THE EFFECT OF COMPANY SIZE, PROFITABILITY AND FINANCIAL LEVERAGE ON INCOME SMOOTHING

(Empirical Study: At Manufacturing Companies Listed on BEI Period 2014-2016)

Regina Fatmanisa Yogisworo*), Noegrahini Lastiningsih, Husnah Nur Laela Ermaya
Department of Accounting, Faculty of Economic and Business,
Pembangunan Nasional "Veteran" Jakarta University
**Email:yogisworo36@gmail.com*

ABSTRACT

This study was conducted to examine the effect of firm size, profitability, and financial leverage on income smoothing. The population in this study were 146 companies listed on the Indonesian Stock Exchange (BEI) in the period 2014-2016 were selected using purposive sampling method. Data obtained from the company's financial report published on the Indonesia Stock Exchange (BEI). Samples obtained a total of 63 companies. The data in this research is secondary data. The analysis technique used is multiple linear regression at a significance level of 5%. This study shows that the income smoothing significantly influenced by firm size, profitability, and financial leverage at the level of 10.3%, where significant variables that affect the profitability and financial leverage are at levels of 0.1% and 2.2% respectively. However, the variable size of the company does not significantly influence the income smoothing, because the significance level was above 5%.

Key Words: Company Size, Profitability, Financial Leverage, Income Smoothing

1. INTRODUCTION

The financial statements is basically the result of the accounting process that can be used as a tool to communicate financial data or activities of the company to interested parties. In the financial statements contain a variety of the company's financial information, including information about the company's revenue. However, external parties, especially investors and creditors are likely to focus on the profit generated by the company contained in the statements of income that can be used as a benchmark for the success of the company. So that management tends to act disfunctional behavior that aims to maximize profitability by leveraging the flexibility of accounting standards which are used without the knowledge of the company externally. One of the actions that can be performed by the management is to create income smoothing.

The recent phenomenon of income smoothing action that leads to earnings manipulation can also beseen in the case of PT Toshiba, a Japanese electronics giant industrial corporation which took place in 2015. Where, based on the findings and independent investigasi accountant, PT Toshiba inflate profits or

income in the financial statements until the exaggerated profit of US $ 1.2 M during the period five years starting from fiscal 2008. Based on this phenomenon, it can be seen that companies take actions to manipulate earnings smoothing earnings to improveor even change the income in one period so that profits in high visible and in accordance with the wishes of management and owners of the company.There are various factors that can affect income smoothing action carried out by the management company that has been done by previous researchers where factors used in this study is the size of the company, profitability and financial leverage.

2. LITERATURE REVIEW

2.1. Agency theory

Agency relationship is a contract between one or more owners (principal) who hire another person (the agent) to perform some of the services on behalf of the owner which includes delegating decision-making authority to the agent (Jensen and Meckling, 1976). Agency problem arises because of the behavior wanted to benefit themselves from an agent, the behavior management in order to maximize their own welfare as opposed to the interests of the principal. Agency problem also occurs because of the asymmetry of information.

2.2. Positive Accounting Theory

Positive accounting theory is a variant of positive economic theory. This theory was developed along with the need to explain and predict reality of accounting practices in the community. This theory is also to explain what policies will have a manager in certain conditions in the future. What it is (Watts & Zimmerman, 1990). In a positive accounting theory, there are several accounting alternatives that can be used by every company in an effort to achieve the efficiency and effectiveness of the company as well as the optimal profit levels. It is often referred to as opportunistic action.

2.3. Hypothesis development

The size of the company can be defined as the average sales revenue in the current period up to the next few years. large companies are considered at low risk because they are considered to have more access to financial resources and to obtain additional capital to debt because the company is considered to have sufficient assets and the total value of a good company so as to obtain greater profits from loans dipinjamkan (Sitanggang, 2012). Research has been conducted by Silviani (2014), Muslichah (2015) gives the result that the size of the company has a significant positiveeffect on income smoothing, which means that the huge government intervention can lead to lower revenues of alternative options.

H1: company size significantly affect income smoothing.

The advantage gained in connection with the sale and investment. The better the profitability ratio, the better the ability to capture high profits of the company. (Fahmi, 2011). higher profitability illustrates that good corporate performance, on the other hand the low level of profitability shows that the company's performance declined.The greater the profitability of the company which led to the possibility of fluctuations in income, the more likely the manager made smoothing earnings. Research conducted by Lasdi & Budianto (2013), Kurniawan, et al (2012), shows that profitability has a positive effect on income smoothing. where firms with higher profitability ratios tend to smooth out earnings compared with companies lower.

H2: Profitability significantly influence income smoothing.

The leverage ratio is used to measure a company's ability to meet all

obligations, both short-term liabilities and long term liabilities (Hary, 2016, p.162). The higher the company's financial leverage ratio will be higher meal is also likely to take management of the income smoothing, because companies with high debt but has a steady profit investors tend to be more acceptable than a company that has no stable income. Research conducted by Wulandari, et al (2013), Silviani (2014), Salim (2014), Prasetya & Rahardjo (2013) gives results that positively affected financial leverage gain leveling. This positive effect means that the greater the amount of financial leverage, the higher the degree of smoothing performed by management.

