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The Impact of Final and Interim Cash Dividends on Earnings Quality: Timing Matters

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ABSTRACT

This research examines and evaluates the impact of cash dividends on the quality of corporate earnings. Unlike prior studies, this research emphasizes the distinction between cash dividends based on their timing of distribution. The sample comprises non-financial companies listed on the Indonesia Stock Exchange, selected through purposive sampling, resulting in a dataset of 1,428 observations. To test the hypotheses, the study employs descriptive and frequency statistical analyses alongside multiple regression techniques. Grounded in signaling theory, the findings reveal that cash dividends and final cash dividends positively influence the quality of corporate earnings, whereas interim cash dividends show no significant effect. Implications for investors provide insights into whether cash dividend distribution can serve as a signal of earnings quality credibility and help investors make more informed investment decisions, not merely by considering the dividend amount but also by assessing whether it truly reflects high-quality earnings. In addition, the findings of this study may serve as a valuable consideration for regulators in formulating policies that promote information transparency, particularly regarding dividend distribution practices and earnings reporting quality.

Keywords:
Dividend, Earning Quality, Final Cash Dividend, Interim Cash Dividend.

1. INTRODUCTION

Financial statements, particularly earnings, are one of the key sources of information investors use to guide their investment decisions. However, numerous financial reporting scandals have raised questions among investors about whether reported earnings can truly be free from accounting manipulation, i.e. managerial actions that can mislead investors' perception of a company's financial performance or economic health.

The decision regarding the number of dividends to be distributed to shareholders is referred to as the dividend policy, where management must decide the portion of net income to be allocated as dividends. Following approval from the Board of Commissioners, the directors, particularly the Chief Financial Officer, will first evaluate the amount of available cash, estimated cash needs, and the company's future earnings potential to enhance its cash position.

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Research on the impact of cash dividends on the quality of corporate earnings has been conducted by numerous researchers, yet the results remain inconsistent. Studies of Tong & Miao (2011), Skinner & Soltes (2009), Sirait & Siregar (2014), Mulchandani et al. (2020), Hussain & Akbar (2022) and Deng et al. (2017) show that cash dividends influence the quality of corporate earnings. This statement is based on the notion that companies are able to distribute cash dividends due to the availability of cash resources. Therefore, a significant discrepancy between the reported earnings and the cash available for dividend payments could pose a problem for the company itself. In contrast, the findings of studies conducted by Grullon et al. (2005), Sarawana & Destriana (2015), and Mousa & Desoky (2019) indicate that cash dividends have no significant effect on the quality of corporate earnings.

Mousa & Desoky (2019) conducted a study in Egypt investigating the impact of dividend payments and five company attributes size, leverage, performance, legal structure, and audit quality on earnings quality. The results revealed no significant relationship between dividend payments and earnings quality, attributed to the empirical evidence that showed many companies in Egypt engaged in earnings management during the first two years of the study, which then declined in the following two years. Differences in dividend policies between developed and developing countries, as well as cultural and business environment characteristics, further explain why the findings cannot be generalized (Kamel & Elbanna, 2012).

In relation to signaling theory, which is based on the information asymmetry between managers (insiders) and shareholders (outsiders), dividend payments are used by managers as a tool to communicate the company's performance to shareholders, thereby reducing the information asymmetry between the two parties. Sirait & Siregar (2014) stated that a company has better earnings quality when paying dividends, although this still depends on whether there is an increase or decrease in dividends. Dividend payments may help in aligning the interests of managers and shareholders by cutting down the cash available for use at the discretion of management and, hence, providing protection against self-interested actions by the management (Easterbrook, 1984). Moreover, paying larger dividends reduces discretionary internal cash flow and forces the firm to seek external financing from capital markets, which places it under the scrutiny and disciplining effects of investment professionals. Jensen (1986) suggests that managers, motivated by compensation and human capital considerations, have incentives to overinvest free cash flows even in the absence of profitable growth opportunities (the free cash flow hypothesis). In this case, dividend payout policy becomes a vehicle for monitoring managers' potential to misuse excess funds.

There are various forms of dividend distribution made by companies, but this study focuses more on cash dividends. The findings of Deng et al. (2017) and Su et al. (2014) suggest that dividend payments are considered an important tool in helping shareholders reduce the free cash flow controlled within the company, thus compelling managers to exercise better command over the company's financial resources. Moreover, companies that pay dividends are also more likely to increase external capital, which can increase monitoring by external parties, making it more difficult for managers to manipulate earnings. Sirait & Siregar (2014) also noted that while investors have rights to the company's assets, it is challenging to prevent internal parties (management) from misusing this cash flow without a routine dividend management.

Regulations can impact various industries in different ways, one of which is through dividend policies implemented in a particular country. Before 2003, Turkey adopted the first mandatory dividend policy. Under this regulation, all companies listed on the Istanbul Stock Exchange were required to distribute at least 50 percent of their distributable income as cash dividends, with other forms of payment being legally prohibited without paying dividends first. This mandatory dividend policy aimed to protect the rights of minority shareholders (Al-Najjar & Kilincarslan, 2017).

On the contrary, in Indonesia, dividend distribution policy is considered voluntary law. Law No. 40 of 2007 concerning Limited Liability Companies and the Company's Articles of Association state that all net income, minus retained earnings, constitutes dividends, unless otherwise determined by the General Meeting of Stakeholders (RUPS). Typically, a company's profits are distributed as dividends after the annual earnings are approved and decided upon in the RUPS. This differs from interim dividends, which are paid before the company's yearly profits are known and approved in the RUPS, as they are based on the decision of the Board of Directors, subject to approval by the Board of Commissioners. However, if the company incurs losses after the fiscal year ends, any interim dividends already distributed must be returned by the shareholders. If not, both the Board of Commissioners and the Board of Directors are jointly liable for the company's losses. The regulations in Indonesia, which indicate that dividend distribution remains a voluntary law based on RUPS decisions, suggest that there are incentives behind dividend payments by companies.

