

# The Effect of Earnings Volatility, Income Smoothing, Corporate Governance, and Firm Size on Earnings Quality Conventional Banks in Indonesia

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**Abstract.** Although there are many other factors that influence a country's economic development, banks are one of the most important factors in the economy. Considering that if the banking system is unstable and does not function efficiently, the allocation of funds will not work well, which can hamper economic growth. Therefore, the stability and financial system in the banking sector should be maintained and even enhanced for the sake of creating sustainable economic growth. The purpose of this research is to determine the effect of earning volatility, income smoothing, good corporate governance, and firm size on earnings quality. The object of the research was to use conventional banks listed on the Indonesian Stock Exchange in 2016-2019 period such as 30 companies which was determined through purposive sampling. The result of this research indicates that earning volatility and good corporate governance have no significant effect on earning quality but income smoothing and firm size have a significant effect on earning quality. Total assets and credit quality of the company can be seen from the level of maturity of the company which is considered to have prospects in generating better profits in the future and producing better returns. The information obtained from this research is expected to be used as consideration in making decisions regarding the importance of maintaining the quality of earnings in order to attract investors to invest in the company.

## 1 Introduction

Profit is one of the potential information contained in financial statements. Where profit is the profit earned from income after deducting taxes and fees [1]. The company's profit is one of the indicators for decision-making for investors. In addition, company profits are also useful as income for investors and people who have an interest in it [2]. As a measure of coverage, the profits generated by the company must be reported in the form of financial statements to find out how far the company's achievements are in terms of investors.

The motivation to meet profit targets can lead managers to neglect good business practices. As a result, the quality of earnings and financial reporting has decreased. According to [3], quality earnings are earnings that can reflect sustainable earnings in the future which are determined by the accrual component and cash flow. While [4] reveal that earnings are said to be of quality if there are no deviations from the actual facts in the acquisition process, even though theoretically it does not conflict with applicable principles so that decisions made by users do not cause bias. Perceptual disturbances in accounting earnings are caused by transitory events or the application of the accrual concept in accounting.

Information about profit measures the success or failure of a business in achieving its stated operating goals. Information about earnings is used to evaluate

management performance, estimate earnings power, and predict future earnings. Earnings can be said to be of high quality if the reported earnings can be used by users to make the best decisions, and can be used to explain or predict stock prices and returns [5]. Due to the fundamental limitations in the accounting system, it is very likely that the company's income shown in the financial statements may not be compatible with the company's original income. According to [5, 6], earnings quality is earnings that can be used to make an accurate assessment of current performance and can be used as a basis for predicting future performance and reflect net cash flows. According to [7], the stability of the company's earnings can be considered as high-quality earnings. Furthermore, high-quality earnings are those that are close to the company's operating cash flow. The farther the profit value from the operating cash flow, the lower the quality of the company's earnings. The closer the profit value to the company's operating cash flow, the less management discretion in determining the value of earnings. Based on the description above, it can be interpreted that earnings quality is an earnings report that reflects the company's real financial performance, quality earnings are earnings that can be an indicator that can reflect the sustainability of earnings in the future, the better the earnings quality, the smaller the discretionary accruals arising from Management policy.

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The banking sector in Indonesia has a vital role in the economy. Like the heart organ which has the function of circulating blood to all parts of the body, banks also have the same role as the heart, which is to distribute funds to all levels of society. The funds distributed to the public are expected to be able to rotate and be able to stimulate the country's economy to be more productive. This flow of funds will also trigger the development of an area and improve the standard of living of the community. Therefore, conventional banks as the oldest banking system and dominating the financial system in Indonesia must be able to become a good intermediary institution for the community.

