ISSN No:-2456-2165

Does Financial Reporting Quality and CSR Disclosure Influence the Efficiency of Investment?

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Abstract:- Investment efficiency of a company become a strategic issue due to this condition can bring to a serious problem. Several study has been conducted by previous researches. However, study in Indonesia is still limited. Therefore, there is a desire need to forthere investigate this phenomena. This study want to analyzed and examine the influences of financial reporting quality and CSR disclosure on investment efficiency. The population in this study are all of companies listed in Indonesia Stock Exchange for the year 2015-2017, except the financial sector. Final sample in this study are 468 companies which obtained by using purposive sampling method. The data is analyzed by using panel data regression. The results of analyzed in this study showed that financial reporting quality has a positive effect on investment efficiency. Meanwhile, Corporate Social Responsibility (CSR) disclosure has no effect on investment efficiency.

Keywords:- *Investment Efficiency, Financial Reporting Quality, CSR Disclosure.*

I. INTRODUCTON

The issue of oversight mechanisms for company management has recently become a widely discussed topic. Conflict between management and shareholders, known as conflict of interest, as well as a lack of supervisory mechanisms for managers, can cause managers to try to maximize their personal well-being (Jensen and Meckling, 1976; Jensen, 1986). When managers strive to maximize their personal well-being, they can make investments beyond the maximum phase by investing something in companies that are not match for shareholders. Therefore, the company is expected to be able to utilize its sources to reach investment efficiency or to avoid the inefficiency of investment.

The first elements that influence investment efficiency is the financial reporting quality which is the accuracy of financial reporting in conveying information about the company's action, which informs investor equity (Biddle et al., 2009). The connection between quality of firm's financial reporting and efficiency of investment is the result of reducing information asymmetry, moral hazard, adverse selection, and agency problems (Healy and Palepu, 2001; Lambert et al., 2007). One method to reduce the existence of information asymmetry is to increase the financial reporting quality (Bushman and Smith, 2001; Healy and Palepu, 2001).

The better financial reporting quality make the investors able to monitor management investment decisions possible (Biddle et al., 2009). McNichols and Stubben (2008) also said that asymmetry of firm informations can reduced by increasing the financial reporting quality, so this can also increase the ability of outsiders to monitor firm's management. If it is associated the efficiency of investment with high financial reporting quality, so the problem of under investment (rejection the good NPV projects) and over investment (implementing the bad NPV projects) can be reduced.

Beside financial reporting quality, another factor that can also influence investment efficiency is the CSR disclosure. Firm's CSR is a proof that the company in carrying out its operational activities is not only responsible for the interests of the owners (shareholders), but also on the government, competing companies, surrounding communities, international environment, institutions outside the company, environmental observers, company workers, people minorities, and others whose existence influences and is influenced by companies (stakeholders) that have direct and indirect relationships (Hadi, 2014). In Indonesia UU No.40 of 2007 which has been discussed regarding Limited Companies Liabilities in Article 74 paragraph 1 explain that companies that carry out their business activities in, and the business related to natural resources are required to carry out environmental and social responsibilities. The law also requires all companies to report the implementation of social responsibility in the company's annual report.

Based on statement from Benlemlih and Girerd-Potin (2017), companies with good CSR performance can invest more efficiently. Because CSR can indirectly improve the phase of efficiency of a company's investment by helping to overcome agency problems and information asymmetry. Zhong and Gao (2017) state that CSR disclosures is support to the decreasing of asymmetry of firm's information, so therefore also support to the decreasing of company's capital costs. Firm that has good CSR performance are usually less vulnerable to do investment in projects with negative Net Pesent Value (over investment) and less vulnerable to releasing projects with positive Net Present Value (under investment) (Cook et al., 2019).

Investment efficiency is related to the company's ability to do investment well, as the implied growth function, the chance of investment, and funding capabilities. Suaryana (2014), states that investment efficiency is a condition when company made an optimal level of investment, where investments made can be profitable for the company. An investment can be said to be efficient if the company can avoid overinvestment and underinvestment.

Since 2016-2018, Indonesia's ICOR ratio has remained at 6.3%. ICOR is the ratio between investment in the past year with regional output growth (GRDP). Indonesia's high Incremental Capital Output Ratio (ICOR) shows the level of investment efficiency that is still low in Indonesia (https://www.indopremier.com, 2017). This shows that the quality of investment efficiency in Indonesia as a whole is still relatively low.