In addition to the gap in previous research, this study is also motivated by the issue of stricter dividend payment regulations, which were proposed to become mandatory since 2013. However, this proposal has yet to reach a final draft due to ongoing debates. The percentage of companies paying dividends hasn't been increasing despite a growing number of listed companies in the Indonesia Stock Exchange (IDX), and many companies refuse to distribute dividends even when they are profitable. On one hand, mandatory dividend payment can be beneficial as it aims to protect the rights of minority shareholders, but on the other hand, it is

seen as limiting the company's ability and opportunity to invest and grow further (Wardhana & Tandelilin, 2018) This study hopes to provide additional insights for regulators, indicating that the timing of cash dividend distribution by companies can serve as a signal of the quality of the company's earnings. This, however, would be a different case if regulations related to dividend payment policies were to become mandatory.

The distinction of this study lies in its subject, which focuses on all non-financial companies in Indonesia. In addition, unlike the studies of Tong & Miao (2011), Skinner & Soltes (2009), Sirait & Siregar (2014), and Deng et al. (2017) this study differentiates cash dividends into two types based on the timing of their distribution: interim dividends (often referred to as special dividends) and final dividends. The aim is to determine whether final and interim dividends have an impact on the quality of corporate earnings.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Signalling Theory

Signaling Theory was first proposed by Spence (1973), who explained how parties with more information (insiders) send signals to parties with less information (outsiders) to reduce information asymmetry. In the context of companies, signaling theory explains that management, as an internal party, has more complete information about the company's financial condition and prospects than investors or external parties. Therefore, management will send signals to the market through various actions or policies that can be interpreted as a reflection of the company's fundamental conditions.

One of the signals most often observed by investors is cash dividend distribution. According to signal theory, cash dividends can serve as a positive signal (good news) for investors that the company has good profit prospects and stable cash flow in the future. Cash dividend payments indicate that the company is confident in its ability to generate profits in the future, because the decision to distribute dividends means reducing the cash available for operational activities, so it is only done when management is confident in the company's fundamental strength.

In the context of this study, cash dividends are viewed as an independent variable that acts as a signal of earnings quality. Earnings quality reflects the extent to which reported earnings can describe actual economic performance and future sustainability. If management consistently distributes cash dividends from high-quality earnings, this strengthens the signal that the reported earnings are not manipulated and reflect the company's real performance. Conversely, if cash dividends are paid without the support of sustainable earnings, the signal becomes weak or even misleading. This study also emphasizes the timing difference between cash dividends, namely final cash dividends and interim cash dividends, in the context of signaling theory.

Final cash dividends are generally paid after the annual financial statements have been audited, so the decision to distribute them is based on verified profit information. Therefore, final cash dividends are seen as a more credible signal of the quality of a company's profits. In contrast, interim cash dividends are paid before the annual report is released, so the information is still preliminary and not fully verified. This causes the signal generated by interim dividends to be weaker or even ambiguous in reflecting profit quality. Based on Signaling Theory, cash dividend distribution, especially final cash dividends, can be an instrument of communication from management to the market regarding the quality of the company's profits. Investors can interpret dividend policy as an indicator of earnings credibility, while regulators can utilize these findings to strengthen information disclosure policies, particularly in the transparency of dividend distribution practices and earnings reporting.

Conceptual Framework

Dividends, as one of the indicators of earnings quality, are based on signaling theory, where managers distribute dividends as a signal to investors about the credibility and financial condition of the company (Miller & Rock, 1985) This statement is based on the idea that a company's ability to pay dividends comes from the availability of cash. Therefore, a significant discrepancy between the reported earnings and the available cash for dividend payments will eventually pose a problem for the company. By distributing dividends, the company's retained earnings will decrease, which signals that the company believes in the sustainability of its ability to generate future income. If this belief is not realized, there is a possibility that managers may need to seek external financing in the future. This could lead to closer monitoring of the company's performance by banks and capital providers, as they are key sources of funding.

Based on the timing of payment, dividends can be categorized into two types: final dividends and interim dividends. The decision to distribute final dividends is made after the company's year-end profit is known and decided at the General Meeting of Shareholders (RUPS), while interim dividends are decided by the Board of Directors with approval from the Board of Commissioners before the year-end profit is known and determined. However, if the company incurs losses after the fiscal year ends, the interim dividends that have been distributed must be returned by the shareholders, and if not, the Board of Commissioners and the Board of Directors are jointly responsible for the loss. Therefore, the distribution of interim dividends is crucial and must be carefully considered. This drives the researcher to distinguish dividends based on their payment timing, as final and interim dividends have different characteristics and rules. The conceptual framework outlined below is based on theories and previous research:

