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RISK DISCLOSURE AND EARNINGS QUALITY IN INDONESIA BANKING INDUSTRIES: FAIR VALUE, DIVERSIFICATION, FINANCIAL STABILITY

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Earnings quality, fair value, diversification, financial stability, risk disclosure.

ABSTRACT

High earnings quality can reflect a company's actual performance. Stakeholder needs high earnings quality as earnings information is used for decision-making by stakeholder. This study investigates the effect of fair value, diversification, and financial stability on earnings quality and the roles of risk disclosure in moderating these effects. This study employs secondary data sourced from annual reports available at www.idx.com. The sample used in this study is bank companies from 2016 to 2020. Using purposive sampling, the sample obtained in this study was 180 observations. The research data were analyzed using multiple linear regression for panel data. This study suggested that fair value does not affect earnings quality. Other than that, diversification positively affects earnings quality while financial stability negatively affects earnings quality. Furthermore, risk disclosure failed to moderate the effect of fair value, diversification, and financial stability on earnings quality. This study indicates that the Indonesian Financial Services Authority needs to regulate the bank's diversification and risk disclosure policies. Moreover, the Indonesian Financial Services Authority should maintain and improve the bank's financial stability policies.

INTRODUCTION

Earnings produced by companies from their business activities are a measure of a firm's performance (Astuti et al., 2017). High earnings quality is earnings derived from financial statements that reflect a firm's actual performance (Irawati, 2012). Dechow et al. (2010) define earnings quality as higher quality earnings that provide more information about a firm's financial performance relevant to a specific decision made by a decision-maker. Low earnings quality is undesirable by the investor because the earnings provide imperfect resource information. Low earnings quality are objectionable as they divert resources from substantive project with actually expected payoffs to chimerical projects with imaginary expected payoffs (Schipper & Vincent, 2003).

Earnings quality provided by a firm can affect expectation and confidence from its investor. As experienced by Wirecard, a leading financial technology firm from Germany, it reveals that 1.9 billion euros had disappeared from its balance sheet (CNBC, 2020). This amount of cash was obtained through inflating revenue with the round-tripping scheme (Financial Times, 2019). Wirecard's share plummeted by 44% as they revealed the cash had disappeared on 16 June 2020 (CNBC Indonesia, 2020). It proves that earnings quality affects investor decision-making.

A similar thing was conducted by Luckin Coffee, a coffee supply firm that has launched its initial public offering on NASDAQ in 2019. Luckin Coffee manage its earnings to inflate revenue for 2.12 billion yuan (Kumparan, 2020). Ernst & Young found that several managers made fictitious transactions (Bloomberg, 2020). This incident caused Luckin Coffee to delist from NASDAQ, and they could not continue their business. It proves that low earnings quality may become a failure factor for business continuity.

Poor earnings quality also occurred in Indonesia, and this incident was experienced by PT Garuda Indonesia, which inflated its revenue for 2.98 trillion rupiahs from its actual revenue. PT Garuda Indonesia established a cooperative transaction with PT Mahata Aero Teknologi to provide connectivity service. PT Garuda Indonesia recognized these transactions as revenue even though there was no payment in 2018 (CNN

Indonesia, 2019). Garuda's share showed a decrease of 7.5% compared to its opening price. It indicates that investor behavior is affected by a firm's earnings quality.

Loss in investor confidence due to poor earnings quality can affect business continuity. As experienced by PT Hanson International, a real estate firm, it was proven to manage its earnings by inflating its revenue for 613 billion rupiahs in 2016. PT Hanson International recognized its revenue from the sale of plots ready to build and did not disclose the agreement on this transaction in its financial statement (CNN Indonesia, 2020). PT Hanson International's share price fell by 50 rupiahs. Central Jakarta district court declared bankruptcy of PT Hanson International on 12 August 2020.

Low earnings quality can result in a loss of investor confidence. The investor can find out firm information limited on financial statements provided by firm management. In contrast, firm managers who carry out day-to-day activities have better information than investors. This event causes information asymmetry between manager and investor to happen. Accounting policy and strategies adopted by a firm have an important role in the quality of its earnings. Company managers have discretion on establishing accounting policy and company strategies to take opportunistic action by not presenting earnings that reflect the actual situation. Furthermore, loss of investor confidence can also result in difficulty getting funds from an investor. Hence, firm policies and strategies through the quality of earnings provided play an important role in investor confidence and business continuity, so investigating the effect of firm policies and strategies on earnings quality is needed.

