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Income Smoothing: Does Firm Size Matter in Indonesia?

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Abstract:
Background*: Income smoothing is one of the earnings management strategies. It can make the information presented in financial reports irrelevant. This study aims to empirically prove the negative effect of company size on income smoothing in all companies listed on the Indonesia Stock Exchange.*
Methods*: The research sample is all go-public companies listed on the Indonesia Stock Exchange (IDX) in the 2015-2019 period, amounting to 449 companies using the purposive sampling technique. Hypothesis testing was conducted using simple linear regression with SPSS 25 software.*
Results:*The results of this study prove that company size has a significant negative effect on income smoothing in all companies listed on the Indonesia Stock Exchange. Large companies get more attention from public, stockholders, investor, creditor. It will limit managers doing income smoothing.*
Key Words*: Earnings Management, Income Smoothing, Company Size, IDX*

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I. Introduction

The earnings figures presented in the income statement should represent the earnings generated by the company. However, management as a company manager can intervene so that earnings looks good by doing earnings management. Based on research by Majid et al. (2020), Romantis et al.(2020), Azizah et al.(2020), Azizah et al.(2019) earnings management practices do occur in Indonesia.

One form of earnings management practice is income smoothing. Income smoothing practices carried out by managers can reflect that the risks faced by investors do not fluctuate, it can also be an image that management performance is good. Disclosure of earnings information becomes misleading due to income smoothing practices and will cause errors in decision-making.

There are very few studies related to income smoothing in all companies listed on the Indonesia Stock Exchange. The results of research related to income smoothing are also inconsistent, Oktaviasari et al. (2018), Oktoriza (2018), Dewi and Suryanawa (2019), Aemanah and Isynuwardhana (2019). Therefore, realizing how important it is to be aware of the income smoothing practices carried out by all go-public companies in Indonesia, the researcher conducted a study entitled "Income Smoothing: Does Firm Size Matter in Indonesia?". The results of this study can be used by users of financial reports as a basis for consideration in analyzing financial statements because management's efforts to perform income smoothing will make the information presented in the financial statements irrelevant.

II. Literature Review, Hypothesis Development, And Methods

Jensen and Meckling (1976) explain in agency theory that a manager is an agent who works for an owner (principal), the contractual relationship between the owner and the manager is an agency relationship. The cooperation contract contains agreements that explain that the company management must work optimally to provide maximum satisfaction such as high earnings to the owner. The implication allows for an opportunistic attitude (Azizah, 2017a). Managers are encouraged to maximize their interests by beautifying the financial statements to match the owner's expectations even though the financial statements do not describe the actual condition of the company. This manager's behavior is called earnings management (Azizah, 2017b).

Subramanyam and Wild (2010) explain that income smoothing is one of the earnings management strategies. Belkaoui (2012) explains that income smoothing is a reduction in earnings fluctuation from year to year by moving income from a year with high income to an unfavorable period.

Company size is considered as one of the driving factors for the practice of income smoothing. Companies that have large total assets will get more attention from outsiders, and besides that, the majority of large companies have implemented good corporate governance practices. Income smoothing carried out by managers as a form of earnings manipulation is deemed not to provide real information regarding company performance. Large companies that get more attention will limit managers in doing income smoothing because if large companies are proven to practice income smoothing, it could drop the value of a company. Therefore, the developed hypothesis:

HA_1: Firm size negatively affects income smoothing.

Research Methods

The population of this research is all companies listed on the Indonesia Stock Exchange. The sample selection method is purposive sampling with the criteria required in this study as follows: the company is consecutively listed on the Indonesia Stock Exchange during the 2015-2019 period; the company publishes audited financial reports for the 2015-2019 period; the company has complete data; the company presents financial reports in the rupiah currency.

The independent variable in this study is the firm size (FIRM SIZE). Firm Size is measured by the natural logarithm (Ln) of the company's total assets. Meanwhile, the dependent variable in this study is income smoothing (INC.SM), using the Eckel Index (1981).

To test the hypothesis proposed in this study, the Simple Linear Regression method was used, using the SPSS version 26 computer program for Windows. The regression equation model for testing the hypothesis is as follows:

$$INC.SM = \alpha + k1\ FIRM\ SIZE + \varepsilon$$

III. Result

Based on purposive sampling, the sample companies were 449 companies with a research period of 5 years (2015-2019), the total data was 2245. The results of hypothesis testing can be seen in the following table 1:

Tabel 1: hypothesis testing resultan:

Variable	Prediction	coefficient	Sig.	Result
(Constant)		1,877	0,000	-
FIRM SIZE	Negative	-0,076	0,006	Significant

Table 1 shows that the company size regression coefficient (FIRM SIZE) is -0.076 with a significance level of 0.006 which is smaller than the 5% significance level. It can be concluded that the company size variable (FIRM SIZE) has a significant negative effect on income smoothing for all companies listed on the Indonesia Stock Exchange.

IV. Discussion

Benny (2014) explains that large companies with large total assets will get more attention from many groups such as analysts, investors, and the government. Investors are more interested in companies that are large and have stable earnings because they guarantee the long-term sustainability of the company. Therefore, investors are looking for large companies because investors usually do not want to take the risk of investing their money in companies that are still small and growing. The existence of a negative relationship between company size and income smoothing practices can also be caused by one of the reasons that large companies have implemented good corporate governance. The bigger the company size, the greater the manager's awareness of the importance of good corporate governance gets. Therefore, managers always try to reduce the information gap between agents and principals through the implementation of good corporate governance.

V. Conclusion

This study succeededtoprovethat company size negatively affects income smoothing in go-public companies listed on the Indonesia Stock Exchange, which means that the larger the size of the company, the smaller the chance for company managers to practice income smoothing. The reason behind this is a large amount of public spotlight and the implementation of good corporate governance so that the information gap between managers and owners can be minimized.

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