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The Effect of Profitability, Financial Leverage, Cash Holding, Audit Committee and Auditor Reputation on Income Smoothing

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ABSTRACT : Information in financial reports that tends to be a major concern for investors in making investment decisions is earnings information. The practice of income smoothing is an action taken by company management in an effort to reduce fluctuations in earnings so that reported earnings appear stable. The purpose of this study is to obtain empirical evidence regarding the effect of profitability, financial leverage, cash holding, audit committee and auditor reputation on income smoothing practices. This research was conducted on property, real estate and building construction companies listed on the Indonesia Stock Exchange in 2016-2019. The number of samples obtained were 51 companies with a purposive sampling method. The number of observations during the 4 years of the study period was 204. The data analysis technique used was logistic regression analysis. Based on the results of logistic regression analysis, it was found that profitability had no effect on income smoothing practices, financial leverage had no effect on income smoothing practices, cash holding had a positive effect on income smoothing practices, the audit committee had no effect on income smoothing practices and auditors' reputation had no effect on income smoothing practices. .

KEYWORDS:*income smoothing, cash holding, audit*

I. INTRODUCTION

Financial statements are the results of operational activities presented by the company in a certain period which are used by interested parties as a means of communication. These interested parties can come from internal parties such as owners and employees, as well as external parties such as investors, creditors and the general public. (Dewi et al., 2018). Information in financial reports that tends to be a major concern for investors in making investment decisions is information on earnings. Profit is very important information for internal and external parties in the company to find out future profits(Sidartha & Erawati, 2017). Earnings information is a means of measuring the results of the company's management performance as stated in the company's financial statements

The average net profit of property, real estate, and building construction companies listed on the Indonesia Stock Exchange for the 2016-2019 period experienced an increase in 2017 and decreased in 2018 and 2019. Average net profit in 2016 was IDR 457,699,000, 000 and an increase of IDR. 153,440,000,000 in 2017. However, the average net profit of companies in the property, real estate, and building construction sector has decreased for two consecutive years, namely in 2018 amounting to IDR45,855,000,000 and in 2019 amounting to IDR 137,809,000,000 from the previous year. The increase in average net profit in 2017 and the decrease in the average net profit of companies in the property, real estate, and building construction sector for two consecutive years, namely in 2018 and 2019 are interesting phenomena to study because investors tend to be more interested in companies. which has a stable profit.

The company management realizes the importance of earnings information so that managers are encouraged to perform dysfunctional behavior (inappropriate) to maximize profits. This behavior is related to agency theory which explains that the agency relationship between shareholders and managers arises because of the separation of responsibilities in managing the company. The difference in responsibilities between shareholders and managers creates differences in information and interests, which is called information asymmetry so that it provides opportunities for managers as agents to practice income smoothing. Income smoothing is an action taken by company management in manipulating earnings to reduce profit fluctuations so that reported earnings look stable because investors are more interested in companies that have stable profits.(Sari & Kristanti, 2015).

Income smoothing is an important issue to research because management (agents) practice income smoothing to reduce profit fluctuations so that the company's performance looks good so that management will be considered capable of managing the company. Conversely, shareholders (principals) want the company's financial statements to show the real condition of the company. Zeff (1978)stated that the impact of accounting reports on the decision-making behavior of businesses, governments, investors, and creditors is called an economic consequence. Income smoothing practice is also related to positive accounting theory. The bonus plan hypothesis states that managers will try to regulate reported earnings so that managers can maximize the bonus received. The debt covenant hypothesis states that managers will try to increase company profits because companies with high debt to equity ratios will have difficulty obtaining additional funds from creditors and are threatened with violating debt covenants. The political cost hypothesis states that managers will try to minimize reported profits to reduce public demands on the company (Ozili, 2019)

Profitability is a description of the company's ability to generate profits or a measure of the effectiveness of company management. The higher the level of company profitability, the management will tend to do income smoothing because management knows the company's ability to generate profits so that it is easy for management to delay or accelerate company profits, while companies that have a low level of profitability will try to carry out earnings management but it is difficult for management to cover it in the following year so that there is no income smoothing(Monjed & Ibrahim, 2020). Dewi & Latrini (2016), Eni & Suaryana (2018); Yanti & Dwirandra (2019)found that profitability has a positive effect on income smoothing practices. However,Natalie & Astika (2016); Pradnyandari & Astika (2019)found that profitability has a negative effect on income smoothing practices.

Financial leverage shows the extent to which the company's assets have been financed by the use of debt. The bigger the company's debt, the greater the risk faced by investors so that investors will ask for a higher level of profit. If the company has a relatively large debt, of course, the company will have a higher risk, which triggers the company to take income smoothing actions to stabilize the company's financial position. Pradnyandari & Astika (2019)found that financial leverage has a positive effect on income smoothing practices. However, Tsuroyya & Astika (2017), Fauzia (2017); Ernayani *et al*. (2020)who found that financial leverage had no effect on income smoothing practices.

Cash holding is cash on hand or available for investment in physical assets and for distribution to investor (Gill & Shah, 2012). The higher the cash holding in the company, the higher the income smoothing action the company takes. The liquid and easily transferable nature of cash holdings make it easy for cash to be hidden for undue actions. The actions of managers who control cash holding policies with the motive of embezzling funds will maintain the amount of cash in the company in an attempt to enrich themselves. Revinsia et al. (2019)found that cash holding has a positive effect on income smoothing practices. Alexander (2019)found that cash holding does not affect income smoothing practices.