A good profit is a stable profit from one period to the next and there is no profit volatility or the condition of rising or falling bank profits in each period. One of the indicators used to measure earnings volatility in banking is to use Return on Assets (ROA). ROA is one of the profitability ratios in banking that measures the bank's ability to generate profits from all assets owned. The trend of increasing banking assets every year makes banks expected to experience a fairly large impact of profit volatility because most of the assets and liabilities of banks are financial instruments. If the company's profits are unstable, then the principal as an agent in the company is considered unable to manage company assets properly. On the other hand, if management is able to manage assets well so that it can generate large profits for the company, then management is considered successful in managing company assets. However, the increase in the company's assets should reflect good earnings quality as well. If the company's earnings report is manipulated, it will affect the quality of earnings, because quality earnings should describe the actual profits earned by the company without any manipulation from any party. The results of research on banking in Indonesia conducted by [8] show that banking management tends to use its discretion to reduce earnings volatility. Profit volatility is a condition where the company's profit fluctuates in a certain period. Profit volatility reflects bank profits which fluctuate from year to year. High-profit volatility will have a negative impact on earnings quality. This research is supported by research by [9] who explains that Loan Loss Provision is one of the tools used by management to carry out income smoothing. Income smoothing is an earnings management practice that can be used to reduce fluctuations in earnings from year to year. Income smoothing is done by averaging the income earned by the bank to reduce the volatility of earnings from one period to the next. One of the tools used to reduce volatility is Loan Loss Provision (LLP) or what is commonly known as Allowance for Impairment Losses (CKPN). This is an attempt by the manager to manipulate the company's profits which results in the destruction of the company's earnings quality. However, this condition can be minimized by implementing data transparency regarding finances in the company. With transparency in reporting and presenting information, managers will think before acting to manipulate earnings. Corporate governance or commonly known as Good Corporate Governance (GCG) is one of the

applications in companies that can regulate and control the company [10].

In general, the implementation of Good Corporate Governance (GCG) can reduce earnings management practices in companies. By implementing the principles of fairness, transparency, accountability, and responsibility, GCG is expected to regulate the relationship between the principal and the agent in the company so that it can create added value for all interested parties. This is consistent with the research of [11, 12] which states that GCG has a negative effect on earnings management practices. Effective governance is also able to provide positive signals to the market regarding a company's capacity to generate sufficient revenue over time. The capacity of the company in this case reflects the size of the company which is judged by the size of the asset turnover that occurs in the company. It means that the bigger the assets, the better the earnings quality of the company is, compared to the smaller company size. However, [13] state that GCG has no effect on earnings quality because the implementation of GCG in companies in Indonesia has not really been used as a tool to minimize information asymmetry between owners and management, but only to comply with applicable rules and regulations.

### 1.1 Objectives

The stability and financial system in the banking sector should be maintained and even enhanced for the sake of creating sustainable economic growth. This is where the function of the regulator works, where the Financial Services Authority (OJK) as one of the regulators must be able to supervise banking performance for the sake of creating financial system security in Indonesia.

Reason for wanting to show good financial performance, banks sometimes practice earnings management so that financial reports from one period to the next look good and stable. CNBC Indonesia explains that there was a time when a bank manipulated data to make the bank's financial performance look good, and this case happened to Bank Bukopin. Whereas Bank Bukopin modified credit card data which caused the credit position and commission-based income to increase inappropriately. This caused Bank Bukopin to revise its financial statements from 2016-2018 [14]. Therefore, oversight from regulators is very important, to anticipate that events such as what happened to Bank Bukopin will not happen again. Furthermore, manipulation of banking financial reports will be detrimental to parties with an interest in these financial reports and can disrupt the stability of the economy and the country's financial system.

From the case of Bank Bukopin, we want to find out whether profits at conventional banks in Indonesia reflect the actual situation and what factors affect the quality of earnings at conventional banks in Indonesia. The role of banking which is so important for the progress of a country, especially Indonesia, is expected to be separated from the practice of earnings management. In addition, banks must also be able to provide sustainable expectations for stakeholders. The

lack of earnings management practices and the failure of the banking business have made investors not hesitate to manage their funds for banking progress in conventional banking in Indonesia. Where banks are the majority of banks in Indonesia. So that conventional banks can continue to function as mediators and are able to participate in the welfare of the Indonesian people. Therefore, we are interested in conducting research on factors that affect earnings quality in companies, such as earnings volatility, income smoothing, good corporate governance and company size. The results of this study indicate that income smoothing and size affect the quality of banking earnings in Indonesia. This shows that banking companies perform income smoothing to obtain earnings quality. Besides that the size of banking assets greatly affects the quality of banking. Companies that have large assets are considered capable of generating quality profits, while on the contrary, companies that have relatively small assets produce low-quality profits).

The results of this study are expected to be useful for parties with an interest in the financial performance of the bank, such as investors, regulators, and other stakeholders. For investors, earnings information is important to determine the earnings quality of a company so that they can reduce information risk. Investors do not expect low earnings information quality because it is a signal of poor resource allocation. Investors and creditors use earnings reports to evaluate management performance, estimate earnings power and predict future earnings [11].