Previous studies have carried out a study on earnings quality both in the international scope and within the scope of Indonesia. At global coverage, determinant factors on earnings quality such as fair value (Takacs et al., 2020; Pompili & Tutino, 2019; Rhee et al., 2018; Tutino & Pompili, 2018; Mauro et al., 2017; Šodan, 2015), corporate social responsibility (Rezaee et al., 2020; Mohamed et al., 2019; Bozzolan et al., 2015; Kim et al., 2012; Salewski & Zülch, 2012), voluntary disclosure (Salem et al., 2020; Karajeh, 2019; Consoni et al., 2017; Kangarlouei et al., 2013; Francis et al., 2008), diversification (Masud et al., 2017; El Mehdi & Seboui, 2011; Rodríguez-Pérez & van Hemmen, 2010), size

(Phuong et al., 2020), financial stability (Riahi, 2020), audit quality (Alzoubi, 2018), profitability (Phuong et al., 2020), dividend (Mulchandani et al., 2020), dan capital structure (Phuong et al., 2020). Studies in Indonesia had investigated several determinant factors such as corporate governance (Sudirgo et al., 2021; Yasa et al., 2020; Saksessia & Firmansyah, 2020; Wijaya et al., 2020; Yasa et al., 2019; Nariman & Ekadjaja, 2018), size (Anam & Afrohah, 2020; Purnamasari & Fachrurrozie, 2020; Anggrainy & Priyadi, 2019; Purnama & Nurdiniah, 2019; Nariman & Ekadjaja, 2018; Salsabila, 2016), leverage (Sudirgo et al., 2021; Yasa et al., 2020; Purnamasari & Fachrurrozie, 2020; Nariman & Ekadjaja, 2018; Pitria, 2017; Salsabila, 2016), diversification (Wijayanti & Mukti, 2018; Dimarcia & Krisnadewi, 2016; Aryati & Walansendouw, 2013), financial stability (Ijudien, 2018; Pratiya & Susetyo, 2018; Abbas, 2017), capital structure (Saksessia & Firmansyah, 2020; Anggrainy & Priyadi, 2019; Leonardi & Handojo, 2019), profitability (Sudirgo et al., 2021; Purnamasari & Fachrurrozie, 2020; Purnama & Nurdiniah, 2019; Pitria, 2017; Salsabila, 2016), fair value (Annisa & Taqwa, 2020; Palasari, 2018), (Anam & Afrohah, 2020; Anggrainy & Priyadi, 2019), investment opportunity set (Yasa et al., 2019; Nariman & Ekadjaja, 2018), voluntary disclosure (Young, 2012), growth opportunity (Pitria, 2017), liquidity (Anam & Afrohah, 2020), audit quality (Anggrainy & Priyadi, 2019), earnings persistence (Wijaya et al., 2020), bonus (Saksessia & Firmansyah, 2020), dividend (Untung & Hanna, 2019), dan tax avoidance (Saksessia & Firmansyah, 2020).

Firm managers have the discretion to establish accounting policies and company strategies in presenting earnings information by preparing financial statements to the investor. This discretion can be exercised by establishing a fair value accounting policy and firm diversification strategy. Fair value accounting is a market-based measurement of assets and liabilities (Palasari, 2018). Fair value evaluations can use a manager's valuation techniques if there is no active market for the assets and liabilities (Mauro et al., 2017). Managers could undertake opportunistically by choosing the method of valuing their assets using fair values that cannot be observed. Meanwhile, the good strategy of financial stability and firm diversification could decrease pressure on managers

to produce good quality earnings following investor interest.

The firm can choose to establish one of several accounting policies within applicable accounting standards for preparing financial statements. Indonesian Accountants Association (IAI) stated financial accounting standard 68 regarding fair value valuation in 2013, which stated that a firm could present its asset and liabilities at fair value. Fair value can present corporate earnings that reflect the actual market conditions. However, fair value also can misrepresent earnings because it can rely upon incorrect assumptions and managers' deceit to take advantage of the valuation (Mauro et al., 2017). Takacs et al. (2020) and Mauro et al. (2017) found that fair value increases earnings quality. However, Pompili & Tutino (2019), Rhee et al. (2018), Tutino & Pompili (2018), Šodan (2015), dan Palasari (2018) found that fair value reduces earnings quality. Besides that, Annisa & Taqwa (2020) found that fair value does not affect earnings quality. The difference in previous studies indicates that the effect of fair value on earnings quality needs to be investigated further.

The firm needs to implement the appropriate strategy to achieve its goal. One strategy which enables a firm to reduce its risk is diversification. Diversification is an expansion strategy to expand a firm's operating activities to reduce its risk profile and increase its value. It has an information advantage to avoid external financing costs (Mehmood et al., 2019). One consequence of implementing diversification is that the firm's operations are increasingly complex, increasing information asymmetry (El Mehdi & Seboui, 2011). Masud et al. (2017), El Mehdi & Seboui (2011), dan Wijayanti & Mukti (2018) found that diversification increases earnings quality. However, Rodríguez-Pérez & van Hemmen (2010) found that diversification reduces earnings quality. Meanwhile, Dimarcia & Krisnadewi (2016) dan Aryati & Walansendouw (2013) found that diversification does not affect earnings quality. The difference in previous studies indicates that the effect of diversification on earnings quality needs to be investigated further.