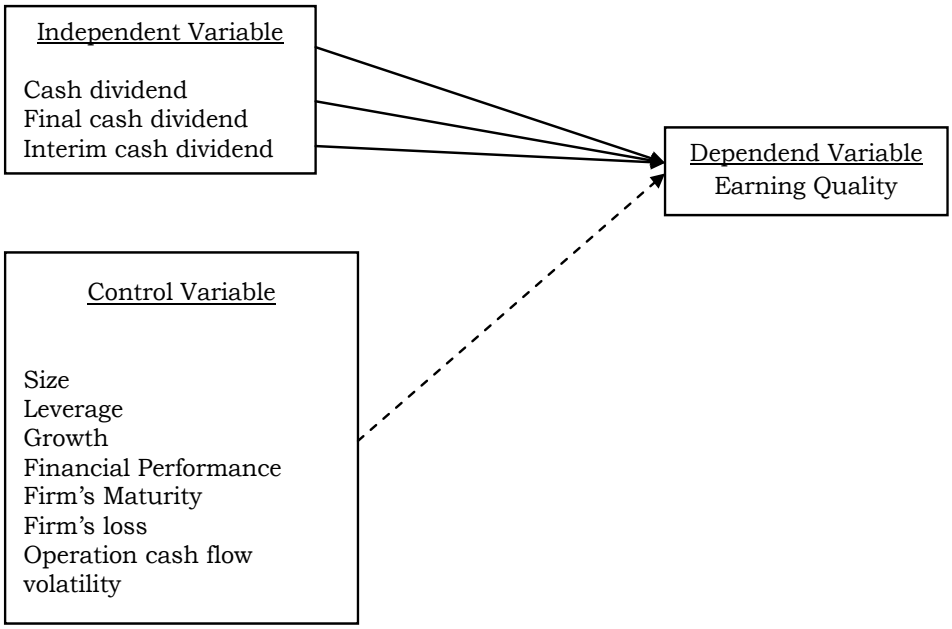


Figure 1
Conceptual Framework
Source: Compiled by Researchers (2022)

The dependent variable in this research is earnings quality, while the independent variables are final cash dividends and interim cash dividends. The study uses control variables to more optimally explain other factors, aside from the independent variables, that may affect the dependent variable, thereby increase the statistical power of the research and ensure more accurate results. The control variables used in this study follow previous research by Deng et al. (2017) and Sirait & Siregar (2014) including company size, debt structure, company growth, financial performance, company age, company losses, and cash flow volatility. Larger companies tend to attract greater attention from both investors and regulators, which motivates them to maintain higher earnings quality. Firms with higher leverage face stronger pressure from creditors to demonstrate favourable performance, potentially influencing earnings management practices. Similarly, high-growth firms have incentives to preserve a positive image, which may encourage earnings manipulation, while superior financial performance may also lead to income smoothing practices in order to present consistent results over time. In terms of firm age, older companies generally have more established governance and reporting systems, which contribute to higher earnings quality. Conversely, firms experiencing losses often have strong incentives to engage in earnings management to present more favorable financial outcomes. Finally, cash flow stability is closely related to the sustainability of earnings, whereas high cash flow volatility may cause reported earnings to deviate from underlying fundamentals, thereby reducing earnings quality.

In terms of firm age, older companies generally have more established governance and reporting systems, which contribute to higher earnings quality. Conversely, firms experiencing losses often have strong incentives to engage in earnings management to present more favourable financial outcomes. Finally, cash flow stability is closely related to the sustainability of earnings, whereas high cash flow volatility may cause reported earnings to deviate from underlying fundamentals, thereby reducing earnings quality

This section outlines the definitions and measurements of each variable, starting with the dependent, independent, and control variables.

Cash Dividends and Earnings Quality

Cash dividends refer to cash payments made as dividends, including both final and interim dividends. There are three arguments supporting the idea that cash dividend payments affect earnings quality. First, the company's net income will be allocated to retained earnings and/or dividends, and the number of dividends to be distributed is determined during the General Meeting of Shareholders (RUPS). In relation to signaling theory, dividend distribution sends a signal to investors regarding the company's financial strength and the credibility of its financial statements, particularly its earnings. This is because it indicates that the proportion of the company's retained earnings will decrease to pay dividends, meaning the company believes in the sustainability of its ability to generate earnings in the long run. Based on this, dividends can be considered an indicator that the company's earnings quality aligns with its actual performance (Deng et al., 2017; Sunday et al., 2023; Tong & Miao, 2011).

Second, dividend payments can reduce the free cash flow controlled by the company's internal management, thereby limiting opportunistic managerial behavior. The distribution of cash dividends, which reduces the company's available cash for financing its operational activities, increases the likelihood that managers will seek external financing at certain points. This leads to closer monitoring of the managers by banks, stock exchanges, shareholders, and capital providers regarding the company's performance. Such external scrutiny can make it difficult for managers to manipulate earnings, which would negatively affect the quality of the company's earnings (Miller & Rock, 1985; Sirait & Siregar, 2014).

Third, the number of dividends announced can signal to shareholders as it creates a pre-commitment for the company to pay dividends. This commitment acts as a signal of the company's financial stability and intention to share profits, which can enhance shareholder confidence in the company's future prospects and governance (Miller & Rock, 1985). Dividend payments can only be made if they are supported by the company's profits and cash flow, as the portion of retained earnings will decrease to pay dividends. This implies that the company is confident in the sustainability of its ability to generate income, which in turn enhances its

liquidity in the long term. Therefore, it is difficult for a company to pay dividends without having high-quality earnings. Dividend payments serve as a signal of the company's actual performance and high-quality earnings, making dividends an indicator of the fairness of reported earnings (Mulchandani et al., 2020). This suggests that companies that distribute cash dividends have better earnings quality. The hypothesis proposed is:

H1. Cash dividends affect the quality of company profits.

