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Earnings management behavior rural banks: The role of moral character based on religiosity

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Abstract

The purpose of the study is the impact of moral character based on religiosity on earnings management behavior through the Theory of Planned Behavior (TPB). This study was conducted in Indonesia Rural Bank. The research method uses a quantitative approach with PLS SEM analysis of data collected from 257 Rural Bank Directors in Indonesia. The main results of the study are the moral character based on religiosity significantly influences earnings management behavior both directly and indirectly through TPB. Despite strong moral character based on religiosity, individuals with expertise in accounting policies may still engage in earnings management. Based on the results obtained conclude that regulatory measures alone are insufficient to curb this behavior, a spiritual approach is essential to reinforce ethical business conduct, emphasizing integrity and honesty. This research concludes that building individual commitment through honesty and integrity must come from personal beliefs, by complying with applicable regulations in preparing financial reports in order to create an ethical and moral business environment. The practical implication of this study is the importance of a spiritual approach that emphasizes the values of integrity and honesty in fostering individual commitment, alongside regulatory measures, to establish an ethical and moral business environment in financial reporting management.

Keywords: Attitude toward behavior, Earning management behavior, Moral character, Perceived behavior control, Religiosity, Rural bank, Subjective norms.

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1. Introduction

The practices of financial statement management, particularly concerning earnings information, have become a significant concern in both the business and academic communities. Earnings management is often conducted through the manipulation of financial statements to achieve specific objectives [1], this raises serious concerns about the ethics and integrity of financial statement preparers. While some view earnings management as a legitimate business strategy, others contend that it constitutes fraud, harming stakeholders and undermining public trust [2]. Decision-making regarding company operations and the control of operational manipulations arising from earnings management fall under the responsibilities of managers, who rely on their judgment and experience [3]. The risk-averse motive in earnings management, characterized by individuals' aversion to risks that may diminish future profits, drives managers to adopt accounting policies that are likely to yield future benefits [4, 5]. The risk of uncertainty also affects investment and financial policies [6].

Bank Perekonomian Rakyat (BPR) in Indonesia is comparable to community banks, credit unions, microfinance institutions, and rural banks in other countries. The primary advantage of BPRs in Indonesia lies in their close relationship with local communities, enabling a more personalized and relevant approach to engaging with customers. Additionally, BPRs demonstrate greater responsiveness to the specific needs of their customers by offering tailored services and products across different regions. Government support, particularly in the form of regulations, further encourages BPRs to focus on local economic empowerment and to address regional challenges more effectively. According to the Indonesian Banking Statistics of 2023, there are 1,402 BPRs in operation-13 times the number of Commercial Banks, which total only 105.

BPRs in Indonesia are not permitted to participate in clearing, a limitation that impacts how they report their financial performance. The primary revenue source for BPRs is derived from interest on loans and deposits, which may incentivize them to engage in earnings management through accrual adjustments or other modifications to their financial statements. Delays in transaction processing, resulting from the inability to utilize clearing services, may prompt revenue recognition to be shifted to more favorable periods. Furthermore, poor credit management has been shown to increase non-performing loans (NPLs), influencing earnings management decisions and potentially compromising the integrity of BPR financial statements [1, 2]. In addition to NPLs, CAR ratio and financial performance can also affect earnings management in BPRs [1, 3, 4].

Each individual possesses unique perceptions and moral values, which can potentially lead to either success or failure when confronted with the same ethical dilemma [1]. Ethical decision-making is a process through which individuals identify ethical issues, evaluate alternatives, and select actions that align most closely with their moral principles. The reinforcement of individual morals in ethical behavior when conducting business activities influences how individuals perceive and assess earnings management practices. Ethical orientation and moral behavior are recognized as being closely associated with decision-making in earnings management [2-5].

The ethical and moral orientations of individuals are shaped not only by their patterns of thinking and behavior, but also by the influence of religion or personal beliefs in teaching honesty and integrity. In a moral framework based on religiosity, individuals are expected to apply their motivation and abilities while displaying moral and ethical behavior consistent with the teachings of their religious beliefs. Honesty and risk avoidance are two core values transmitted through religion. Managers with high levels of religiosity tend to exhibit minimal deviations in corporate financial reporting [6]. The results of previous research in several countries show that religiosity can reduce earnings management [7-11].

