

Comparison Of Conservatism In Islamic And Conventional Banks In Indonesia And Malaysia

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Abstract: Malaysia and Indonesia are two of the ten countries with the largest total assets of Islamic financial markets in the world. The religiosity of a company can influence one of the qualities of accounting. The accounting quality of a company can be measured from accounting conservatism. This study aims to determine the comparison of conservatism between Islamic banks and conventional banks. The samples are Islamic banks and conventional banks in Indonesia and Malaysia from 2013 to 2017. The samples are 13 Islamic banks and 45 conventional banks so that the total sample is 290 observations. Data analysis using pooled least square regression. The result showed that conventional banks in Indonesia tend to be more conservative compared to sharia banks and sharia banks in Malaysia tend to be more conservative compared to conventional banks. Furthermore, changes in non-performing loans and changes in loan charge-offs have positive effect on conservatism.

Keywords: conservatism, Indonesia, Malaysia, religiosity.

INTRODUCTION

The accounting quality of a company can be measured from accounting conservatism and earnings management of the company (Abdelsalam *et al.*, 2016). The religiosity of a company can influence one of the qualities of accounting. Some previous studies have proven that religiosity has an important role in shaping the behaviour of a company. Religiosity provides significant benefits for the company and its shareholders (Callen and Fang, 2015). The religiosity of a good company can result in better corporate governance and a stronger legal environment (Li and Cai, 2016).

One form of application of religiosity in the company is the application of the Islamic financial system. The Islamic financial system has now been applied in the financial sectors of various countries in the world. The sector is currently developing and continues to increase from year to year and has reached a total value of \$ 1.88 trillion. Based on the 2016 Islamic Financial Services Industry Stability Report, the Islamic banking sector is the dominant sector in the Islamic financial sector (IFSB, 2016). This sector controls 80% of the global Islamic finance sector. Its total assets have continued to increase since 2008. In 2015, the amount reached \$ 1.5 trillion, up 1.4% from 2014. The main difference between Islamic banks and conventional banks is on the religiosity

principle applied in operations. Islamic banks do not use the interest mechanism, but the principle of profit sharing, buying and selling, or leasing.

The concept of religiosity in Islamic banking will improve employee performance accountability in Islamic banking (Abdelsalam *et al.*, 2016). Islamic financial system ensures justice between savers and investors. By demolishing risk-free return and promotion of profit and loss sharing, justice is ensured for both parties i.e. capital supplier as well as capital user. As a model of modern commercial banking, initially capital is supplied by depositors and later on by bank to business community. Under Islamic financial system bank can invest in businesses to earn variable return based on actual results of activities and share profit earned with depositors based on agreed sharing formula. Hence it is ensured to distribute the actual outcome, and none is to bear risk alone and none is to earn with zero risk.

In particular, due to the wide spectrum of Islamic bank accountability, the Shariah broadens the concept of stakeholder interest and business legitimacy to include socio-religious compliance and ethics in the governance system of this alternative banking industry (Haridan *et al.*, 2018). Meanwhile, in their research they found that Sharia Boards members, whose ultimate responsibility is to serve as agents to both shareholders and other stakeholders, were found not to be diligently performing their fiduciary duty of religious compliance as they remained heavily dependent on the outcome and results presented to them by internal officers thus compromising independence. This means despite religious environment, those Sharia Boards member couldn't maintain conservatism in place.

(Ullah *et al.*, 2018) highlighted that some Islamic banks engage in recruiting liberal scholars to attain permissibility of action especially when dealing with Islamic transactions or financial contracts. The concern was raised because managers may attempt to dictate to Sharia Boards' decisions and opinions to tie up to their goal and objectives which is referred to by the authors as "Fatwa Shopping".

Based on the 2015/2016 State of the Global Islamic Economy Report, Malaysia is considered the most successful country in developing the Islamic economy in its Islamic financial system (Thomson, 2016). Besides, the Malaysian Islamic financial system is also considered to have the highest ranking globally. This assessment is based on the number of Islamic financial assets and the number of Islamic financial institutions in the country. Malaysia and Indonesia are among the 10 countries with the largest total Islamic financial market assets in the world. Since banks operate in a highly regulated environment, in that they are monitored by Central Banks and other regulatory agencies, softer dimensions such as religion may not be as important in constraining earnings management (Kanagaretnam *et al.*, 2015), which means they tend to be more conservative. Many companies considered accounting conservatism to limit the amount of risk in accounting information.

Tests are performed using pooled least square regression. The results showed that conventional banks tended to be more conservative than Islamic banks in Indonesia whereas in Malaysia Islamic banks tended to be more conservative compared to conventional banks. This research gave the empirical evidence that conventional banks in Indonesia tend to be more conservative compared to sharia banks in Indonesia, and sharia

banks in Malaysia tend to be more conservative compared to conventional banks in Indonesia. Furthermore, changes in non-performing loans and changes in loan charge-offs have positive effect on conservatism.

