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THE IMPACT OF BOARD INDEPENDENCE, PROFITABILITY, LEVERAGE, AND FIRM SIZE ON INCOME SMOOTHING IN CONTROL OF AGENCY CONFLICT

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Abstract: This research is aimed to earn empirical results about the effect of board independence, profitability, leverage and firm size on income smoothing. The study used purposive sampling as its sampling method on manufacture companies that's listed on BEI for years 2015-2017. Information for this research was acquired from multiple online sources that store financial reports of companies. This research used Eckel Index to determine if a corporation did an income smoothing on its financial report or not. The results were significant relationships between board independence and income smoothing and between profitability and income smoothing while insignificant relationships were found in between leverage and income smoothing and between firm size and income smoothing. To improve this study there are multiple ways that has been written in conclusion part.

Keywords: *Board Independence, Firm Size, Income Smoothing, Leverage, Profitability*

INTRODUCTION

Companies that conduct business operations will produce financial reports regularly. The financial statements will be used by companies to provide financial information consisting of changes in the elements of the profit report to interested parties in providing an assessment of the financial performance of the company and the company's management (Fahmi, 2011).

Management's efforts to intervene in earnings information in financial statements aimed at increasing the expectations of corporate stakeholders who have a desire to know the financial condition and performance of the company are referred to as earnings management. It is realized by the company management, how important the earnings information is when

determining policy to prepare financial statements based on various principles and methods of applying to account specifically for the purpose of achieving certain targets or goals.

Brigham and Daves (2001) in Ahmad and Septriani (2008) stated that from the perspective of financial management, one of the objectives of the company is to maximize shareholder wealth. According to Ahmad and Septriani (2008), these goals can often only be achieved if corporate management responsibilities are left to professionals (managers). According to Jensen and Meckling (1976) in Sanjaya and Wirawati (2016), agency theory is a theory that explains the relationship between principals and agents who are bound in a contract. According to Dewata, Sari, and Fithri (2016), the agency relationship between the principal and the agent can cause conflict because both try to maximize their respective utilities. According to Scott (2015) agency theory is a branch of an agency theory that studies a contractual capital that encourages management to take action in accordance with investor interests even though the interests are not the same as the interests they want. Because of these differences, management is motivated to practice earnings management.

The use of earnings management by company management aims to resolve conflicts that may arise between management and company stakeholders. Management actions in making income smoothing are usually based on various reasons such as to satisfy the interests of the company's owners in increasing the value of the company so that it is considered to have a low risk of uncertainty, raising the company's stock price, maintaining position, and getting compensation.

Profit Management has five forms, consisting of methods of taking a bath, income minimization, income maximization, income smoothing and timing revenue, and expense recognition. Income smoothing is the most common and most popular form of earnings management. Managers increase or decrease to reduce reported earnings fluctuations so the company looks stable and does not look at risk.

Zurich in Butar and Sudarsi (2012) states that income smoothing is a method used by managers for reported earnings fluctuations that do not appear to be too volatile in order to achieve the objectives to be achieved either through accounting methods or through transactions. Income smoothing will result in the disclosure of information about corporate earnings to be misleading.

Butar and Sudarsi's (2012) research results cause uncertainty about the effect of variables on income smoothing practices. The results of research from Gayatri and Wirakusuma (2013) revealed that company size, bonus plan, dividend payout ratio, and auditor's reputation affect income smoothing. Research conducted by Ginantra and Putra (2015) found results that net profit margins affect income smoothing while factors that do not affect income smoothing are profitability, financial leverage, company size, public ownership, and dividend payout ratio.

Peranasari and Dharmadiaksa (2014) revealed that all the variables they examined affected income smoothings such as company size, financial leverage, profitability, debt to total assets ratio, firm value, and leadership structure. This is different from the results of research from Zuhriya and Wahidahwati (2015) which states that company size and company value do not affect income smoothing and are followed by other factors, namely net profit margin, operating profit margin, and standard deviation. But profitability and debt to equity ratio factors affect income smoothing.

Based on the research results above, it is necessary to have further research to determine the effect of Board Independence, Profitability, Leverage and Firm Size variables on Income Smoothing.

