



Credit Loss Provisions, Audit Committee, and Financial Distress in Indonesian Banking: The Moderating Role of Credit Relaxation

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Abstract

Background: Financial distress in banking carries systemic consequences, so its early detection is a central concern for regulators and bank management.

Objective: This study examines the effect of credit loss provisions and audit committee characteristics on financial distress in Indonesian banking, and tests whether credit relaxation moderates the relationship between credit loss provisions and distress. Financial distress is proxied by a modified Altman Z''-score adapted to the balance-sheet structure of banks.

Methods: The analysis uses a balanced panel of 21 banks listed on the Indonesia Stock Exchange that disclosed restructured-loan data over 2020–2024, yielding 105 firm-year observations, and applies panel regression with a fixed-effect specification selected through the Chow and Hausman tests.

Results: Credit loss provisions raise financial distress, while a larger audit committee is associated with higher, not lower, distress, contrary to the governance-based expectation. Credit relaxation has no direct effect but acts as a pure moderator that strengthens, rather than weakens, the influence of credit loss provisions on distress, contradicting the stabilizing intent of the pandemic-era policy. Larger banks are more resilient, whereas rapid credit growth heightens distress.

Conclusion: By integrating credit risk, governance, and regulatory intervention within one model, the study offers new evidence that credit relaxation may defer, rather than resolve, the recognition of credit risk, with implications for prudential regulation and bank risk management in emerging markets.

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INTRODUCTION

The stability of the financial system is inseparable from the health of the banks that intermediate credit within it (Acharya & Ryan, 2016; Ahmmed, 2025; Jameaba, 2024). Because banks channel public deposits into loans, a deterioration in a single sizeable institution can transmit quickly across the system, which is why the early identification of financial distress has become a core instrument of prudential supervision. In Indonesia, the Financial Services Authority (OJK) assesses bank soundness through the risk profile, good corporate governance, earnings, and capital (RGEC) framework, and within that framework the adequacy of provisions for uncollectible loans occupies a central place (Aksan et al., 2026; Mulatsih et al., 2025; Putra & Azzahra, 2026). When a bank's capacity to absorb credit losses weakens, its composite soundness rating declines and the institution moves closer to the very distress that supervision is designed to forestall.

Among the accounts that reveal this vulnerability, the allowance for credit losses (in
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Indonesia, *Cadangan Kerugian Penurunan Nilai*, or CKPN) is arguably the most informative. Since the adoption of IFRS 9 through PSAK 71, effective 1 January 2020, provisioning has moved from an incurred-loss basis to a forward-looking expected-credit-loss model. This approach recognizes anticipated losses earlier and is therefore more sensitive to deteriorating credit conditions, yet it also embeds considerable managerial judgment. A rising provision may signal prudent recognition of risk, but it simultaneously erodes earnings and capital, which is precisely why loan loss provisions have been tied in the literature to both bank risk-taking and systemic fragility (Bouvatier & Lepetit, 2012; Dou et al., 2018).

This condition creates a critical interpretive tension because a higher CKPN may reflect either prudent recognition of credit risk or a deterioration in the quality of the loan portfolio. Therefore, the direction of the relationship between CKPN and financial distress depends on whether increased provisioning precedes or follows loan-portfolio deterioration. This distinction provides the primary motivation for the present empirical investigation.

Governance mechanisms are expected to temper these risks. OJK requires every financial institution to maintain an audit committee that assists the board of commissioners in overseeing financial reporting, internal control, and risk management (Afrilia, 2025; Pangaribuan et al., 2019; Simanjuntak et al., 2025). The committee's structural attributes, particularly its size and the intensity of its work, are commonly used as proxies for monitoring quality. Evidence from Indonesian banking is nonetheless mixed. Audit committee size and meeting frequency shape distress, whereas Irfan and Luthan (2024) find that only meeting frequency matters, leaving the committee's effectiveness an open question in a sector where credit-risk estimation and regulatory scrutiny are unusually demanding. Under ECL, provisioning involves substantial managerial judgment and forward-looking assumptions. The audit committee constrains opportunistic accounting choices by monitoring ECL model assumptions, validations, and credit-risk assessments, thereby influencing both the level and credibility of distress indicators.

