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INCOME SMOOTHING: IMPACT FACTORS, EVIDENCE IN INDONESIA

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ABSTRACT: *Indonesia's banking sector is expected to improve the performance management productivity positive direction (in other words the emphasis on earnings quality and performance should be improved), and making it into the (Association of Southeast Asia Nations) ASEAN free market in 2020 and became the largest bank in ASEAN.The aim of this study are to determine the factors that affect income smoothing on the National Private Commercial Foreign Exchange Banks that listed in Indonesia Stock Exchange (IDX). Variables used in this study are the firm size, profitability and financial leverage. Eckel Index (1981) was used to measure income smoothing, where net profit after tax as income smoothing object.The sample was taken by random sampling of 10 private foreign exchange national banks that listed in Indonesia Stock Exchange (IDX) during the years 1/1/2009 to 31/12/2013 with a sub-sample of 50 financial reports. Testing is done through panel data analysis technique with simultaneous test (F test) and partial test (t test) was used to identify factors that affect income smoothing.The results showed that income smoothing is done by most of the National Private Commercial Foreign Exchange Bank which listed on the Indonesia Stock Exchange (IDX). The test results result are variable size of the company, profitability and financial leverage simultaneously significant effect on income smoothing. Partial test results are that the variable size of the company, profitability and leverage financial has effect on income smoothing.*

KEYWORDS: Company Size, Profitability, Financial Leverage, smoothing earnings.

INTRODUCTION

During 2009, Indonesia's financial sector continues to grow and has been maintained. It was supported by conducive domestic economy and visible signs of global economic recovery. Banking as an industry that dominated the Indonesian financial sector still shows a positive performance, despite the implementation of the economic unstable turmoil, the bank was able to maintain a positive performance. It is seen from profitability, solvency and liquidity of banks which are generally stable at an adequate level. In growing pressure from domestic and global economy during 2013, Indonesia’s banking industry has successfully face the challenges and showed positive results as seen from the aspect of intermediation, profitability and capital structure.

Overall, the banks were able to perform the intermediation function as indicated by the amount of public funds collected and disbursed loans. Indonesia's banking sector is expected to improve the performance management productivity positive direction (in other words the emphasis on earnings

quality and performance should be improved), and making it into the (Association of Southeast Asia Nations) ASEAN free market in 2020 and became the largest bank in ASEAN.
Profit growth occurred in the Indonesia banking sector, was still resistant to economic crisis in 2008. It demonstrated by various indicators, such as; the rate of credit growth, adequate liquidity, capitalization, and provisioning problem loans. Increased profits occur that affecting the stability earnings in Indonesia, and it more likely to investor to makes an investment.

Income smoothing is closely related to the management concept of profit (earnings management). As the management earnings, income smoothing concept also uses agency theory approach. This theory states that earnings management is influenced by a conflict of interest between the Management (agent) with the owner (principal) that arises when each party seeks to achieve or maintain a level of prosperity of the company. (Masodah. 2005).Income smoothing cannot be separated from affecting factors. In some previous studies, Masodah (2005) suggested that a general measure of the size of the company is in buy and- sell their shares in the company on the stock exchange, which means that if the company has issued shares in the stock exchange, the company can be categorized as a large company. the size of the company to be one of the reasons in doing smoothing earnings management, with the goal of providing the satisfaction of both internal and external parties. Investor expectations of profit growth is the high rate of return on capital that is embedded which can be measured by the ratio of profitability. Profitability ratios are commonly used is the return on assets (ROA). ROA is used to measure the effectiveness of the bank in generating profits by optimizing assets.

The larger the company, the greater the financial risks that must be faced by the company. Then the other characteristics deemed to affect income smoothing Financial leverage is demonstrated efficiency in utilizing the company owner's equity in anticipation of long-term debt and short-term. Large debt resulting leverage ratio becomes large resulting in increased risk of investing in the company, so that this could lead to the income smoothing.Based on the problems identification, this study is testing whether there is a relationship between firm size, profitability and financial leverage on income smoothing in a national private commercial foreign exchange banks in Indonesia for period 1/1/2009-31/12/2013.The reminder of the paper is organized as follows. Section II discusses the literature review.. Section III contains methodology. Section IV concludes with some result and finding, Section V Discussion, Section VI. Implication to Research and Practice, Section VII. Conclusion, Section VIII Areas for future research and finally section IX references.