H3: Financial Leverage significantly affect income smoothing.

3. DATA AND RESEARCH TECHNIQUE ANALISYS

3.1. Population and sample

The population in this study are all sectors in manufacturing companies that have listed on the Indonesia Stock Exchange since 2014 until 2016. The sampling technique used was purposive sampling.

3.2. Measurement *smoothing income*

Income smoothing can be seen as deliberate efforts are intended to normalize the income to achieve the desired trend or degree. Variable income smoothing measured or tested by Eckel Index (1981), which calculates income smoothing index based on changes in income and changes in sales in the period. Earnings used to calculate the index Eckel is net income. These variables are expressed using a ratio scale and unit of measure <1 for companies that do the income smoothing. Formula:

$$indeks\ eckel = \frac{CV\ \Delta I}{CV\ \Delta S}$$

Where:

$CV\ \Delta I$ = Coefficient of variation for the change in income

$CV\ \Delta S$ = Coefficient of variation to changes in sales

1) CV$^{\Delta I}$ can be calculated by:

$$\Delta I = \frac{I_t - I_{t-1}}{I_{t-1}}$$

$$CV\Delta I = \sqrt{\left(\frac{\sum(\Delta I - \Delta I)^2}{n-1}\right)} : \Delta\bar{I}$$

Where : ΔI = changes in income in the period

$\Delta\bar{I}$ = Average change in income

n = Number of years

2) CV $^{\Delta S}$ can be calculated by:

$$\Delta S = \frac{S_t - S_{t-1}}{S_{t-1}}$$

$$CV\ \Delta S = \sqrt{\frac{\sum(\Delta S - \overline{\Delta S})^2}{n-1}} : \overline{\Delta S}$$

Where :

ΔS = the coefficient of variation for the change in sales

$\overline{\Delta S}$ = Average change in sales

n = Number of years

3.3. *Size of Company*

The size of the company is a scale to classify the size of the company, which can be done by assessing the total assets, log size, the value of the stock market, and others. The higher a company's size, the higher the tendency of companies to take the income smoothing for keeping size of the company. These variables are expressed using a ratio scale and unit of measure in decimal form.

The size of the company = Log Total Assets

3.4. *Profitability*

Profitability ratios measure the

overall effectiveness of management directed by the size of profits in connection with the sale and investment. The better the profitability ratio, the better the ability to capture high profits of the company. Measurement of this variable is measured by the ratio between net profit after tax and net sales. The higher level of profitability of the company will increase the tendency of the income smoothing companies. These variables are expressed using a ratio scale and unit of measurement in percentage (%).

$$NPM = \frac{net\ income}{net\ sales}$$

3.5. *Financial leverage*

Leverage Ratio is the ratio used to measure the extent of the company's assets are financed by debt. In broad terms, the leverage ratio is used to measure a company's ability to meet all obligations, both short-term liabilities and long term liabilities. Measurement of this variable is measured by the ratio of corporate debt and the company's capital. The higher the debt level of the company, the higher the likelihood that the company would take the income smoothing. These variables are expressed using a ratio scale and unit of measurement in percentage (%).

$$DER = \frac{Total\ Liabilities}{Total\ Equity}$$

3.6. Data Analysis Methods

Our analysis technic is a multiple regression model. Multiple regression model in this study are:

$$IS = \beta 0 + \beta 1UP + \beta 2PB + \beta 3FL + \varepsilon$$

Where:

IS_{it} : Income Smoothing according to the year t
B_o : constant
$\beta_1\beta_2\beta_3$: Regression coefficients for each independent variable
UP : Size Companies
PB : Return On Asset Ratio enterprises in t
FL : Debt to Equity Ratio enterprises in t
ε : The term Errors

4. RESULT AND DISCUSSION

4.1. Descriptive statistics

The first analysis is done by analyzing the data using descriptive statistics. Descriptive statistics of research data stated in table 1.

Table 1. Results Descriptive statistics after outlier

	N	Min	Max	Mean	Std. Deviation
size of company	93	24.64	31.78	28.2004	1.52613
profitability	93	0.11	17.43	7.0333	4.43785
Financial leverage	93	0.08	1.48	.6412	0.34898
smoothing income	93	-2.29	2.31	.2229	1.00541
Day N (listwise)	93				

Source: secondary data that has been processed

Referring to the table of descriptive statistics, we can see that income smoothing index measured by proxy Eckel has a low or minimum value of -2.29, high or maximum value of 2.31, and the average value of 0.2229, and has a standard deviation of 1,00541, The size of the company (UP) measured by total natural logarithm of total assets that have a minimum value of 24.64 and a maximum value of 31.78, and has an average value of 28.2004, and the

standard deviation value 1.52513. And Profitability (NPM) was measured by a proxy or a profit margin net profit measured value of the net sales. The minimum value of NPM is 0.11, the maximum value is 17.43 and the average or mean of NPM is 7.0333 with a standard deviation of 4.43785. While financial leverage (DER) is proxied by the ratio of total debt divided by total capital.