The study period also coincides with an extraordinary policy intervention. To cushion the shock of COVID-19, OJK issued a countercyclical credit-relaxation policy under POJK No. 11/POJK.03/2020, permitting banks to restructure loans for affected borrowers without immediately downgrading asset quality. The measure helped contain non-performing loans and preserve intermediation in the short run, but it also raised the prospect of deferred loss recognition, or hidden NPLs, and of capital pressure once the relief expired. Whether relaxation genuinely mitigated risk or merely postponed its recognition remains contested (Nopiyani et al., 2021; Rimbawan, 2022).

Prior research has largely examined these forces in isolation: loan loss provisions and systemic risk, audit committees and distress, or credit restructuring and performance, and much of the provisioning evidence originates outside Indonesia (Artiningsih et al., 2026; Siahaan & Susanti, 2026). What has not been tested is an integrated model that places credit risk, governance, and regulatory intervention within a single framework for Indonesian banks operating under the new expected-credit-loss regime. This study addresses that gap by treating credit relaxation not as a direct determinant of performance but as a contingency that may amplify or dampen the effect of provisioning on distress, thereby situating the Indonesian experience within the broader debate on forbearance and forward-looking accounting. A critical empirical question remains regarding the regulatory conditions under which the relationship between CKPN and financial distress strengthens or weakens. Specifically, this study examines whether regulatory forbearance through credit-relaxation policies amplifies or mitigates the distress-inducing effects of increased provisions. This interaction has not been adequately examined in previous research on the Indonesian banking sector.

The study therefore pursues three objectives. The first is to examine the effect of credit loss provisions on financial distress in Indonesian banking; the second is to examine the effect of audit committee characteristics on financial distress; and the third is to test whether credit relaxation moderates the relationship between credit loss provisions and distress. Its contribution is twofold. Theoretically, the study extends the distress literature by combining accounting-based credit risk, governance, and policy contingency within one model grounded in legitimacy and agency perspectives. Practically, it offers regulators and bank management evidence on whether a well-intentioned relaxation policy can inadvertently heighten the sensitivity of banks to credit risk.

METHOD

This study adopted a quantitative, associative-causal design to examine the relationships among credit loss provisions, audit committee characteristics, credit relaxation, and financial distress. It drew on secondary data from the audited annual reports of banks listed on the Indonesia Stock Exchange (IDX) for the 2020–2024 period, complemented by market data on share prices obtained from the IDX. The population comprised banking-sector issuers listed on the IDX. Of the 46 listed banks, the sample was selected purposively: a firm was retained only if it was listed throughout 2020–2024, published complete audited financial statements with an unqualified audit opinion, and disclosed the value of restructured (relaxed) loans in its annual report. Because credit relaxation was reported to the Financial Services Authority (OJK) but was not mandated to be disclosed in audited financial statements, only 21 banks satisfied all the criteria, resulting in a balanced panel of 105 firm-year observations.

The reduction from 46 to 21 banks introduced potential sample-selection concerns, as inclusion depended on the voluntary disclosure of restructured loans. Banks with greater transparency or more developed institutional practices may therefore have been overrepresented.

Financial distress (FD), the dependent variable, was measured using the modified Altman Z"-score, which was selected for its suitability for service-sector and emerging-market firms. To accommodate the banking balance sheet, the working-capital term was replaced with core capital to total assets, the profitability term was measured as earnings before tax to total assets, and the leverage term retained the ratio of equity to total liabilities. Credit loss provisions (CKPN) were measured as the total credit-loss allowance scaled by total loans, while audit committee characteristics (KA) were measured by the number of audit committee members. Credit relaxation (RK), the moderating variable, was measured as the ratio of restructured loans to total loans. Two control variables were included: firm size (TA), measured as the natural logarithm of total assets, and credit growth (PK), measured as the annual change in total loans. The operational definitions of the variables are summarized in Table 1. The dependent variable was operationalized as the reverse-coded Altman Z"-score ($FD = -Z''$) to maintain directional consistency with the theoretical expectations and facilitate the interpretation of positive coefficients as associations with higher levels of financial distress.

The data were analyzed using panel regression estimated in EViews. The fixed-effects specification controlled for unobserved bank-specific heterogeneity. Robust inference was applied to account for potential within-panel correlation. Marginal effects and conditional slopes were computed to illustrate the moderation effect across the distribution of credit relaxation. The regression model was specified as follows:

$$FD = \beta_0 + \beta_1 CKPN + \beta_2 KA + \beta_3 RK + \beta_4 (CKPN \times RK) + \beta_5 TA + \beta_6 PK + \varepsilon$$

The most appropriate specification among the common-effects, fixed-effects, and random-effects models was selected using the Chow and Hausman tests. The residuals were subsequently subjected to classical-assumption tests for normality, multicollinearity, heteroskedasticity, and autocorrelation. The hypotheses were tested first using a direct-effect model and subsequently using a moderated model through moderated regression analysis, in which the interaction between credit loss provisions and credit relaxation captured the moderating effect. Because the study relied solely on publicly available secondary data and involved no human or animal participants, ethical approval was not required. Nevertheless, all data were collected and handled in accordance with institutional research-integrity standards.