LITERATURE REVIEW

Agency Theory according to the concept, is used to explain the relationship that exists between shareholders (Principal) and managers (Agents). Agency Theory (Agency Theory) is a theory that occurs due to differences in interests that lead to conflicts between the Principal and the Agent which causes the Agent to prioritize his interests before the Principal's interests. (Natalie and Astika, 2016). There is a difference in position between Agent and Principal, in accordance with applicable economic law, the relevant parties are given the assumption that the interests of each party are first so that the effort made is to maximize the interests of the parties themselves within the agency structure space. applicable.

In an effort to reduce conflicts that occur between the two parties so that the practice of earnings management does not spread within the company, the implementation of Corporate Governance can be done by the company. Good Corporate Governance (GCG) arises because there are management controls aimed at the behavior of managers, by way of monitoring to determine whether management actions will be beneficial or not for the company.

In good corporate governance, there are five principles that are considered positive for the management of a company, namely openness, accountability, responsibility, independence, and fairness (Terzaghi, 2012: 36). With the implementation of Corporate Governance in the organization, the company is considered able to strengthen the trust of users of the company's financial statements and the quality of the company's financial statements can be guaranteed (Oktaviani, Nur, & Ratnawati, 2015). The implementation of good corporate governance measures is directed towards reducing agency problems at the lowest point.

Research by Houque, et al. (2010: 2-4) is done by dividing corporate governance mechanisms into management shareholding, institutional shareholding, government shareholding, board size, board independence, audit quality, and family control. The independent board of commissioners is the highest level of the company's internal management system. The role of the independent board of commissioners is also expected to improve earnings quality by limiting the level of earnings management through the monitoring function of financial reports (Rupilu, 2011: 110) Financial Reporting or financial reporting includes recording financial information which according to the applicable accounting standards. According to Vargriya (2015), Financial Reporting is written within a predetermined period of time and includes financial information relating to the company to stakeholder parties.

In Financial Reporting reliable quality information is a very vital subject. The term "reliable quality" is very important and affects directly whether information relating to finance is useful for the wearer. Reliable quality information is information that guarantees the management of things recorded directly capturing the real conditions (Osho and Ayorinde, 2018).

Income Smoothing according to Acharya and Lambrecht (2011) is done by insiders by manipulating production and business decisions to manage public expectations. Based on the Republic of Indonesia Law No. 40/2007 concerning Limited Corporation article 120 paragraph 2, an independent Commissioner (Board independence) is a commissioner that

has no affiliation with members of the board of directors, major shareholders and/or other members of the Board of Commissioners and is appointed based on the resolution of the GMS, numbering one or more people and regulated in the company's articles of association. Independent commissioners can contribute significantly to the decision making of the Board of Commissioners. They can bring an objective view that can provide an evaluation of the performance of the board and the management.

Profitability (Profitability) is the ability to generate profits by a company. If the level of profitability of the company is high, it means that the management has the ability to manage the company so as to generate profits. Companies that have good performance in generating net profits from sales and own capital will be reflected in the company's higher profitability (Widana and Yasa, 2013).

Leverage is the result of using borrowed capital when investing that capital to develop the company and generate returns on risk capital. According to Kasmir (2011), Leverage will provide information to users how much the company uses debt to finance the company's assets. Creditors will pay attention to how high leverage the company has to identify risks that must be borne when providing loans to the company.

Herni and Susanto explained that company size is a value that shows how big the company is related. The size of the company has a variety of proxies that can be used, namely total assets, number of employees, stock market value, log size, and others. The determination of the size of the company is based on the natural logarithm proxy for assets. (Butar and Sudarsi, 2012).

Here is a research model that shows the relationship of independent variables with the dependent variable:

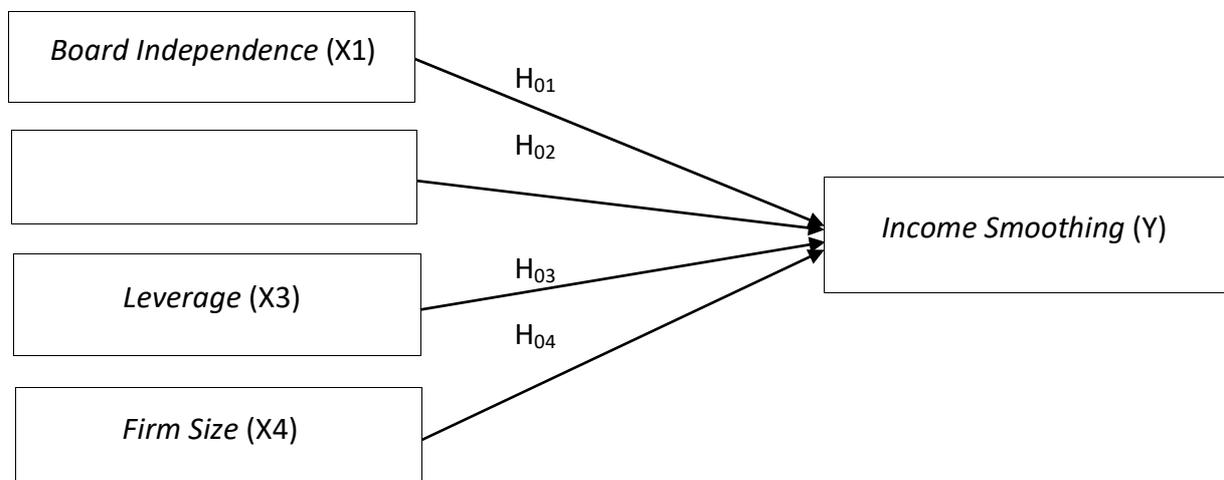


Figure 1. Conceptual Framework

Figure 1. The conceptual framework shows the dependent variable in this study is Income Smoothing and five independent variables namely Board Independence, Profitability, Leverage, and Firm Size.

H₀₁: Board Independence has a significant effect on Income Smoothing

H₀₂: Profitability has a significant effect on Income Smoothing

H₀₃: Leverage has a significant effect on Income Smoothing

H₀₄: Firm Size has a significant effect on Income Smoothing.

RESEARCH METHODS

This study has a subject in the form of companies listed in the manufacturing sector on the Indonesia Stock Exchange (IDX) in 2015-2017. The population chosen to be the subject of the research is manufacturing companies reselected using predetermined criteria. The criteria used in this study for the samples to be taken are 1. Manufacturing Companies listed on the Indonesia Stock Exchange (BEI) 2015-2017; 2. Manufacturing companies experiencing delisting on the Indonesia Stock Exchange in the period of 2015-2017; 3. Manufacturing companies conducting IPOs after the start of 2015; 4. Manufacturing companies that do not use the rupiah in the presentation of the company's financial statements for the years 2015-2017; 5. Manufacturing companies that suffered losses in the period 2015-2017. Outlining the sample selection criteria, there are 155 manufacturing companies listed on the IDX that will be reduced by the criteria. After reselecting the data with the criteria, the number of samples obtained for the study amounted to 57 companies in manufacturing with an observation period of 3 years starting from 2015 to 2017 producing 171 data.

The object of this research is Income Smoothing as the dependent variable and Board Independence, Leverage and Firm Size as the independent variables

The Income Smoothing variable uses the Eckel Index proxy. Eckel index can be formulated as follows:

$$Eckel\ Index = \frac{CV\Delta I}{CV\Delta S}$$

Description:

$CV\Delta I$: *Coefficient variation of income*

$CV\Delta S$: *Coefficient variation of sales*

The Board Independence variable is proxied by dividing the number of independent board members by the total number of board members in the company. The proxy is stated in the formula as follows:

$$Board\ Independence = \frac{Number\ of\ independent\ commissioners}{Total\ number\ of\ company\ commissioners}$$

Profitability is proxied by Return on Assets.

Return on Assets can be formulated as follows:

$$Return\ on\ Assets = Net\ Profit : Total\ Assets$$

The Leverage variable is proxied by Debt to Assets Ratio.

Debt to Assets Ratio can be formulated as follows:

$$Debt\ to\ Assets\ Ratio = Total\ Debts : Total\ Assets$$

Firm Size variable is proxy by natural asset logarithm. The proxy is stated in the formula as follows:

$$\text{Firm Size} = \ln \text{ Total Assets}$$

In this study descriptive statistical tests, -2 Log Likelihood Test, Hosmer and Lemeshow Goodness of Fit Test, Omnibus Test, Classification Table, Determination Coefficient Test, Multivariate Test Enter method and Multivariate Test Stepwise method.