Investors tend to avoid investing in companies with a high-risk profile (Ackert & Deaves, 2010). A firm needs to get a stable financial condition to reduce its risk profile. Financial stability is low volatility, and there is no turbulence (Mamatzakis

& Tsionas, 2020). Firm managers will implement appropriate policies and strategies to get a stable financial condition because a stable rate of return could guarantee a firm's financial stability in the long term and increase investor expectations (Ali et al., 2019). A firm with a stable financial condition tends to avoid pressures to control themselves not to commit fraudulent practices that result in poor quality financial statements (Abbas, 2017). The stability of financial condition pursued by a firm could lead managers to commit fraudulent practices in preparing financial statements, especially when facing unstable or threatened financial conditions (Aprillia et al., 2015). Riahi (2020) dan Abbas (2017) found that financial stability increases earnings quality, while Skousen et al. (2011) found that financial stability reduces earnings quality. Besides that, Ijudien (2018) dan Pratiya & Susetyo (2018) found that financial stability does not affect earnings quality. The difference in previous studies indicates that the effect of financial stability on earnings quality needs to be investigated further.

This study aims to investigate the effect of fair value, diversification, and financial stability on earnings quality with risk disclosure as a moderating variable. The difference between this study and previous studies is the use of risk disclosure as a moderating variable which is expected to have a role in the relationship between fair value, diversification, and financial stability on earnings quality. Another difference is that this study investigates the role of risk disclosure on earnings quality which is still rarely investigated. This study also incorporates risk disclosure in the association between fair value, diversification, financial stability and earnings quality. Risk disclosure could reduce asymmetric information between firm managers and investors (Firmansyah & Triastie, 2020). According to agency theory, information asymmetry in a firm arises when managers have more specific and accurate information about the firm's operating activities. One method to minimize asymmetric information is that firm managers disclose firm information to the investor through a financial statement that they provide. It is a bonding cost in the form of time and effort borne by firm managers to provide financial statements (Godfrey et al., 2010).

Risk is an important factor for the investor in deciding because investor decision-making needs to consider between risk and rate of return

of the investment that will be carried out. However, investors do not know about the specific risks because managers only know specific information about a firm's daily operations. Salem et al. (2020), Karajeh (2019), Consoni et al. (2017), Omar et al. (2014), Kangarlouei et al. (2013), Young (2012), dan Francis et al. (2008) found that voluntary disclosure increases earnings quality. Thus, disclosure such as risk and voluntary disclosure has a close relationship with earnings quality. There is still no study on risk disclosure's effect on earnings quality. To fill this research gap, along with the close relationship among risk disclosure, fair value, diversification, financial stability, and earnings quality, it is necessary to investigate risk disclosure as a moderating variable of the effect of fair value, diversification, and financial stability on earnings quality.

This study employs data on banking companies listed on Indonesia Stock Exchange. The use of Indonesian data is because Indonesia is one of the countries with the highest earnings management, with Taiwan and Malaysia (Cai et al., 2011). Furthermore, Boulton et al. (2011) explained that Indonesia has the highest earnings management and China and Taiwan. Surbakti et al. (2017) also stated that Indonesia is reported to have poor earnings quality with a rank of 35th out of 48 countries in the world based on Milken Institute. The low level of earnings quality in Indonesia causes this study to use Indonesian data to be carried out.

This study also employs bank industry data because the industry is filled with risks involving the management of public money and is managed in the form of various investments such as providing credit, purchasing securities, and investing other funds (Ghozali, 2007). The main basis of the bank industry is trust, either in collecting funds or distributing funds (Wijayani, 2017). Firms in bank industries have an important role as the main source of financing the economy of a country, especially for developing countries such as Indonesia (Ferdyant et al., 2014) so that the failure of the bank industry in carrying out its function can result in an economic crisis in a country. As experienced by Indonesia in 1998, the liquidity difficulties experienced by the bank industry caused worries, anxiety, and panic in public, resulting in massive withdrawals of money by the public (Infobanknews, 2020). This incident resulted in the inflation rate

reaching 77.6% in 1998 (Ekonomi Bisnis, 2019). This event caused the bank to be closely monitored and supported by independent institutions such as Financial Service Authority (OJK) and Deposit Insurance Corporation (LPS). This situation could lead to the emergence of moral hazard behavior by firm managers by utilizing its discretion to provide firm profits according to its interest. These circumstances indicate that the earnings quality of banks in Indonesia needs to be investigated further.

This study contributes in several ways. First, this study contributes to firm managers in establishing policies and strategies to provide good earnings quality. Second, this study can assist the investor in deciding by evaluating earnings generated from firms' policies and strategies. Third, this study can be input for Financial Service Authority in formulating minimum criteria for risk disclosure policies that can affect earnings quality and supervision of banks listed in Indonesia Stock Exchange. Finally, this study also contributes to academics for providing insight and material for further study related to fair value, diversification, financial stability, risk disclosure, and earnings quality.