Final Cash Dividends and Earnings Quality

The difference between final and interim cash dividends lies in their timing. Final cash dividends are distributed after the company has determined its annual earnings and are decided during the Annual General Meeting of Shareholders, while interim cash dividends are distributed before the company's annual earnings are known. Cash dividends are preferred by investors over capital gains because they come with lower risk (Kent Baker & Powell Gary, 2012). The requirements that a company must meet if it wishes to distribute dividends after the end of the fiscal year are regulated in Article 7, Paragraph 3 of the Limited Liability Company Law. It states that the company's net profit for the current year must be sufficient to cover the accumulated losses from previous fiscal years before any dividend can be distributed (Indonesia, 2007). Balachandran (2003) A is a researcher who conducted a study on the impact of reductions in interim and final cash dividends on market reactions in the UK. The study found that the market reacts more strongly to reductions in interim cash dividends compared to reductions in final cash dividends. Dasilas et al. (2008) Based on signaling theory, interim cash dividends, also known as special dividends, also send a signal to investors about the company's earnings quality. Interim dividends are typically paid before the annual profit is determined, but they must meet strict requirements to ensure that the company's net wealth does not fall below the amount of paid-in capital and mandatory reserves. The decision to distribute interim dividends is made by the board of directors after obtaining approval from the board of commissioners.

However, because interim dividends are paid before the company knows its final earnings, this payment indicates that the company has strong expectations for positive financial performance, even before final profit figures are available. Paying interim dividends, while risky, also reflects the company's confidence that it will be able to cover losses and still pay dividends. Therefore, a company that distributes interim dividends signals that it is managing its financial resources well and can be relied upon by shareholders. However, if at the end of the fiscal year the company incurs a loss, the interim dividend already paid must be returned to the company. If not, the board of directors and the board of commissioners are jointly responsible for the company's losses. This demonstrates that paying interim dividends must be done carefully, as it sends a stronger signal about the company's financial stability and the expected quality of earnings. The hypothesis proposed is:

H2. Final cash dividends affect the quality of company profits.

Interim Cash Dividends and Earnings Quality

Interim dividends, also known as special dividends, are paid before the annual profit is determined, as long as it is regulated in the company's articles of association. If a company decides to pay interim dividends, it must meet the requirements for distributing final dividends and additional provisions specific to interim dividends. These include ensuring that the company's net wealth does not fall below the amount of issued and paid-up capital and mandatory reserves when paying interim dividends. The decision to distribute interim dividends is made by the board of directors after receiving approval from the board of commissioners.

However, if at the end of the fiscal year the company experiences a loss, the interim dividends that have been distributed must be returned by the shareholders. If the shareholders do not return the interim dividends, the board of commissioners and the board of directors are jointly responsible for the company's losses (Indonesia, 2007).

Balachandran (2003) is a researcher who conducted a study on the impact of interim and final cash dividends' reduction on market reactions in the UK. The study found that the market responds more strongly to the reduction of interim cash dividends compared to the reduction of final cash dividends. Dasilas et al. (2008) using the signaling theory, found that the Greek market reacts more positively to the simultaneous announcement of both final and interim dividends, as indicated by changes in stock prices and trading volumes on the announcement day. The payment of interim dividends is considered a rare phenomenon, often resulting from the exceptional performance of a company during one or more of the first quarters of the fiscal year (Dasilas et al., 2008). A company that distributes interim cash dividends sends a stronger signal to investors about the credibility of its financial statements. This is because if the company distributes interim cash dividends, but its profits do not reflect the true financial situation, the risks borne by the company increase in accordance with the regulations stipulated in the law. Ozo & Arun (2019) also adds dividend increases are associated with positive stock price reaction, while dividend decreases are associated with negative stock price reaction. Companies that do not change their dividends reported insignificantly positive average abnormal returns. These results are consistent with the tax-based signaling models which predict that the higher taxes on dividends relative to capital gains make dividends informative. Similar to Al-Yahyaee et al. (2011), the evidence from the Nigerian stock market suggests that the signaling effect of dividends is not restricted to the developed stock markets, but also prominent in emerging markets with different institutional environment. The hypothesis proposed is:

H3. Interim cash dividends affect the quality of company profits.

3. RESEARCH METHOD

The purpose of this study is to examine and evaluate the effect of cash dividends on firms' earnings quality. This research employs a quantitative approach using secondary data obtained from companies listed on the Indonesia Stock Exchange (IDX), excluding the financial sector, during the 2015–2018 period. The financial sector is excluded because it is subject to different regulatory frameworks, has distinctive financial reporting characteristics, and applies specific dividend policies that could distort comparisons with non-financial firms. The analysis technique applied is panel data regression, with several control variables included in the model. The research period begins in 2015 because, although the Financial Services Authority (OJK) in the capital market sector specifically tasked with implementing a system of supervision and regulation for the capital market was established in 2011, the Financial Services Authority Regulation Number 32/POJK.04/2014, Article 36, which governs the planning and implementation of General Meetings of Shareholders (GMS), was enacted in 2014. The year 2019 is excluded to avoid potential bias in the results, as many companies canceled their dividend distribution plans in response to the widespread impact of the COVID-19 outbreak announced that year.

