

Fair Value Disclosures Score Analysis of Indonesian Banking based on Pillar 3 of Basel II

Ita Mustika ¹, Desyana Putri ², Iskandar Muda ³

¹ Ibnu Sina University, Indonesia.

² STIE Harapan Duri, Indonesia.

³ Universitas Sumatera Utara, Indonesia.

¹ ita@uis.ac.id, ² desyanaputriku@gmail.com, ³ iskandar1@usu.ac.id

Article Info

Page Number: 1195-1202

Publication Issue:

Vol. 71 No. 3s (2022)

Article History

Article Received: 22 April 2022

Revised: 10 May 2022

Accepted: 15 June 2022

Publication: 19 July 2022

Abstract

This research aims to know about the implementation of Fair Value Disclosures Score Analysis of Indonesian Banking based on Pillar 3 of Basel II to financial statements as regulated by PSAK 68. To minimize this risk, Basel II is implemented to increase standards for banks that go public to manage their risk management properly. The research method used is a quantitative descriptive approach by measuring the value of CAR, BOPO, NPL, and ROA in the Indonesian Banking Statistics report. The results of the analysis show that the implementation of fair value disclosure average already has an increased level of risk management.

Keywords: Fair value, PSAK 68, basel II, risk management.

JEL Classification Codes: D81, G21, G32.

1. Introduction

Indonesia's economic growth cannot be separated from the role of banks in extending credit to those in need. Credit growth and economic growth are interrelated. This relationship shows that credit growth requires good economic conditions, while credit growth encourages economic growth. Indonesia's credit distribution has experienced good growth in five years with rate of 12.01%. The main contributors to credit growth were State-Owned Commercial Banks, followed by Regional Development Banks (BPD), National Private Commercial Banks (BUSN), Foreign Exchange Banks, Joint Venture Banks, and Foreign Banks. Meanwhile, lending from Non-Foreign Exchange National Private Commercial Banks declined. This phenomenon shows the good performance of Indonesian banks as intermediaries nationally (Suryanto, 2019). According to accounting-based risk measures, on average, banks in Indonesia, Singapore, and Australia can be stated to be the most stable compared to banks in Japan and Taiwan. However, banks in Indonesia have a higher probability of bankruptcy than in Singapore, Malaysia, and Australia, which are thought to be due to bad credit problems (Fu, Lin, & Molyneux, 2014). Therefore, high credit growth needs to be balanced with good supervision. Apart from generating income, excessive credit growth can also lead to losses and bankruptcy for banks. Saving banks from the threat of bankruptcy is the main focus of regulators in several countries, including Indonesia. The Basel

Committee on Bank Supervision (BCBS) is an international body whose mission is to improve financial stability by strengthening regulation and supervision of banking operations worldwide. Indonesia as a member of the BCBS has adopted various regulations agreed upon by the BCBS as outlined in the Basel Accords I, II, and III. Bank Indonesia has developed and implemented the basic framework for a comprehensive banking system by introducing the Basel Accords I, and II, III known as the Indonesian Banking Architecture (API) concerning the contents of the Basel Accord (Suryanto, 2019).

Research related to the Basel accord I, II, III Yoseph Y.F. (2018) stated that to minimize the worst risks and bankruptcies in banking, Basel II has been implemented to better manage risk management by increasing standards for public banks. With the increasingly complex risks of the banking industry, good corporate governance practices are needed. According to Suhardjanto & Rahmawati (2012) in their research, the results of multiple regression analysis show that the size of the board of commissioners affects the level of operational risk disclosure. The board of commissioners has a central role in corporate governance, ensuring corporate strategy, monitoring management, and providing accountability. Risk disclosure, including operational risk, is becoming increasingly important in the new Capital Framework (Basel II), especially to meet market discipline aspects related to transparency and disclosure of business risks, strengthen supervision, improve security, sound banking, and financial systems (BCBS, 2001). Finally, the historical cost concept is no longer used because it does not reflect market value (Wilestari & Afriani, 2019). The research of Haq & Pratama (2021) stated that the quality of accounting information increased after the implementation of IFRS and no difference in the quality of accounting information before and after the implementation of IFRS 15. The importance of supervising banking operations is carried out, to improve financial stability by strengthening regulations in Indonesia. Based on this background, this research was conducted to analyze the fair value disclosure in Indonesian banking which is based on the three pillars of Basel II.