Previous research that relating to the financial reporting quality on efficiency of firm’s investment already done by Biddle et al. (2009), Aulia and Siregar (2018) and also Umiyati (2017). Previous research relating to CSR disclosure of investment efficiency has been conducted by Samet and Jarboui (2017); Cook et al. (2019), Benlemlih and Girerd-Potin (2017), and also Zhong and Gao (2017) found that, there is a positive influence between CSR disclosure and efficiency of firm’s investment.

Referring to research conducted by Zhong and Gao (2017), as well as several previous studies that have been carried out in various countries, this study wants to know the impact of the financial reporting quality and CSR disclosure on efficiency of investment in firm that listed on the Indonesia Stock Exchange (IDX) except the financial companies. This study wants to see whether the existence of some differences such as research objects, measurement variables, and also data analysis methods will affect the results of the research conducted.

Based on the description above, the researchers formulated the problem as follows:

1. Does financial reporting quality can affect investment efficiency?
2. Does disclosure of Corporate Social Responsibility (CSR) can affect investment efficiency?

Based on the description of the problem above, the purpose of this study is to test empirically:

1. The effect of financial reporting quality on investment efficiency.
2. The effect of Corporate Social Responsibility (CSR) disclosure on investment efficiency.

II. LITERATURE REVIEW

➢ *Agency Theory*

This research is related on agency theory which talked about the connection between agents and principals. Jensen and Meckling (1976), explained that agency theory is a kind of connection that happen between the owner (principal) and the company manager (agent).

Literature in theoretical and empirical shows that there are various internal conflicts that can cause the inefficiency of investment. The most common conflicts are moral hazard and adverse selection, which is caused by the asymmetry of information between managers and outside investors. This situation can cause companies to experience underinvestment (investingis lower than the optimal level) or overinvestment (investing beyond the optimal level) (Zhong and Gao, 2017). Conflicts of interest between management and shareholders, as well as a lack of monitoring to managers, can cause managers to try to increase their personal well-being and doing investment exceed the optimal level by making a not suitable investment for shareholders (Jensen and Meckling, 1976; Jensen, 1986).

To avoid negligence by the management, the management is doing obligation to offer the real condition signal of the company to the owner through the company's control mechanism. Every factor that contributes to reducing the asymmetry of information, can also contribute to increase the efficiency of investment (Zhong and Gao, 2017). The company's control mechanism can be carried out through financial and non-financial disclosures. Financial disclosure can be through the quality of financial reporting. Meanwhile, non-financially, CSR disclosure can be used as additional information to support the financial reporting quality (Hung et al., 2013; Zhong and Gao, 2017).

➢ *Investment Efficiency*

According to Suaryana (2014), investment efficiency is the condition of the higher level of investment in the company, where this investment is a kinf of investment that is profitable for the company and owner. In order for an investment to be said to be efficient, the company should be able to avoid an overinvestment and underinvestment situation. Underinvestment conditions arise when companies face investment opportunities that require the use of large amounts of debt, without guarantees of adequate debt repayment, as well as companies with high levels of leverage. If the company is unable to realize the investment as expected, the company must seek additional alternative funds. Meanwhile, according to Dwiwana (2012), overinvestment conditions occur in companies that are in the mature stage where excess assets are in place and free cash flow, but the rate of growth is low (slow growth).

Investment efficiency is related to the company's chance to invest in optimal way as a function of company's implied growth, opportunities of investment and funding capabilities. Companies that doing investment efficiently can avoid from over-invest condition (undertake projects with negative NPV) or under-invest (release projects with positive NPV) (Biddle et al., 2009).

➢ *Financial Reporting Quality*

The financial reporting quality is the expand to which the firm's financial statements could show true and honest informations (Payamta, 2006).

Biddle et al. (2009) found that financial reporting quality, as an accuracy of firm's financial reporting delivering information about the company's operations, specifically the expected cash flows, which give information investors' equity.

The main purpose of financial reporting in companies is to support shareholders and other parties in determining financial decisions by helping them predict the company's cash flow (Hendriksen E.S, 2001).