## 2 Literature review

### 2.1 Agency theory

Agency theory has become a strong research base in the disciplines of finance and accounting. Agency theory explains about two parties who have different interests, namely the principal and the agent. [15] state that in agency theory, agency relationships arise when one or more people (principals) hire another person (agent) to provide a service and then delegate decision-making authority to the agent. Agency theory results in an asymmetric relationship between the principal and the agent.

The asymmetric relationship between management (agent) and shareholders (principal) can provide opportunities for managers to take opportunistic actions such as earnings management regarding the company's economic performance so that it can harm the owners (shareholders). Managers will try to maximize their personal interests without the consent of the owners or shareholders. [16] states that agency theory is based on three assumptions of human nature, namely humans are generally self-interested (self-interest), humans have limited thinking power regarding future perceptions (bounded rationality), and humans always avoid risk (risk-averse).

Based on these human assumptions, the agent and the principal are both trying to maximize their respective interests. Shareholders as the principal want the maximum return on the investment they have invested. Meanwhile, the manager as the agent who is authorized by the principal to manage the company expects the maximum compensation or incentive for its performance. This ultimately causes managers to act inconsistently with the interests of shareholders. Thus there are two different interests in the company, and this can trigger a conflict called an agency conflict. The agency conflict will result in the nature of management reporting earnings opportunistically for their personal interests. This will result in low earnings quality. The low quality of earnings will result in users of financial statements making mistakes in making decisions such as investors and creditors so that the value of the company will decrease. To reduce agency conflict, supervision is needed. The supervisory mechanism that can be used is the corporate governance mechanism. The corporate governance mechanism as a system that regulates and controls the company is expected to provide supervision to the management as the agent in managing the company so that it can convince the principal that the agent has acted in accordance with the interests of the principal.

### 2.2 Earnings volatility and earnings quality

Profit volatility reflects the rise and fall of profits from a company at a certain time. High-profit volatility indicates a high level of profit fluctuation, while low-profit volatility indicates a low level of profit fluctuation. In other words, earnings volatility is a measure that describes the degree of stability of profits or income generated by conventional banks from year to year.

High-profit volatility will have a negative impact on the earnings quality of conventional banks. The higher the profit volatility, the greater the risk the bank has [3]. Therefore, managers in the banking sector and regulators have an interest in keeping the volatility of bank earnings to a minimum. Profit instability in conventional banks can also reduce the soundness of banks. The level of the soundness of a bank that is not good will certainly make potential investors or prospective customers reluctant to invest or keep their funds in the bank. Because they consider banks with unstable profits to be unable to provide certainty of returns for investors or customers.

[8] proves that earnings volatility has a positive effect on earnings management in the banking industry. This is in line with the research of [3] which states that a high level of earnings volatility indicates a high level of management discretion in conventional banks. High management discretion will reduce the quality of earnings in conventional banks.

Based on the theoretical studies that have been stated above and the results of previous studies above, the hypotheses proposed in this study are:

Ha1: Profit Volatility has a significant effect on Earning Quality

### 2.3 Income smoothings and earnings quality

Income smoothing is one of the earnings management practices that can be used to reduce fluctuations in earnings from year to year. The management's purpose of smoothing earnings is to get a good assessment from various parties, if profits look stable then management is considered capable of carrying out their duties in managing the company. The practice of earnings management with income smoothing will certainly harm interested parties in the financial statements. Given that investors will focus on the profits generated by the company, profits must reflect the actual situation. So, the practice of income smoothing is not good for the company because it indicates that the profit report provided by the company is an incorrect report.

[17] states that banks in Turkey perform income smoothing using a loan loss provision. Banks are more concerned with credit quality than the quality of company profits. [18] states that banks in Africa carry out income smoothing practices to facilitate bank income. The Bank will increase the loan loss provisions when potential losses on non-performing loans are expected to increase.

The effect of income smoothing on earnings quality is conveyed in [19] which states that income smoothing can improve earnings quality in Kuwait, the United Arab Emirates, and Oman. On the other hand, Rizqi, Murdayanti, and Utaminingsyas (2019) state that income smoothing has no effect on earnings quality. This is probably because investors do not get comprehensive information so they ignore income smoothing actions [20]. Based on the theoretical studies that have been stated above and the results of previous studies above, the hypothesis proposed in this study is:  
Ha2: Income Smoothing has a significant effect on Earning Quality.