The development of the business environment and society brings about various changes in perspectives and values. The Theory of Planned Behavior suggests that ethical and moral orientations of individuals arise not only from the formation of thinking and behavioral patterns, but also from the influence of religion or personal beliefs in teaching honesty and integrity. Within a moral framework based on religiosity, individuals are expected to apply their motivation and abilities while exhibiting moral and ethical behavior in alignment with the teachings of their religious beliefs. Honesty and risk avoidance are two key norms transmitted through religion. Managers with high levels of religiosity tend to exhibit minimal deviations in corporate financial reporting [6]. The results of previous research in several countries show that religiosity can reduce earnings management [7-11].

Furthermore, this research employs moral character based on religiosity and the Theory of Planned Behavior (TPB) to examine the impact of these two variables on earnings management behavior. This study aims to describe the effect of individual morality on their behavior in earnings management practices. Understanding the reasons why individuals engage in earnings management can assist in the formulation of company rules and policies to prevent unethical earnings management practices from occurring. The research questions are outlined as follows:

1. Does moral character based on religiosity has an effect on earnings management behavior?
2. Does moral character based on religiosity affects earnings management behavior through Attitude toward behavior?
3. Does moral character based on religiosity affects earnings management behavior through subjective norms?
4. Does moral character based on religiosity affects earnings management behavior through perceived behavior control?

2. Literature Review and Hypothesis

Positive Accounting Theory (PAT) explains and predicts that individuals use several alternatives provided in accounting policies to obtain benefits from the selection of the alternatives, both for individuals and companies [10]. The alternatives in the policy are a form of flexibility of management preferences in managing their business, including in the preparation of financial statements. Earnings management is a disclosure made by management with the aim of influencing the external reporting process with the intention of obtaining personal benefits [11]. Managers can intentionally increase or decrease reported earnings where this does not result in a corresponding increase or decrease in long-term economic profitability [12]. Three earnings management techniques used in financial reporting are 1) the opportunity to make accounting estimates

through judgment that can affect reported earnings, 2) the opportunity to voluntarily change accounting method to a method that can be selected and/or recognized by applicable financial accounting standards and 3) the opportunity to shift the period of costs or revenues so as to affect cash flow and earnings that are under the authority of managers [13]. Earnings management behavior is often associated with the desire to meet performance expectations that are expected to generate profits or bonuses and, in other aspects, is also associated with avoiding risks due to a decrease in profits that will be received [14].

Earnings management behavior is often associated with the intention of the individual concerned. The Theory of Planned Behavior (TPB) is often used to predict the reasons for individual behavior. TPB emphasizes the rationality of human behavior and the assumption that their behavior is under the control of their consciousness [1]. The TPB is divided into three as follows: 1) Attitude Toward Behavior (ATB) where an individual will have a strong attitude towards a behavior when the individual believes that the behavior is related to the positive goals that will be achieved, and vice versa; 2) Subjective Norms (SN) where the desire of an individual to carry out a particular behavior becomes stronger when other parties such as friends, colleagues, or superiors, are able to encourage the individual to comply, or due to the social pressure felt by the individual and vice versa; and 3) Perceived Behavior Control (PBC) in which the greater the resources or opportunities an individual has and the various obstacles or barriers that can be anticipated, the greater their control in carrying out the behavior.

The ethical dilemma faced by individuals is also felt in business decisions in corporates. It is known that by upholding professional ethics and spiritual awareness, individuals can remain stable in controlling themselves and not get carried away and feel a dilemma. The Model of Ethical Action Theory begins to develop four main components of individual ethical behavior, one of which is moral character [15, 16]. Furthermore, higher moral development indicates an increasing level of individual commitment to prioritizing the interests of their organization [17, 18]. Moral character can prevent individuals from engaging in bad behavior and helps them in obtaining stronger self-control so they can improve ethical culture [19]. Commitment to high ethical and moral behavior is one of the religious materials that explains stronger moral reasoning abilities [20, 21]. Some research found that a high religiosity can reduce earnings management [22-24] while the other research did not find any influence of those two [25]. Individuals with strong moral character based on religiosity will reduce unethical behavior and will assess Earnings Management as unethical behavior.