THEORITICAL REVIEW

International Accounting Standard Board (IASB) defines conservatism as a precautionary approach to the determination of judgment needed to make estimates in conditions of uncertainty that are always inherent in the company, keeping assets and income not overstated, and liabilities and expenses not understated. Financial Accounting Standard Board (FASB) in Statement of Financial Accounting Concepts No. 2 means conservatism as a precautionary measure against uncertainty, as an effort to ensure that the uncertainties and risks inherent in the company's business can be overcome. However, the accounting conservatism policy may be inconsistent with accounting standards, thus an estimation that are not demonstrable and potentially subject to manipulation maybe created (Khudhair Al-Taie *et al.*, 2017).

Accounting conservatism secures for the debtors' stricter policies in declaring profits and, consequently, limits profit distribution, as this provides the company with a better opportunity to meet its liabilities (Hamdan *et al.*, 2012). Accounting conservatism is considered a financial approach by many companies to limit the amount of risk in accounting information. Conservatism in this study was measured using a model from (Leventis *et al.*, 2013) by linking loan loss provisions with non-performing loans last year, current and future years and loan charge-offs for the current and future years.

Measurement of Conservatism. As mention before, accounting conservatism is considered a financial approach by many companies to limit the amount of risk in accounting information. Thus, it can be measure using accounting information. (Watts, 2003) distinguishes the measurement of conservatism into three, namely: (1) Earnings/stock returns relation measures. Conservatism has higher verification requirements for gains compared to losses. Differences in the level of verification of gains and losses information by taking into account the differences between actual net asset gains and losses when there are gains and losses captured by accounting. Measurements using earnings/stock relations are associated with positive or negative estimates of stock returns. (2) Net assets measures. The verification difference between gains and losses is due to more unrecognised gains than unrecognised losses, thus making net assets experience understatement. The equity valuation model is widely used in estimating the level of understatement of net assets. There are two types of valuations, namely The Feltham-Ohlson models and Book-to-Market-Ratio. The Feltham-Ohlson model uses parameters that can reflect the degree of understatement of operational assets. (3) Earnings/accrual measures. This measure of conservatism uses accruals, namely the difference between net income and cash flow. Net income used is net income before depreciation and amortisation, while the cash flow used is operational cash flow. If negative accruals occur (net income is smaller than operational cash flow) which is consistent for several years, then this is an indication of the application of conservatism.

There are two types of accruals, namely operating accrual which is the number of accruals that appear in financial statements as a result of company operations and non-operating accruals.

Sharia Bank. Islamic banks, the contract carried out has practical and religious consequences because contracts are carried out based on Islamic law (Antonio, 2001). Each contract in Islamic banking, both in terms of goods, actors, transactions, and other provisions, must fulfil the contractual conditions such as harmony and conditions. Pillars consist of sellers, buyers, goods, prices, and contracts. While the conditions include goods and services must be halal, the price of goods and services must be clear, the place of delivery must be clear, and the goods transacted must be entirely in ownership.

Comparison between Islamic banks and conventional banks is presented in the following table:

Table 1. Difference between Sharia Banks and Conventional Banks

| Sharia Banks | Conventional Banks |
|--|--|
| Making halal investments only. | Halal and haram investments. |
| Based on the principle of profit sharing, buying and selling, or leasing. | Using an interest mechanism. |
| Profit and Falah oriented. | Profit-oriented. |
| Relations with customers in the form of partnership relationships. | Relations with customers in the form of debtor-creditor relationships. |
| The collection and distribution of funds must be in accordance with the fatwa of the Sharia Supervisory Board. | There is no similar council. |

Source: (Antonio, 2001)

Islamic banking is not a mere copy of conventional banks as perceived by certain Muslims. It has its own way of doing business and all operations are duly certified by Shari'a experts ranging from Shari'a advisor to Shari'a boards and finally Islamic Fiqh Academy (IFA). Portfolios of IFIs are dominated by Shari'a compliant modes of financing and negligible investments are being made under Musharaka and Mudaraba. Shari'a based modes of financing which can create a real difference in the society are not getting momentum in the operations of IFIs (Hanif, 2014).

Furthermore, Islamic banks are doing business in a nonconductive environment which makes operations challenging (Hanif, 2014). IFIs cannot claim interest on their balances with other banks, on mandatory cash reserve maintained with central bank, cannot invest in government securities, interest based bonds, cannot claim time value of money from defaulters, bear risks in sale and lease transactions, can only invest in Shari'a compliant securities and not in all available equities and finally have to compete with conventional banks in deposit servicing as well as in financing.

Hypotheses Development. Agency conflict is complex in Islamic banking. In Islamic banking, customers act as investment account holders. In practice, managers of Islamic banks have full control of customer investment funds. Customers have a low level of representation on the board of directors and cannot directly monitor bank performance. The absence of customers in the board of directors is an additional agency cost that comes from the customer (Abdelsalam *et al.*, 2016).