RESULTS AND DISCUSSION

Results

Sample Characteristics and Study Context

Of the 46 listed banks reviewed, only 21 disclosed restructured-loan data consistent with POJK No. 11/POJK.03/2020, giving 105 firm-year observations over 2020–2024. The disclosure gap is itself informative. Although every bank was obliged to implement the relaxation policy and report it periodically to OJK, the information was not uniformly presented in audited annual reports, and this reporting inconsistency constrained the usable sample. The operational

definitions and measurement of each variable are presented in Table 1.

Table 1

Operational Definitions of Variables

Variable	Measurement	References
Financial Distress (FD) – Dependent	$Z'' = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$, where X_1 = core capital/total assets; X_2 = retained earnings/total assets; X_3 = EBT/total assets; X_4 = equity/total liabilities	Altman (1968); Malik et al. (2022)
Credit Loss Provisions (CKPN) – Independent	Total credit-loss allowance / total loans	Bouvatier & Lepetit (2012); Dou et al. (2018)
Audit Committee (KA) – Independent	Number of audit committee members	Irfan & Luthan (2024)
Credit Relaxation (RK) – Moderator	Restructured loans / total loans	Rimbawan (2022)
Firm Size (TA) – Control	$\ln(\text{total assets})$	Andika & Nuryaman (2022); Wangsih et al. (2021)
Credit Growth (PK) – Control	$(\text{Loans}_t - \text{Loans}_{t-1}) / \text{Loans}_{t-1}$	Fahlenbrach et al. (2018); Foos et al. (2010)

Source: Authors' compilation (2026)

Table 2 reports the descriptive statistics. The mean financial-distress score of 1.44 sits within the grey zone of the modified Altman scale ($1.10 \leq Z'' \leq 2.60$), indicating that, on average, the sampled banks were exposed to a non-trivial probability of distress; the maximum of 18.59 reflects a very safe position and the minimum of -2.46 a clearly distressed one. Credit loss provisions average about 4.26 per cent of total loans and range from 0.15 to 21.68 per cent, while audit committees comprise between two and ten members. Restructured loans average roughly 14.70 per cent of total loans, and the two controls display the wide dispersion expected of a heterogeneous banking panel, with credit growth spanning a contraction of about 105 per cent to an expansion of nearly 68 per cent.

Table 2

Descriptive Statistics

Statistic	FD	CKPN	KA	RK	TA	PK
Mean	1.4388	-0.0426	3.7524	0.1470	8.8036	0.0096
Median	0.9540	-0.0257	3.0000	0.0969	8.2961	0.0193
Maximum	18.5890	-0.0015	10.0000	0.9750	13.2197	0.6760
Minimum	-2.4650	-0.2168	2.0000	0.0000	6.3384	-1.0477
Std. Dev.	2.6095	0.0415	1.4195	0.1661	1.9474	0.2280

Source: EViews output (2026); $N = 105$ firm-years.

Model selection followed the standard sequence. The Chow test rejected the common-effect model, and the Hausman test favored the fixed-effect over the random-effect specification, so the fixed-effect model was adopted. This choice is consistent with the expectation that unobserved, time-invariant differences across banks, such as size, business model, and risk appetite, materially affect distress and must be controlled. Table 3 summarizes the two tests.

Table 3

Panel Model Selection: Chow and Hausman Tests

Test	Statistic	d.f.	Prob.	Decision
Chow – Cross-section F	4.7982	(20, 79)	0.0000	Reject CEM
Chow – Cross-section Chi-square	83.4894	20	0.0000	Fixed effects preferred
Hausman – Cross-section random	12.6760	5	0.0266	Reject REM; adopt FEM

Source: EViews output (2026)

The fixed-effect residuals satisfy the classical assumptions. The Jarque–Bera test does not reject normality, the centered variance inflation factors lie well below conventional thresholds, the ARCH test indicates homoskedasticity, and the Durbin–Watson statistic falls within the acceptable range, signalling no serial correlation. These results, collected in Table 4, confirm that the estimates can be interpreted reliably.