Statistical Test Results

Descriptive statistical tests provide an overview or description of research data as seen from the minimum value, maximum value, mean (mean), standard deviation. The following Table 1. displays the results of the statistical tests for this study

Table 1. Descriptive Statistics Test Results

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Index Eckel	171	0	1	.49	.501
Board Independence	171	.200000000000 000	.600000000000 000	.403529025000 000	.088325715700 000
Profitability	171	.001377172970 000	.917868404000 000	.148572151000 000	.184349860000 000
Leverage	171	.070740038600 000	.933230343000 000	.376662540000 000	.180319355000 000
Firm Size	171	25.6194830600 00000	33.3201839100 00000	28.6221322900 00000	1.67044986800 0000
Valid N (listwise)	171				

Source: Data Processing

Table 1. Descriptive Statistics Test Results show that: The results of the Eckel Index analysis found 87 samples that did not make income smoothing and 84 samples that did income smoothing.

-2 Log Likelihood Test is used to determine whether the logistic regression model used is fit or not by comparing the value of -2 log-likelihood before the regression analysis includes the independent variables in the model and after the inclusion of the independent variables. The results obtained from the test are the initial log-likelihood value of 237.04 and final log-likelihood value of 218,265; A decrease in the value of -2 log-likelihood means the regression model is declared fit.

The Hosmer and Lemeshow Goodness of Fit Test is one of the tests used to test the feasibility of a regression model. The results which state that the regression model used is fit is if the sig value of the Hosmer and Lemeshow Test is greater than 0.05. The results obtained

from the test are the significance value obtained at 0.917. This value is greater than the value of 0.05 and means the regression model is declared fit.

Omnibus Test The test is used to test simultaneously the independent variables on the dependent variable. Obtained from the test results that the significance value of the Omnibus Test for this study was 0.01. This value is smaller than the value of 0.05 and means that simultaneously the independent variable influences the dependent variable and the regression model can be declared fit.

The Classification Table test is used to show the predictive power of the model. Obtained from the classification table of 87 samples that did not do income smoothing, predicted 52 exact data and 35 wrong data and from 84 samples that did income smoothing predicted 55 true data and 29 false data with a total percentage of true of 62.6%.

Determination Coefficient Test is used to test how much influence the independent variable can affect the dependent variable. Nagelkerke R Square value for this study is 0.140 which means that the independent variable can explain 14% of the dependent variable.

Multivariate Test Enter method is used to find out partially whether the independent variable has a significant effect on the dependent variable. The independent variables of the study, namely the Board Independence (X1), Profitability (X2), Leverage (X3) and Firm Size (X4) variables are used together. The confidence level used in this test is 5%. Here are the results of the test

**Table 2. Multivariate Test Results for Enter Method
Variables in the Equation**

	B	S.E.	Wald	df	Sig.	Exp(B)
Step 1a Board Independence	-5.826	1.957	8.859	1	.003	.003
Profitability	-3.138	1.068	8.632	1	.003	.043
Leverage	.049	.922	.003	1	.957	1.051
Firm Size	.135	.104	1.693	1	.193	1.144
Constant	-1.115	2.901	.148	1	.701	.328

a. Variable(s) entered on step 1: Board Independence, Profitability, Leverage, Firm Size.

Source: Data Processing

Table 2. Enter Method Multivariate Test Results show that the significance value of Board Independence is 0.003 and has a significant effect on Income Smoothing. The significance value of Profitability is 0.003 and has a significant influence on Income Smoothing. The significance value of Leverage is 0.957 and has no significant effect on Income Smoothing and the last variable, Firm Size, has a significant value of 0.193 and has no significant effect on Income Smoothing.

Based on the B value of each independent variable and the dependent variable from Table 2 it can be estimated that the parameter estimates for the logistic regression model of this study are:

$$Y = -1,115 - 5,826X_1 - 3,138X_2 + 0,049X_3 + 0,135 X_4$$

Description:

Y = *Income Smoothing* X₁= *Board Independence* X₂= *Profitability*

X₃ = *Leverage*

X₄ = *Firm Size*

The logistic regression equation of this study means that the Board Independence and Profitability variables have a negative influence on the Income Smoothing variable. If the Board Independence variable increases by one unit and the other variables do not experience any changes, the possibility of the company doing income smoothing will decrease by 5,826. The same can be applied to the Profitability variable which will result in a reduction in Income smoothing of 3,138.