Earnings management is closely related to the ethical dilemmas faced by managers in managing their business activities. The actions taken by managers must reflect behavior and decisions that reflect integrity, honesty, and moral responsibility [26]. The existence of risks faced by companies can give rise to conditions forcing managers to behave unethically, but with a strong moral character based on religiosity, managers can obey the rules and take actions that are considered ethical and have a high moral. When the practice of earnings management is considered an act of manipulation, deception, and fraud, of course this is contrary to the values and moral principles permitted in religious teachings. A strong moral character from religious teachings is the main source of morality and individual ethical behavior [21]. A strong moral character based on religiosity will affect the behavior of individuals in earnings management practices.

H₁. Moral character based on religiosity has an effect on earnings management behavior.

TPB predicts that the intention of individuals is able to drive them in behaving. When individuals intend to behave ethically and morally then they will show ethical and moral behavior and vice versa. Attitude toward behavior influences earnings management behavior [2, 3, 5]. The moral character based on religiosity, which is perceived as a positive attitude that individuals must have in managing and reporting their business activities, can reduce their behavior in the earnings management practices. TPB predicts that social pressure, norms that apply around individuals, and the role of people around the individuals are able to drive the behavior of the individuals. Subjective norm states that when individuals believe that people around them accept earnings management behavior as something ethical in business management and company performance reporting, they will carry out earnings management behavior [3, 27]. A moral character based on religiosity perceived as the behavior and self-identity of individuals, with a high moral and ethics, and supported by important people in behaving ethically and morally, will reduce individuals' behavior in earnings management practices.

The role of managers in deciding policies and various choices of information to be reported in financial reports is extremely important. In a case where the individuals do not want to violate generally accepted rules (GAAP), but are supported by more opportunities and less obstacles, their intention to perform earnings management increases [3]. TPB predicts that perceived behavior control can increase the chances of individuals to act unethically in earnings management, and morality assessment that tends to emphasize the reputation of managers who achieve targets also force the individuals to engage in earnings management [28]. The moral character based on religiosity, which is perceived as the ability to suppress the desire to commit fraud and break the rules, is contrary to religious teachings and prevailing social morals. Moreover, if it is supported by the individual's belief that the rules are very strict, then earnings management behavior will be reduced.

H₂. Moral character based on religiosity affects earnings management behavior through Attitude toward behavior.

H₃. Moral character based on religiosity affects earnings management behavior through subjective norms.

H₄. Moral character based on religiosity affects earnings management behavior through perceived behavior control.

Based on the theoretical foundations and logical arguments above, a model of earnings management behavior that integrates Moral Character based on Religiosity and TPB is constructed as shown in Figure 1. The model will be used to investigate individual intention to engage in Earnings Management.

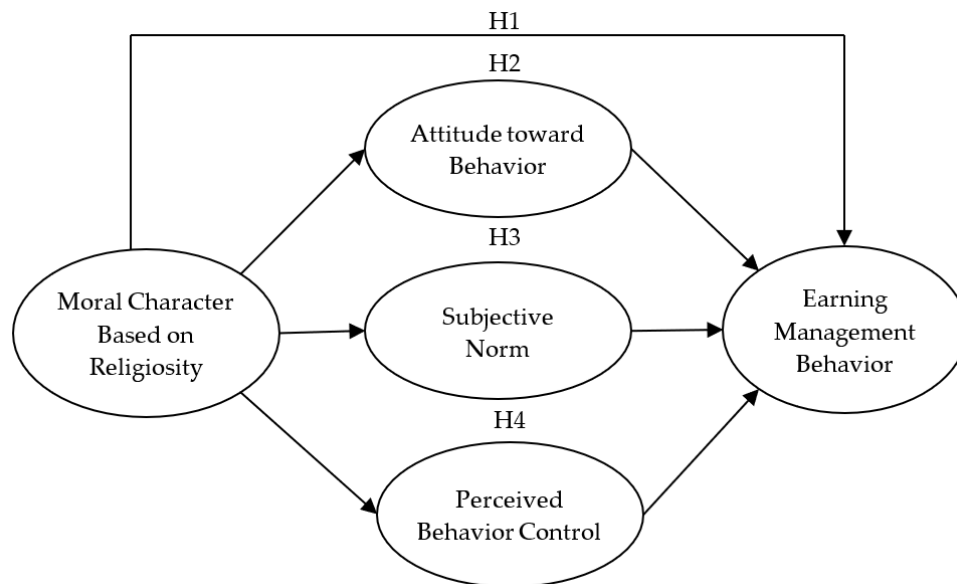


Figure 1.
Conceptual framework of research.