However, religiosity in Islamic banks allows a decrease in agency cost through organizational moral accountability constraints. Previous research stated that opportunistic behavior of actors in a company can be reduced by a work environment that has moral values in the organization (Ha-Brookshire, 2015). The distinguishing feature and portfolios of Islamic banks requires additional corporate governance mechanisms that ensure adherence to religious principles in their business operations and transactions (Haridan *et al.*, 2018). Therefore, we conduct this research using agency theoretical foundations.

Accounting conservatism arises naturally between contracting parties and is necessary as an efficient contracting mechanism (Watts, 2003). This view stems from the idea that certain contracts (e.g., debt and executive compensation) have asymmetric payoffs to contracting parties, thereby resulting in timelier reporting of information that has the greatest potential to affect the contracting parties. For example, a debt agreement has asymmetric payoffs for the lender. While strong financial performance on the part of the debtor does not increase the payoff to the lender, weak financial performance on the part of the debtor increases the risk of default, thus reducing the lender's potential payoff. Consequently, the lending party demands that the borrowing party report information that may reflect weak financial performance (i.e., bad news) in a timelier manner than it would report information that may reflect strong financial performance (i.e., good news) (Ruch and Taylor, 2015).

Accounting conservatism is important in the banking sector because of the complexity of the sector, high information asymmetry, opacity, and contracting particularities (Leventis *et al.*, 2013). Regulators prefer conservative financial statements to avoid litigation if companies go bankrupt. The central bank also has more prudent practices, such as increasing the loan provision during economic progress (Leventis *et al.*, 2013). Organisations with high levels of religiosity will show lower risk exposures indicated by a higher return on assets and higher required internal rate of return. Therefore, the hypotheses that are built are as follows:

- H₁.** Sharia bank conservatism tends to be higher compared to conventional banks in Indonesia.
- H₂.** Sharia bank conservatism tends to be higher compared to conventional banks in Malaysia.

Non-Performing Loans. Conservatism measurements were obtained from the recording of loan loss provisions (LLPs) relative to non-performing loans (NPL). Accounting records for loan losses in banks reflect management behaviour in the face of credit risk and can lead to information asymmetry between management and shareholders. The calculation to find out the non-performing loans, namely, Changes in non-performing

loans between years t and t-1 are divided by total loans in year t-1 (Leventis *et al.*, 2013; Dewi and Eveline, 2017).

H3. The higher the value of non-performing loans, the more conservative the company.

Loan Charger. Loan charge-offs are uncollectible loans which are then written off and included in the type of bad debt expenses that will be charged in the income statement (Abdelsalam *et al.*, 2016). Loan charge-offs are expected to have a positive effect on LLPs because loan charge-offs provide information about the collectability of loans in the future (Kanagaretnam *et al.*, 2010). The calculation to find out the non-performing loans. Namely, loan charge-offs in year t are divided by total loans in year t-1.

H4. The higher the value of the loan charge-offs, the more conservative the company.

Government Ownership. State ownership has a significant influence in corporate accounting conservatism. Based on previous research, state ownership has a negative relationship with accounting conservatism (Cullinan *et al.*, 2012). The calculation to find out the Government Ownership, namely, a percentage of shares owned by the government.

H5. The higher the government's ownership in the company, the more the company is not conservative.

Foreign Ownership. International companies have better accounting quality among types of ownership of other companies such as the private sector, government, employees and others (Xu *et al.*, 2012). The calculation to find out the foreign investors, namely, a percentage of shares foreign investors.

H6. Ownership of foreign investors influences the company's conservatism.

Independence of the Board of Commissioners. The independence of the board of commissioners is measured by the ratio between the number of independent commissioners to the entire board of commissioners. Independence of the board of commissioners contributes to the integrity and quality of financial statements (Dimitropoulos and Asteriou, 2010). Expected to have a positive coefficient value in the conservatism model. The calculation to find out the foreign investors, namely, the ratio of board members who are independent of the total members of the board of commissioners.

H7. The more independent the company's board of commissioners, the more conservative the company.

The control variables used in this study are company size, leverage, capital adequacy ratio, audit quality, operating cash flow and state corruption level, as explained below:

Company Size (SIZE). This variable is measured using the natural logarithm of total assets. Analysts tend to follow larger banks (Leventis and Dimitropoulos, 2013) so that these banks tend not to engage in aggressive earnings management (Cornett *et al.*, 2009). Therefore, it is expected that there is a negative coefficient on the SIZE variable in the earnings management model. Similar research also found by (Shabihi *et al.*, 2014) that negative and significant relationship between accounting conservatism and control variables of enterprise size.

Leverage (LEV). LEV variable is measured using the ratio of total debt to common equity. Risky banks may overestimate income for a variety of reasons related to capital adequacy requirements and regulatory oversight (Leventis and Dimitropoulos, 2013). Therefore, it is expected that there is a positive coefficient for LEV.