### 2.4 Good corporate governance and earnings quality

Good Corporate Governance is a system that regulates and controls the relationship between company managers and company owners. The main objective of GCG is to manage the company's risk so that the company can meet its business goals and success. A good Good Corporate Governance (GCG) mechanism can improve earnings predictability and improve a firm's ability to produce high-quality earnings [21]. This is due to increased transparency in financial reporting which increases the accuracy of decision-making of users of financial statements. In other words, the mechanism of GCG, or what is commonly called good corporate governance will make the quality of earnings higher.

Wati and Putra (2017) show that the implementation

of good corporate governance has a positive effect on earnings quality because good corporate governance will improve company performance which affects the increase in quality earnings. This shows that the higher the GCG, the higher the earnings quality. Based on the theoretical studies that have been stated above and the results of previous studies above, the hypotheses proposed in this study are:

Ha3: Good Corporate Governance has a significant effect on Earning Quality.

### 2.5 Size and earnings quality

Company size reflects how often asset turnover occurs within the company. The greater the asset turnover, the greater the profit earned by the company. In other words, large companies are considered capable of managing company assets to generate maximum profit. This will be of concern to investors and the public in general. Quality earnings are earnings that reflect real profits and can reflect profits to be earned in the future, so the size of the company is one of the determining factors of quality earnings. This is in line with research conducted by [12] which states that the larger the size of the company, the greater the public's attention, so companies avoid earnings management behavior to maintain the reputation and trust of external parties.

However, this research is in contrast to research conducted by Nalarreason, Sutrisno, and Mardiati (2019) which states that large companies tend to face agency conflicts. The larger the company, the greater the possibility of information asymmetry. Large companies tend to carry out earnings management because large companies are under great pressure to meet the expectations of financial analysts. Based on the theoretical studies that have been stated above and the results of previous studies above, the hypothesis proposed in this study is:

Ha4: Firm Size has a significant effect on Earning Quality

## 3 Methods

### 3.1 Population and sample

The research method is a quantitative research method using multiple linear regression analysis with SPSS statistical test. As the study needs historical financial data, which are from annual reports, accessing publicly available data is assumed as a suitable method for the accuracy of the data. This study takes 30 samples of 41 banking companies consistently listed on the Indonesia Stock Exchange and publishes financial statements consecutively from 2016 to 2019.

### 3.2 Measures

This study uses some of the variable measurements listed in Table 1.

**Table 1.** Variable operationalization.

Variable	Definition	Proxy	References
Earnings Quality (EQ)	Quality earnings can reflect sustainable earnings in the future	$DA_{it} = (TA_{it} / A_{t-1}) - NDA_{it}$ Where: $DA_{it}$ = Discretionary Accruals of company $i$ in year period $t$ ; $TA_{it}$ = Total Accrual of company $i$ in year period $t$ ; $A_{t-1}$ = Total assets of company $i$ in period $t-1$ ; $NDA_{it}$ = Nondiscretionary Accruals of company $i$ in year period $t$	Dechow (1995)
Earnings Volatility (EV)	Profit volatility shows the level of profit fluctuations obtained by the bank from its operational activities for several periods	Standard deviation from ROA	Haan dan Poghosyan (2012)
Income Smoothing (IS)	To overcome the impact of earnings volatility, bank managers are suspected of using discretion in the form of income smoothing to generate more stable profits	$LIP = \text{Allowance for Impairment Losses} / \text{Total Asset}$	Oktavianti (2015) [8]
Good Corporate Governance (GCG)	The level of compliance that is reflected in the implementation of Corporate Governance in banks will affect bank managers in conducting income smoothing. The greater the level of compliance, the potential for income smoothing will decrease.	Composite Self Assessment from Surat Edaran BI No 9-12-DPNP Tanggal 30 Mei 2007	Wijayanti dan Diyanti (2017) [3]
Firm Size (SIZE)	Large companies that have reached the maturity stage reflect that their company is relatively more stable and more able to generate profits than other companies small.	Size = LN Total Asset	Putra dan Muharam (2015)

### 3.3 Data analysis

The data analysis method used is quantitative data analysis. In the data analysis stage, the hypothesis will be tested using panel data model regression analysis with statistical software e-views 10. Panel data regression analysis is used because this study combines data consisting of time series data and cross-section data. The result of panel data analysis is a regression coefficient for each statistical variable. This coefficient is obtained by predicting the value of the dependent variable with an equation. The regression model in this research is:

$$EQ = \alpha + \beta_1EV + \beta_2IS + \beta_3GCG + \beta_4SIZE + e$$

Where; EQ = Earnings quality, EV = Earnings volatility, IS=Income smoothing, GCG=Good corporate government, SIZE=Total Asset

## 4 Results and discussion

### 4.1 Numerical results

#### 4.1.1 Descriptive statistic

The results of descriptive statistical tests are presented in Table 2.