Table 4*Classical Assumption Tests*

Test	Statistic	Prob.	Conclusion
Normality (Jarque–Bera)	3.4107	0.1817	Residuals normally distributed
Multicollinearity (Centered VIF)	1.04–1.09	–	No multicollinearity
Heteroskedasticity (ARCH, F-stat)	2.0234	0.1579	Homoskedastic
Autocorrelation (Durbin–Watson)	1.6368	–	No autocorrelation

Source: EViews output (2026).

Interpretation of Regression Results

Table 5 presents the fixed-effect estimates of the direct model. Credit loss provisions carry a positive and significant coefficient ($\beta = 20.4715$; $p = 0.0447$), indicating that a higher provisioning ratio is associated with greater financial distress. Audit committee size is likewise positive and significant ($\beta = 0.7880$; $p = 0.0146$), a direction opposite to the governance-based expectation. Credit relaxation is not significant on its own ($\beta = 1.2559$; $p = 0.4345$). Among the controls, firm size is negative and significant ($\beta = -1.2248$; $p = 0.0015$), while credit growth is positive and significant ($\beta = 1.9737$; $p = 0.0456$). The model explains a substantial share of the variation in distress ($R^2 = 0.5852$; adjusted $R^2 = 0.4539$) and is jointly significant (F-statistic = 4.4578; $p = 0.0000$).

Table 5*Fixed-Effect Regression Results: Direct Model*

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	9.9332	3.3081	3.0026	0.0036
CKPN	20.4715	10.0366	2.0397	0.0447
KA	0.7880	0.3156	2.4969	0.0146
RK	1.2559	1.5989	0.7855	0.4345
TA	-1.2248	0.3724	-3.2888	0.0015
PK	1.9737	1.0163	1.9421	0.0456

Source: EViews output (2026). $R^2 = 0.5852$; Adjusted $R^2 = 0.4539$; $F = 4.4578$ ($p = 0.0000$); Durbin–Watson = 1.6368.

Table 6 reports the moderated model. The interaction term between credit loss provisions and credit relaxation is positive and significant ($\beta = 6.5132$; $p = 0.0166$), whereas credit loss provisions on their own lose significance once the interaction is included ($\beta = 16.1733$; $p = 0.2181$). Because credit relaxation has no significant direct effect yet its interaction with provisioning is significant, it operates as a pure moderator. Audit committee size remains positive and significant, firm size remains negative and significant, and credit growth remains positive and significant, confirming the stability of these relationships across specifications.

Table 6*Moderated Regression Results (Moderated Regression Analysis)*

Variable	Pred. Dir.	β	Std. Error	t-Statistic	Prob.	Decision
C		9.1518	3.5441	2.5823	0.0117	
CKPN	(+) Positive	16.1733	13.0276	1.2415	0.2181	H1 Supported
KA	(-) Negative	0.7532	0.3150	2.3913	0.0192**	H2 Not supported
M1 (CKPN×RK)	(-) Weakening	6.5132	2.8672	2.2716	0.0166**	H3 Not supported
TA		-1.1156	0.3880	-2.8752	0.0052***	

Variable	Pred. Dir.	β	Std. Error	t-Statistic	Prob.	Decision
PK		1.6472	1.0118	2.6279	0.0175**	

Source: EViews output (2026). $R^2 = 0.5823$; Adjusted $R^2 = 0.4502$; $F = 4.4058$ ($p = 0.0000$); Durbin-Watson = 1.6120. *** $p < 0.01$; ** $p < 0.05$; * $p < 0.10$.

Table 6 collates the outcomes of the three hypotheses. The first hypothesis is supported, the second is rejected because the effect runs in the opposite direction, and the third is not supported in the predicted direction, since credit relaxation strengthens rather than weakens the influence of provisioning on distress.

Discussion

The finding that higher credit loss provisions accompany greater financial distress is coherent with both the legitimacy and agency perspectives that frame this study. Under the expected-credit-loss regime, a growing allowance is a forward-looking admission that the quality of the loan book is deteriorating; rather than reassuring stakeholders, it signals that the bank is absorbing losses that compress earnings and capital. Read through agency theory, the provision is also a discretionary accrual, and its rise marks the point at which managerial estimates of credit risk can no longer be smoothed away. This interpretation aligns with the view that provisioning is among the most sensitive indicators of underwriting quality and systemic fragility, and it locates Indonesian banks within the same risk dynamics documented in the international provisioning literature.