3. Materials and Methods

This type of research is quantitative where the population in this study are all rural bank Directors in East Java Province, which is 257 BPRs. The position of Director in rural bank is President Director/Director/Compliance Director/Operational Director. This study uses a census technique, namely using the entire population as a research sample, so that the sample of this study is 257 rural bank Directors. This study uses Structural Equation Modeling Partial Least Squared (SEM PLS) in testing the influence of moral character based on religiosity on earning management behavior through attitude toward behavior, subjective norm, perceived behavior control. The difference with previous studies, this model emphasizes more on variables from the description of the theory of planned behavior in mediating the relationship between moral character based on religiosity and earning management behavior.

The indicators used in the earnings management behavior variable use 13 items [29, 30] namely expense early, postpone expenses (quarterly statements), postpone expenses (annual statement), pull next year's sales, work overtime year end, selling excess assets, record supplies late, prepay expenses (record as current expense), write-off of inventory (inventory has value), write-up of inventory (previously of inventory), write-up of inventory (to meet profit targets), postpone paying invoices (amount immaterial) and postpone paying invoices (amount material). Indicators to measure the variable of moral character based on religiosity use 4 indicators developed in this study, namely motivation in consistency of beliefs, ability to behave religiosity and spirituality, ability in building connections and appreciation to form identity [19, 31]. Indicators to measure the variable attitude toward behavior are measured using two items, namely belief in behavior with expected results and positive/negative beliefs about the behavior carried out [1, 2]. Indicators to measure the variable subjective norm are measured using four indicators of superior support in behavior, support from friends/closest colleagues in behavior, compliance with demands (injunctive) and the desire to imitate the behavior of people around them [1]. Indicators to measure the perceived control behavior consist of two, namely the individual's freedom control factor in choosing to do/not do the behavior and the strength of the influence of the control factor related to the availability of resources/time/ability/knowledge [1]. The indicators developed in this study are described in Table 1. This study uses data analysis techniques, namely descriptive statistics to describe data related to respondents and respondents' answers to the statement items developed in this study.

Table 1.
Variable measurement.

No	Variables	Item
1	Earnings management behavior	Expense early Postpone expenses (Quarterly statements) Postpone expenses (Annual statement) Pull next year's sales Work overtime year end Selling excess assets Record supplies late Prepay expenses (Record as current expense) Write-off of inventory (Inventory has value) Write-up of inventory (Previously of inventory) Write-up of inventory (To meet profit targets) Postpone paying invoices (Amount immaterial) Postpone paying invoices (Amount material)

No	Variables	Item
2	Moral Character Based on Religiosity	I have the drive to behave consistently according to the religious beliefs and practices that I adhere to and believe in. I have the will to act ethically because my religion teaches me to do so. I have the ability to attend and participate in religious activities. I have the ability to adhere to the teachings of my religion. I have the ability to practice the teachings of my religion in my daily life. I have the ability to interpret and relate the spiritual experiences I have had to my daily life. I have the ability to grow my spirituality in order to achieve my inner peace. I have the ability to build relationships with my religious or spiritual community. I have the ability to act ethically for others and to gain support from my religious or spiritual community. I have confidence that I am seen as a religious person in society. I act ethically because I have been recognized as a religious person in the society.
3	Attitude toward behavior	I believe that I benefit from delaying the recording of current period expenses. I believe that it is easier to achieve my profit target by delaying the recording of current period expenses
4	Subjective norms	My superior supports achieving targets by not delaying recording current period costs. My colleagues do not delay arranging current period costs. I think that by complying with not delaying current period costs, profit targets can be achieved. I think that when my colleagues do not delay current period costs, I should not do the same.
5	Perceived control behavior	I have the control to choose policies that can delay the recording of current period costs. I have the skills and knowledge to choose policies that can delay the recording of current period costs.

Furthermore, to analyze using PLS-SEM, inferential statistics are used which consist of three stages, namely outer model test, inner model test and hypothesis testing. The outer model test in this study consists of convergent validity test, discriminant validity test and composite reliability test, for the inner test consists of the determination coefficient model (R^2), predictive relevance (Q^2), path coefficient, and effect size (f^2) and path coefficient estimation (β) and hypothesis testing by evaluating the calculated t value and the significance p value of β .

