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[JDAB] Editor Decision

Heru Fahlevi <jurnal@unsyiah.ac.id> Wed, Nov 9, 2022 at 5:09 AM
To: Dr Bernadia Linggar Yekti <Ling@unika.ac.id>
Cc: jdab@unsyiah.ac.id

Dr Bernadia Linggar Yekti:

We have reached a decision regarding your submission to Jurnal Dinamika Akuntansi dan Bisnis, "The Effects of Corporate Governance Mechanism towards Fair Value Measurement in the Indonesian Banking and Financial Industries".

Our decision is: Revisions Required

Please find the comment attached. We expect to receive the revision before 9 December 2022. If you need more time, please let us know

Best regards

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The Effects of Corporate Governance Mechanism towards Fair Value Measurement in the Indonesian Banking and Financial Industries

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Abstract

Fair value is one of an important measurement since the diffusion of International Financial Reporting Standards around the world. Studies of manager opportunistic behaviors thorough fair value numbers in developing countries have been overlooked. This study aims to investigate the influence of corporate governance mechanism towards an opportunistic behavior through fair value measurement i.e. fair value inputs level 3. This study applies multiple regression and use sample of banking and financial companies listed in Indonesia Stock Exchange. The corporate governance is proxied by three measurements i.e. managerial ownership, institutional ownership and audit committee educational background. This study finds that managerial ownership and institutional ownership have positive influences on fair value inputs level 3. Meanwhile, the independent commissioners and audit committee educational background have negative influences on fair value inputs level 3. Therefore, this study provides evidence that independent commissioners and audit committee educational background can reduce management opportunistic behaviors which is conducted through fair value measurement.

Keywords: fair value_corporate_governance, managerial_ownership, institutional_ownership, audit_committee, opportunistic_behaviour

Introduction

The diffusion of International Financial Reporting Standards (IFRS) has led the issues to fair value to be more prominent. Fair value is defined as "the price that a seller would receive in exchange for the sale of an asset or would pay to transfer a liability" (IASB, 2018). Previous studies indicate fair value implementation is challenging both in advanced (Gebhardt, 2012) and emerging markets (He, Wong, & Young, 2012; Nugraheni, Cummings, & Kilgore, 2022). Emerging markets face more challenges given that market transaction does not reflect arm's length transaction among market participants and limited assets have quoted price in the market (Xiao & Hu, 2017). Standard for fair value measurement in Indonesia is Pernyataan Standar Akuntansi Keuangan (PSAK) 68

[Statement of Financial Accounting Standards] which based on IFRS 13 Fair Value Measurement. It has been effectively implemented since 2013 hence Indonesian public companies must comply with that particular standard when applying fair value measurement.

Studies of fair value accounting have been conducted by some scholars (Šodan, 2015; Yao, Percy, Stewart, & Hu, 2016; Zhang & Chong, 2019). Šodan (2015) conducts research about the association of fair value and earnings quality. Meanwhile, Yao et al. (2016) investigate the determinants of fair value measurement and Zhang & Chong (2019) focus on the association between fair value, corporate governance and social responsibility performance. This study aims to investigate the influence of corporate governance mechanism towards fair value measurement in banking and financial industries.

Fair value measurement assumes the exchange of assets or liabilities in an orderly transaction between market participants at the measurement date based on current market conditions (IASB, 2018). IFRS 13 explained that the valuation technique in measuring fair value is useful for maximizing observable inputs and minimizing unobservable inputs. Level 1 inputs are quoted prices that can be found in active markets, level 2 inputs are inputs other than quoted prices that can still be observed either directly or indirectly, while level 3 inputs are unobservable inputs and rely on modelling and management discretion. Since fair value level 3 inputs are based on modelling, companies are required to disclose how they measure fair value. Although disclosure of the fair value method is mandatory, companies still have the option to adopt the level to measure fair value. These conditions raise special concerns regarding the use of level 3 fair value inputs (Zhang & Chong, 2019). Level 3 fair value valuation gives managers the flexibility to manipulate earnings because their value is estimated internally and therefore banks may opportunistically choose to classify more financial assets at level 3 for the purpose of earnings management

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Commented [a3]: Paragraf ini bermaksud menjelaskan motivasi penelitian yang menjelaskan hasil hasil penelitian terdahulu yang berkaitan dengan isu yang sedang dibahas. Tapi penulis **tidak** menjelaskan dengan baik hasil penelitian terdahulu yang berkaitan dengan "the influence of corporate governance mechanism towards fair value measurement in banking and financial industries" Hasil penelitian pertama mungkin benar, hasil penelitian kedua mungkin benar Tapi, kesimpulan tidak turun dari kedua hasil penelitian. Paragraf ini menjelaskan **gap penelitian sebelumnya** yang menjadi peluang penelitian ini.

Commented [a4]: Di terbitkan di jurnal mana? Di reference tidak disebutkan nama jurnalnya.

Commented [a5]: What does it mean? Apa maksudnya diestimasi secara internal? Pahami dengan baik mekanisme penilaian fair value dengan level 3.

(Chong, Huang, & Zhang, 2012; Yao et al., 2016). (Chong et al., 2012) finds banks use level 3 inputs for earnings management and there is positive association between level 3 inputs towards poor performance of banking industries.

Zhang & Chong (2019) provide evidence a negative association between corporate governance and the use of level 3 inputs, in where companies with higher corporate governance level will have lower level of level 3 inputs. Buallay, Hamdan, & Zureigat (2017)explain that corporate governance is a combination of policies, laws and instructions that affect the way a company manages and controls its organization. Good corporate governance can be implemented through the board of commissioners and directors who carry out their duties and responsibilities, the existence of audit and risk committees who carry out their duties appropriately.

Xiao et al. (2017) investigate the challenges of fair value implementation in China, an emerging country. The study conducts survey to on the Chief Financial Officer (CFO), auditors, and financial analysts and finds several challenges, one of which is the difficulty in obtaining fair value information. Difficulty in obtaining fair value information occurs because of certain shares are inactive. This happens on fair values at levels 2 and 3 as they are not available in an active market.