**Table 2.** Descriptive statistic.

	Y	X1	X2	X3	X4
Mean	-0.004657	1.612750	0.013067	2.035500	17.74996
Median	-0.004196	1.180000	0.008515	2.000000	17.50109
Maximum	0.017797	6.230000	0.157620	3.140000	21.07164
Minimum	-0.039560	0.030000	9.00E-05	1.000000	14.53747
Std. Dev.	0.007851	1.398983	0.018806	0.454000	1.787056
Skewness	-1.027468	1.401987	4.694054	0.221401	0.115200
Kurtosis	6.559156	4.746748	32.27240	4.575113	1.942254
Jarque-Bera	84.45178	54.56698	4725.050	13.38527	5.859548
Probability	0.000000	0.000000	0.000000	0.001240	0.053409
Sum	-0.558860	193.5300	1.568030	244.2600	2129.995
Sum Sq. Dev.	0.007335	232.9014	0.042087	24.52777	380.0347
Observations	120	120	120	120	120

Based on Table 2. It can be explained as follows:

- Earnings quality (Y) shows that the minimum value is -0.039560, owned by PT Bank BTPN Tbk in 2019. While the maximum value of 0.017797 is owned by PT Bank of India Indonesia Tbk in 2016. Earning quality is calculated from This discretionary accrual explains the average value of discretionary accruals in banking each year is -0.04657. This discretionary accrual is a part that cannot be explained by the economic phenomenon of the company.
- Profit volatility (X1) shows a minimum value of 0.03 owned by PT Bank Arta Graha Internasional Tbk in 2019. The maximum value of 6.23 is owned by PT Bank of India Tbk in 2017. The mean value obtained is 1.612750 where this value is greater than the standard deviation of 1.398983. This shows that the average profit of conventional banks studied does not have high-profit volatility. As for the bank whose profit fluctuates quite high, it can be seen again the condition of the company.
- Income smoothing (X2), the results of descriptive statistical tests show a minimum value of 0.00009 owned by PT Bank Pembangunan Daerah Banten Tbk in 2019. The maximum value of 0.157620 is owned by PT Bank of India Indonesia Tbk in 2016. The mean value The obtained value is 0.013067 where this value is smaller than the standard deviation value of 0.018806. This indicates that the companies studied are relatively small to perform income smoothing actions using the allowance for impairment losses.
- Good corporate governance (X3), the results of descriptive statistical tests show a minimum value of 1, from several companies that have this value there is one company that is stable to get this value during the research period, namely PT Bank OCBC NISP Tbk. The maximum value of 3.14 is owned by PT Bank Pembangunan Daerah Jawa Barat Tbk in 2016. The mean value obtained is 2.035 where this value is greater than the standard deviation value of 0.454 so it can be interpreted that the majority of companies have implemented good corporate governance (GCG). The smaller the value of X3 indicates the good implementation of GCG in the company.
- Company size (X4) shows a minimum value of 14.53747 and a maximum value of 21.07164. This value indicates that this study uses company data with various company sizes assessed from total assets. The minimum value is owned by PT Bank Harda Internasional in 2016 with a total asset value of IDR 2.06 trillion. While the maximum value is owned by PT Bank BRI Tbk in 2019 with a total asset value of IDR 1,416.76 trillion. While the average value (mean) of the firm size variable is 17.74996 where this value is greater than the standard deviation value of 1.787056, which means that the company size in this study is mostly close to the mean value. In other words, the average value of the company's total assets in this study is approximately IDR 51 trillion.

#### 4.1.2 Chow test result

In this study, only two tests were used to select the right model. The two tests are the Chow Test and the Hausman Test because the results of the Chow and Hausman tests produce the same panel data model, namely the Fixed Effect Model, so there is no need to do the Lagrange Multiplier test to determine other types of models. This test is to determine the most appropriate model to be used between the Fixed Effect Model (FEM) and the Pooled Least Square (PLS). The results of processing with the chow test can be seen in Table 3.