LITERATURE/THEORETICAL UNDERPINNING

Belkaoui and Ahmed (2007) states essentially an operational definition of earnings management is the potential use of accrual management with the goal of personal gain. Scott (1997) in Masodah (2005) supported by Sri Sulistyano (2008: 177) states that the shape or pattern of earnings management consists of:"1) Taking a Bath

Taking a bath usually occurs in periods of stress or reorganization. This form acknowledges expense in future periods and the loss in the current period, if the poor condition cannot be avoided. Therefore, management should eliminate some of the assets and impose the estimated future costs.

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2) Profit Minimization
This form is similar to taking a bath, but performed at a very high profits obtained. How to speed up the elimination of fixed assets and intangible assets and recognizes expense which happened as costs. This is done with the intent to profit politically not get attention.
3) Profit Maximization
This action aims to report higher net income, for the benefit of the larger bonuses. This action is usually done at a low earned income.
4) Income Smoothing
This action is normalized profit intentional or trends to achieve a certain level. (Belkaoui, 2000: 186)"

Income Smoothing
According Belkaoui (2006: 37), the definition of income smoothing is as follows:
"Reduction of income fluctuations from year to year by transferring income from the years of high earnings for the periods that are less favorable. Final definition of income smoothing see it as a phenomenon of manipulation process time profile of income or earnings to make a profit and become less varied, while at the same time does not increase the income reported during that period ".

Purpose of Alignment Income (Income Smoothing)

The purpose of income smoothing by Foster (1986) are as follows:
1. Improving the company's image in the eyes of outsiders that the company has a low risk.
2. Provide relevant information to make predictions against earnings in the future.
3. Improving the business relationship satisfaction.
4. Improve the perception of external parties on the ability of management.
5. Increase compensation for management.

Factor Affecting Earnings

Size of Company
Machfoedz (1994) in Suwito and Herawaty (2005) states that the size of the company is:
"A large scale which can be classified as small companies in a variety of ways, including: total assets, the log size, the value of the stock market and others. Basically the only firm size are divided into three categories: large companies, medium and small firms. Determining the size of the company is based on the total assets of the company ".

Profitability
Dendawijaya (2003: 119) analysis of bank profitability ratio is a tool to analyze or measure the level of business efficiency and profitability achieved by the bank concerned. Moreover, the ratios in this category can also be used to measure the health of banks.

Financial Leverage
Sartono (2001: 120) states that:
"Financial leverage indicates the proportion of the use of debt to finance its investments or show the company's capacity to meet the obligations of both for short term and long term ".

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METHODOLOGY

Research Methods

Population and Sample

In this study, the population are the size of the company, profitability and financial leverage of the National Private Commercial Foreign Exchange Bank for period 1/1/2009-12/31/2013. The sampling technique used in this study is a random sampling, so that the samples used were 10 National Private Commercial Foreign Exchange Banks for Year 1/1/2009-31/12/2013.

Data Analysis

Data analysis techniques used by researchers is econometric model. Data analyzed with the data panel regression using the software E-Views 6.0. Individual panel data is data at a time and provides some observations for each individual, in other words the data panel combines cross section data with time series data.There are several common methods for estimating the regression model with panel data, but are often used there are 3 ie, Pooled Least Square, Fixed Effects and Random Effects. From the estimation of the three models, will be some statistical tests to see more valid model among the three. Tests include Chow Test, Hausman Test, and LM Test.