2. Literature Review

2.1. Banking Public Hearing

The Bank in the form of a business entity, which does not only pursue profit because its wealth is mainly in the form of financial assets, but also has profit and social motives. Go Public refers to the sale of securities (shares) by a company to the public for the first time (Yoseph Y.F., 2018).

Companies that have gone public get several benefits, including:

- a. Get new funding sources.
- b. There are advantages to growing their business.
- c. The financing of acquisitions or mergers by other companies can be done through the issuance of new shares.
- d. Improve company viability.
- e. The company's image has been enhanced.
- f. Add company value.

In addition to the benefits, a go-public company will also get various consequences with the status of a public company, including:

- a. Share ownership.
- b. Comply with applicable capital market regulations.
- c. Increased reporting costs.
- d. Fear of being taken over.
- e. The go-public process sacrifices energy and time

2.2. Basel II Implementation

Basel II to improve risk management as a rule of international banking agreements and is contained in the Bank of International Settlement (BIS). The Basel Committee as a simple standard, requiring banks to always separate their exposures into broader classes, reflecting the common types of debtors (Ritonga et al., 2020). The exposures to customers will have the same capital requirements, credit repayment capabilities and the risks of each customer (Yoseph Y.F., 2018). The framework for calculating capital that is more risk-sensitive and provides incentives for improving the quality of risk management implementation in banks (Ginting et al., 2020). The capital requirements to the risk of credit losses and also by introducing in the capital calculation of the risk of losses due to bank operational failures (Yoseph Y.F., 2018).

The aspect of transparency can expand the involvement of market players to create market discipline in the banking industry. There are three things that banks must pay attention to in implementing Basel II:

1. Banks must understand and study the various applications of the Basel II concept and the ability of banks to implement risk management is an absolute must.
2. Each bank needs to carry out a balanced analysis based on this understanding of Basel II.
3. Each bank is expected to be able to immediately find out the impact of the implementation of Basel II with more certainty on the amount of capital adequacy.

2.3. Fair Value

A framework which contain regulations regarding the recording, preparation, treatment, and presentation of financial statements prepared by the Indonesian Institute of Accountants have been agreed upon and have been approved by an official institute or institution in Indonesia (Wilestari & Afriani, 2019).

Based on PSAK No. 68 of 2013 concerning Fair Value Measurement, Fair value valuation techniques are (1) Market Approach uses involving assets, liabilities, or groups of assets and liabilities that are identical or similar to those of a business and (2). Cost Approach reflects the amount currently required to replace the asset's service capacity or as a current replacement cost, (3) Income Approach converts future amounts to a single discounted present amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts. Fair value measurement consists of 3

levels of measurement (Santoso et al., 2020). Meanwhile, level 3 uses unobserved inputs. For example, a manager may estimate fair value using the discounted value of future cash flows. This will require projections of future cash flows, level 3 inputs, and other inputs, such as credit-adjusted risk-free interest rates (Lin, Lin, Fornaro, & Huang, 2017).

3. Methods

This study uses a quantitative descriptive approach using secondary data that is accessed online. The statistical data used in this study is sourced from Statistik Perbankan Indonesia (SPI) data issued by the OJK in the last six months (September 2021 - February 2022). The entire data used in this research is sourced from OJK via <https://www.ojk.go.id/>. The fair value analysis carried out in this study is CAR, NPL, BOPO, ROA (Return on Assets) at Commercial Banks listed in Indonesian banking based on Pillar 3 Basel II.

4. Result and Discussions

4.1. Result

Online secondary data collection in Statistik Perbankan Indonesia (SPI) report, which is a publication media that presents Indonesian banking data. The SPI is published monthly to provide a periodic overview of banking developments in Indonesia. SPI is also a Valuation Standard for Financial Reporting, which provides arrangements for appraisers in providing information related to fair value, in the context of financial reporting.