Capital Adequacy Ratio (CAR). Regulatory oversight of banks that have a high capitalization rate is looser than banks that have low capitalization rates which create opportunities for earnings management (Cornett *et al.*, 2009). However, managers from low capitalization banks may have incentives to do earnings management to avoid sanctions.

Audit Quality (AUDQ). This variable is measured by entering a dummy variable (AUDQ) which indicates that the bank is audited by one of the public accounting offices included in the Big Four, which is expected to publish high quality financial reports (Gul *et al.*, 2006). Banks that are audited by public accounting firms have higher LLPs relative to NPLs which indicate higher conditional conservatism. Therefore, this variable is expected to have a negative coefficient on the earnings management model and a positive coefficient on the conservatism model.

Cash Flow from Operations (CFO). Variables of bank financial performance are measured from net cash originating from operations minus the average total assets (CFO). Companies that have good performance tend to use conservative accounting policies (Leventis *et al.*, 2013) have lower motivation for earnings management. Therefore, the CFO coefficient is expected to be positive in the conservatism model and is negative in the earnings management model.

State Corruption Level (CORRUPT). The corruption level variable (CORRUPT) is taken from Worldwide Bank Governance Indicators published by the World Bank. CORRUPT values are between 0 and 100, where higher values indicate a higher level of corruption.

METHODOLOGY

The object of this research is the comparison of conservatism in Islamic banks and conventional banks. The population of this study were all Islamic banks and conventional banks registered in the Financial Services Authority (Otoritas Jasa Keuangan) and Bank Negara Malaysia in 2013-2017, which amounted to 123 banks. In this study, determining the sample using purposive sampling. Purposive sampling is the determination of samples that are limited to certain types of people who can provide the desired information, either because they are the only ones who have it, or they are in accordance with several criteria set by researchers (Sekaran and Bougie, 2013; Ghozali, 2013). The criteria for determining the sample in this study include (Abdelsalam *et al.*, 2016): (1) The company has issued financial statements during the period used in the study. (2) Availability of corporate governance (such as the board of directors and ownership structure) during the entire

period used in the study. (3) Availability of at least 4 banks in each country included in the study (Beck *et al.*, 2013).

Based on the above criteria, the selection of research samples is as follows obtained by 58 bank samples consisting of 13 Islamic banks and 45 conventional banks during the five years of observation (2013-2017).

RESULTS AND DISCUSSION

Descriptive Statistic . Based on the table 2, explained below about the descriptive statistic for each variable:

Non-performing Loans ($\overline{\Delta NPL_{it-1}}$, $\overline{\Delta NPL_{it}}$, and $\overline{\Delta NPL_{it+1}}$)

The average change in the ratio of non performing loans in the previous year, the current year and the coming year to Islamic banks are 0.009, 0.005 and 0.004 respectively. Whereas, the average value of non performing loans changes in the previous year, current year and upcoming years at conventional banks are 0.002, 0.004 and 0.006 respectively. From these descriptive statistics it can be concluded that the average value of the variable non-performing loans of Islamic banks is greater than conventional banks. The minimum value of this variable is -0.184 and the maximum value is 0.243.

Loan Charge Offs ($\overline{LCO_{it}}$ and $\overline{LCO_{it+1}}$)

The average value of the current loan charge offs ratio and the coming year for Islamic banks are 0.128 and 0.115 respectively. Meanwhile, the average value of the current loan charge offs ratio and the coming year for conventional banks is 0.09. From this descriptive statistic it can be concluded that the variable average value of the ratio of loan charge offs to Islamic banks is greater than conventional banks. The minimum value of this variable is -0,0004 and the maximum value is 0,281.

Government Ownership (GOVOWN). The average value of government ownership in Islamic banks is 0, proving that there is no Islamic bank in the sample owned by the government. Meanwhile, the average value of government ownership in conventional banks is 0.038 or 3.8%. From these descriptive statistics it can be denied that the government in conventional banks is higher than Islamic banks. The minimum value of this variable is 0 and the maximum value is 0.87.

Tabel 2. Descriptive Statistic

| | Sharia Banks | | | | | Conventional Banks | | | | |
|---------|--------------|--------|-------|-------|----------|--------------------|--------|-------|-------|----------|
| | n | Min. | Max. | Mean | Std. Dev | n | Min. | Max. | Mean | Std. Dev |
| NP Lt-1 | 65 | -0,108 | 0,229 | 0,009 | 0,043 | 225 | -0,184 | 0,225 | 0,002 | 0,027 |
| NP Lt | 65 | -0,108 | 0,118 | 0,005 | 0,03 | 225 | -0,184 | 0,225 | 0,004 | 0,026 |
| NP Lt+1 | 65 | -0,108 | 0,118 | 0,004 | 0,027 | 225 | -0,184 | 0,243 | 0,006 | 0,029 |