Nugraheni et al. (2022) argue Indonesia market has the same challenges and also inactive. Moreover Linawati (2016) also states that the stock market in Indonesia has low liquidity because there are quite a lot of dormant or inactive stocks. The capital market in Indonesia is still experiencing several problems, one of which is the very limited availability of products in the capital market due to the lack of number and diversity of products.

The data on stock transactions in Indonesia differs substantially from Hong Kong market which has more advanced market. On June 15, 2021, the Indonesia Stock Exchange recorded transactions of 18,194,000,000 shares while on the same date the Hong Kong

Commented [a6]: Beberapa paragraph dimulai dengan nama peneliti sebelumnya, sangat membosankan. Ceritakan lebih variative.

Commented [a7]: Ini maksudnya apa? Apa berarti level 3 semakin tidak dipakai? Atau nilai yang dihasilkan dari menggunakan level 3 yang semakin rendah. Apa earnings management dilakukan melalui level3 dengan menurunkan nilai asset? Jelaskan maksudnya disini. Baca dan pahami lagi Zhang & Chong (2019) dengan lebih baik. Sepertinya statement di paper ini keliru. Ini salah satu statement di Zhang " *This paper finds that banks with a higher social responsibility disclosure score and stronger corporate governance tend to have lower percentages of Level 3 fair-value assets. Banks with a higher Level 3 fair-value asset disclosure have a lower financial performance*" apa sama pemahaman nya denga yang disampaikan di paper ini. Salah satu penekanan zhang: *disclosure*.

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Stock Exchange (The Stock Exchange of Hong Kong Limited) reported transactions of 261,555,408,371 shares. This considerable difference illustrates that the capital market in Indonesia is still less liquid when compared to another country.

Other evidence of illiquid market of Indonesia is that several companies measure the fair value of their financial assets at levels 2 and 3 indicating that quoted prices for assets and liabilities in active markets are still very limited. If quoted prices for certain assets and liabilities are not available in an active market, the company must use levels 2 and 3 to measure the fair value of its assets and liabilities. Fair value level 2 is an input that can still be observed either directly or indirectly, one way is through the fair value of similar assets or liabilities in an active market (IASB, 2018). However, it is different from fair value level 3 where the input of assets and liabilities is completely unobservable so that the measurement uses manager assumptions and uses modelling and estimation.

Commented [a13]: Apaiya, pasar di Indonesia tidak liquid? Yang benar.

Commented [a14]: Bukankah financial asset diukur dengan fair value level 1 karena ada nilai pasarnya. Level 3 khusus untuk asset yang tidak memiliki nilai pasar sehingga perlu appraisaluntuk menilainya. Cek Kembali, baca PSAK terkait hal ini.

The implementation of fair value level 3 in Indonesia needs more attention because it can be an opportunity for managers to take opportunistic actions that benefit the company. This study tests whether the good corporate governance influence the level of fair value inputs level 3 in the banking and financial companies. This study use data from banking and financial industries from 2015 to 2019. Banking industry is an industry which support economic stability and growth (Zhang & Chong, 2019). In addition, the banking company has significant amount of of financial instruments where the implementation of fair value has substantial effects on them (Beatty & Liao, 2014; Mauro, Guido, & Elisa, 2017). Fair value reporting is very important for banking industry because it helps to increase trust, accountability, transparency, and commitment to financial markets and society (Zhang & Chong, 2019). Fair value also help improve the efficiency of internal decision-making and the accuracy of revenue forecasts (Xiao et al., 2017).

However, Zhang & Chong (2019) argue that company using level 3 fair value measurement tend to disguise a poor company performance, including in banking industry. Banks with poor performance are more likely to use the discretion available in measuring the fair value of level 3 assets to engage in opportunistic behavior (Yao et al., 2016). Wang & Zhang (2017) state there is an increase in agency conflict which is driven by the measurement of fair value that is less reliable (fair value level 3) due to the manager's opportunistic behavior and estimation errors. Therefore, it can be interpreted that there is opportunistic behavior in the level 3 fair value measurement which is used to disguise poor company performance.

Previous research tests the influence of corporate governance towards fair value inputs level 3 and use an existing score for corporate governance (Zhang & Chong, 2019). On the other hand, this study uses governance indicators based on self-assessment and is divided into 4 types of governance mechanisms i.e. managerial ownership, institutional ownership, independent commissioner board size, and audit committee size. The corporate governance mechanism plays an important role in reducing managers' opportunistic behavior practices through level 3 fair value input.

Managerial ownership is one of the corporate governance mechanisms in which managers also act as shareholders of the company (Aprianingsih & Yushita, 2016). Managerial ownership will drive management to align their interests with other shareholders while monitoring and directing management and this will have a major impact in deterring managers' opportunistic behavior (Agustiany, 2020; Mwapula, 2016; Sianturi, Syarif, & Wahyudi, 2017). Meanwhile, institutional ownership is the percentage of company shares owned by institutions (Giovani, 2019). Herdjiono & Sari (2017) argue that institutional ownership leads to increase a supervision by institutional investors which can reduce managers' opportunistic behavior.

Independent board of commissioners is member of board of commissioners who have no any relationship with the management of the company (Rimardhani, Hidayat, & Dwiatmanto, 2016). Aprianingsih & Yushita (2016) argue that an independent board of commissioners can carry out supervision and provide input to the board of directors more objectively. The independence of the board of commissioners is key in ensuring that managers not to engage in opportunistic behavior (Mwapula, 2016).

Finally, there are various kinds of effective oversight and governance mechanisms by the audit committee, including the number of audit committee meetings, the number or proportion of audit committees with an accounting and/or financial background, and the number or proportion of independent audit committees (Pamudji & Trihartati, 2012). This study uses the proportion of audit committees having accounting and/or finance backgrounds with the total audit committee owned by the company. Audit committee mechanism will reduce the opportunistic behavior by the manager (Huang, Dao, & Fornaro, 2016; Lawrence, Young, & Susan, 2000; Perdana, 2019).