The number of conventional Commercial Banks and Branch Offices of Banks Domiciled Abroad recorded by OJK as of February 2022 is 107 banks. According to the grouping based on the Core Capital Banking Office (KPMI), commercial banks consist of 73 KBMI-1 banks, 18 KBMI-2 banks, 12 KBMI-3 banks, and 4 KBMI-4 banks. Meanwhile, based on ownership, commercial banks consist of 4 State-Owned Banks, 27 Regional Development Banks (BPD), 68 National Private Banks, and 8 as Banks Domiciled Abroad. The total number of commercial bank offices recorded at OJK is 28,530 offices. The following is data for the last six months of commercial bank performance in Indonesian banking.

Table 1. Commercial Bank Performance Data in Indonesian Banking

Ratio	Sep 21	Oct 21	Nov 21	Des 21	Jan 22	Feb 22	Average
CAR	25,18%	25,32%	25,59%	25,66%	26,00%	25,99%	25,62%
BOPO	83,68%	83,12%	82,97%	83,55%	80,90%	79,91%	82,36%
NPL	3,22%	3,22%	3,19%	3,00%	3,10%	3,08%	3,14%
ROA	1,91%	1,93%	1,91%	1,85%	2,56%	2,36%	2,09%
Source: Processed Data, 2022							

Based on Table 1, the average CAR (Capital Adequacy Ratio) is 25.62%, BOPO (Operating Costs Per Operating Income) is 82.36%, and NPL (Non-Performing Loans) is 3.14%, and ROA (Return on Assets) is 2.09%.

4.2. Discussions

Fair Value is Regulated by PSAK 68

Fair value is regulated by PSAK 68 regarding fair value measurement. PSAK 68 regulates measurement using observable input information, and valuation techniques. Fair value is measured by considering information at the reporting date and does not include information that contains predictions about the future. PSAK 68 fair value measurement was passed on December 19, 2013 which adopted IFRS 13 as of January 1, 2013. This rule was adjusted again on August 27, 2014, and became effective as of January 1, 2015. PSAK 68 states that fair value is a market-based measurement, not a specific measurement of an entity (PSAK 68 of 2015 paragraph 02). This explanation illustrates that the purpose of determining fair value is to estimate the price at which an orderly transaction to sell an asset or transfer a liability will occur between market participants on the measurement date that has been determined. The main focus of this regulation is on assets and liabilities because the main subject of accounting measurement (PSAK 68 of 2015 paragraph 04). During the 2020 Covid-19 pandemic, fair values reported by banks tend to involve measurements based on unobservable inputs (level 3) that reflect how market participants will weigh the effects of COVID-19 in their expectations of future cash flows related to assets, or liability at the reporting date. This is also done to avoid high volatility and a significant decrease in transaction volume on the stock exchange and to influence bank considerations in determining the fair value of securities (OJK, 2020). Furthermore, post-pandemic in the last six months based on Indonesian Banking reports tend to involve level 1 inputs that use active market prices at the fair value measurement date through profit or loss and other comprehensive income related to financial assets and liabilities as of the main subject of accounting measurement. Financial information with a fair value approach is more relevant and can provide more accurate information in predicting the financial performance of Indonesian banks.

Capital Adequacy Ratio

The provisions for the Basel Accord II minimum capital limit have been outlined in POJK No. 11/POJK.03/2016 concerning Minimum Capital Adequacy Requirements for Banks. Article 2 paragraph (3) explains that the minimum capital adequacy is set at a minimum of 8%. This stipulation is also an instrument of bank supervision, especially in Article 3 paragraph (2) part an of OJK Regulation No.15/POJK.03/2017 which explains that intensive supervision is carried out if it is considered to have potential difficulties that endanger business continuity, including for banks that have less CAR. of 8%. Based on Table 1 the average CAR ratio is 25.62% which indicates a good capital adequacy ratio because the ratio is greater than 8%. The average CAR results obtained at Commercial Banks in the last six months are better than in previous years reported by Suryanto (2019). This result also shows that the higher the CAR value, the better the bank's ability to bear the risk of any risky productive asset (Yanti, 2020). The fulfillment of banking regulations regarding capital is expected to maintain the sustainability of the bank's business because capital is one of the sources to absorb the risks that will be faced by banks (Kabir Hassan, Unsal, & Emre Tamer, 2016).