Table 2. Results of linear regression

Variables	*coefficient*	t	Sig
(Constant)	, 763	0.401	.690
company size	-, 059	-.845	0,400
Profitability	, 094	3.539	0,001
Financial leverage	, 735	2,324	0,022
R2	, 103		
F	4504		

Dependent Variable: Income Smoothing source: secondary data that has been process

From the test results, multiple linear regression model that is formed is as follows:

UP IS = 0.763 to 0.059 + 0.735 + 0.094 PB FL

The regression coefficient of firm size (UP) is equal to -0.059 which indicates if there is an increase in the unit size of the company assuming the other independent variables tidak changed, it will decrease the value of the income smoothing of -0.059.

Koefisien regression profitability (NPM) is 0.094 which indicates if there is an increase in the unit's profitability assuming the other independent variables do not change, then increase the value of the income smoothing by 0.094.

Financial Leverage regression coefficient (DER) is 0.735 which indicates if there is an increase in one unit of Financial Leverage assuming other independent variables unchanged, thereby increasing the value ofsmoothing earnings equal to the 0735 action.

Based on the test results table the coefficient of determination, it can be seen that the value obtained is adjusted R-square 0.103 or 10.3%. This indicates that company size, profitability, and financial leverage are able to explain 10.3% of income smoothing and the remaining 89.7% is explained by other factors outside of this study.

While based on the t-test -0.845 Company size is smaller than t table is 0,400 1.66216 and the significance of> 0.05, which means that the company no significant negative effect on the income smoothing.

Profitability variable has a value of t calculated 3539, which means greater than t tables 1.66216 significance 0.001 <0.05 so it can be concluded that the profitability of income smoothing affect positive meaning.

Financial leverage has counted 2,324 t value which is longer than t tables 1.66216 significance 0.022 <0.05. So it can be concluded that the financial leverage has a significant positive effect on income smoothing.

4.2. Discussion

The test results show that the size of the company (UP) had no negative effect variables significant on Income

Smoothing action. It is based on the hypothesis test results in which significant value 0,400> 0,05. Company size has a significant influence on Income Smoothing. The research result is different from the initial hypothesis in which it was previously assumed that the size of the company is affected by the action of Income Smoothing. This can be caused by the fact that a company with the size of large companies tend to not perform income smoothing because they feel the profit generated by the company usually has been able to achieve its targets and is able to increase the size of the company without having to raise or reduce the income of accident in the current year. The results of this study contradict the research conducted by Silviani (2014), Lasdi & Budianto (2013), which indicates that company size has an influence on income smoothing. However, the results of this study are consistent with a study conducted by Kurniawan, et al (2012), Wijoyo (2014), Salim (2014), and Prasetyo & Rahardjo (2013) which has the result that company size has no effect on the action of Income Smoothing.

The test results showed that the variables Profitability (NPM) has a positive meaning to the action of Income Income. It is based on the results of the hypothesis test in which the value of significance 0.001 <0.05. Results of research has been done in line with the initial hypothesis in which the influence Profitability Income Smoothing action. These results indicate that firms with higher profitability actually tend to do the income smoothing. The results of this study contradict the research conducted by Salim (2014), Prasetya & Rahardjo (2013), and Christina (2012), which shows that profitability has no effect on the income smoothing. However, the results of this study are consistent with the results obtained Kurniawan, et al (2012), Wijoyo (2014), Wulandari, et al (2013).

The results of multiple linear regressiontest against third hypothesis indicates that the variable Financial Leverage (DER) has a significant positive effect on Income Smoothing action. It is based on the results of the hypothesis test in which the significant value of 0.022> 0.05. Results of studies have been conducted in line with theinitial hypothesis that previously estimated that the Financial Leverage affect the action of Income Smoothing These results indicate that the effect of Financial Leverage on Income Smoothing is because of the leverage ratio is higher, the higher the risk that investors should invest in the company, so the higher manager tendency for the rate of profit that investors assume that the company is able to guarantee the debt with a stable profit every year. The results of this study contradict the research conducted by Kurniawan, et al (2012), Wijoyo (2014), Lasdi & Budianto (2013), which shows that the financial leverage ratio has no effect on income smoothing. However, the results of this study are consistent with the results obtained Silviani (2014), Wulandari, et al (2013), Salim (2014), Prasetya & Rahardjo (2014) which has the result of research that the ratio of companies leverage effect on Treasury to act smoothing earnings.

5. CONCLUSION

Companies that have a size large companies tend not to do the income smoothing because the original profit from the sale of the company remains stable and increasing every year without the need to take the income smoothing. Managers tend to do the income smoothing to improve the company's profitability or maintain profitability and increase it to allow the company to provide a promising investment returns and attract investors. Companies tend to

do the income smoothing so that the debt proxyed by Debt to Equity Ratio (DER) to increase stable and visible in every period, able to manage the debt they have and be able to pay the debt, so the lenders feel safe to lend capital to the company.

Limitations of this study is the number of samples that cannot represent the entire population because of financial statement information that is limited listed on the Indonesia Stock Exchange, Research needed outliers in data processing so that the number of samples used must be reduced, and the independent variables used in this study did not have variations variables such as moderating variable.

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