➢ *Corporate Social Responsibility (CSR)*

Corporate Social Responsibility (CSR) is the activity of corporate responsibility for the impact caused by operational activities of the company, where these responsibilities include economic, legal, ethical, and community discretionary expectations of the company at a certain time (Carroll, 1979). According to Dhaliwal et al. (2011) Corporate Social Responsibility (CSR) is a kind of important contributor for the economic development and reflects the company's commitment to behave responsibly. Dhaliwal et al. (2014) states that CSR disclosures provide additional information that can reduce information asymmetry between companies and stakeholders.

According to Carroll (1979); (1991), there are four responsibilities in CSR, namely: (1) economic responsibilities for generating profits; (2) responsibility for laws and regulations; (3) ethical responsibilities so that they conduct business activities properly and fairly; (4) the responsibility of being a good company contributes in the form of resources to education, arts and community. In other words, the company is expected not only to make a profit, but also to obey regulations, be ethical and be a company that is responsible for its stakeholders.

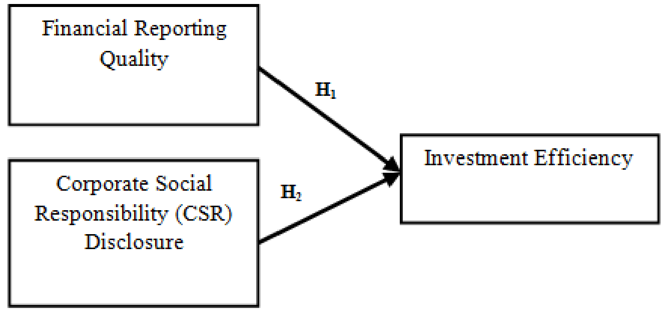

Fig 1:- Research Conceptual Framework

From the research conceptual framework above, we can conclude the hypotheses in this study are formulated as follows:

H_1: Financial reporting quality has a positive effect on Investment Efficiency.

H_2: Corporate Social Responsibility (CSR) disclosure has a positive effect on Investment Efficiency.

III. RESEARCH METHODS

This kind of research is a quantitative research. The population used in this study were all of the companies listed on the Indonesia Stock Exchange (IDX) during 2015-2017, except the financial sector. The sampling technique is done by using purposive sampling method. The final sample in this study was 468 companies. The data that used in this study are secondary data that we got in the form of annual reports and company sustainability reports for the 2015-2017 period. The data was obtained from the Indonesia Stock Exchange (IDX) website, namely www.idx.co.id and the sites of each sample company.

➢ *Research Variables and Measurement Variables*

a. Investment Efficiency

The investment efficiency in this study was calculated as the absolute residual value from the Chen et al. (2011) and Zhong and Gao (2017). This model estimates the normal investment level as follows:

$$Investasi_{i,t} = \beta 0 + \beta 1 \ Sales\ Growth_{i,t-1} + \varepsilon_{i,t}$$

Where, $Invest_{i,t}$ is the total of company's i investment in year t divided by the book value of the asset year in the begining and multiplied by 100. $Sales\ Growth_{i,t-1}$ represents the annual sales growth rate of company i in year t-1 (previous year).

$Invest_{i,t}$ then calculated from the residual value. The reflection of the residual value of this equation is the deviation from the expected level of firm's investment (investment efficiency). A negative residual value indicates an under-investment condition, and a positive-residual value indicates an over-investment condition. The value of the absolute residue is then multiplied by -1, so a higher value means a higher level efficiency of investment.

b. Financial Reporting Quality

The model that used in this study is the calculation model used by (Kasznik, 1999):

$$TA_{i,t} = \beta_0 + \beta_1 \Delta Sales_{i,t} + \beta_2 PPE_{i,t} + \beta_3 \Delta CFO_{i,t} + \varepsilon_{i,t}$$

Where, $TA_{i,t}$ is the total accrual which is calculated as a illiquid current assets change, reduced by changes in current liabilities, plus the changes in short-term from bank debt, less depreciation. $\Delta Sales_{i,t}$ is a change in income, $PPE_{i,t}$ are property, plant, and equipment, $\Delta CFO_{i,t}$ is the cash flow changes. All variables are reduced by total assets left behind. The value of absolute residuals from this model is then multiplied by -1. Thus, a high value indicates that FRQ is also high, or it can be interpreted that the higher the absolute value of the residue obtained, also shows the better quality of financial reporting.

c. *Corporate Social Responsibility* (CSR) *Disclosure*

CSR disclosure in this study was measured using the Corporate Social Responsibility Disclosure Index (CSRDI) which refers to GRI G4 using the following formula:

$$CSRDI_j = \frac{\sum X_{ij}}{n_j}$$

Where, $CSRDI_j$ is the Corporate Social Responsibility Disclosure Index of company j. $\sum X_{ij}$ is the total number of CSR disclosure categories by the company (1 if category i is disclosed, 0 if category i is not disclosed). n_j is the number of items that report by company j, $n_j = 91$ (maximum score). Therefore, $0 < CSRI_j < 1$.