This study uses control variables in the form of firm size and leverage. Control variables are intended to increase the study's accuracy and ensure that only independent variables affect the dependent variable. Phuong et al. (2020), Anam & Afrohah (2020), Purnamasari & Fachrurrozie (2020), Anggrainy & Priyadi (2019), Purnama & Nurdiniah (2019) dan Nariman & Ekadjaja (2018) found that firm size increases earnings quality. Firms with large sizes tend to have a higher level of profit and sustainability so that firms with large sizes could increase investor confidence. Increasing investor confidence would improve the quality of profits generated (Anam & Afrohah, 2020). Furthermore, Purnamasari & Fachrurrozie (2020) dan Yasa et al. (2020) found that leverage reduces earnings quality. Firms that have high level of leverage will tend to manipulate earnings because a high level of leverage could increase pressures on firm managers (Purnamasari & Fachrurrozie, 2020). Thus, the use of firm size and leverage in this study is expected to explain the research phenomenon more optimally because it takes into account other factors outside the investigated variables.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

To achieve its goal, a firm can face various kinds of problems. One of the problems it can encounter is the agency problem. Jensen and Meckling first introduced the agency problem in 1976. Jensen and Meckling explained that an agency relationship arises when there is a contract where a party (the principal) engages another party (agent) to perform some services on the principal's behalf. Both principal and agent are utility maximizers, and there is no reason to believe that the agent will always act in the principal's best interests. The agent can transfer wealth from principal to agent because the agent has decision-making authority. The more company information managers have than investors, the more opportunities to carry out earnings management (Mahawyaharti & Budiasih, 2017).

Managers could have incentives to manipulate earnings by utilizing their information to increase firm profit because the bonuses they get are measured based on firm profit (Godfrey et al., 2010). One of the discretion that managers can use to increase firm profit is the application of fair value accounting. Fair value measurement gives managers more discretion over the valuation of assets and liabilities; also, fair value is more difficult and expensive to audit (Benston, 2008). Pompili & Tutino (2019), Rhee et al. (2018), Tutino & Pompili (2018), Šodan (2015), dan Palasari (2018) found that earnings can reduce earnings quality.

H1: Fair value has a negative effect on earnings quality.

Managers can diversify the firm to reduce the firm's risk expectation to serve the interest of investors by lowering the expected bankruptcy costs (DeLong, 2003). A firm's diversification can reduce its risk by producing low earnings variability because earnings generated from business units are not perfectly correlated (El Mehdi & Seboui, 2011). Managers can also make risky investments to increase firm performance, while investors wish managers to make low-risk investments. However, a good diversification strategy can eliminate information asymmetry by aligning the managers' risk profile to match investors' risk profile. Therefore,

diversification can reduce asymmetric information and increase earnings quality. Masud et al. (2017), El Mehdi & Seboui (2011), dan Wijayanti & Mukti (2018) found that diversification can increase earnings quality.

H2: Diversification has a positive effect on earnings quality.

Managers can avoid pressure from investors because managers have more firm information than investors. These pressures can motivate managers to commit fraud in producing financial statements, reducing earnings quality (Aprillia et al., 2015). However, investors desire a firm's financial condition to be stable because a stable rate of return can guarantee the firm's financial stability in the long term (Ali et al., 2019). The firm's stable financial condition could meet investors' interests so that pressures on managers can be reduced. Managers will control themselves not to commit fraudulent practices that can reduce earnings quality because the forces given by investors have been reduced (Abbas, 2017). Riahi (2020) dan Abbas (2017) found that financial stability can increase earnings quality.

H3: Financial stability has a positive effect on earnings quality.

One way for investors to obtain information about a firm's risk is from the disclosure made by the firm's managers in its financial statements (Beretta & Bozzolan, 2004). One form of information transparency that can reduce information asymmetry is risk disclosure regarding activities that have been managed by managers or how managers manage risks in the future (Fathimiyah et al., 2012). Risk disclosure is a part of disclosure that shows the firm's ability to manage its risk (Abraham & Shrivs, 2014). Risk disclosure can reveal the risk management managers have implemented in various types, scopes, and locations (Dobler et al., 2011). Risk disclosures are a control tool to prevent fraudulent practices and inform investors about the firm's condition (Fitania & Firmansyah, 2020). Therefore, preventing managers' opportunistic behavior and reducing information asymmetry through risk disclosure can increase earnings quality.

H4: Risk disclosure has a positive effect on earnings quality.

RESEARCH METHODS

This research employs data obtained through the company's financial statements dan stock price from 2016 to 2020. The data is derived from www.idx.co.id, and firm websites. Regarding the purposive sampling, the research sample is shown in table 1.

This study employs quantitative methods. This study also uses secondary data in financial statements and annual reports of banks listed on the Indonesia Stock Exchange (IDX) from 2016 to 2020. Data were obtained from www.idx.co.id and the bank's official website that has gone public. The sample was conducted using purposive sampling that met these criteria (1) firm included in the banking sector during the data collection period; (2) firm listed on Indonesia Stock Exchange before 1 January 2016; (3) firm has complete financial statements, and annual report for 2016 to 2020; (4) firm has complete data related to research variables.