Operating Cost Per Operating Income Ratio

Bank efficiency is even now a very important factor for OJK to consider opening new offices or networks. Article 21 paragraph (1) explains that OJK considers achieving the level of bank efficiency in approving the number of office networks that are planned to be opened by banks by the bank's business plan. Paragraph (2) of the article explains that the achievement of a bank's efficiency level is measured by, among others, the ratio of Operating Costs to Operating Income (BOPO). Based on Table 1, the development of banking efficiency in Indonesia using the BOPO parameter has a ratio score in the last six months showing a recent decline of 79.91% indicating that commercial bank operations are getting better, while the average BOPO ratio is 82.36%. If a bank's BOPO ratio in a year decreases from the previous year, the bank's operations will be more efficient. On the other hand, if a bank's BOPO ratio increases in one year from the previous year, then the bank's operations are increasingly inefficient (BPS, 2022).

Non-performing Loan Ratio

Banks which explains the ratio of non-performing loans or the ratio of non-performing loans to a maximum of 5% of total loans or total financing. Table 1 shows that during the last 6 months the performance of commercial banks in Indonesian banks generally had an NPL value below 5%. The average NPL value is around 3%, this shows the ratio of non-performing loans at commercial banks to Indonesian banks is still well controlled. This result is not much different from the previous year reported by Suryanto (2019). Judging from the level of compliance, conventional banks in general have tried to comply with OJK regulations regarding the maximum limit for NPL. By Regulation No.15/POJK.03/2017, bank compliance is encouraged by conducting supervision in the form of normal supervision, intensive supervision, and special supervision. Article 3 paragraph (2) part d of OJK Regulation No.15/POJK.03/2017 explains that banks under intensive supervision are determined by the OJK if banks are considered to have potential difficulties that endanger business continuity, including banks that achieve an NPL of more than 5%. However, if the condition worsens, the supervision status can be increased to special supervision.

Profitability

ROA is one of the profitability ratios that can measure the company's ability to generate profits from the assets used. ROA can measure the company's ability to generate profits in the past and then project in the future (Yanti, 2020). Based on Table 1 shows an increasing ROA in the last 6 months. This indicates that the ability of Indonesian banking companies to generate profits in the future is getting better.

Based on the analysis carried out on the CAR, BOPO, NPL, and ROA scores, it shows that the performance of Indonesian banking in the last six months is getting better after the post-pandemic. This is possible because activities and restrictions in daily activities have been lifted by the government. These results also show that the average ability of Indonesian banks to implement Basel II has an improved level of risk management.

5. Conclusion

The asset valuation of banking and risk management companies, the CAR ratio is 25.62% which indicates a good average capital adequacy ratio. The BOPO parameter also shows a decline which indicates that commercial bank operations are getting better. The average NPL value of around 3% also shows that the ratio of non-performing loans at commercial banks in Indonesia is still well controlled. Likewise, the ROA parameter shows that the ability of Bank Indonesia Commercial Banks to generate profits in the future is getting better. From these several parameters, in Indonesian banking has an increasing level of risk management.