➢ *Data Analysis Method*

In this study, the data collected will be analyzed by using descriptive statistical analysis, Pearson correlation test and panel data regression analysis. The data analysis tool used in this study was Eviews 10.

IV. RESULT AND DISCUSSION

Variables	N	Min	Max	Mean	Std. Dev
EI (Abs.resid)	468	-2.41	0.00	-.0941	.18407
FRQ (Abs.resid)	468	-3.79	0.00	-.1699	.26390
CSR (Index)	468	.03	1.00	.3601	.21096

Table 1:- Descriptive Statistics
Source: result of data processing by Eviews 10

From Table 1 we can see that the results of descriptive statistics tests on sample company data for 2015-2017 with an N value (number of samples) of 468. From results of the analysis above, we can concluded that the descriptive statistics of each variable are as follows:

- The investment efficiency variable (EI) has value of minimum data is -2.41. The maximum data's value of the investment efficiency variable is 0.00. Mean value of investment efficiency from the entire sample company is -0.0941. While the standard deviation of investment efficiency is 0.18407, which means that the size of the distribution of data from the investment efficiency variable is 0.18407 from a total of 468 samples.
- Financial reporting quality (FRQ) variable has minimum value of -3.79. The maximum value of the variable financial reporting quality is 0.00. The average value of financial reporting quality of all sample companies is -0.1699. While the standard deviation of financial reporting quality is 0.26390, which means that the size of the spread of data from financial reporting quality variables is 0.26390 from a total of 468 samples.
- CSR disclosure variable (CSR) has minimum value of 0.03. The maximum value of CSR disclosure variables is 1.00. The average CSR disclosure value of the entire sample company is 0.3601. While the value of standard deviation from CSR disclosures is 0.21096 which means that the size of data dissemination of CSR disclosure variables is 0.21096 from a total of 468 samples.

Correlation Probability	EI	FRQ	CSR
EI	1.000000		
	–		
FRQ	0.225741	1.000000	
	(0.0000)	–	
CSR	-0.05671	-0.01353	1.000000
	(0.2207)	(0.7703)	–

Table 2:- Pearson Correlation
Source: result of data processing by Eviews 10

Table 2 shows the value of the correlation probability from financial reporting quality variable is 0.225741, with the significance value 0.0000. This means that there is a positive connection between financial reporting quality and investment efficiency (interrelated). The positive direction in this connection indicates that if the level of the financial statements from the company is good, the efficiency of the company's investment will also be high. But on the contrary, if the the company's financial statements is bad, then the investment efficiency of the company will also become low.

The correlation probability value of CSR disclosure variables is -0.05671, significance value 0.2207. This means that, there is no relationship between CSR disclosure and investment efficiency (not related to each other). The negative direction of the relationship shows that if the company's CSR disclosure is good, company's investment efficiency will be deteriorate. But on the other hand, if CSR disclosure is bad, the investment efficiency will actually improve.

Pearson correlation's test table also shows that there is no correlation between financial reporting quality and efficiency of investment. As indicated by the correlation probability value -0.01353 and the significance 0.7703.

➢ *Hypothesis Analysis*

Based on the formulation of the problems and hypotheses raised in the previous chapter, panel data regression analysis uses in this study. Panel data regression analysis is used because this study used panel data consisting of several companies in several years. The stages of hypothesis testing analysis in this study can be seen from the following description:

R-Squared	0.053838
Adjusted R- squared	0.049769
S.E. of Regression	0.179429
S.D. dependent var	0.184068

Tabel 3:- Regression Coefficient Test (R^2)
Source: result of data processing by Eviews 10

According to Table 3, we can see that the adjust R^2 value is about 0.049769. This shows that 4.97% of variation in investment efficiency variables can be describe by variations of all the independent variables of financial reporting quality and CSR disclosure. While the the other, 95.03% are explained by other factors outside the two variables.