Table 1 Sample

Criteria	Total
Banks listed on Indonesia Stock Exchange as of May 2021	45
Banks listed on Indonesia Stock Exchange after 2016	-5
Banks listed on Indonesia Stock Exchange in 2016-2020	40
Banks that don't have complete financial statements and annual reports in 2016-2020	-1
Banks that have complete financial statements and annual reports in 2016-2020	39
Banks that don't have complete research data in 2016-2020	-3
Number of banks used in this study	36
Period (year)	5
Total sample (<i>Firm year</i>)	180

Source: data processed

The dependent variable in this study is earnings quality. This study uses discretionary accrual proxy in measuring earnings quality as used by Riahi (2020), Leventis & Dimitropoulos (2012), dan Yasuda et al. (2004).

$$\frac{TACCR_t}{TA_{t-1}} = \beta_1 \left(\frac{1}{TA_{t-1}} \right) + \beta_2 \left(\frac{\Delta OI_t}{TA_{t-1}} \right) + \beta_3 \left(\frac{PPE_t}{TA_{t-1}} \right) + \varepsilon_t$$

$$NDAC_t = \hat{\beta}_1 \left(\frac{1}{TA_{t-1}} \right) + \hat{\beta}_2 \left(\frac{\Delta OI_t}{TA_{t-1}} \right) + \hat{\beta}_3 \left(\frac{PPE_t}{TA_{t-1}} \right)$$

$$ADAC_t = \left| \frac{TACCR_t}{TA_{t-1}} - NDAC_t \right|$$

Where $TACCR_t$ is total accrual which is the difference between net income and operating cash flows; TA_{t-1} is total assets at the beginning of the year; ΔOI_t represents the change in operating income from the previous year; PPE_t is total fix assets; $NDAC_t$ is non-discretionary accrual, and $ADAC_t$ represents the absolute value of discretionary accrual.

Independent variables in this study are fair value, diversification, and financial stability. The fair value proxy used in this study follows Annisa & Taqwa (2020), which is calculated as follows:

$$Total\ Fair\ Value = Fair\ Value\ 1 + Fair\ Value\ 2 + Fair\ Value\ 3$$

Diversification proxy in this study refers to the research of Laeven & Levine (2007) dan Elsas et al. (2010), modified by Khan et al. (2020). The measurement of diversification is as follows:

$$Diversification = 1 - 2 * \left| \frac{Net\ Interest\ Revenue}{Total\ operating\ income} \right| -$$

Financial stability proxy in this study refers to the research of Riahi (2020), Ahamed & Mallick (2017), dan Čihák (2007), which is calculated as follows:

$$Financial\ Stability = \ln \frac{ROA_{it} + EQA_{it}}{\sigma(ROA)_i}$$

Where ROA_{it} is the ratio of net income to total assets of firm i year t; EQA_{it} is the ratio of equity to total assets of firm i year t; $\sigma(ROA)_i$ is the standard deviation of ROA for the last three years.

This study uses risk disclosure as a moderating variable. Measurement of risk disclosure refers to the research of Utami (2015), Agista et al. (2017), dan Triyanti (2019) financial reporting risk, complexity, firm industry, size and risk management committee on enterprise risk management disclosure based

on ISO 31000:2009. This study uses purposive sampling as a sampling technique so it obtained 353 companies by 3 study years so the total datas are 1.059 non financial listed companies on Indonesia Stock Exchange according to the criterias. By using Partial Least Square (PLS using content analysis of ISO 31000:2009 index, which is measured as follows:

$$RD = \frac{Total\ ISO\ 31000:2009\ criteria\ disclosed}{Total\ ISO\ 31000:2009\ disclosure\ criteria}$$

In addition, this study also uses two control variables, namely firm size and leverage, which are expected to control the research model. Firm size proxy in this study refers to Purnamasari & Fachrurrozie (2020), Anam & Afrohah (2020), dan Anggrainy & Priyadi (2019), which is measured as follows:

$$Total\ Aset = \ln Total\ Aset$$

Leverage proxy in this study refers to Purnamasari & Fachrurrozie (2020), Pitria (2017), dan Salsabila (2016), which is measured as follows:

$$Leverage = \frac{Total\ Liabilities}{Total\ Assets}$$

Hypothesis testing uses multiple regression with panel data. The research model is as follows:

$$ADAC_{it} = \alpha_0 + \beta_1 TFV_{it} + \beta_2 DIV_{it} + \beta_3 SK_{it} + \beta_4 TA_{it} + \beta_5 LEV_{it} + \varepsilon_{it} \quad (Model\ 1)$$

$$ADAC_{it} = \alpha_0 + \beta_1 TFV_{it} + \beta_2 DIV_{it} + \beta_3 SK_{it} + \beta_4 RD_{it} + \beta_5 TFV_{it} * RD_{it} + \beta_6 DIV_{it} * RD_{it} + \beta_7 SK_{it} * RD_{it} + \beta_8 TA_{it} + \beta_9 LEV_{it} + \varepsilon_{it} \quad (Model\ 2)$$

Where $ADAC_{it}$ represents earnings quality of firm I year t; TFV_{it} is the total fair value of firm's assets and liabilities; DIV_{it} is diversification of firm i year t; SK_{it} represents financial stability of firm i year t; RD_{it} is risk disclosure index of the firm i year t; TA_{it} is total assets of firm i year t, and LEV_{it} represents leverage of firm i year t.