Earnings Quality

The dependent variable used in this research is earnings quality (EQ). High-quality earnings are characterized by their ability to accurately reflect the company's current performance and serve as a reliable indicator of its future operational performance (Istianingsih, 2021; McNichols, 2002; Saleh et al., 2020; Zadeh et al., 2022). This research employs two measurement tools for earnings quality. First, non-performance matched discretionary accruals, which qualitatively yield results similar to performance-adjusted discretionary accruals (ADA), are used in this study because they capture managerial opportunistic policies in financial reporting and indicate the extent to which earnings are reported accurately. This measurement is based on the Modified-Jones model, as modified by Kothari et al. (2005). The model uses as a regressor to control the impact of performance on the measurement of discretionary accruals, presented with the following:

$$TACC_{i,t} = \beta_0 + \beta_1 (1/ASSET_{(it-1)}) + \beta_2 \Delta SALES_{i,t} + \beta_3 PPE_{i,t} + \beta_4 ROA_{(i,(t-1)} + \varepsilon_{i,t}$$

Explanation:

$TACC_{i,t}$	= Total company accruals, which is the earnings before extraordinary items minus operating cash flow.
$ASSET_{(it-1)}$	= The total assets of company i in year t-1
$\Delta SALES_{i,t}$	= The change in sales of company i in year t
$PPE_{i,t}$	= The value of gross property, plant, and equipment of company i in year t
$ROA_{(i,(t-1))}$	= Return on asset company i in year t-1
$\varepsilon_{i,t}$	= The error of company i in period t

$TACC_{i,t}$, $ASSET_{(it-1)}$, $PPE_{i,t}$, and dIvided by $ASSET_{(it-1)}$, the assets of the previous year, which is used as a deflator in this study to reduce heteroskedasticity in the residuals.

Cash Dividends

The independent variable in this research is cash dividends. Dividends in this study are categorized based on the timing of their payment because they have different characteristics and rules, namely final and interim cash dividends. Cash dividends represent the total cash dividends, both final and interim, announced by the company from the current year's earnings to the shareholders, which have been paid in cash. This study measures cash dividends using dummy variables and ratios.

First, cash dividends (CASH_DUMMY) are measured based on the dividend payment status using a dummy variable, which will take a value of 1 if the company announces a final or interim cash dividend from the current year's earnings and has been paid, and 0 otherwise.

The second measurement tool is the dividend yield ratio (CASH_YIELD), which is calculated using the following formula (Deng et al., 2017):

Dividend Yield Ratio= (Cash Dividends per Share)/(Stock Price)

Final Cash Dividends

Final cash dividends are dividends announced by the company from the current year's earnings after the earnings have been determined and approved in the General Meeting of Shareholders (GMS), which have been paid in cash. In this study, final cash dividends are measured using dummy variables and ratios. First, final cash dividends (FIN_DUMMY), measured using a dummy variable, will take a value of 1 if the company announces a final cash dividend from the current year's earnings and it has been paid, and 0 otherwise. The second measurement tool is the final dividend yield ratio (FIN_YIELD), which is calculated using the following formula (Deng et al., 2017):

$$\text{Final Dividend Yield Ratio} = \frac{\text{(Final Cash Dividends per Share)}}{\text{(Stock Price)}}$$

Interim Cash Dividends

Interim cash dividends are dividends announced and paid by a company before the current year's profit is determined and approved at the General Meeting of Shareholders (GMS), based on the decision of the Board of Directors and approved by the Board of Commissioners. In this study, cash interim dividends are measured using dummy variables and ratios. First, cash interim dividends (INT_DUMMY), measured using a dummy variable, are assigned a value of 1 if the company announces and pays interim cash dividends from the current year's profit, and 0 otherwise. The second measurement tool is the dividend interim yield ratio (INT_YIELD), calculated using the following formula (Deng et al., 2017):

$$\text{Interim Dividend Yield Ratio} = \frac{\text{(Interim Cash Dividends per Share)}}{\text{(Stock Price)}}$$

Table 1. Number of Companies Used as Research Samples

Variables	Year	Samples Criteria					Total Samples
		Company listed in IDX 2015-2018	Financial sector	Companies with Negative equity	Uncomplete data	Sample per year	
ADA	2015	525	-81	-19	-68	357	1428
	2016	540	-81	-20	81	357	
	2017	568	-81	-23	-107	357	
	2018	620	-81	-23	-159	357	
EP	2015	525	-81	-19	-82	343	1372
	2016	540	-81	-20	-96	343	
	2017	568	-81	-23	-121	343	
	2018	620	-81	-23	-173	343	
AAQ	2015	525	-81	-19	-77	348	1392
	2016	540	-81	-20	-91	348	
	2017	568	-81	-23	-116	348	
	2018	620	-81	-23	-168	348	

Source: Data Processed, 2025

The total number of companies listed on the Indonesia Stock Exchange (IDX) from 2015 to 2018 is 2,253 companies. From these 2,253 companies, a sample elimination was carried out, consisting of 409 companies, namely 324 financial companies and 85 companies with negative equity, leaving 1,844 companies in the remaining sample. Based on the remaining sample, further elimination was conducted for samples with incomplete data according to the measurements used in this study. After the elimination process based on the criteria, the final sample size for the dependent variable measurements is as follows: 1,428 companies for ADA, 1,372 companies for EP, and 1,392 companies for AAQ.

4. RESULTS AND DISCUSSION

The description of the research results is presented using descriptive statistics and frequencies according to the needs of each variable. The results of the descriptive statistical analysis are shown in Appendix 1.

The independent variables in this study are cash dividends, final cash dividends, and interim cash dividends, which are measured using dummy variables and dividend yield ratios. Frequency statistical analysis is used to describe cash dividends, final cash dividends, and interim cash dividends measured using dummy variables, as shown in Table 2.