The next two variables namely the Leverage variable and the Firm Size variable actually have a positive influence on Income Smoothing. If the Leverage variable increases by one unit, and there is no change in the other variables, then the possibility of the company doing income smoothing increases by 0.49. The same applies to the Firm Size variable which will result in an increase in income smoothing by 0.135 if the Firm Size variable increases by one unit and the other variables remain constant.

The Multivariate Test Stepwise Method is a multiple logistic regression test with the aim to find out the independent variable that has the most influence on the dependent variable. Here are the final results of testing

**Table 3. Multivariate Test Results for the Stepwise Method
Variables in the Equation**

	B	S.E.	Wald	Df	Sig.	Exp(B)
Step 1aBoard Independence	-5.525	1.913	8.339	1	.004	.004
Profitability	-2.760	1.009	7.482	1	.006	.063
Constant	2.584	.807	10.243	1	.001	13.251

a. Variable(s) entered on step 1: Board Independence, Profitability.

Source: Secondary Data Processing with SPSS 24 for Windows

To see the ability of the independent variable in influencing the dependent variable, the data can be obtained by taking into account the value of Exp (B) of the related independent variable. The Independence Board variable has an Exp (B) value of 0.004. The Profitability variable has an Exp (B) value of 0.063. From these data, it can be concluded that the ability of the Profitability variable to influence the Income Smoothing variable is greater than the Board Independence variable.

FINDINGS AND DISCUSSION

The results of the analysis that provides information that the Board Independence variable

has a significant effect on the Income Smoothing variable gives the meaning of the first hypothesis (H01) which states the Board Independence variable has a significant influence on the Income Smoothing variable accepted. This is in accordance with the research of Principe et al. (2011) who got the result that the Board Independence variable had a significant and negative effect on Income Smoothing.

The results of the analysis that provides information that the Profitability variable has a significant influence on the Income Smoothing variable gives the meaning of the second alternative hypothesis (H02) which states that the Profitability variable has a significant effect on the Income Smoothing variable accepted. The research conducted by Yulia (2013) got results that match this research. The Profitability variable has a significant effect on the Income Smoothing variable also found in the results of Herni and Susanto's research (2008).

The results of the analysis provide information that the Leverage variable has no significant effect on the Income Smoothing variable and thus, the third alternative hypothesis (H03) which states the Leverage variable has a significant effect on the Income Smoothing variable is rejected. This result is supported by the research of Manukaji and Juliana (2018) who also found that the Leverage variable had no significant effect on the Income Smoothing variable. Butar and Sudarsi (2012) also found the same results.

The results of the analysis provide information that the Firm Size variable has no significant effect on the Income Smoothing variable and thus, the fourth alternative hypothesis (H04) which states the Firm Size variable has a significant effect on the Income Smoothing variable is rejected. Research conducted by Principe et al. (2011) obtained results similar to this study. The results of this study are also supported by the results of research by Gusnardi and Budiharta (2008).

CONCLUSION AND SUGESTION

The results of research conducted on the influence of Board Independence, Profitability, Leverage and Firm Size on Income Smoothing in manufacturing companies on the Indonesia Stock Exchange (BEI) for the 2015-2017 period show that Board Independence has a significant effect

on income smoothing, Profitability has a significant effect on income smoothing, leverage does not significantly influence income smoothing and the last variable Firm Size has no significant effect on income smoothing.

This study has several limitations, including Samples collected by researchers for this study, were quite limited, 171 samples from 57 companies operating in manufacturing and listed on the Indonesia Stock Exchange (BEI) 2015-2017; In taking a sample the researchers only took data within a period of three years namely 2015-2017, which was quite short. This will cause research on the variables that have not shown the actual reality; The influence variables chosen by the researcher are limited. There are still many other factors that can influence the dependent variable. These facts cause researchers to not be able to give the whole picture the effect of the dependent variable ..

Suggestions for further research are as follows: For subsequent studies, research can be carried out that digs deeper into the dependent variable traced in this study. Samples taken are expected not to be limited to manufacturing companies; The time period can be extended to provide more precise and realistic results; The variables that influence the dependent variable can be selected even more so that they can provide a clearer picture of influence.

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