RESULTS AND DISCUSSION

Table 2 shows descriptive statistics for each variable employed in this study. The descriptive statistics presented in this study include the median, mean, standard deviation, maximum value, and minimum value of the research data. The mean describes the average of each of the observed variables. The median aims to see the middle value between the mean and the extreme points. The maximum and minimum values describe the highest and lowest extreme values. Meanwhile, the standard deviation shows the difference between individual data points to the average. The summary of descriptive statistics for all variables processed in this study is shown in Table 2.

Furthermore, the best regression model in this study is the fixed effect model (FEM), either for model 1 or model 2. The results are shown in Table 3, which shows that hypothesis testing in model 1 was conducted to examine the effect of fair value, diversification, and financial stability on earnings quality. Meanwhile, the best regression model for hypothesis testing in model 2 is the fixed effect

Table 2 Descriptive statistics

Variabel	Obs	Median	Mean	Std. Dev	Min	Max
ADAC	180	0.0449	0.0592	0.0581	0.0004	0.4179
TFV	180	0.7472	0.6543	0.4929	0	1.8557
DIV	180	0.4025	0.4091	0.2302	0.0338	0.9841
FS	180	4.0775	3.9468	1.4954	0.3498	7.2987
RD	180	0.8400	0.8296	0.1167	0.3600	1.0000
TA	180	31.0533	31.4480	1.7331	28.3530	34.9521
LEV	180	0.8417	0.8197	0.1018	0.2755	0.9365

Source: data processed

model (FEM), which was conducted as an additional test to examine the effect of risk disclosure in the relationship of fair value, diversification, and financial stability on earnings quality.

The result in model 1 shows that the probability value of the fair value is greater than 10%, representing that fair value has no effect on

earnings quality. This result is in line with the result of the research of Annisa & Taqwa (2020). However, this result is not in line with the result of Pompili & Tutino (2019), Rhee et al. (2018), Tutino & Pompili (2018), Šodan (2015), Palasari (2018), Takacs et al. (2020), and Mauro et al. (2017). This difference is presumed to occur because this study uses a total fair value proxy as used in the research of Annisa & Taqwa (2020), while other research uses various proxies to measure fair value.

According to agency theory, managers can have incentives to manage earnings by exploiting their information asymmetry (Godfrey et al., 2010). However, this study found that fair value as a whole is not the main alternative for managers to manage earnings (Choi et al., 2015). The purpose of applying IFRS on fair value is to improve earnings quality by reflecting the actual market value of assets and liabilities (Takacs et al., 2020). However, there is no significant effect from the implementation of IFRS on accrual earnings management on the bank (Zubairu & Ame, 2018). A parameter in assessing the quality of financial statements is the comparability of financial statements (Schipper & Vincent, 2003). There is no significant change in the level of comparability of financial statements both before and after the implementation of IFRS related to fair value (Khomsatun, 2016). Fair value does not affect earnings quality since fair value IFRS fails to improve earnings quality.

The bank's main activities are to manage public funds in various forms of investment, such as providing credit, purchasing securities, and investing other funds (Ghozali, 2007) in the form of financial instruments. Financial instruments are then measured using fair value not to be separated from the bank, closely related to financial instruments. Hence, implementing fair value, which has become a regular activity of banks, does not cause the fair value to be the main alternative for managers in managing earnings since it is only a formality that the bank

Table 3 Panel Data Regression Results

Variable	Sign	Model 1			Model 2		
		Koefisien	t-Statistic	Prob.	Koefisien	t-Statistic	Prob.
C		-1.6385	-3.2191	0.0016 ***	-0.7464	-1.2749	0.2045
TFV	+	0.0169	0.9024	0.3684	0.0518	0.5775	0.5646
DIV	-	0.0803	3.6141	0.0004 ***	0.0785	0.5750	0.5662
FS	-	-0.0057	-2.4523	0.0154 **	-0.0275	-1.6939	0.0926 *

Variable	Sign	Model 1			Model 2		
		Koefisien	t-Statistic	Prob.	Koefisien	t-Statistic	Prob.
TA		0.0514	3.2001	0.0017 ***	0.0208	1.1077	0.2699
LEV		0.0733	0.5754	0.5659	0.0874	0.6814	0.4968
RD					0.0682	0.3903	0.6969
TFV*RD	+				-0.0387	-0.3133	0.7545
DIV*RD	-				0.0084	0.0522	0.9584
FS*RD	-				0.0257	1.4341	0.1538
R ²			0.4681			0.4881	
Adj. R ²			0.3151			0.3212	
F-Stat.			3.0584			2.9250	
Prob. (F-Stat.)			0.0000			0.0000	

* significant at the level of (0.10). ** significant at the level of (0.05). *** significant at the level of (0.01).