Compared to Zhang & Chong (2019) who use Corporate Governance Perception Index, measurement of corporate governance with self-assessment will be able to produce more specific data for each governance mechanism in each company and not based on values measured globally.

Problem Formulation

1. Does managerial ownership have a negative effect on level 3 fair value input?
2. Does institutional ownership have a negative effect on level 3 fair value inputs?
3. Does the independence of the board of commissioners have a negative effect on the level 3 fair value input?
4. Does the size of the audit committee having financial and accounting background have a s negative effect on the level 3 fair value input?

Literature Review

Corporate Governance

Corporate governance often emerges as a response to systemic crises or corporate failures and has evolved over the centuries (International Finance Corporation (IFC), 2014). Examples are the collapse of the British South Sea Company in 1720 which then comes up with a system that revolutionized law and business practice in England, the failure of famous companies such as Barings Bank in England, Enron in the United States, and the Parmalat scandal in Italy. Those scandals and failures were responded with the adoption of new governance frameworks such as the Sarbanes-Oxley Act for public company accounting reform and investor protection, other similar corporate governance codes, and the current trend of requiring more stringent oversight on banks and other financial institutions in each country.

Indonesia has also experienced a major financial crisis in 1997-1998 which has social, economic and political impacts. Many experts argue that the crisis was triggered by very poor supervision of the financial sector and weak regulation of the central bank. However, this incident actually increases understanding and awareness of the importance of corporate governance. These changes are consistent with ongoing progress made on a legal and regulated corporate governance framework.

Corporate governance refers to the way of company to run, regulate, and control its operation and it can affect the success of the company. The relationship between managers, the board of commissioners, employees, and other stakeholders is very influential on the governance system of a company. Corporate governance also provides a structure that can be used to set corporate goals, ways to achieve these goals and monitor company performance (Buallay, 2017; Chorafas, 2006; Herdjiono & Sari, 2017; Huang et al., 2016; ICSA, 2020; World-Bank, 2018; Zhang & Chong, 2019).

At present, the implementation of corporate governance is very necessary in order to fulfill public trust and helps company to grow successfully hence it can achieve the ultimate goal of maximum profit, company growth, company sustainability, and the welfare of members and the community. Good corporate governance encourages sustainable business growth by facilitating company access to capital and protecting the rights of stockholders and stakeholders (Buallay, 2017; Das, 2014). The corporate governance mechanism may include institutional ownership, managerial ownership, independent board of commissioners, board of directors, and audit committee mechanism (Putri & Suprasto, 2016).

The principles of corporate governance throughout the world are constantly evolving. In 2015, the Organization for Economic Co-operation and Development (OECD) published a final revision to address these developments.

Fair Value

Studies show fair value is more prominent when the diffusion of IFRS happens around the world (Nugraheni et al., 2022). In the US, companies are required to disclose the techniques used to measure fair value based on SFAS 157. The publication of SFAS 157 was then followed by the publication of IFRS 13 which led other countries to adopt fair value and even became a reference for countries to develop reporting standards regarding fair value.

Indonesia establishes PSAK 68 which is based on IFRS 13. The definition of fair value in PSAK 68 (2013) is “the price that would be received when selling an asset or the price that would be paid when transferring a liability in an orderly transaction between market participants on the measurement date”. Orderly transactions mean that these transactions occur in general and not due to pressure, for example, such as forced liquidations or forced sales. Meanwhile, the definition of market participants according to PSAK 68 are buyers and sellers in the main market who have certain characteristics.

There are three levels of the fair value hierarchy described in PSAK 68 (2013), i.e. 1) Inputs level 1, quoted prices for an asset or liability that can be found in an active market and can be accessed by the entity at the measurement date. Quoted prices that can be found in an active market are the most reliable evidence and do not require adjustment 2) Inputs level 2, are inputs that can still be observed either directly or indirectly but in addition to quoted prices which are included in level 1, 3) Inputs level 3, are unobservable inputs for assets or liabilities. These unobservable inputs represent the assumptions market participants use when pricing an asset or liability, including assumptions about risk.

Level 1 fair value assets are also known as mark-to-market because they are traded in an active market whereas level 2 and level 3 assets are illiquid assets and are known as mark-to-model because their value cannot be found in an active market (Nugraheni et al., 2022; Zhang & Chong, 2019). Those studies argue that the three levels have different levels of objectivity. Level 1 has the highest objective level because it is in an active market while level 2 is less objective because the price is obtained from similar assets or liabilities found in an active market. The level 2 is less objective because the price is obtained from similar assets or liabilities in an active market. Finally, level 3 is considered the least objective because it only relies on market information as input for the estimation of fair value.

Chong et al. (2012) argue that banks that have poor performance tend to use level 3 input and use it as a loophole to manage income. This condition can occur because level 3 is an estimate that includes valuation techniques (discounted cash flow models and income approaches) that only rely on information and assumptions (Mauro et al., 2017).

Xiao et al. (2017)) show the challenges in the application of fair value accounting in China are high difficulty in obtaining fair value information of assets and liabilities, lack of technical knowledge related to fair value and professional judgment skills among accountants and complexity in measuring fair value. Moreover, implementation of fair values is costly and volatized revenue. It worsens by inadequate guidance on fair value implementation, imperfect facilities and support systems, low level of independence and competence of auditors and asset appraisers.