| | Sharia Banks | | | | | Conventional Banks | | | | |
|-----------|--------------|---------|--------|--------|----------|--------------------|---------|--------|--------|----------|
| | n | Min. | Max. | Mean | Std. Dev | n | Min. | Max. | Mean | Std. Dev |
| LCOt | 65 | -0,0002 | 0,128 | 0,014 | 0,022 | 225 | -0,0004 | 0,281 | 0,009 | 0,022 |
| LCOt +1 | 65 | -0,004 | 0,115 | 0,013 | 0,016 | 225 | -0,0004 | 0,281 | 0,009 | 0,024 |
| Gov_ Own | 65 | 0 | 0 | 0 | 0 | 225 | 0 | 0,87 | 0,038 | 0,194 |
| For_ Own | 65 | 0 | 1 | 0,215 | 0,439 | 225 | 0 | 1 | 0,358 | 0,437 |
| IND | 65 | 0,286 | 1 | 0,573 | 0,178 | 225 | 0,25 | 1 | 0,551 | 0,133 |
| SIZE | 65 | 14,526 | 31,835 | 18,572 | 5,407 | 225 | 14,729 | 38,542 | 29,211 | 5,740 |
| LEV | 65 | 0,697 | 20,99 | 9,361 | 5,79 | 225 | 0,244 | 16,711 | 7,612 | 3,4 |
| CAR | 65 | 0,093 | 0,62 | 0,152 | 0,086 | 225 | 0,097 | 1,071 | 0,189 | 0,116 |
| AUD Q | 65 | 0 | 1 | 0,785 | 0,414 | 225 | 0 | 1 | 0,769 | 0,422 |
| CFO | 65 | -0,185 | 0,299 | 0,006 | 0,091 | 225 | -0,758 | 0,524 | 0,012 | 0,102 |
| COR RUP T | 65 | 25,238 | 68,269 | 51,05 | 17,839 | 225 | 25,238 | 68,269 | 36,980 | 15,244 |

Source: (Data Processed, 2019)

Foreign Ownership (FOROWN). The average value of foreign investor ownership in Islamic banks is 0.215 or 21.5%. Meanwhile, the average value of foreign investor ownership in conventional banks is 0.358 or 35.8%. From this descriptive statistic it can be concluded that the average value of investor ownership in conventional banks is higher than Islamic banks. The minimum value of this variable is 0 and the maximum value is 1.

Independence of the Board of Commissioners (IND). The average value of the independence of the board of commissioners in Islamic banks is 0.573 or 57.3%. Meanwhile, the average value of the independence of the board of commissioners in conventional banks is 0.551 or 55.1%. From these descriptive statistics it can be concluded that the average value of the independence of the board of commissioners in Islamic banks is higher than conventional banks. This minimum variable value is 0.25 and the maximum value is 1.

Company Size (SIZE). The average value of company size in Islamic banks is 18,572. Meanwhile, the average value of company size in conventional banks is 29,211. From this descriptive statistic it can be concluded that the average value of company size in conventional banks is higher than Islamic banks. This minimum variable value is 14,526 and the maximum value is 38,542.

Leverage (LEV). The average value of leverage in Islamic banks is 9,361. Meanwhile, the average value of leverage in conventional banks is 7,612. From this descriptive statistic it can be concluded that the average value of leverage in Islamic banks is higher than

conventional banks. This minimum variable value is 0.244 and the maximum value is 20.99.

Capital Adequacy Ratio (CAR). The average value of the capital adequacy ratio in Islamic banks is 0.152 or 15.2%. Meanwhile, the average value of the capital adequacy ratio in conventional banks is 0.189 or 18.9%. From these descriptive statistics it can be concluded that the average value of the capital adequacy ratio in conventional banks is higher than Islamic banks. This minimum variable value is 0.093 and the maximum value is 1.071.

Audit Quality (AUDQ). The average value of audit quality in Islamic banks is 0.785 or 78.5%. Meanwhile, the average value of audit quality in conventional banks is 0.769 or 76.9%. From this descriptive statistic it can be concluded that more Islamic banks are audited by auditors from big four public accounting firms compared to conventional banks. The minimum value of this variable is 0 and the maximum value is 1 because the variable is dummy.

Cash Flow (CFO). The average value of the cash flow ratio in Islamic banks is 0.006. Meanwhile, the average value of the cash flow ratio in conventional banks is 0.012. From this descriptive statistic it can be concluded that the average value of cash flow ratios in conventional banks is higher than Islamic banks. The minimum value of this variable is -0.758 and the maximum value is 0.524.

Corruption Level (CORRUPT). The average level of corruption in Indonesia and Malaysia is 40.1328. The minimum value of this variable is 25,238. This value is the value of the level of corruption in Indonesia in 2010. The maximum value of the level of corruption is 68,269. This value is the value of the level of corruption in Malaysia in 2014.

Based on explanation above it can be concluded that conventional banks in Indonesia are more conservative compared to sharia banks in Indonesia. The moderating variable of IBs towards loan charge-offs is more significant than the moderating variable of IBs on non-performing loans, which means that management in sharia banks tends not to consider the value of non-performing loans before writing off a loan on loan charge-offs. The results of this study are incompatible with (Abdelsalam *et al.*, 2016). Based on study conducted by (Ahmad and Pandey, 2010), sharia banks have higher impaired loans and loan reserves compared to conventional banks which indicate that conventional bank credit policies in reserves and provisioning are more conservative than sharia banks.