Default error value in S.E. of Regression is 0.179429, smaller than the standard deviation value indicated by S.D. dependent var that is equal to 0.184068. This means that the regression model is valid as a predictor model.

F- statistic	13.22971
Prob (F-statistic)	0.000003

Tabel 4:- Simultant Hypothesis Test (F Test)
Source: result of data processing by Eviews 10

The results of this panel data regression test in table 4 shows that, an F-statistic value of 13,22971 was obtained with a probability of 0.000003 (<0.05). Because the probability is much smaller than 0.05, so we can concluded that accepting H_1, namely that the independent variables jointly influence the dependent variable.

Variable	Hipothesis Sign	Coefficient	t-*Statistic*	Prob.
FRQ	+	0.156945	4.9877860	0.0000
CSR	+	-0.046826	-1.189644	0.2348
Constant (α)		-0.050528	-2.935783	0.0035

Tabel 5:- Partial Hypothesis Test (t Test)
Source: result of data processing by Eviews 10

T-test results from Table 5 shows that, the t-statistic of financial reporting quality (FRQ) variable is 4.9877860, with a prob. value of 0.0000 (<0.05). It means that there is a positive efeect of financial reporting quality (FRQ) on efficiency of investment (EI).

While the t-statistic value of CSR disclosure is -1.189644, with a Prob. value of 0.2348 (> 0.05). This means that CSR disclosure can not affect the investment efficiency (EI).

➢ *Discussion of Hypothesis Testing Results*

a. The Effect of Financial Reporting Quality on Investment Efficiency

Based on the results of tests conducted on the first hypothesis (H_1), a beta coefficient (β) is 0.156945 with a t-statistic value is 4.9877860 means positive with a significance value (probability) of 0.0000 which is smaller than α = 5% (0.0000 < 0.05). Because the significance level is smaller than α = 5%, the first hypothesis (H1) is accepted. So it can be stated that financial reporting quality affect on efficiency of investment positively.

These results indicate that the better the quality of financial statements from a company, the more efficient the investment which is conducted by the company. The result of this study is consistent with the formulation of the first hypothesis (H_1) and also research conducted by Umiyati (2017) which concludes that the financial reporting quality can make the occurrence of over investment became low and under investment. Overinvestment and underinvestment is a condition experienced by companies with inefficient investment. Therefore, the better the quality of the company's financial statements, will further reduce the inefficiency of the investments made by the company.

b. Effect of Corporate Social Responsibility Disclosure on Investment Efficiency

Based on the results of tests conducted on the second hypothesis (H_2), the beta coefficient value (β) was -0.046826 with a t-statistic value of -1.189644 and it was negative with a significance value (probability) of 0.2346 higher than $\alpha = 5\%$ (0.2346> 0.05). Because the significance level is greater than α = 5%, the second hypothesis (H2) is rejected. So it can be stated that CSR disclosure not affect the efficiency of investment.

This result shows that CSR disclosure is only used as an additional report to complete the financial statements, as the company's main report. The presence or absence of CSR disclosure in a company cannot have an impact on the efficiency of investments made by the company. The results of this study ais not in accordance with the formulation of the second hypothesis (H_2) and also the results of several previous studies, such as Samet and Jarboui (2017) and Benlemlih and Girerd-Potin (2017) which conclude that CSR disclosure can affect investment efficiency positively.

V. CONCLUSION, LIMITATION, AND FUTURE RESEARCH

➢ *Conclusion*

From the results of data analysis and hypothesis testing that have been done, several conclusions are obtained, namely:

- Financial reporting quality can positively affect the investment efficiency.
- CSR disclosure can not affect the investment efficiency.

➢ *Research Limitation*

The research conducted still has several limitations, namely:

- This study used limited research sample, only three years 2015-2017, so the results of this study can only be used in a limited observation period of three years.
- The test of coefficient determination indicate that the independent variable and the moderating variable are only able to explain the investment efficiency of the sample company of 4.97% which means that there are still many other factors outside the model that can influence the variable.

➢ *Future Research*

- For research related to investment efficiency, it can then add other factors as variables that affect investment efficiency, such as debt maturity.
- Future research can also add research objects, not only companies in Indonesia. And can extend the research period of more than three years.

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