Hypotheses Development

Corporate governance is an internal control mechanism that oversees managers in disclosing items fairly and ensures that managers act in the interests of shareholders. Corporate governance has an important role in supervision and acts as a mechanism to ensure effective corporate decision making to safeguard the interests of stakeholders (Mwapula, 2016; Zhang & Chong, 2019). Corporate governance may reduce opportunistic behavior (Wu, Coleman, & Bawuah, 2020), including through fair value level 3 inputs (Ghio, Filip, & Jeny, 2018; Song, Thomas, & Yi, 2010). Firms with strong governance are less likely to use level 3 fair value inputs as a loophole to engage in opportunistic behavior such as earnings management and proves that corporate governance scores are significantly negatively related to the percentage of level 3 assets, meaning that banks with strong corporate governance tend to use fewer level 3 fair value inputs(Zhang & Chong, 2019).

Managerial Ownership and Fair Value Input Level 3

Managerial ownership is one of the corporate governance mechanisms in which managers also act as shareholders of the company (Aprianingsih & Yushita, 2016; Ulfa & Asyik, 2018). The larger the managerial ownership of the company is, the higher management motivation to further maximize its performance. Managerial ownership leads managements benefit from the their decisions and at the same time bear the risk if they make the wrong decision (Hartono & Nugrahanti, 2014).

Managerial ownership will provide assurance that management will align their interests with other shareholders while monitoring and managing a company hence deters managers' opportunistic behavior (Agustiany, 2020; Mwapula, 2016; Sianturi et al., 2017). Regarding this study, managerial ownership will minimize the level 3 fair value input which represents managers' opportunistic behavior. Therefore, the higher the managerial ownership is, the lower the level 3 fair value input.

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Ha1: Corporate governance as measured by managerial ownership has a negative effect on level 3 fair value inputs.

Institutional Ownership and Fair Value Input Level 3

Institutional ownership is the percentage of company shares owned by other institutions (Giovani, 2019). Institutional ownership could be an insurance company, investment company, government, and other institutions that invest in a company and have rights in decision making (Abduh & Rusliati, 2018). Herdjiono & Sari (2017) and Hartono & Nugrahanti (2014) argue that institutional ownership leads to increased supervision by institutional investors which can reduce managers' opportunistic behavior.

Commented [a16]: Bagian ini juga sama seperti bagian sebelumnya. Belum menjelaskan pengaruh institutional ownership terhadap lev3l 3 fair value, langsung menyimpulkan bahwa institusional ownership berpengaruh terhadap fair value level 3. Cerita pengaruhnya bagaimana, kok bisa institusional ownership mempengaruhi level 3?

Generally, institutions have a special department for investment so that supervision becomes more stringent, which can then help reduce manager's opportunistic behavior. Therefore, the interests between management and stakeholders can be aligned and can have a positive impact on company performance (Agustiany, 2020; Hartono & Nugrahanti, 2014; Wimelda & Chandra, 2018). Regarding this study, institutional ownership of shares is expected to help minimize the manager's opportunistic behavior that can occur through level 3 fair value inputs. Therefore, the higher the institutional ownership, the lower the use of level 3 fair value input.

Ha2: institutional ownership has a negative effect on input fair value level 3.

Independence of the Board of Commissioners and Fair Value Input Level 3

Independent commissioners are members of the company's board of commissioners who are independent and have no special relationship with board of directors of a company (Putri & Suprasto, 2016; Rimardhani et al., 2016). Wimelda & Chandra (2018) states that the independent board of commissioners is a tool to monitor shareholders and control company management. The ratio of independent commissioners determines the quality of decisions taken by the board (Wu et al., 2020).

Aprianingsih & Yushita (2016) argue that an independent board of commissioners can carry out supervision and provide objective inputs to the board of directors. The independence of the board of commissioners is an important key in ensuring that managers do not engage in opportunistic behaviors (Mwapula, 2016). The existence of an independent board of commissioners is expected to provide stricter and objective supervision of management so as to help the company and stakeholders to avoid opportunistic behavior of managers. Therefore, the higher the size of the independent board of commissioners, the lower the level 3 fair value input of the company's financial assets.

Ha3: Independent board of commissioners has a negative effect on the fair value input level 3.

Audit Committee Mechanism and Fair Value Input Level 3

Aprianingsih & Yushita (2016) explain that the audit committee is responsible for carrying out internal supervision of the company in the process of preparing financial statements, conducting audits, risk management, and implementing corporate governance. The establishment of the audit committee aims to improve oversight of the company's financial statements and ensure that the company's management works in accordance with the interests of shareholders and stakeholders (Lawrence et al., 2000; Perdana, 2019; Verriest,

Commented [a17]: Bagian ini juga sama, belum ada bagaimana cerita pengaruhnya, langsung ada kesimpulan. Penulis seharusnya menjelaskan pengaruh independence of board commissioner terhadap input level 3, bukan terhadap opportunistic behaviour.

Commented [a18]: Bagian ini juga sama. Penjelasan tidak konsisten dengan kesimpulan, therefore….

Gaeremynck, & Thornton, 2008).

Herdjiono & Sari (2017) argue that the audit committee can reduce managers' opportunistic behavior through supervision of financial statements, external audits, and supervision of the company's internal control system. The audit committee can carry out internal control that monitors the effectiveness of the company's internal controls and reduce the opportunistic behavior of managers (Wimelda & Chandra, 2018). The higher the number of audit committees owned by the company, the higher the supervision of the company, especially in the company's financial statements Measurement of the audit committee can be done by looking at several characteristics, one of which is the educational background of the audit committee (Pamudji & Trihartati, 2012).

The existence of a competent audit committee can increase investor confidence in the company's financial statements and minimize corporate governance violations (Lawrence et al., 2000). It proves that the existence of a competent audit committee can help to minimize fraud and misstatement of financial statements. Therefore, the higher the number of audit committees having financial and accounting background owned by the company, the lower the financial assets classified at fair value level 3.

Ha4: Audit committee having financial and/or accounting backgrounds have a negative effect on the level 3 fair value input.

Research Method

Population and Sample

Population of this study is companies listed in Indonesia Stock Exchange (IDX). The sample in this study are banks that apply PSAK 68 in measuring the fair value of their financial instruments. The research sample was obtained using purposive sampling method. The following are some of the sample criteria

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Commented [a20]: Sampelnya hanya banks, ngak masuk other financial institution.