Table 2. Frequency Statistics

Variable		ADA		EP		AAQ	
		Freq	Percent	Freq	Percent	Freq	Percent
CASH_ DUMMY	**0**	785	55	734	53,5	754	54,2
	1	643	45	638	46,5	638	45,8
FIN_ DUMMY	0	797	55,8	746	54,4	766	55
	1	631	44,2	626	45,6	626	45
INT_ DUMMY	**0**	1319	92,4	1263	92,1	1283	92,2
	1	109	7,6	109	7,9	109	7,8
LOSS	**0**	1052	73,7	1027	74,9	1038	74,6
	1	376	26,3	345	25,1	354	25,4

Source: Data Processed, 2025

Multiple regression analysis was conducted to test the effect of cash dividends on earnings quality. The equation was tested six times based on three different proxies used for earnings quality (ADA, EP, and AAQ) as well as cash dividends (CASH_DUMMY and CASH_YIELD). Cash dividends here refer to both final cash dividends and interim cash dividends. The results of testing the effect of cash dividends on earnings quality for each model are presented in Appendix 2.

The measurement of ADA captures managerial opportunistic policies in financial reporting and indicates the extent to which earnings are reported accurately. A larger ADA value signifies higher discretionary accruals, so a smaller ADA value reflects better earnings quality. Therefore, to obtain earnings quality, the ADA value has been multiplied by -1. The results of the model testing in Table 3 show that cash dividends positively influence ADA, whether cash dividends are measured using a dummy variable or a continuous variable. The regression results demonstrate a positive effect of cash dividends on the company's earnings quality (ADA). Cash dividends distributed by the company indicate better earnings quality. These findings are consistent with previous research of (Deng et al., 2017; Lee, 2022; Nguyen & Bui, 2019).

The measurement of EP indicates that a company has more persistent earnings, which have predictive value for future earnings based on the current year's earnings. Table 3 shows that cash dividends have a positive effect on EP, whether cash dividends are measured using a dummy variable or a continuous variable. The regression results confirm that cash dividends positively influence the company's earnings quality (EP). Companies that distribute cash dividends exhibit better earnings quality. The payment of cash dividends provides information on the extent of changes in reported current-period earnings, as an increase in earnings considered permanent by management is accompanied by an increase in dividends, and vice versa. These findings are consistent

with previous research (Deng et al., 2017; Miller & Rock, 1985; Skinner & Soltes, 2009).

AAQ explains whether the reported accrual-based cash flows accurately reflect the actual cash flows. A higher AAQ value indicates poorer earnings quality, while a smaller AAQ value suggests better earnings quality. Therefore, to obtain earnings quality (EQ), the AAQ value is multiplied by -1, simplifying the interpretation of data analysis results. Based on Appendix 2, it is shown that cash dividends have no effect on the company's earnings quality, as evidenced by the low significance level of the independent variables on the dependent variable. Overall, the regression results support the first hypothesis, namely, companies that pay cash dividends tend to have better earnings quality.

In this study, cash dividends are differentiated based on their payment timing: final cash dividends and interim cash dividends. This section examines the effect of final cash dividends on the company's earnings quality using multiple regression analysis. The equation was tested six times based on three different proxies for earnings quality (ADA, EP, and AAQ) and final cash dividends (FIN_DUMMY and FIN_YIELD). The results of the testing on the effect of final cash dividends on earnings quality for each model are presented in Appendix 3.

Appendix 3 presents several empirical findings. First, final cash dividends have a positive effect on ADA, whether measured using a dummy variable or a continuous variable. The regression results demonstrate a positive influence of final cash dividends on the company's earnings quality (ADA). Companies that distribute final cash dividends exhibit higher-quality earnings. The payment of final cash dividends reduces free cash flow controlled by management, thereby decreasing the likelihood of discretionary expenditures (Deng et al., 2017; Denis et al., 1994; Kargar & Ahmadi, 2013; Mulchandani et al., 2020).

Second, final cash dividends have a positive effect on the company's earnings quality (EP), whether measured using a dummy variable or a continuous variable. The regression results confirm that final cash dividends positively influence the company's earnings quality (EP). Companies that distribute final cash dividends exhibit better earnings quality. Dividend payments provide information on the extent of reported changes in current-period earnings, as an increase in earnings considered permanent by management is accompanied by an increase in dividends, and vice versa (Deng et al., 2017; Miller & Rock, 1985; Skinner & Soltes, 2009).

Third, it is shown that final cash dividends have no effect on the company's earnings quality (AAQ), indicating a low level of significance of the independent variable on the dependent variable. This suggests that the distribution of final cash dividends does not impact whether accrual-based reported cash flows accurately reflect actual cash flows. The regression results above confirm that the second hypothesis is accepted, namely that companies paying final cash dividends have better earnings quality.

The next test examines the effect of interim cash dividends on the company's earnings quality using multiple regression analysis based on model equation 3.15. The equation was tested six times using three different proxies for earnings quality (ADA, EP, and AAQ) and interim cash dividends (INT_DUMMY and INT_YIELD). The results of the tests on the effect of interim cash dividends on earnings quality for each model are presented in Appendix 4.

Based on Appendix 4, it shows that interim cash dividends, measured using the dummy variable, do not affect ADA. The regression results prove that interim cash dividends have no effect on the company's earnings quality. This is because the number of companies in Indonesia paying interim cash dividends is still very small.