**Table 3.** Chou test result.

Effect Test	Statistic	Df	Prob
Cross-section F	1.880161	(29,86)	0.0133
Cross-section Chi-square	58.924291	29	0.0008

From Table 2, it is obtained that the F-Statistics is 1.880161 and the probability value is 0.0133, which means that the F-Statistical probability value is smaller than the 5% significance level ( $0.0133 < 0.05$ ). The appropriate model in this study uses the fixed effects model. And the test continued with the Hausman test to compare with the use of the random effect model.

#### 4.1.3 Hausman test result

The Hausman test is used to compare the most appropriate model between the fixed effect model and the random effect model. The Hausman test provides an assessment using the Chi-square statistic and the value  $\alpha = 5\%$  so that the decision to choose the model can be determined appropriately. The results of processing with the test results can be seen in Table 4 as follows:

**Table 4.** Hausman test result.

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f	Prob.
Cross Section Random	14.195138	4	0.0067

Based on the results of the Hausman test in table 3 above, the Chi-square statistic is 14.195138 with a probability value of 0.0067. Where this probability value is smaller than the 5% significance level ( $0.0067 < 0.05$ ). From this value, it can be concluded that  $H_0$  is rejected so the most appropriate model in this test is the fixed effect model. And to find out the feasibility of this model, the regression equation with the fixed-effect model will be continued with the classical assumption test.

#### 4.1.4 Normality test result

To test whether in the regression model the confounding or residual variables have a normal distribution or not be known by comparing the Jarque-Bera value with the Chi-Table, the data in the study are normally distributed [22]. The result of the normality test is Jarque-Bera's count value is 3.752028 and the profitability value is 0.153200 because the probability value is greater than

the significance level = 5% ( $0.153200 > 0.05$ ). So it can be concluded that the data in this study were normally distributed.

#### 4.1.5 Multicollinearity test result

The following is a multicollinearity test using variance inflation factors:

**Table 5.** Multicollinearity test result.

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.000116	255.7456	NA
EV	3.00E-07	3.000223	1.282081
IS	0.001530	1.757708	1.182185
GCG	4.12E-06	39.43287	1.853872
SIZE	2.12E-07	148.7639	1.480476

Table 5 by looking at the Centered VIF table proves that there is no multicollinearity problem. This is because the value of the correlation matrix of all independent variables is less than 10. Multicollinearity usually occurs in estimates using time series data. By combining time series with cross-section data, the multicollinearity problem can technically be reduced.

#### 4.1.6 Heteroscedasticity test result

The following are the results of the heteroscedasticity test with the white test:

**Table 6.** Heteroscedasticity test result.

F-statistic	1.653659	Prob. F(4,115)	0.1656
Obs*R-squared	6.526814	Prob. Chi-Square(4)	0.1631
Scaled explained SS	19.09663	Prob. Chi-Square(4)	0.0008

Based on Table 6 it can be seen that the probability value of chi-square is greater than  $\alpha = 5\%$  ( $0.1631 > 0.05$ ). This indicates that the data of this study does not contain heteroscedasticity. So it can be concluded that the research data is free from heteroscedasticity problems.

#### 4.1.7 Autocorrelation test result

This study, uses the Breusch-Godfrey method to determine whether there is autocorrelation in the observation data. According to the Breusch-Godfrey method, there is no autocorrelation if the probability  $> = 5\%$ . The following are the results of the autocorrelation test:

**Table 7.** Autocorrelation test result.

F-statistic	1.293974	Prob. F(2,113)	0.2782
Obs*R-squared	2.686732	Prob. Chi-Square(2)	0.2610

Based on Table 7 it states that the probability value is  $> 5\%$  ( $0.2782 > 0.05$ ). So this indicates that this study does not contain autocorrelation. So it can be concluded that the research data is free from autocorrelation problems.

#### 4.1.8 Goodness of fit test

In this study, the feasibility test of the model used included: the significance test of the coefficient of determination, partial test (t-test), and simultaneous significance test (F statistic test). The results of testing the coefficient of determination (adjusted R square) are:

**Table 8.** The goodness of fit test result.

R-squared	0.477421	Mean dependent var	-0.004657
Adjusted R-squared	0.276896	S.D. dependent var	0.007851
S.E. of regression	0.006676	Akaike info criterion	-6.947028
Sum squared resid	0.003833	Schwarz criterion	-6.157239
Log-likelihood	450.8217	Hannan-Quinn criter.	-6.626291
F-statistic	2.380857	Durbin-Watson stat	2.089125
Prob(F-statistic)	0.000728		

Based on Table 8 the coefficient of determination is 0.276896 or 27.69%. It can be seen that 27.69% of earnings quality can be explained by independent variables such as earnings volatility, income smoothing, good corporate governance, and firm size. While 72.31% is explained by variables outside of the independent variables used, such as liquidity, profitability, audit quality, and others.