1. Banking companies listed on the IDX from 2015-2019.
2. Banking companies that use the fair value hierarchy, namely the fair value measurement of their financial assets, are guided by PSAK 68.

Table 1. Sample

No.	Description	2015	2016	2017	2018	2019	Total
1.	Banking and financial companies listed in the IDX from 2015-2019.	86	89	91	96	99	**461**
3.	Companies that do not use the fair value hierarchy.	(20)	(20)	(21)	(21)	(22)	**(104)**
Total							**357**

Source: Processed secondary data, 2021

Commented [a21]: Ini jumlah perusahaan non keuangan: banking and other financial companies. **Studi ini hanya menggunakan banking sebagai sampel**.

Commented [a22]: Tidak mungkin sebanyak ini yang menggunakan fair value level 3 di perbankan.

Operational Definitions and Variable Measurement

Independent Variables

1. Managerial ownership

   Managerial ownership is the proportion of the number of company shares owned by managers (Anwar et al., 2013). Managerial ownership is measured by the following formula::

$$MO = \frac{Management\ owned\ shares}{Total\ shares\ outstanding}\ x\ 100\%$$

   Description:

   MO : Managerial ownership

   Management owned stock : Number of shares owned by the board of directors.

   Total shares outstanding : Total number of company shares outstanding

2. Institutional ownership

Institutional ownership is the percentage of company shares owned by institutions such as insurance companies, banks, and other institutions that exist outside and within the country (Giovani, 2019).

$$IO = \frac{Institutional\ owned\ shares}{Total\ shares\ outstanding}\ x\ 100\%$$

Description:

IO : Institutional ownership

Institutional owned shares : Number of shares owned by the institution

Total Shares outstanding :Total number of company shares outstanding

3. Board of Commissioners independence

Giovani (2019), states that the independence of the board of commissioners is the proportion of the independent board of commissioners who are members of the company's board of commissioners.

$$IC = \frac{Number\ of\ independent\ commissioners}{Total\ board\ of\ commissioners}\ x\ 100\%$$

Description:

BCI : Board of commissioners independence

Number of independent commissioners : Number of independent commissioners

Total board of commissioners : Total company board of commissioners

4. Audit committee size

The size of the audit committee is measured using the proportion of audit committees that have an accounting and/or financial background owned by the company (Sari & Husaini, 2016).

$$ACS = \frac{Number\ of\ audit\ committees\ with\ accounting/finance\ background}{Total\ audit\ committee}\ x\ 100\%$$

Dependent Variable

The fair value input percentage of level 3 financial assets is the total fair value of company assets classified as level 3 compared to the total fair value (Chong et al., 2012).

Commented [a23]: Apakah financial asset dinilai menggunakan level 3? Financial asset merupakan asset yang dapat diobservasi nilai pasarnya. Sedangkan level 3 digunakan untuk asset yang tidak dapat diobservasi nilai pasarnya. Menurut PSAK 68 "Input Level 3 adalah input yang tidak dapat diobservasi untuk aset atau liabilitas"

$$FV\ level\ 3 = \frac{Fair\ value\ financial\ asset\ level\ 3}{Total\ fair\ value\ of\ financial\ assets}\ x\ 100\%$$

Description:

FVIP Level 3 : Fair value input percentage level 3

FV financial asset level 3 : Total fair value of level 3 financial assets

Total FV financial asset : Total fair value of the company's financial assets

Hypothesis testing in this study was carried out using multiple linear regression tests, with the following equation model.

FV_LV3 = β0 + β1MO + β2IO + β3IC + β4ACS + ε

Description:

FV_Level3 : Fair value input percentage level

β0 : Constant

β1- β3 : Independent variable coefficient

MO : Managerial ownership

IO : Institutional ownership

IC : Independent Commissioners

ACS : Audit committee size

Results and Discussion

Descriptive Statistics

The data of banking companies that meet the research criteria initially amounted to 357 and decreased to 322 after underwent classical assumption tests. Following is table of descriptive statistics from 322 research sample data:

Table 2 . Descriptive Statistics

	N	Minimum	Maximum	Average	Deviation Standard
MO	322	0,000	0,124	0,0042	0,01527
IO	322	0,000	0,982	0,8435	0,18931
IC	322	0,425	1,000	0,5976	0,11254
CAS	322	0,200	0.400	0,232	0,07235
FV_LV3	322	0,000	1,000	0,4326	0,38421

Source: Processed secondary data, 2021

The dependent variable of this study is the fair value input level 3 (FV_LV3). The minimum value of the variable is 0.000, while the maximum value of the variable is 1,000. The value of 0 on the fair value variable level 3 explains that the company does not have financial assets classified at fair value level 3. While the value 1 explains that the company classifies all of its financial assets at fair value level 3. The average variable FV_LV3 is 0.4326 means that the average sample in this study classifying its financial assets at fair value level 3 is 43,26% of total financial assets measured using fair value. The value of the standard deviation of the input variable fair value level 3 is 0.38421.

The managerial ownership variable (MO) is obtained from the number of shares owned by the board of directors and the board of commissioners divided by the total number of outstanding shares. The minimum value for the MO variable is 0.000 and the maximum value is 0.124. The average MO variable is 0.0042 which explains that the average managerial ownership in this research data is 0.42% of the company's total outstanding shares. The standard deviation of the managerial ownership variable is 0.01527.

The variable of institutional ownership (IO) is obtained from the number of company shares owned by the institution divided by the total number of outstanding shares. The minimum and maximum values of this variable are 0.000 and 0.982 respectively. The average institutional ownership variable (IO) is 0,8435, which means that the average company shares in this research sample are owned by institutions of 84.35% of the total number of outstanding shares. The value of the standard deviation of the institutional ownership variable is 0,18931.