Cash Dividends and Earnings Quality

The results indicate that cash dividends exert a positive influence on earnings quality, as they are regarded as an indicator of greater transparency in constraining earnings management (Deng et al., 2017; Mulchandani et al., 2020). In non-financially constrained firms, dividend distributions serve to curtail managers' opportunistic behavior in engaging with earnings management (Hussain & Akbar, 2022). Furthermore, dividend increases serve as a signal that conveys information about future performance (Ham et al., 2020). Placing priority on substantial dividend payouts benefits investors, as such payments reflect the company's financial robustness (Sunday et al., 2023). The findings of this study are also supported by previous research conducted by Tong & Miao (2011), Skinner & Soltes (2009), Sirait & Siregar (2014), which shows that cash dividends have an impact on the company's earnings quality. This statement is based on the idea that a company is able to pay cash dividends because of the availability of cash. Therefore, a significant difference between the reported earnings and the cash available for dividend payments will become a problem for the company itself. However, the results of the study Mousa & Desoky (2019) do not align with the results of this study. Mousa & Desoky (2019) show that there is no significant effect of cash dividends on the company's earnings quality. This lack of effect is due to an empirical study in Egypt, which found that companies in that country engaged in earnings management during the first two years of the study period, and this decreased in the following two years of the study.

Final Cash Dividends and Earnings Quality

The hypothesis testing results demonstrate that final cash dividends have a positive effect on the quality of a company's earnings. The difference between final and interim cash dividends lies in their timing of distribution. Final cash dividends exert a positive influence on earnings quality due to their formal nature, as they are determined through the General Meeting of Shareholders, based on audited annual financial statements, and reflect the actual cash flows available (Baker & Gary, 2012). Since final cash dividends are distributed only after the financial statements have

been disclosed to the public, managers have limited opportunity to engage in opportunistic actions that could otherwise affect earnings quality. Institutional pressures and the necessity to maintain the credibility of such signals encourage managers to act more prudently, thereby enhancing the quality of reported earnings.

It is difficult for companies to distribute dividends if they are not supported by good earnings quality. This indicates that companies distributing final cash dividends tend to have better earnings quality compared to those that do not. As far as the reviewed literature suggests, research on the relationship between cash dividends and earnings quality remains very limited. However, there is research that supports these findings, which also utilizes signaling theory, such as the study conducted by Dasilas et al. (2008). The research findings revealed that the market reacts more positively to the simultaneous announcement of final and interim dividends, as indicated by changes in stock prices and trading volume on the announcement day (Felimban et al., 2018).

Interim Cash Dividends and Earnings Quality

The research findings indicate that interim dividends do not have a significant effect on earnings quality. Interim dividends are declared based on semi-annual or quarterly financial statements that have not been audited. Consequently, the earnings information underlying these dividends is less credible compared to that of final dividends. With such a weaker foundation, interim dividends exert limited pressure on managers to maintain the quality of annual earnings. Moreover, their flexible and easily adjustable nature makes them less binding, as they can be revised when the final dividend is announced. Due to this flexibility, managers are not strongly compelled to ensure that reported earnings are of high quality.

This result can also be attributed to the fact that only a small proportion of companies in Indonesia distribute cash interim dividends, approximately 7–8% of the total sample. The characteristics of the research subjects in Dasilas et al. (2008) in Greece are quite similar to those in this study, as only a small number of companies distribute cash interim dividends. Therefore, the arguments in this study are linked to those in Dasilas et al. (2008), which found that cash interim dividends generate smaller market reactions compared to final cash dividends, as cash interim dividends do not affect the quality of a company's earnings.

Research on cash interim dividends has received limited attention in academia. Based on the researcher's review, no studies have examined the effect of cash interim dividends on the quality of a company's earnings. Existing research on cash interim dividends has only been conducted in the UK and Greece, focusing on the impact of cash interim dividend announcements on market reactions. Balachandran (2003) found that the market reacts more strongly to a decrease in cash interim dividends. This contrasts with the study by Dasilas et al. (2008) which found that the announcement of cash interim dividends generates a smaller

market reaction compared to final cash dividends. This is likely because the number of companies distributing cash interim dividends in Greece is significantly smaller than those distributing final cash dividends.

5. CONCLUSIONS AND SUGGESTIONS

Conclusion

The results of this study indicate that overall cash dividends, particularly final cash dividends, positively affect earnings quality, whereas interim cash dividends show no significant effect. The positive effect of cash dividends and final cash dividends on the quality of a company's earnings is based on three arguments developed using signalling theory.

First, the payment of dividends signals to investors the company's financial strength and the credibility of its financial statements, as the company's retained earnings are reduced to pay dividends. This suggests that the company has confidence in the sustainability of generating long-term earnings.

Second, the payment of cash dividends can reduce free cash flow controlled by internal parties, thereby limiting managerial opportunistic behaviour. Moreover, the payment of cash dividends, which reduces the company's available cash for financing operational activities, increases the likelihood of external financing, leading to closer monitoring by banks, stock exchanges, shareholders, and other capital providers

Third, the amount of cash dividends announced creates a pre-commitment for the company to pay them, which must be supported by appropriate earnings and cash flows. Cash interim dividends do not affect the quality of a company's earnings because only a small number of companies in Indonesia, around 7–8% of the research sample, distribute cash interim dividends, and the announcement of interim dividends is not yet supported by audited financial statements.

The implication of this research is that investors may use dividend policy as a screening tool to assess the credibility of reported earnings and the financial stability of firms. From a practical standpoint, firms that consistently distribute substantial dividends are more likely to strengthen their reputation and foster greater trust in the capital market.

Suggestions

The limitation of this study lies in the issue of endogeneity, where company characteristics can influence whether a company pays cash dividends or not. Additionally, company characteristics may determine the amount of cash dividends paid, while variables related to company characteristics are on the same side as the dividends. Therefore, future research is expected to address the potential issue of reverse causality by re-estimating the main model using lagged values of the independent variables (AlQadasi, 2018; Leszczensky & Wolbring, 2022).