Testing Statistics

Statistical tests in this study calculations using statistical software E-Views 6.0.
Data obtained during the research process then further analyzed to obtain more detailed results to answer the problems that exist in this study. Analytical techniques in predicting financial performance was conducted using multiple regression analysis with the Ordinary Least Square.
It can determine the effect of independent variables on the dependent variable.
Equation regression model in this study using a regression model to be estimated using OLS. The equation is as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

RESULTS/FINDINGS

Based on calculations using the approach Fixed Effect, obtained regression model as follows:

$$Y = -4.03586 + 0.868498 (X_1) + 0.130501 (X_2) - 0.250967 (X_3) + e$$

Calculated F value is equal to 174.2335 much larger than the magnitude of F Table 2.807. Significance F Calculate the value was 0.000 which is smaller than α level was set at 0.05. From both of these, then based on the criteria of experiments, we concluded that Ho is rejected and H1 is accepted. So there are statistically significant effect between firm size (log. Of Total Asset) (X_1), profitability (ROA) (X_2) and financial leverage (DER) (X_3), income smoothing (Index Eckel) (Y). From the results of tests of significance in the above table obtained t value of 5.595237> t table (1.67) and the p-value of 0.001 <α (0.05) thus Ho is rejected, or it can be concluded that the size of the company (log.of TA) has a significant influence on income smoothing variable income smoothing..

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From the test results gained significance in the above table t value of 2.050166 <t table (1.67) and the value of p value of 0.0475 $<\alpha = 0.05$. thus Ho is rejected, or it can be concluded that the profitability (ROA) has a significant influence on income smoothing variables (Income Smoothing).

From the results of tests of significance in the above table t value obtained by -20.8164420, ≥ t table (1.67) and the value of p value of $0.000 \leq \alpha = 0.05$. thus Ha rejected, or it can be concluded that the financial leverage (DER) has a significant influence on the variable income smoothing. Large coefficient of -0.250 Financial leverage.

Testing Coefficient Of Determination

R Square value is 0.977, so it can be concluded that the contribution of the size of the company (log.TA) (X_1), profitability (ROA) (X_2) and financial leverage (DER) (X_3) on income smoothing (Index Eckel) (Y) is equal to 97.7%, while the remaining 3.3% is explained by other variables not examined in this study.

DISCUSSION

This study is not in line with the research conducted by Ashari et al. (1994) which mentions that large companies will be more inclined to do the income smoothing practices than smaller companies. Masodah (2005) "Asset size companies that are considered to have less risk than small companies, because large companies are considered more have access to the capital markets that are considered to have a smaller beta".

Basically large companies generally tend to get more attention from analysts and investors than small companies so that when companies do the income smoothing, it will provide considerable risk for the company.

Large-sized company category is a company with a great asset value, where large companies generally will get more attention from various parties such as analysts, investors, and government to the large companies is expected to avoid income smoothing to avoid risk.

IMPLICATION TO RESEARCH AND PRACTICE

Profitability is an important measure to assess the soundness of the company, which may affect the investor in making a decision. The test results showed a significant positive direction indicates that management will strive to do if the earnings management company profitability decreased because of the importance of the information value of the return of the assets owned by the company, so as to attract investors to invest in the company. This will make the company with a low level of profitability is more motivated to do the income smoothing, in addition to the value of a stable income can also give satisfaction to the owner of the company top management performance.

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CONCLUSION

a) Based on the data that has been observed can be seen that the three independent variables studied were Firm Size (log. Total assets), profitability (ROA) and Financial leverage (DER) simultaneously affect income smoothing on the National Private Commercial Foreign Exchange Bank in proxy with Eckel Index calculation results.

b)

c) Based on the data that has been observed can be seen that the size of the Company (Log. TA), profitability (ROA) and a significant negative effect on income smoothing. While variable Financial Leverage (DER) partially significant positive effect on income smoothing (Income Smoothing) on National Private Commercial Foreign Exchange Bank year 2009-2013.

FUTURE RESEARCH

I. For management companies, particularly National Private Commercial Foreign Exchange Bank listed in the Indonesia Stock Exchange, should not perform income smoothing policies beyond the reasonable limits of variability, so it does not mislead decision-making in the future.

II. Variables examined and years will be increased to enable a true picture of income smoothing on the National Private Commercial Foreign Exchange Bank.

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