The variable of the independent board of commissioners (IC) is obtained from the number of independent commissioners of the company divided by the total number of the company's board of commissioners. The minimum value for the variable of the independent board of commissioners is 0.425 while the maximum value is 1,000. The average value of the independence of the board of commissioners in this study is 0,5976, which means that the average sample in this study has the independent board of commissioners of 59.76% of the total company's board of commissioners. The variable of the independent board of commissioners in this study has a standard deviation of 0,07235.

The variable the audit committee size (ACS) is measured by the percentage audit committees having financial and/or accounting backgrounds divided by the total number of company audit committees. The minimum and maximum values for this variable are 0.200 and 0,400 respectively. Meanwhile, the average value is 0,232 which means that the average sample in this study has an independent audit committee of 23,2 % of the total number of company audit committees. The proportion of audit committee having financial and accounting background has a standard deviation of 0,07235.

Fit Model Test and Coefficient of Determination

The F test has significance value of 0.000 or lower than 0.05 hence this research model is classified as robust and fit. Meanwhile, the adjusted R2 in this study of 0.359. This means that independent variables in the model of this study can explain 35.9% of the dependent variable while the rest is explained by other variables.

Hypothesis Testing

The following table is showing the result of the hypothesis testing :

Table 3. Hypothesis Testing

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.398	.369		1.078	.283
	MO	11.954	2.045	.434	6.867	.000
	IO	2.748	.159	.947	11.967	.000
	IC	-.610	.249	-.126	-2.627	.092
	CAS	-2.240	.332	-.421	-5.436	.003

Source : Processed secondary data, 2021

Based on table 3, the managerial ownership variable has a p value of 0.000 with a beta coefficient of 11.954. The significance value is lower than 0.05 but the positive beta coefficient contradicts hypothesis 1a which says that managerial ownership has a significant negative effect on the fair value input of level 3 financial assets. Therefore, it can be concluded that hypothesis 1a is rejected. The result of the beta coefficient is contrary to the negative direction of hypothesis 1a. Hence, a higher managerial ownership will result in a higher fair value input level 3 of financial assets. This relationship can occur because managers who own company shares will have a personal interest i.e. the interest to increase profits by showing good company performance in order to attract more investors.

Interestingly, these results indicate a positive and significant correlation between managerial ownership and the fair value input of level 3 financial assets. This indicates the opposite results as proposed in hypothesis. According to Wimelda & Chandra (2018), this may happen because managers who act as management as well as shareholders can bias the control function.

This opinion is supported by Agustia (2013) explaining that managers who own company shares tend to think from the investor's point of view so that managers tend to want to make up the company's financial performance with the aim of attracting more and more investors. Utami (2016) also states that the ownership of company shares by managers will increase personal interests in the form of return on shares investment.

It can be concluded that high managerial ownership cannot be a good control function but will instead encourage managers to commit fraud by classifying their financial assets at fair value level 3.

The results of this study contradict the results of Song et al. (2011) and Zhang et al. (2019) where estimation errors and opportunistic behavior through level 3 fair values can be prevented through good corporate governance mechanisms. On the contrary, the results of this study are in line with previous research by Aygun, Ic, & Sayim (2014) and Haryati, Afrizal, & Wahyudi (2017) which find that managerial ownership has a significant positive effect on the practice of company opportunistic behavior through earnings management.

The p value of the institutional ownership variable is 0.000 with a beta coefficient of 2.748. The p value is lower than 0.05 but the positive beta coefficient contradicts hypothesis stating that institutional ownership has a negative effect on the fair value input of level 3 financial assets. Hence, it can be concluded that hypothesis 2 in this study is rejected. The result contradicts the direction of hypothesis which indicate there is a negative association between independent and dependent variables. This means that high institutional ownership results in a higher fair value inputs level 3 of financial assets.

According to Kirana, Wibawaningsih, & Wijayanti (2020), this can happen because institutional investors tend to be short-term profit oriented so that they prefer financial statements with high profit levels. This encourages companies to take opportunistic actions with the aim of producing the best possible company financial statements. Agustia (2013) also states that institutional investors are able to push the company's management to take policies that can benefit investors.

It can be concluded that institutional ownership cannot be a good control mechanism but instead encourages company management to classify its financial assets at fair value level 3. The pressure from institutional investors towards company management to take policies that benefit investors makes management take advantage of loopholes that can be used to disguise the company's poor performance through input of the fair value of level 3 financial assets.

The results of this study are not in line with the research of Song et al. (2011) and Zhang et al. (2019) which states that a good corporate governance mechanism can reduce the adverse impact of level 3 fair value. The corporate governance mechanism proxied by institutional ownership is not able to minimize the percentage of input fair value of level 3 financial assets which is often used as loopholes to practice managers' opportunistic behavior. The results of this study support previous research by Perdana (2019) who prove that high institutional ownership increases the practice of managers' opportunistic behavior through earnings management..

The p value of the independent board of commissioners variable is 0.092 with a beta coefficient of -0.610. Hypothesis 3 states that the independence of the board of commissioners has a significant negative effect on the fair value input of financial assets level 3. The p value/2 is 0.046 is significant, hence it can be concluded that hypothesis 3 is accepted. This means that the independence of the board of commissioners has a significant negative effect on the fair value inputs of level 3 financial assets. The higher the independence of the board of commissioners of a company is, the lower the financial assets measured at fair value level 3.

The results of this study support the study conducted by Mwapula (2016) and Wu et al. (2020) which states that the role of the independent board of commissioners is very important in reducing opportunistic behavior and helping to produce quality decisions. It can be interpreted that if a company has a high independence of the board of commissioners, the supervision of the company's operations will be more stringent. The results of this study are consistent with previous research by Song et al. (2011) and Zhang et al. (2019) which states that improved corporate governance mechanisms can help minimize estimation errors and opportunities for opportunistic behavior practices through fair value level 3.