Source: data processed

routinely carries out. Furthermore, value in the market does not reflect fair value since there are markets considered inactive (Immanuela, 2012). In addition, fair value requires further information to confirm the accuracy of financial statements. This is due to fair value, which is not independent since it is influenced by various factors, such as market condition, certain entity factors, analyst interaction with data, third party verification, and availability of other information (Kluever, 2012).

The results of model 1 show that diversification probability is smaller than 1% with a positive coefficient value which illustrates that diversification reduces earnings quality. The result of this study is in line with the result of research by Rodríguez-Pérez & van Hemmen (2010). However, this result is not in line with the results of research by Masud et al. (2017), El Mehdi & Seboui (2011), Wijayanti & Mukti (2018), Dimarcia & Krisnadewi (2016), and Aryati & Walansendouw (2013). The difference in results is presumed because the research of Masud et al. (2017), El Mehdi & Seboui (2011), Wijayanti & Mukti (2018), Dimarcia & Krisnadewi (2016), and Aryati & Walansendouw (2013) measure diversification through various proxies but none of them use revenue-based diversification. Other than that, these five research use various types of firm data, but none specifically use bank data.

Implementing a diversification strategy is to increase market share and bank profits. However, at the same time, bank diversification strategy increases the risk profile of banks since non-interest income from the bank will bring new risks such as operating, market, liquidity, and legal risks (Zhou, 2014). An increase in bank risk profile could

increase pressure on managers because a low-risk profile that is one of the investors' interests is not achieved. This finding re-ignited agency theory regarding the emergence of agency problems caused by the difference in interest between investors and managers (Jensen & Meckling, 1976). In addition, diversified firms have greater information asymmetry, less transparent operations, and more complex organizational structures than focussed firms (El Mehdi & Seboui, 2011). Therefore, diversification strategy could increase pressures on managers so that managers avoid these pressures by exploiting the information asymmetry they know to manage earnings.

Inefficient allocation of sources in bank diversification strategy could detract banks' performance. Managers or directors who are less focused and lack experience in carrying out activities other than main banking activities could cause an inefficient allocation of resources on their diversification strategies (Filson & Olfati, 2014). A decline in bank performance resulting from implementing a diversification strategy could increase pressures on managers so that bank managers could take advantage of information asymmetry they know to manage earnings (Abbas, 2017). Hence, bank diversification reduces earnings quality since it could detract bank performance, increasing pressure on managers to take advantage of the information asymmetry they know to avoid investor pressures by managing earnings.

The bank manager's behavior is a reason for the decline in bank earnings quality. Bank managers in Indonesia could be encouraged to implement a risky diversification strategy because

banks receive assistance from Deposit Insurance Corporation (LPS), reducing bank risk profiles. Bank managers could have moral hazard behavior because of deposit guarantees for customers or the public on their funds at the bank (Dam & Koetter, 2012). Safety guarantees for public cause there is no supervision on decision making regarding bank credit risk by the public. It could lead to moral hazard behavior by managers to take high credit risk (Demsetz et al., 1997).

The result of model 1 also suggests that financial stability probability is less than 5% with a negative coefficient value which illustrates that financial stability increases earnings quality. This result is in line with Riahi's (2020) and Abbas's (2017). However, this result is not in line with the research of Ijudien (2018), Pratiya & Susetyo (2018), and Skousen et al. (2011). The difference in result is presumed because the research of Ijudien (2018), Pratiya & Susetyo (2018), and Skousen et al. (2011) use various types of firms data. Still, none of them use bank data specifically. Furthermore, this research measures financial stability using asset growth and not using z-score.

A bank needs to achieve a stable financial condition to gain the trust of investors and the public (Brychko et al., 2019). Trust's main basis in bank business activities is either raising or distributing funds (Wijayani, 2017). Moreover, banks have an important role as the main resource for financing a country's economy, especially for developing countries such as Indonesia (Ferdyant et al., 2014). The failure of banks in carrying out their functions can result in an economic crisis in a country. Investors and the public have concerns regarding the risk of bankruptcy of a bank since banks are very laden with risks (Ghozali, 2007). It causes investors and the public to desire a stable financial condition for banks to reduce the risk of bankruptcy.

This finding points out that the agency problem caused by the difference of interests between managers and investors could be decreased (Jensen & Meckling, 1976). Stable financial conditions can reduce pressures on managers so that earnings quality can increase (Abbas, 2017). A stable financial condition can reduce information asymmetry by fulfilling the interest of investors who desire safety in their investments (Ijudien, 2018). This reduction in information asymmetry between managers and

investors could reduce managers' pressures so that managers' motivation to manage earnings could be reduced. Furthermore, the pressure reduction on managers can control themselves not to drive earnings for their interest (Abbas, 2017). Therefore, financial stability can control the behavior of managers and provide good earnings quality.