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Appendix 1. Descriptive Statistics

Variable	Min	Max	Mean	Std. Dev	Min	Max	Mean	Std. Dev	Min	Max	Mean	Std. Dev
ADA	-0,71	0,00	-0,06	0,07								
EP					-14,96	8,51	0,18	0,92				
AAQ									-0,72	0,00	-0,05	0,06
CASH_ YIELD	0,00	0,06	0,02	0,04	0,00	0,06	0,02	0,04	0,00	0,06	0,02	0,04
FIN_YIELD	0,00	0,56	0,01	0,03	0,00	-0,56	0,01	0,04	0,00	0,56	0,01	0,03
INT_YIELD	0,00	0,06	0,00	0,02	0,00	0,06	0,00	0,02	0,00	0,60	0,00	0,02
SIZE	15,85	26,57	21,76	1,68	15,85	26,57	21,79	1,67	15,85	26,57	21,80	1,66
GROWTH	-16,94	36,42	0,22	1,99	-16,94	33,98	0,19	1,74	-16,94	36,42	0,22	1,99
ROA	-67,36	110,26	3,05	9,89	-67,36	110,26	3,29	9,89	-67,36	110,26	3,23	9,79
AGE	2,20	6,14	5,10	0,69	2,20	6,14	5,11	0,69	2,20	6,14	5,10	0,69
CFO_STD	0,00	1,75	0,07	0,10	0,00	1,75	0,07	0,10	0,00	1,75	0,07	0,10
N	1428				1372				1392			

Source: Data Processed, 2025

Appendix 2. Regression Results of Cash Dividends and Earnings Quality

	Predicted Sign	ADA		EP		AAQ	
		(1a)	(1b)	(2a)	(2b)	(3a)	(3.b)
CASH_DUMMY	+	0.01*		0.15**		0.00	
CASH_YIELD	+		0.05**		0.60**		0.02
SIZE	+	0.04***	0.04***	-0.22	-0.18	0.05***	0.05***
LEV	-	-0.01**	-0.01**	-0.16***	-0.16***	-0.01***	-0.01***
GROWTH	-	0.01	0.01	-0.01	-0.01	0.00	0.00
ROA	+	0.00	0.00	-0.11*	-0.09	0.01**	0.01**
AGE	-	-0.02*	-0.03**	-0.35**	-0.36**	0.00	0.00
LOSS	-	0.00	0.00	0.12*	0.09	-0.01***	-0.01**
CFO_STD	-	-0.13***	-0.13***	-0.05	-0.06	-0.08***	-0.08***
Adj R^2		0.07	0.07	0.02	0.02	0.05	0.05
F		14.22	14.26	4.17	3.90	10.88	10.89
Sig.		0.00	0.00	0.00	0.00	0.00	0.00
N		1428	1428	1372	1372	1392	1392

***Correlation is significant at level 1%

**Correlation is significant at level 5%

*Correlation is significant at level 10%

Source: Data Processed, 2025

Appendix 3. Regression Results of Final Cash Dividends and Earnings Quality

Variabel	Predicted Sign	ADA		EP		AAQ	
		(1a)	(1b)	(2a)	(2b)	(3a)	(3.b)
CASH_DUMMY	+	0.01*		0.16**		0.01	
CASH_YIELD	+		0.04*		0.65**		0.03
SIZE	+	0.04***	0.04***	-0.23	-0.18	0.05***	0.05***
LEV	-	-0.01**	-0.01**	-0.16***	-0.16***	-0.01***	-0.01***
GROWTH	-	0.01	0.01	-0.01	-0.01	0.00	0.00
ROA	+	0.00	0.00	-0.11**	-0.11*	0.01**	0.01**
AGE	-	-0.02*	-0.03**	-0.35**	-0.36**	0.00	0.00
LOSS	-	0.00	0.00	0.13*	0.09	-0.01***	-0.01**
CFO_STD	-	-0.13***	-0.13***	-0.06	-0.07	-0.07***	-0.08***
Adj R^2		0.07	0.07	0.02	0.68	0.05	0.05
F		14.30	14.04	4.27	3.97	10.96	11.05
Sig.		0.00	0.00	0.00	0.00	0.00	0.00
N		1428	1428	1372	1372	1392	1392

***Correlation is significant at level 1%

**Correlation is significant at level 5%

*Correlation is significant at level 10%

Source: Data Processed, 2025

Appendix 4. Regression Results of Interim Cash Dividends and Earnings Quality

Variabel	Predicted Sign	ADA		EP		AAQ	
		(1a)	(1b)	(2a)	(2b)	(3a)	(3.b)
CASH_DUMMY	+	0.00		0.11		0.00	
CASH_YIELD	+		0.07		0.38		-0.02
SIZE	+	0.04***	0.04***	-0.16	-0.14	0.05***	0.05***
LEV	-	-0.01**	-0.01**	-0.17***	-0.17***	-0.01***	-0.01***
GROWTH	-	0.01	0.01	0.00	0.00	0.00	0.00
ROA	+	0.00	0.00	-0.12**	-0.12**	0.01**	0.01**
AGE	-	-0.03*	-0.03**	-0.37**	-0.36*	0.00	0.00
LOSS	-	0.00	0.00	0.06	0.05	-0.02***	-0.01***
CFO_STD	-	-0.13***	-0.13***	-0.05	-0.05	-0.08***	-0.08***
Adj R^2		0.07	0.07	0.02	0.01	0.05	0.05
F		13.66	13.98	3.51	3.40	10.72	10.79
Sig.		0.00	0.00	0.00	0.00	0.00	0.00
N		1428	1428	1372	1372	1392	1392

***Correlation is significant at level 1%

**Correlation is significant at level 5%

*Correlation is significant at level 10%

Source: Data Processed, 2025