The results of multiple regression with panel data using the fixed effects model F-table is 2.45 where this value is greater than the F-count of 2.380857. And when viewed from the probability value of 0.000728 < 0.05. So from these results, it can be concluded that it shows that earnings volatility, income smoothing, good corporate governance, and company size simultaneously have a significant effect on earnings quality.

#### 4.2 Hypothesis test result

The results of the t statistical test with a significant level ( $\alpha$ ) of 0.05 obtained the following coefficient values:

**Table 9.** Hypothesis test result.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.283206	0.093379	3.032865	0.0032
EV	0.000962	0.001147	0.838965	0.4038
IS	0.110349	0.041370	2.667402	0.0091
GCG	-0.000236	0.002839	-0.082986	0.9341
SIZE	-0.016359	0.005354	-3.055696	0.0030

The regression coefficient of EV is 0.000962 with a t-statistic of 0.838965 and sign 0.4038 > 0.05, it can be stated that the earnings volatility variable has no significant effect on earnings quality. Profit volatility as measured by the standard deviation of return on assets (ROA) has not been able to provide an illustration that conventional bank profits do not reflect the actual conditions. The results of this study are different from [8] who states that earnings volatility affects earnings management practices in the banking industry. However, the results of this study are in line with research conducted by [6] that bank financial performance seen from several indicators such as ROA, ROE, and others, does not have a significant effect on

the quality of bank earnings. This can happen because of the nature and characteristics of the bank which is highly regulated by the regulator and seeks to show good company performance. So that the volatility of earnings in this study describes the rise and fall of profits in conventional banks due to an increase in assets, the majority of which comes from credit realization. When the bank is able to increase the outstanding credit, the profit will also increase. The increase in profit due to increased credit can increase the bank's health ratio, such as ROA. However, when the resulting credit is problematic and creates a Non-Performing Loan (NPL) for the bank, it will reduce ROA value and will affect the soundness of the bank. Credit quality can be one of the factors that support the emergence of earnings volatility. The addition of the NPL ratio will be a deduction factor for the bank's profit, and vice versa, the decrease in the NPL ratio will increase the bank's profit and soundness level.

The results of statistical analysis in this study stated that the regression coefficient of IS is 0.110349 with a t of 2.667402 and a significance of 0.0091 < 0.05, it can be stated that the income smoothing variable has a significant effect on earnings quality. The application of PSAK 55 makes bank management have the policy to evaluate debtor credit. Management's policy in evaluating debtor credit to determine the amount of CKPN to be formed is indicated as part of earnings management. Because the size of the CKPN value will affect the profits to be received by the company. Therefore, management will try to reduce CKPN costs by providing good evaluation results on lending to debtors. Especially when the company's profit is less than the predetermined target. This is in line with the research of [3] which states that conventional bank NRE has a negative effect on LLP. Where this indicates that the cost of allowance for losses will decrease when profits are high. And the cost of allowance for losses will increase when profits are low. Through income smoothing, management tries to improve the quality of earnings in order to attract external parties to invest their funds in them. It is important for external parties to know, especially investors, before deciding to invest their funds. Where the movement of the value of loan loss provisions needs to be considered because a low LLP value does not mean the bank is performing well, and vice versa. The results of this study are also in line with several other studies such as those conducted by ([8], [17], [19], [23]) which state that income smoothing through Loan Loss Provisions has a significant effect on earnings quality in the banking industry.

Based on the results of statistical analysis in this study that the regression coefficient of GCG is 0.000236 with a t statistic of -0.082986 and a significance of 0.9341 > 0.05. Because the significance value > 0.05, it can be stated that the good corporate governance variable has no significant effect on earnings quality. Bank Indonesia in its circular letter No. 9-12-DPNP dated 30 May 2007 [24] requires commercial banks in this case conventional banks to be able to conduct self-assessments in terms of the implementation of good corporate governance. The results of the Good Corporate Governance assessment in conventional

banks indicate that the conventional banks studied have implemented good business governance, but it is not enough to prove that the bank has a fairly good earnings quality. In [13] research state that the application of good corporate governance has no significant effect on the quality of corporate earnings. And external stakeholders tend not to pay attention to the self-assessment carried out by the management. The composite value of good corporate governance does not affect the decision of investors to invest in the company. External stakeholders such as customers and investors are more focused on the interest rate of return offered by banks.