The p value of the audit committee mechanism variable as measured by the level of educational background is 0.003 with a beta coefficient of -2.240. The value of sig./2 is 0.0015< 0.05. Hypothesis 4 stating that the size of audit committee having financial and accounting background has a significant negative effect on the fair value input of financial assets level 3 is accepted. This means that the size of the audit committee measured by educational background has a significant negative effect on the fair value input of level 3 financial assets. It can be concluded that the higher the number of audit committees with accounting/finance background is, the lower the financial assets classified at fair value level 3 will be. Those results support studies conducted by Lawrence et al. (2000), Sari & Husaini (2016) and Wimelda & Chandra (2018) suggesting that the role of the audit committee is very important in reducing the possibility of fraud committed by the company.

The higher the number of competent audit committees of a company is, the supervision of the financial statements will be higher and more objective. Therefore, the opportunity for managers to commit fraud through financial statements, especially fair value level 3 will decrease. This study also supports previous studies conducted by Song et al. (2011) and Zhang et al. (2019) which state that the better the corporate governance mechanism, the lower the estimation error and opportunistic behavior that may occur through level 3 fair value.

Conclusion

Conclusion

This study aims to examine the effect of corporate governance mechanisms proxied by managerial ownership, institutional ownership, independence of the board of commissioners, and the committee audit educational background on the fair value input of level 3 financial assets. The findings of this study are: 1) managerial ownership has a significant positive effect on the fair value input of financial assets level 3; 2) institutional ownership has a significant positive effect on the fair value input of financial assets level 3; 3) the independence of the board of commissioners has a significant negative effect on the fair value input of financial assets level 3; 4) the size of the independent audit committee has a significant negative effect on the fair value input of level 3 financial assets.

Implication

This study provides some theoretical implication in some ways. First, this study provides an enrichment to the existing literature on the implementation of fair value in developing countries. Some previous research on fair value, especially fair value level 3 by Chong et al. (2012), Yao et al. (2016) and Zhang et al. (2019) were conducted in the developed countries such as in the United States. This study suggests conducting more studies of fair value implementation in developing countries. Second, this study is also able to provide additional understanding of the effects of corporate governance on the implementation of fair value, especially fair value level 3 in the Indonesian context. Previous studies by Song et al. (2010) and Zhang et al. (2019) showing the effects of corporate governance and fair value level 3 in developed countries.

This study also has some practical implications. First, banking and financial companies in Indonesia need to pay more attention to the measurement and disclosure of fair value, especially fair value level 3 because the fair value disclosure can theoretically be relevant information to determine the performance and condition of a company. Second, investors in Indonesia can use level 3 fair value as an additional indicator to assess the performance of a company because the disclosure of fair value can theoretically be relevant information to determine the performance and condition of a company.

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Commented [a24]:

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[JDAB] Permintaan Revisi kedua

Heru Fahlevi <jurnal@unsyiah.ac.id> Wed, Dec 14, 2022 at 10:54 AM
To: Dr Bernadia Linggar Yekti <Ling@unika.ac.id>
Cc: jdab@unsyiah.ac.id

Yth Dr Bernadia Linggar Yekti:

Editor telah melakukan evaluasi bersama dengan reviewer terkait hasil revisi naskah Ibu yang berjudul "The Effects of Corporate Governance Mechanism towards Fair Value Measurement in the Indonesian Banking and Financial Industries". Berdasarkan hasil evaluasi tersebut, kami meminta Ibu untuk melakukan perbaikan dan klarifikasi sebagai berikut

1. Membuat rebuttal letter yang memuat tabel yang isinya seluruh komentar reviewer di naskah dan respon Ibu terhadap komentar tersebut. Rebuttal letter tersebut bisa diupload di OJS/ website
2. Memberikan tanda warna hijau untuk setiap revisi yang dilakukan
3. Permintaan klarifikasi dari sisi teori dan regulasi (misalnya PSAK), instrumen keuangan yang diukur dengan fair value level 3. Tidak bisa hanya dengan menunjukkan laporan keuangan saja. Dilaporan keuangan pun, praktiknya berbeda, tidak bisa kita jadikan landasan (teori atau regulasi), mandiri dan BCA (contoh yang dikasih) saja berbeda dalam perlakuan level 3 ini.
4. Kenapa fokus menggunakan level 3 untuk instrument keuangan,? di PSAK diatur, instrumen keuangan diukur dengan level 1 dan 2. Jelaskan di introduction dan teori (institutional setting).
5. Beri argumentasi yang kuat mengapa fokus menggunakan level 3 untuk mengukur instrument keuangan di perbankan. Jelaskan di introduction di pargraf 1 dan 2. Karena praktik ini tidak mendukung sepenuhnya PSAK mengenai instrumen keuangan, jelaskanjustifikasi mengapaperbankan menggunakan level 3 untuk instrument keuangan mereka. instrumen keuangan yang mana yang menggunakan level 3.? mengapa?

Demikian kami sampaikan

Salam hormat

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[JDAB] Hasil evaluasi naskah revisi

Heru Fahlevi <jurnal@usk.ac.id> Thu, Mar 2, 2023 at 11:42 AM
To: Dr Bernadia Linggar Yekti <Ling@unika.ac.id>
Cc: jdab@unsyiah.ac.id

Yth Ibu Dr Bernadia Linggar Yekti:

Terimakasih atas kiriman hasil revisi naskah berjudul, "The Effects of Corporate Governance Mechanism towards Fair Value Measurement in the Indonesian Banking and Financial Industries". Tim editor sudah melakukan penilaian dengan melibatkan reviewer terkait. Berdasarkan penilaian tersebut, kami memutuskan untuk meminta perbaikan kembali karena terdapat beberapa poin krusial yang masih belum terjawab dan direvisi.