Stable financial conditions can carry out their main function even though it is affected by external crisis/shock conditions (Schinasi, 2004). The good reputation of bank managers can also influence financial stability since the good reputation of managers could overcome the crisis (Helm et al., 2011). Managers also do not have the motivation to manage earnings because opportunistic behavior like earnings management could injure the reputation of banks and themselves (Adeyemo, 2012). Managers tend to choose the reputation they have built over the benefits of earnings management because it takes years for bank managers to make a good reputation, but only take a few seconds to injure it (Macey, 2013). Hence, bank managers tend to maintain the reputation that they have built by providing good earnings quality.

The results of model 2 show that the probability value of the interaction risk disclosure with fair value, diversification, and financial stability is more than 10% which describes that risk disclosure does not succeed in moderating either weakening or strengthening the effect of fair value, diversification, and financial stability on earnings quality. One way to reduce information asymmetry between managers and investors, an agency cost, is through bonding cost carried out by bank managers in the form of financial statements (Godfrey et al., 2010). However, risk disclosure carried out by the manager is not a manager's initiative to reduce asymmetric information but to comply with the Financial Service Authority Regulation number 18 of 2016, which only requires banks to disclose risk in terms of performance and the direction of risk management policies. Furthermore, risk disclosure which is a disclosure that banks routinely disclose, is not the main alternative for managers to reduce information asymmetry since it is only a formality that banks routinely carry out.

Banks are very laden with risks (Ghozali, 2007), so banks need good risk management. Risk management implementation in banking and financial companies has developed throughout

the world, both in developed countries and in developing countries such as Germany financial companies which have implemented and developed risk management since 2000 (Altuntas et al., 2011); Taiwanese financial companies that have made continuous improvement in risk management since 2001 (Chen et al., 2020); American banks that have constantly developed risk management since 1994 (Ellul & Yerramilli, 2013); Nigerians bank that has implemented risk management before the regulation of the implementation of Nigerian banking risks (Dabari & Saidin, 2015); and Indonesian banks that have implemented risk management since the enactment of the regulation on risk management committees in 2006 (Glynis et al., 2016). In addition, banks routinely disclose risk disclosure, which can be observed using a relatively large average value of risk disclosure. Therefore, risk disclosure, a routine disclosure, is not the main alternative for managers to reduce information asymmetry since it is only a formality routinely carried out by banks.

This study's use of risk disclosure is based on ISO 31000:2009 framework. At the same time, Indonesian banks disclose the implementation of their risk management based on Financial Service Authority number 18 of 2016, which has not regulated risk disclosure specifically so that risk disclosures made by banks in their annual report are disclosures based on self-assessment or independent claims. In addition, the risk disclosure proxy used in this study is not the quality of risk disclosure made by a bank but the quantity level of risk disclosure in its annual report. Therefore, the quantity level of risk disclosure has no interaction with fair value, diversification, and financial stability. It cannot weaken or strengthen the effect of these three variables on earnings quality.

CONCLUSION

Fair value is not a factor that affects earnings quality, although the use of fair value is closely related to the main activities of banks. Furthermore,

bank diversification strategy reduces earnings quality because it can increase the risk profile of banks. Moreover, financial stability is needed to improve earnings quality. The good reputation of bank managers can keep the bank's financial condition stable. Meanwhile, risk disclosure made by banks is only a formality to fulfill administrative compliance so that banks are not subject to sanctions by Financial Service Authority.

This study has several limitations. First, companies data used in this study is data of banking companies listed on the Indonesia Stock Exchange. This study cannot capture the behavior of all companies listed on the Indonesia Stock Exchange. Second, moderating variable used in this study does not observe the quality of a bank's risk disclosure. This study uses the quantity level of risk disclosure by identifying the number of risk disclosure criteria disclosed in the annual report. Moreover, there is an element of subjectivity in calculating risk disclosure variables based on ISO 31000:2009 criteria.

Investors need to be careful when analyzing bank diversification since diversification can bring new operating, market, liquidity, and legal risks. Investors also need to consider the reputation of bank managers since the good reputation of bank managers tends to overcome shocks when a crisis occurs so that the manager can keep the bank's financial condition stable. Furthermore, the results of this study can be used by Financial Service Authority to increase the stability of banks by formulating regulations regarding the level of earnings volatility on banks. In addition, Financial Service Authority Regulation number 18 of 2016 concerning the implementation of risk management for commercial banks only requires banks to disclose the performance and the direction of risk management policies. Hence, Financial Service Authority is expected to formulate a special regulation regarding the risk disclosure of bank companies that is more specific based on best practices in line with risk management frameworks such as ISO 31000:2009.

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