More striking is the positive association between audit committee size and distress, which runs against the conventional expectation that stronger oversight suppresses risk. Three readings are plausible. The committee may be largely ceremonial, an organ that satisfies a regulatory requirement without materially improving risk control, so that its size conveys little about monitoring quality. Alternatively, the relationship may reflect reactive monitoring, in which banks enlarge their committees precisely when conditions worsen, making committee size a symptom rather than a cause of stress. A third and more benign interpretation is that an active committee enforces conservatism, so that distress indicators appear more elevated simply because losses are recognized earlier and more fully. Each reading carries a different governance implication, and disentangling them is a worthwhile agenda for further work. An important alternative explanation is reverse causality: distressed banks may expand audit committees to improve monitoring, making committee size a symptom rather than cause of distress.

The most consequential result concerns credit relaxation. It exerts no direct influence on distress yet functions as a pure moderator that strengthens the effect of provisioning, an outcome that inverts the policy's stated purpose. The relaxation introduced under POJK No. 11/POJK.03/2020 was meant to shield banks from the immediate impact of pandemic-era credit risk, but the evidence suggests that when a bank simultaneously carries high provisions and a large restructured portfolio, its exposure to distress intensifies rather than eases. This pattern is consistent with the concern that restructuring defers, rather than removes, the recognition of losses: once the quality of relaxed loans erodes, the postponed risk resurfaces with greater force. Relaxation, in this sense, may operate as a mechanism of delayed recognition rather than genuine mitigation, a caution that resonates with debtor moral-hazard arguments raised in the restructuring literature.

The control variables reinforce established understandings of bank resilience. Larger banks are less prone to distress, consistent with the view that scale brings deeper capital buffers and more developed risk-management systems, echoing the too-big-to-fail and bank-soundness literatures. Conversely, rapid credit growth is associated with greater distress, in line with evidence that aggressive lending elevates future provisioning and depresses capital, so that expansion unaccompanied by commensurate risk controls becomes a source of fragility rather than strength.

Taken together, these results advance the distress literature by showing that credit risk, governance, and regulatory intervention are best understood jointly rather than in isolation. The novelty of the study lies in demonstrating that a policy designed to stabilize banks can, under an expected-credit-loss regime, magnify the sensitivity of distress to provisioning. The implication

reaches beyond Indonesia: as emerging markets increasingly operate under IFRS 9 and Basel III, the interaction between forbearance measures and forward-looking provisioning is a general concern for supervisors weighing short-term stability against the transparent recognition of risk. The study is not without limits. Its reliance on disclosed restructuring data restricts the sample to banks that reported relaxation, the observation window captures only the pandemic and its immediate aftermath, and audit committee quality is proxied by size alone. These boundaries temper the generality of the findings and point toward richer measures and longer horizons in future research.

CONCLUSION

This study explains financial distress in Indonesian banking by integrating credit risk, corporate governance, and regulatory intervention within a single empirical model. The findings identify credit loss provisions as a significant predictor of financial distress and show that a larger audit committee is associated with higher distress rather than providing a protective effect. Credit relaxation acts as a pure moderator that strengthens the effect of provisioning on financial distress instead of weakening it. Firm size reduces financial distress, whereas rapid credit growth increases it. The main contribution of this study is the finding that a countercyclical credit-relaxation policy intended to support banks during a crisis operated indirectly in a manner contrary to its objective by amplifying the effect of credit risk on bank fragility during the observation period.

The findings suggest that regulators should accompany crisis-relief measures with stronger safeguards to prevent deferred credit risk from accumulating without adequate recognition. Bank management should also apply careful and forward-looking judgment when determining provisions under the principle-based expected credit loss regime because provisioning decisions may affect financial distress over both short- and long-term horizons. Nevertheless, this study is limited by its reliance on disclosed restructuring data, a relatively restricted sample, an observation period confined to the pandemic era, the measurement of audit committee effectiveness based solely on size, potential endogeneity between CKPN and financial distress, and possible sample-selection bias arising from disclosure requirements. Future research should include pre-pandemic and post-relaxation periods, employ broader measures of audit committee effectiveness, address potential endogeneity, and test the model across emerging-market banking systems to determine the generalizability of the moderating role of regulatory forbearance.

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Han Hwa Tjoa contributed to the conceptualization, data curation, formal analysis, methodology, investigation, and preparation of the original draft. Etty Murwaningsari contributed to the conceptualization, methodology, supervision, validation, and editing of the manuscript. Both authors read and approved the final manuscript.

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