4. Results

This research uses a questionnaire with a five-point Likert scale to test the model (Figure 1). The questionnaire is distributed to Directors of Rural Bank in East Java-Indonesia. The data obtained shows that the respondents consist of Managing Director, Director, Compliance Director and Operational Director at Rural Banks in Indonesia.

Table 2.
Respondent characteristic.

Respondent characteristic	Frequency	Percentage
Gender		
Male	143	55.97%
Female	114	44.02%
Age		
25-35 Years	21	8.21%
36-45 Years	69	26.87%
46-55 Years	104	40.30%
More than 56 years	63	24.63%
Religion		
Islam	236	91.7%
Christian	13	5.22%
Hindu	8	2.99%
Education level		
Undergraduate	219	85.07%
Master	38	14.93%

Respondent characteristic	Frequency	Percentage
Working period		
0-10 Years	82	32.1%
11-20 Years	115	44.77%
More than 21 years	60	23.13%
Position		
Managing director	142	55.22%
Director	36	14.18%
Compliance director	61	23.88%
Operational director	18	1.49%

Respondents in this study are 257 Managing Directors (55.22%), Compliance Directors (23.88%), Director (14.18%) and Operational Director (1.49%); with the following characteristics the majority of respondents are male, totaling 75 (55.97%), while the remaining 59 people (44.02%) are female. The religion of the most respondents is Islam, with 123 people (91.7%), followed by 7 Christians (0.05%) and 4 Hindus (0.03%). The majority of respondents have an undergraduate education (85.07%), while 14.93% hold a Master's Degree. The age of most respondents ranges between 46-55 years (40,30%), and the longest work experience falls within 11-20 years (44.77%).

To analyze the model (Figure 2), this research uses partial least squares-structural equation modeling (PLS-SEM) which allows path models with latent variables. PLS is used for complex path models and consists of multi-item constructs. The sample size required for PLS is small and does not require normality requirements. So, this technique is suitable for use in this research, where PLS involves a two-step analysis to interpret the model.

Step 1 begins by testing the reliability of the research construct. In this research, composite reliability (CR) with a range between 0.70 to 0.80 is used. All CR values in this research are higher than 0.70 as shown in Table 2. Furthermore, convergent validity using the average variance extracted (AVE) is measured. The minimum value of AVE of 0.50 indicates a good measure of convergent validity, which means that the probability of indicators from a construct entering another variable is lower [1]. In this research, all the AVE values are above the limit or higher than 0.50 as shown in Table 2.

Discriminative validity is also used to measure the extent to which a construct is truly different from other constructs by empirical standards [1]. The Fornell-Larcker criterion is used to compare the square root of the AVE value with the correlation of the latent variables. This research model meets the criteria needed to assess discriminant validity as shown in Table 3.