Based on the results of statistical analysis in this study that the regression coefficient of SIZE is -0.016359 with a t of -3.055696 and a significance of 0.0030 <0.05, it can be stated that the firm size variable has a significant effect on earnings quality. Company size reflects the number of assets owned by the company. Companies with large assets can indicate management has good performance. Banks with large assets will attract investors to invest in the bank. Because investors think that management is able to perform well, it will affect the return on their investment. So that banks with large sizes will be more careful and pay attention to the quality of their performance. The size of the company is related to the quality of earnings because the higher the continuity of the company's business is accompanied by improving financial performance which can make the company grow or increase in revenue or profits. The results of this study are in accordance with the research of [12] which states that company size affects the quality of company earnings.

## 5 Conclusion

This study investigates the effect of profit volatility, income smoothing, GCG, and company size on earnings quality in banks listed on the IDX in 2016-2019. Profit volatility has no significant effect on earnings quality in banks listed on the IDX in 2016-2019. The rise and fall of the value of banking profits have no significant effect on the quality of earnings. Profit fluctuations do not always indicate that profits do not reflect the actual situation. High-profit volatility can occur due to a significant increase in the amount of credit or a decrease in credit quality that can erode company profits. If this is proven, then the volatility of earnings does not affect the quality of earnings, because bank profits have explained the actual conditions. Therefore, it is necessary to deepen further related to other supporting factors of earnings volatility, it is necessary to deepen research related to quality with factors that can influence the occurrence of earnings volatility. Income smoothing has a significant effect on earnings quality in banking companies listed on the IDX in 2016-2019. The size of the Loan Loss Provisions reserved by conventional banks has a significant effect on earnings quality. Income smoothing with LLP indicates management's discretion in determining the amount of allowance for losses that will be formed. Banks tend to hold back the

formation of loss reserves when profits are deemed insufficient to meet the set targets. Vice versa, reserves for losses will be formed when the bank has excess profits compared to the previous period. GCG does not affect the profit quality of conventional banks listed on the IDX in 2016-2019. Based on this research, the results of self-assessment on the implementation of GCG by conventional banks have no effect on the quality of banking profits. In this study, conventional banks in Indonesia have a fairly good score. This is good for conventional banks because banks are considered capable of implementing good governance by taking into account many factors. And banks are considered open to the public. However, this has not become the main factor for investors to invest in the banking industry. The main focus of investors is still related to the return they will receive. SIZE has a significant effect on the quality of conventional banks listed on the IDX in 2016-2019. The size of the company seen from the size of banking assets greatly affects the quality of banking. Companies that have large assets are considered capable of generating quality profits, while on the contrary, companies that have relatively small assets produce low-quality profits).

Future research should use other independent variables that can affect earnings quality, such as audit quality. Because one of the important elements in assessing the company's performance is an audit of the company's financial statements in one accounting period by an independent auditor from the Public Accounting Firm who will provide an opinion on whether the financial statements are prepared with financial accounting standards. So that investors can respond to the earnings information as an indication of intervention from the company's management on the financial statements so that profits have increased and use other proxies such as management discretion regarding the determination of the value of loan loss provisions, loan paid offs, etc. so that they can be compared with proxies that have been used so that it will be obtained which proxy is more ideal to be used as a proxy for quality. profit. If using the same type of company and proxy, further research can add to the effect of the implementation of the latest PSAK, namely PSAK 71 which replaces PSAK 55 related to allowance for impairment losses. Where in PSAK 71 companies are required to provide an allowance for impairment losses since the beginning of the credit period.

The results of this study are expected to be taken into consideration in making investment decisions by analyzing the company's performance from previous years in order to accurately assess the quality of the company's earnings and avoid the risk of investment losses. In addition, it considers the total assets and credit quality of the company so that it can be seen the level of maturity of the company which is considered to have prospects in generating better profits in the future and producing better returns. The information obtained from this research is expected to be used as consideration in making decisions regarding the importance of maintaining the quality of earnings in order to attract investors to invest in the company.



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