Model Selection Testing. Data will be analyzed with the help of STATA13 software. There are three methods in panel data regression, namely common effect (pooled least square) method, fixed effect method and random effect method. The selection of the appropriate regression model is done by testing as follows:

Chow Test. This test is used to choose between the common effect (pooled least square) or fixed effect models in processing panel data. This test is carried out with the hypothesis:

Ho: Common effect method (pooled least square)

H1: Fixed effect method

The results of the Chow test in STATA13 show that Prob> F is 0.7183 so that with a 95% confidence level Ho cannot be rejected. Based on the Chow test, the common method of pooled least square is more appropriate to use than the random effect method.

Hausman Test. The Hausman test can be defined as a statistical test to choose whether the fixed effect or random effect model is the most appropriate to use. The Hausman test is carried out with the following hypothesis:

Ho: Random Effect Model

H1: Fixed Effect Model

The results of the Hausman test in STATA13 show that Prob> chi2 is 0.1842 so that with a 95% confidence level Ho cannot be rejected. Based on the Hausman test, the random effect method is more appropriate to use than the fixed effect method.

Test The Lagrange Multiplier. The Lagrange Multiplier test is used when the Chow test shows the model used is the common effect model (pooled least square), while the Hausman test shows the most appropriate model is the random effect model. Then a lagrange multiplier test is needed as the final step to determine the most appropriate common effect or random effect model. The Hausman test is carried out with the following hypothesis:

Ho: Common Effect Model (pooled least square)

H1: Random Effect Model

The results of the Hausman test in STATA13 show that Prob> chibar2 is 1 so that with a 95% confidence level Ho cannot be rejected. Based on the Hausman test, the pooled least square method is more appropriate to use than the random effect method.

Regression Analysis. The data processing process produces a research model based on (Abdelsalam *et al.*, 2016), as follows:

$$\begin{aligned} LLP_{sit} = & -0,003 + 0,052 \overline{NPL_{it-1}} + 0,328 \overline{NPL_{it}} + 0,04 \overline{\Delta NPL_{it+1}} + 0,253 \overline{LCO_{it}} + 0,241 \\ & \overline{LCO_{it+1}} - 0,033 IBSit * \overline{\Delta NPL_{it-1}} - 0,24 IBSit * \overline{NPL_{it}} - 0,042 IBSit * \overline{\Delta NPL_{it+1}} - 0,028 \\ & IBSit * \overline{LCO_{it}} + 0,753 IBSit * \overline{LCO_{it+1}} + 0,006 GOVOWN_{it} + 0,0005 FOROWN_{it} + 0,0004 \\ & IND_{it} + 0,002 SIZE_{it} + 0,0004 LEV_{it} + 0,027 CAR_{it} - 0,0007 AUDQ_{it} - 0,002 CFO_{it} - \\ & 0,0002 CORRUPT_{it} + e_{it} \end{aligned}$$

The interpretation for the coefficients in the regression equation above is as follows:

(1)The coefficient for $\overline{NPL_{it-1}}$ is 0.052 which indicates that the increase of 1 unit non performing loans in the previous year caused an increase of 5.2% in LLPs in the current year. (2)The coefficient for $\overline{NPL_{it}}$ is 0.328 which indicates that the increase of 1 unit non performing loans this year caused a 32.8% increase in LLPs in the current year. (3)The coefficient for $\overline{\Delta NPL_{it+1}}$ is 0.04 indicating that the increase of 1 unit non performing loans in the coming year causes a 4% increase in LLPs in the current year. (4)The coefficient for $\overline{LCO_{it}}$ is 0.253 which indicates that an increase of 1 unit LCO in the current year caused a