References

1. BCBS. (2001). Basel II: The New Basel Capital Accord.
2. Central Bureau of Statistics (BPS). (2022). Operating Costs and Operating Income (BOPO). Retrieved May 28, 2022, sirusa.bps.go.id website: <https://sirusa.bps.go.id/>
3. Fu, X. (Maggie), Lin, Y. (Rebecca), & Molyneux, P. (2014). Bank competition and financial stability in Asia Pacific. *Journal of Banking and Finance*, 38(1), 64–77. <https://doi.org/10.1016/j.jbankfin.2013.09.012>
4. Ginting, S.F.B.R, Lase, R.T.M, Muda, I, (2020). BASEL III Pilar and Internal Capital Adequacy Assessment Process (ICAAP): Implementing ICAAP in Indonesian Banking Sector. *Turkish Online Journal of Qualitative Inquiry*. 11(4). 735- 740. <https://tojqi.net/index.php/journal/article/view/6715>
5. Malla, S., M. J. . Meena, O. . Reddy, R, V. . Mahalakshmi, and A. . Balobaid. “A Study on Fish Classification Techniques Using Convolutional Neural Networks on Highly Challenged Underwater Images”. *International Journal on Recent and Innovation Trends in Computing and Communication*, vol. 10, no. 4, Apr. 2022, pp. 01-09, doi:10.17762/ijritcc.v10i4.5524.
6. Haq, V.H. El, & Pratama, A. (2021). Implementation Of Ifrss 9, 15, And 16 Towards Accounting Information Quality: An Indonesian Case Study. *Academy of Accounting and Financial Studies Journal*, 25(Special Issue 4), 1–8.
7. Kabir Hassan, M., Unsal, O., & Emre Tamer, H. (2016). Risk management and capital adequacy in Turkish participation and conventional banks: A comparative stress testing analysis. *Borsa Istanbul Review*, 16(2), 72–81. <https://doi.org/10.1016/j.bir.2016.04.001>
8. Lin, Y.H., Lin, S., Fornaro, J.M., & Huang, H.W.S. (2017). Fair value measurement and accounting restatements. *Advances in Accounting*, 38(September), 30–45. <https://doi.org/10.1016/j.adiac.2017.07.003>
9. Financial Services Authority (OJK). (2020). Guidelines For Application Of Psak 71 And Psak 68 For Banking During The Covid-19 Pandemic. Press Release SP 28/DHMS/OJK/IV/2020, 1-3.
10. Pawan Kumar Tiwari, P. S. . (2022). Numerical Simulation of Optimized Placement of Distibuted Generators in Standard Radial Distribution System Using Improved Computations. *International Journal on Recent Technologies in Mechanical and Electrical Engineering*, 9(5), 10–17. <https://doi.org/10.17762/ijrmee.v9i5.369>
11. Ritonga, R, Sinukaban, F.D, Muda, I (2020). Basel Internal Control As Corporate Governance For Bank. *Turkish Online Journal of Qualitative Inquiry*. 11(4). 712-717.

12. <https://tojqi.net/index.php/journal/article/view/6712>
13. Santoso, M.R., & Muda, I. (2020). Shareholders and Firm Value for Manufacturing Companies Listed in Indonesia Stock Exchange. *Journal of Economics, Business, & Accountancy Ventura*, 23(1), 138-147.
14. Ghazaly, N. M. . (2022). Data Catalogue Approaches, Implementation and Adoption: A Study of Purpose of Data Catalogue. *International Journal on Future Revolution in Computer Science & Communication Engineering*, 8(1), 01–04. <https://doi.org/10.17762/ijfrsce.v8i1.2063>
15. <https://journal.perbanas.ac.id/index.php/jebav/article/view/2171>
16. Suhardjanto, D., & Rahmawati, E. (2012). The Role of the Board of Directors in Operational Risk Disclosure: An Empirical Study of Indonesian Banking. *Trichonomics*, 11(1), 1–14.
17. Suryanto, D.A. (2019). Credit Growth in Indonesia: An Analysis of Bank Compliance with the Implementation of the Basel Accord I-III. *ASSET Journal (Research Accounting)*, 11(2), 224–237.
18. Wilestari, M., & Afriani, W. (2019). Application of Fair Value for Asset Valuation of Banking Companies at Bank Permata, Tbk. *Journal of Accounting and Finance*, 1(1), 1–14.
19. Yanti, T.A. (2020). Analysis of the Effect of Credit Risk on Profitability of Islamic Banks in North Sumatra. *Economics, Finance, Investment and Sharia (EQUITY)*, 1(2), 93–99.
20. <https://ejurnal.seminar-id.com/index.php/ekuitas/article/view/103>
21. Yoseph Y.F., D. (2018). Risk Management Analysis in Go Public Banking Companies. *BIP's Journal of Business Perspective*, 10(2), 161–174. <https://doi.org/10.37477/bip.v10i2.60>
22. Vanitha, D. D. . (2022). Comparative Analysis of Power switches MOFET and IGBT Used in Power Applications. *International Journal on Recent Technologies in Mechanical and Electrical Engineering*, 9(5), 01–09. <https://doi.org/10.17762/ijrmee.v9i5.368>
23. 2.