with Kalbuana et al. (2022) and Wulan and Syahzuni (2023), but differ from As'ad et al. (2021). Agency theory explains that although leverage may create monitoring pressure, effective creditor oversight and conservative financing structures in ISSI firms reduce its influence. In signaling theory, leverage is not interpreted as a strong indicator of future performance because investors focus more on operational fundamentals than capital structure.

In contrast, financial reporting compliance has a positive and significant effect on both earnings quality and stock returns. This indicates that higher compliance improves the reliability of earnings and enhances investor response. These findings are consistent with Videsia et al. (2022) and Siladjaja and Siladjaja (2025), but differ from Fajrin et al. (2025). From an agency perspective, compliance reduces information asymmetry and limits opportunistic managerial behavior, thereby strengthening reporting credibility. Signaling theory further explains that compliance acts as a strong positive signal of transparency, governance quality, and commitment to both regulatory and Sharia principles.

Earnings quality has a positive and significant effect on stock returns, indicating that the market rewards firms with more reliable and informative earnings. This finding is consistent with Siladjaja et al. (2022) and Marbun and Suhartini (2024). High earnings quality reduces information risk and uncertainty, which increases investor confidence and stock valuation. In agency theory, better earnings quality

reduces conflicts between managers and shareholders, while signaling theory confirms that high-quality earnings serve as a strong positive signal of firm stability and future prospects.

The findings suggest that accounting-based indicators such as depreciation, accruals, operating expenses, and leverage do not directly influence market reactions in the ISSI context, while governance-related factors such as reporting compliance and earnings quality play a more dominant role. These results imply that investors in the Islamic stock market place greater emphasis on transparency, credibility, and real economic performance rather than accounting adjustments. Therefore, companies should strengthen reporting compliance and improve earnings quality to enhance investor trust, while regulators should continue reinforcing governance standards to sustain market confidence and efficiency.

6. Conclusion

Based on the analysis of 34 companies in the Primary Consumer Goods sector listed on the Indonesian Sharia Stock Index during the 2020–2024 period, this study concludes that the depreciation index, sales general and administrative expenses index, total accruals to total assets index, and leverage index do not have a significant effect on earnings quality or stock returns. These results indicate that conventional earnings management proxies are not effective in explaining financial reporting quality and market reactions in Islamic capital market firms. In contrast, financial reporting compliance has a significant positive effect on both earnings quality and stock returns, and earnings quality also has a significant positive effect on stock returns. This shows that higher compliance and better earnings quality improve financial reporting credibility and increase investor confidence, which is reflected in higher stock returns.

These findings strengthen agency theory and signaling theory by showing that reducing information asymmetry and improving reporting credibility are more important than technical accounting indicators in explaining market behavior. The insignificance of earnings management proxies also suggests that such measures are less relevant in the Islamic capital market context due to stronger governance and ethical constraints. Companies are advised to prioritize financial reporting compliance and transparency rather than focusing on accounting discretion. Investors should emphasize earnings quality and compliance when making investment decisions, while regulators need to strengthen supervision and disclosure standards to enhance market stability and investor protection. This study is limited to one sector and a specific period, which may reduce generalizability. Future research should expand the sample across sectors, extend the observation period, and include additional variables such as corporate governance and audit quality to obtain more comprehensive results.

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Acknowledgment

We gratefully acknowledge the contributions of individuals who supported the completion of this article.

Funding Information

This research did not receive any funding.

Conflict of Interest Statement

The authors declare that there is no conflict of interest.

Ethical Approval and Originality Statement

Ethical approval was obtained for this study. The manuscript represents original work and has not been previously published, nor is it under consideration by another journal.

Data Disclosure Statement

The data that support the findings of this study are available from the corresponding author upon reasonable request.



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