Berikut beberapa hal yang perlu ditanggapi dan direvisi:
(1) aset apa yang diukur oleh bank dengan menggunakan input level 3. Harap disampaikan di naskah revisi
(2) mengapa bank menggunakan input level 3 untuk aset dan liabilities padahal kedua items tersebut ada nilai pasarnya, bisa pakai input level 1 atau 2 (mohon disampaikan di naskah jwaban ini)
(3) di latar belakang dijelaskannya bahwa penggunaan input level 3 jika pasar kurang likuid, "When market liquidity is less" Tapi berikutnya di hasil dan di pembahasan, hal ini tidak diungkit ungkin lagi. Padahal kondisi ini menjadi syarat utama penerapan Level 3 (menurut penulis ini di introduction);
(4) tolong papernya direvisi menurut yang saya sampaikan di paper di bagian comment, yang ada tanda 290123.

Demikian kami sampaikan. Kami berharap dapat menerima hasil revisi sebelum 15 Maret 2023. Jika diperlukan perpanjangan waktu, mohon disampaikan. Terlampir file dengan komentar tambahan dari reviewer.

Salam

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13 March 2023

Heru Fahlevi

Editor in Chief of Jurnal Dinamika Akuntansi dan Bisnis

Syiah Kuala University Banda Aceh

Indonesia

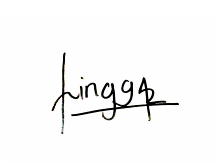
Dear Heru,

<u>Re: Revised Version of Manuscript 28355-93774-1-RV</u>

Please find attached the revised version of my paper titled *The Effects of Corporate Governance Mechanism on Fair Value Measurement in the Indonesian Banking and Financial Industries.* I feel that it now reads better for the academic audience. I also have addressed reviewer's specific comments as comprehensively as possible on the paper.

I hope these changes meet to your satisfaction. Please let me know should you require any further clarification or revisions. I look forward to your reply in due course.

Yours Sincerely



Bernadia Nugraheni

Assistant Professor in Accounting

Soegijapranata Catholic University

Comments and Responses

(1) aset apa yang diukur oleh bank dengan menggunakan input level 3. Harap disampaikan di naskah revisi

Page 2

Fair values of complex securities, asset-backed securities such as mortgage, private equity shares, and debt securities are primarily estimated using pricing model (input level 3). When market liquidity is less, limited assets are traded in the market hence it is challenging to generate direct quoted market price from the market.

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Examples of assets measured using fair value input level 3 are securities which are not actively traded, complex securities or derivatives, currency swap, asset-backed securities such as mortgage, private equity shares, and debt securities (PWC, 2022). Interestingly, fair value inputs level 3 is also applicable for held for trading and available for sale securities (Kisseleva et al., 2016).

(2) mengapa bank menggunakan input level 3 untuk aset dan liabilities padahal kedua items tersebut ada nilai pasarnya, bisa pakai input level 1 atau 2 (mohon disampaikan di naskah jwaban ini)

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Fair value inputs level 3 is used for financial instruments when they are traded infrequently thus has limited pricing information (Kisseleva et al., 2016; PWC, 2022). Moreover, when there is lack of observable inputs, banking companies will apply internal modelling and significant assumption regarding the adjustment of credit value and discount rate

(3) di latar belakang dijelaskannya bahwa penggunaan input level 3 jika pasar kurang likuid, "When market liquidity is less" Tapi berikutnya di hasil dan di pembahasan, hal ini tidak diungkit ungkin lagi. Padahal kondisi ini menjadi syarat utama penerapan Level 3 (menurut penulis ini di introduction);

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Fair value input level 3 creates opportunities for manager to use discretion for estimating discount rates, credit value and other assumptions because financial instruments are not actively traded, hence there are no market price available

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The results of this study are consistent with previous research by Song et al. (2011) and Zhang et al. (2019) who find that improved corporate governance mechanisms can help minimize estimation errors and opportunistic behavior practices through fair value level 3 because financial instruments are not actively traded representing less market liquidity for those instruments.

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Inputs level 3 are applied when there are shortages in observable inputs. Management use internal estimation and modelling creating opportunities to boost performance based on management's interests.

(4) tolong papernya direvisi menurut yang saya sampaikan di paper di bagian comment, yang ada tanda 290123.

Comments have been addressed accordingly

Linggar Yekti <ling@unika.ac.id>

Subject: [JDAB] Editor Decision

Jdab Unsyiah <jdab@usk.ac.id> Mon, Apr 3, 2023 at 10:03 AM
To: Bernadia Linggar Yekti <Ling@unika.ac.id>

Dear. Dr Bernadia Linggar Yekti:

We have reached a decision regarding your submission to Jurnal Dinamika Akuntansi dan Bisnis, "The Effects of Corporate Governance Mechanism towards Fair Value Measurement in the Indonesian Banking and Financial Industries".

Our decision is to: Accept Submission

Please pay the article processing fee and open access fees (Rp1,500,00) to following bank account:

Account name: JDAB
Bank: BSI (Bank Syariah Indonesia)
Account number: 7107753731

Please send the proof of transfer to jdab@unsyiah.ac.id

LOA will be sent after publication fees are paid. The manuscript will be sent to the lay-out editor. We will contact you again during the editing process.

Best regards

Heru Fahlevi
[Scopus ID 57189895148] Accounting Department, Economics and Business Faculty, Syiah Kuala University

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Jdab Unsyiah <jdab@usk.ac.id> Fri, Jun 2, 7:06 AM

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Selamat Pagi Ibu

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Harap menggunakan track changes agar kami dapat melihat perubahan yang dilakukan.
Salam
Heru

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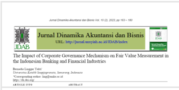
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The Impact of Corporate Governance Mechanism on Fair Value Measurement in the Indonesian Banking and Financial Industries

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Linggar Yekti <ling@unika.ac.id> Wed, Jun 7, 7:32 PM

to Jdab

Yth Pak Heru..

Kami kirimkan naskah yang sudah saya cek dan update, mohon bisa diterima dengan baik. Terima kasih