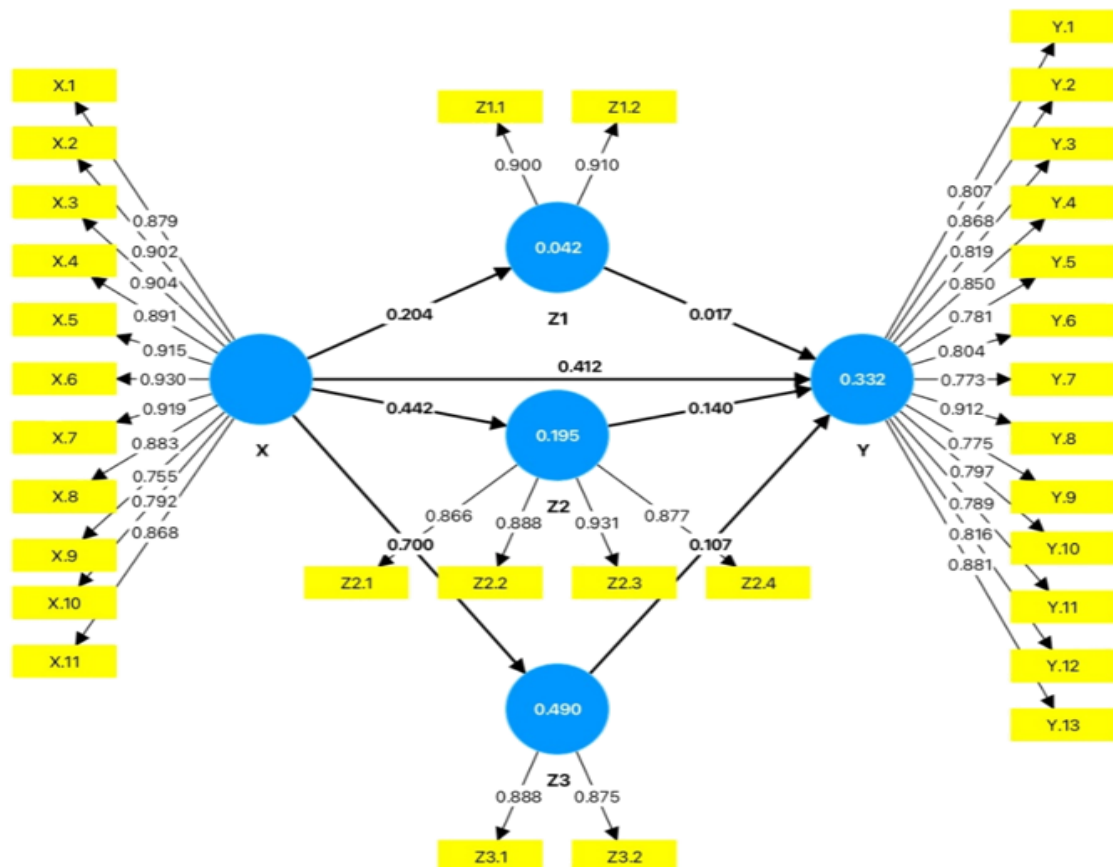


Figure 2.
Structural model analysis.

Table 3.

Outer model.

Variables	CR	AVE	1	2	3	4	5
Moral character based on religiosity	0.974	0.770	0.878				
Earnings management behavior	0.964	0.676	0.552	0.882			
Attitude toward behavior	0.901	0.819	0.204	0.168	0.905		
Subjective norms	0.939	0.794	0.442	0.317	0.267	0.891	
Perceived control behavior	0.874	0.777	0.700	0.459	0.281	0.417	0.881

After testing the model (Figure 2) by confirming the reliability and validity of the construct, then the relationship between dependent and independent variables is analyzed by calculating the predictive validity using the Stone-Geisser criterion (Q2). If $Q2 > 0$ then the exogenous construct variables have predictive relevance for the endogenous construct variables. The result of this analysis shows that the value of Q2 is 48.7%, above the threshold value [2]. Next, the Variance Inflation Factor (VIF) value is checked because it shows the collinearity statistics of the model. The threshold value allowed is more than 0.20 but less than 5. In this research, the VIF values are within the threshold range.

Then the goodness fit model is assessed by R^2 analysis as shown in Table 4. This value is calculated by running the PLS algorithm and the p value of the path coefficient generated through bootstrapping with 500 literacies. The R^2 value of the model is 0.311, meaning that 31.1% of the variance of the Y variable is explained or can be influenced by the independent variable. While the R^2 value of the Z1 variable variance is 0.034 meaning that 3.4% of the variance of the Z1 variable can be explained or can be influenced by the independent variable, the R^2 value of the Z2 variable variance is 0.189 meaning that 18.9% of the variance of the Z2 variable can be explained or can be influenced by the independent variable, and the R^2 value of the Z3 variable variance is 0.487 meaning that 48.7% of the variance of the Z3 variable can be explained or can be influenced by the independent variable.

Table 4.

Inner model test result (R square).

Variables	R-square adjusted
Earnings management behavior	0.311
Attitude toward behavior	0.034
Subjective norms	0.189
Perceived control behavior	0.487

The results of the PLS-SEM regression and hypothesis testing are shown in Table 5. The effect size calculated using f^2 is used to analyze the impact of each independent variable on the dependent variable. Based on the results of Table 5, the highest value of f^2 is 0.962, indicating that H4 has the highest effect size, namely the Perceived Control Behavior.

Table 5.

Hypothesis test results.

Hypothesis	Path coefficient (β)	t-value	Effect size (f^2)	P-value	Hypothesis decision
H1	0.412	3.657	0.123	0.000	Accepted***
H2	0.204	2.532	0.043	0.011	Accepted**
H3	0.442	5.037	0.242	0.000	Accepted***
H4	0.700	8.924	0.962	0.000	Accepted***

Note: *** $p < 0.01$, ** $p < 0.05$.