25.3% increase in LLPs in the current year. (5)The coefficient for $\overline{LCO_{it+1}}$ is 0.241 which indicates that an increase of 1 unit LCO in the coming year causes an increase of 24.1% in LLPs in the current year. (6)The coefficient of $\overline{IBSit^* \Delta NPL_{it-1}}$ is equal to -0.033 which indicates that the increase in 1 unit variable causes a decrease of 3.3% in LLPs in the current year. (7)The $\overline{IBSit^* NPL_{it}}$ coefficient is equal to -0.24 which indicates that the increase in 1 unit variable causes a decrease of 24% in LLPs in the current year. (8)The coefficient of $\overline{IBSit^* \Delta NPL_{it+1}}$ is equal to -0,042 which indicates that the increase in 1 unit variable causes a decrease of 4.2% in LLPs in the current year. (9)The coefficient of $\overline{IBSit^* LCO_{it}}$ is equal to -0.028 which indicates that the increase of 1 unit variable causes a decrease of 2.8% in LLPs in the current year. (10)The coefficient of $\overline{IBSit^* LCO_{it+1}}$ is 0.753 which indicates that the increase in 1 unit variable causes an increase of 75.3% in LLPs in the current year. (11)The coefficient for $\overline{GOVOWN_{it}}$ is 0.006 which indicates that the increase in 1 unit of government ownership in the current year caused an increase of 0.6% in LLPs in the current year. (12)The coefficient for $\overline{FOROWN_{it}}$ is 0,0005 which indicates that the increase in 1 unit of ownership of foreign investors in the current year caused an increase of 0.05% in LLPs in the current year. (13)The coefficient for $\overline{IND_{it}}$ is 0,0004 which indicates that an increase of 1 commissioner independence unit in the current year caused an increase of 0.04% in LLPs in the current year. (14)The coefficient for $\overline{SIZE_{it}}$ is 0.002 which indicates that an increase in 1 unit of company size in the current year causes an increase of 0.2% in LLPs in the current year. (15)The coefficient for $\overline{LEV_{it}}$ is 0,0004 which indicates that an increase in 1 unit leverage ratio in the current year causes an increase of 0.04% in LLPs in the current year. (16)The coefficient for $\overline{CAR_{it}}$ is 0.027 which indicates that the increase in 1 unit of the capital adequacy ratio in the current year causes an increase of 2.7% in LLPs in the current year. (17)The coefficient for $\overline{AUDQ_{it}}$ is -0,0007 which indicates that if the company is audited by the big four public accounting firm in the current year it causes a decrease of 0.09% in LLPs in the current year. (18)The coefficient for $\overline{CFO_{it}}$ which indicates that an increase in 1 unit ratio of CFO in the current year caused a decrease of 0.2% in LLPs in the current year.

Simultaneous Hypothesis Testing (F-Test). The simultaneous hypothesis testing can be seen from the Prob value > F. The simultaneous hypothesis formulation to be tested is as follows:

Ho: There is no simultaneous significant influence between the independent variable and the dependent variable

Ha: There is a simultaneous significant effect between the independent variable and the dependent variable

The testing criteria used for the basis of decisions are:

- If the Prob value is > F < 0.05 then Ho is rejected
- If the Prob value is > F > 0.05 then Ho cannot be rejected

By using the STATA13 software, the following results are obtained:

Table 3. Conservatism of Islamic Banks and Conventional Banks in Indonesia and Malaysia – Simultaneous Hypothesis Testing

| Regression with Driscoll-Kraay standard errors | | | | | |
|--|---|------------|------------------|---|--------|
| Method | : | Pooled OLS | Number of obs | : | 232 |
| Group variable (i) | : | Id_bank | Number of groups | : | 58 |
| Maximum lag | : | 1 | F(19,3) | : | 15,64 |
| | | | Prob>F | : | 0,0238 |
| | | | R-squared | : | 0,7216 |
| | | | Root MSE | : | 0,0109 |

Source: (Data Processed, 2019)

The results of data processing using STATA13 show the Prob> F model value of 0.0238 lower than the value of α of 0.05 (5%) so that according to the testing criteria it can be decided to reject H_0 and accept H_a which means that the independent variables have a significant effect on dependent variable.

Partial Hypothesis Testing. The summary of the test results is presented in the Table 4. Sharia banks in Malaysia are more conservative compared to conventional banks in Malaysia. This is because the moderating variable of IBs on non-performing loans is more significant than the moderating variable of IBs on loan charge-offs, which means that management of Islamic banks considers the value of non-performing loans before writing off a loan on loan charge-offs. The results of this study are in accordance with (Abdelsalam *et al.*, 2016) and supported by State of the Global Islamic Economy Report in 2015/2016 (Thomson Reuters, 2016) which states that Malaysia is considered the most successful country in developing Islamic economics in its Islamic financial system. In addition, the Malaysian Islamic financial system is also considered to have the highest ranking globally. Religiosity that is well implemented in sharia banks in Malaysia causes sharia banks in Malaysia to tend to be more conservative compared to conventional banks.

Table 4. Conservatism of Islamic Banks and Conventional Banks in Indonesia and Malaysia – Partial Hypothesis Testing

| Variable | Hypotheses Direction (+/-) | Indonesia | | Malaysia | |
|------------------------------------|----------------------------|-----------|---------|----------|----------|
| | | +/- | P-Value | +/- | P-Value |
| IBS* Δ NPL _{it-1} | + | - | 0,95 | + | 0,033** |
| IBS * Δ NPL _{it} | + | - | 0,96 | + | 0,003*** |
| IBS * Δ NPL _{it+1} | + | + | 0,22 | + | 0,021** |
| IBS*LCO _t | + | + | 0,02** | - | 0,998 |
| IBS*LCO _{t+1} | + | - | 0,93 | + | 0,004*** |

Source: (Data Processed, 2019)

Description:

***: 1% significance level

**: 5% significance level,

*: 10% significance level

The regression test results show that future NPL changes have a positive regression coefficient and a p-value of more than 0.1, meaning that future NPL changes will not have a significant positive effect on conservatism. Current NPL changes and previous year's NPL changes have a positive regression coefficient and a p-value of less than 0.05 means that this year's NPL changes and previous year's NPL changes have a positive and significant effect on conservatism. The regression results also show that management tends to take into consideration last year's non-performing loans and the current year compared to upcoming year's non-performing loans in determining loan provision. The results of this study support the previous research (Kanagaretnam *et al.*, 2010; Leventis *et al.*, 2013) which predicts a positive relationship between changes in current year's non-performing loans and current year's loan loss provisions. The number of loan loss provisions in the year shows the anticipated rate of loan losses based on information from changes in non-performing loans. An increase in non-performing loans will cause an increase in loan loss provisions.

The regression test results show that LCO for the current year and LCO for the coming year have a significant positive effect on conservatism. The results of this study support the previous study (Kanagaretnam *et al.*, 2010) which state that loan charge-offs have a positive influence on loan loss provisions because loan charge-offs provide information regarding the collectability of loans in the future.

The regression test results show the regression coefficient of government ownership has a p-value of more than 0.1 meaning that government ownership does not have a significant negative effect on conservatism. The results of this study are in accordance with the results of previous research (Abdelsalam *et al.*, 2016). Government ownership does not have a significant effect on conservatism allegedly because banks owned by the government in the study were only 5 banks out of 58 banks or about 8% of the total sample.

The regression test results show that the p-value of more than 0.1 means that the ownership of foreign investors does not have a significant effect on conservatism. The results of this study are in accordance with the results of the prior research (Abdelsalam *et al.*, 2016). This is presumably because the ownership of foreign investors in the bank in the sample is still classified as a minority (less than 50%). Of the 58 banks, approximately only 28 banks are majority owned by foreign investors.

The regression test results show that the ratio of the number of independent board of commissioners has a positive regression coefficient and the p-value of more than 0.1, meaning that the ratio of the number of independent commissioners does not have a significant positive effect on conservatism. The independence of the board of commissioners has no significant effect on conservatism, presumably because the oversight of the independent board of commissioners is not optimal as a management

oversight tool, besides the presence of independent commissioners may only fulfil regulatory requirements but not enforce good corporate governance (Limantauw, 2012).

Control variables that have a partial influence on conservatism are firm size and leverage. The capital adequacy ratio, audit quality, operating cash flow and level of corruption do not affect conservatism. The size of a public accounting office (big four or non-big four) does not significantly influence audit quality (Nindita and Siregar, 2012). The level of corruption does not affect because the level of corruption in a country has more to do with banks owned by the government while banks owned by the government in the study were only 5 banks out of 58 banks or around 8% of the total sample.

Coefficient of Determinant

Table 5. Coefficient of Determinant

| Regression with Driscoll-Kraay standard errors | | | | | |
|--|---|------------|------------------|---|--------|
| Method | : | Pooled OLS | Number of obs | : | 232 |
| Group variable (i) | : | Id_bank | Number of groups | : | 58 |
| Maximum lag | : | 1 | F(19,3) | : | 15,64 |
| | | | Prob>F | : | 0,0238 |
| | | | R-squared | : | 0,7216 |
| | | | Root MSE | : | 0,0109 |

Source: (Data Processed, 2019)

The value of the coefficient of determinant (R^2) of 0.7216 indicates that the independent variable can explain the dependent variable of 72.16% and the remaining 27.84% is explained by other factors outside the model.

CONCLUSION

Based on the results of the analysis and discussion carried out in the previous chapter, the researcher draws the following conclusions:

Conventional banks tend to be more conservative compared to sharia banks in Indonesia. This shows that sharia banks have higher impaired loans and loan reserves compared to conventional banks which indicate that conventional bank credit policies in reserves and provisioning are more conservative than sharia banks.

Sharia banks tend to be more conservative compared to conventional banks in Malaysia. That is to say that religiosity that is well implemented in sharia banks in Malaysia, as Malaysia is considered the most successful country in developing Islamic economics in its Islamic financial system.

Changes in non-performing loans have a positive effect on conservatism. It means that the number of loan loss provisions in the year shows the anticipated rate of loan losses based on information from changes in non-performing loans.

Changes in loan charge-offs have a positive effect on conservatism. It shows that loan charge-offs provide information regarding the collectability of loans in the future.

Government ownership have no significant negative effect on conservatism. Banks owned by the government in the study were only 5 banks out of 58 banks or around 8% of the total sample.

The ownership of foreign investors is have no significant positive effect on conservatism. Ownership of foreign investors in banks in the sample is still classified as a minority (less than 50%). Of the 58 banks, approximately only 28 banks are majority owned by foreign investors.

The independence of the board of commissioners have no significant positive effect on conservatism. Supervision of the independent board of commissioners is less optimal as a management oversight tool.

Control variables that have influence on conservatism are firm size and leverage.

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