The results of this research prove that moral character based on religiosity has an effect on earnings management behavior. The results indicate that 31.1% of the variance in earnings management behavior is explained by moral character based on religiosity. Based on the results, H1 is accepted, so that moral character based on religiosity has a significant effect on earnings management behavior ($\beta = 0.412$ and $p < 0.000$). Based on the results of the analysis, moral character based on religiosity has a significant and positive effect on earnings management behavior through attitude toward behavior ($\beta = 0.204$ and $p < 0.011$), meaning that H2 is accepted. The stronger the moral character based on religiosity that is prepared as a positive attitude in behavior, the more it will affect the earnings management behavior of an individual. Furthermore, the results show that moral character based on religiosity has a significant and positive effect on earnings management behavior through subjective norms ($\beta = 0.442$ and $p < 0.000$), meaning that H3 is accepted. The stronger the moral character based on religiosity supported by the acceptance of people around the individual in behaving, the more it will influence the earnings management behavior of the individual. Finally, moral character based on religiosity has a significant and positive effect on earnings management behavior through perceived control behavior ($\beta = 0.700$ and $p < 0.000$), meaning that H4 is accepted. In addition, of all the factors in the model, the variable perceived control behavior has the strongest predictive value. It means that the effect of moral character based on religiosity on earnings management behavior becomes stronger with the presence of control, skills, and knowledge in determining accounting policies.

5. Discussion

The findings of this study have theoretical and practical implications. The theoretical implication of this research is that this research contributes on behavioral accounting theory by empirically establishing that there is a significant effect of moral character based on religiosity on earnings management behavior. This finding expands the theoretical framework by explaining that moral character based on religiosity possessed by individuals in preparing financial statements affects earnings management behavior. Furthermore, the exploration of the theory of planned behavior as an intermediary variable between the moral character based on religiosity and earnings management behavior shows that the role of control performed by individuals with skills and knowledge in choosing accounting policies encourages earnings management behavior.

This study suggests that strengthening of regulatory aspects is needed to limit individuals with control and ability to determine accounting policies through strengthening of moral character based on religiosity to suppress earnings management behavior. Strengthening of moral character based on religiosity performed not only by looking at whether the individual is religious, but also at the ability of the individual in applying these beliefs into the behavior and decisions being made in reporting the company's financial performance.

While the practical implications of this research are that it offers insight for companies and their managers to run their businesses ethically by adhering to transparent and integrity business practices. Ethical business management is one element of good governance, western corporate governance combined with Islamic principles can create a better governance structure [1]. Apart from that, consistently improving financial performance can also be used to maintain environmental, social and governance activities in the long term [2].

Corporate controllers and regulators can consider creating policies to suppress earnings management behavior through regulations that encourage the implementation of transparent and integrity-based financial reporting. A spiritual approach to improving individual morality in a company can be used to strengthen their commitment to realize that honest, ethical, and moral behavior is not only needed for the company but also for the people around them. Ultimately, the impact of earnings management behavior is not only felt by stakeholders, but also by society.

6. Conclusion

This study provides findings that religiosity-based moral character has a significant influence on earnings management behavior among directors of Rural Banks (BPR) in Indonesia. Religiosity-based moral character not only influences behavior directly but also through three dimensions of the Theory of Planned Behavior (TPB) in the form of attitude toward behavior, subjective norms, and perceived behavioral control. Perceived behavioral control was found to be the strongest mediator in this relationship. This means that an individual's ability and control over accounting policies significantly increase the potential for earnings management, even when religiosity-based moral character is strong. The importance of regulatory oversight that focuses not only on strengthening norms, but also on controlling opportunities for accounting policy manipulation.

Practically, the implications of this study will provide insight for companies and regulators to develop a spirituality-based approach in business ethics training and strengthening regulations. The combination of modern corporate governance principles and religious values can help create a more ethical and transparent business environment.

The limitation of this study is that it was only conducted on BPR directors in Indonesia, so it cannot be generalized to the banking sector in other countries or to other types of financial institutions. This study has not included other variables based on religiosity in explaining its relationship to earnings management behavior.

Further research can expand the sample to other banking sectors, such as commercial banks or Islamic banking. In addition, it can integrate other variables such as spiritual-based organizational culture, the influence of technology, and regulatory changes in the banking sector.

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