The audit committee is a committee formed by and responsible to the board of commissioners in helping to carry out the duties and functions of the board of commissioners. The audit committee is in charge of overseeing financial reports, overseeing external audits, and observing the internal control system as well as overseeing internal audits to reduce the opportunistic nature of management. The greater the number of audit committees, it is assumed that the better the supervisory function performed by the audit committee so that the indication that the company is implementing income smoothing practices will also be lower. Handayani et al. (2016)found that the audit committee has a negative effect on income smoothing practices. Napitupulu et al. (2018)andIndrawan et al. (2018)who found that the audit committee had no effect on income smoothing practices. Auditor's reputation is a measure that shows the quality of the audit results of the company's financial statements. The higher the auditor's reputation, the lower the indication the company is doing income smoothing. Handayani et al. (2016)found that auditors' reputation has a negative effect on income smoothing practices. Natalie & Astika (2016)andNapitupulu et al. (2018)who found that auditors' reputation did not affect income smoothing practices.

This research was conducted on the property, real estate, and building construction companies listed on the Indonesia Stock Exchange for the period 2016-2019. The motivation of companies in the property, real estate, and building construction sectors to practice income smoothing is to reduce profit fluctuations in less profitable periods. From 2016 to 2018 purchases in the property sector had decreased. The total pre-sales of the 10 largest developers in Indonesia until October 2018 only reached IDR 27.68 trillion. The total pre-sales in 2018 has decreased when compared to 2017 which reached IDR 42 trillion and is also lower than 2016 which reached IDR 34.51 trillion. In addition, the property industry has declined due to the low availability of property units, especially those targeting the Low-Income Community segment as the largest market for the property industry in Indonesia. The impact of the decline in the property sector decreased company profits and of course, influenced managers' decisions in maintaining the company's financial performance. In addition, the property sector company needs a long-term time to earn a profit so that in the process before making a profit, the company may experience a decline in profit. Therefore, company management will tend to practice income smoothing to reduce profit fluctuations in less profitable periods.

II. HYPHOTHESIS DEVELOPMENT

Profitability describes the company's ability to generate profits. Based on positive accounting theory, companies that have a high level of profitability will tend to be taxed more by the government so that companies try to reduce reported profits to reduce their tax costs. Companies that have high ROA levels allow management to carry out income smoothing compared to companies that have low ROA levels because management already knows the company's ability to earn profits in the future so that it is easy for management to delay or accelerate the company profits. (Josep et al., 2016). Ayunika & Yadnyana (2018); Herdjiono et al. (2019)andYanti & Dwirandra (2019)who found that profitability has a positive effect on income smoothing practices, the higher the level of company profitability, the higher the tendency for managers to practice income smoothing.

H1: Profitability has a positive effect on income smoothing practices.

Financial leverage shows the extent to which the company's assets have been financed by the use of debt. Based on the positive accounting theory, namely the debt covenant hypothesis, companies that have a high level of leverage will find it difficult to obtain additional funds from creditors and even companies are threatened with violating debt covenants. Companies that have a high level of leverage will tend to perform income smoothing compared to companies with low levels of leverage because companies with high levels of leverage reflect that the company is not healthy. Companies that have a high level of financial leverage indicate the greater the risk faced by investors so that investors will ask for a higher level of profit and creditors also expect the profit generated by the company to be stable so that the company can overcome its debt risk (Putri & Budiasih, 2018).Putri & Budiasih (2018);Pradnyandari & Astika (2019); Indrawan & Damayanthi (2020)who found that financial leverage has a positive effect on income smoothing practices.

H2: Financial leverage has a positive effect on income smoothing practices.

Cash holding is cash on hand or available for investment in physical assets and distribution to investors. Based on agency theory, the conflict between management (agent) and shareholders (principal) creates the desire of both parties to hold the company's cash (cash holding). Shareholders (principal) expect the cash to be distributed in the form of dividends, while the management (agent) wants to hold cash for certain purposes. Managers use cash holding to minimize external funding and company operations. Cash holding is very easy to withdraw and controlled by managers because it is liquid so that cash can be easily hidden and used for income smoothing practices (Revinsia et al., 2019). Dewi & Latrini (2016), Napitupulu et al. (2018), Revinsia et al. (2019)who found that cash holding has a positive effect on income smoothing practices.

H3: Cash holding has a positive effect on income smoothing practices.

The audit committee is a committee formed and responsible to the board of commissioners in helping to carry out the duties and functions of the board of commissioners. Based on agency theory, the existence of a conflict of interest between the agent and the principal makes the management (agent) take actions that deviate from the wishes of the shareholders (the principal). The role of the audit committee is to assist the board and encourage the establishment of an adequate internal control structure to increase the transparency and quality of financial reports presented by management (agents). The audit committee was formed to protect the interests of shareholders (principals) by conducting independent and objective assessments as well as monitoring and examining policies taken by the company(Indrawan et al., 2018).Handayani et al. (2016)who found that the audit committee had a negative effect on income smoothing practices.

H4: The audit committee has a negative effect on income smoothing practices.

Auditor's reputation is a measure that shows the quality of the audit results of the company's financial statements. Based on agency theory, the existence of a conflict of interest between the agent and the principal makes the management (agent) take actions that deviate from the wishes of the shareholders (the principal). Management (agents) practice income smoothing to reduce fluctuations in earnings so that the company's performance looks good so that management will be considered capable of managing the company. Conversely, shareholders (principals) want financial reports that show the real condition of the company so that an audit of the company's financial statements is carried out. Handayani et al. (2016)who found that auditors' reputation had a negative effect on income smoothing practices.

H5: Auditor's reputation has a negative effect on income smoothing practices.

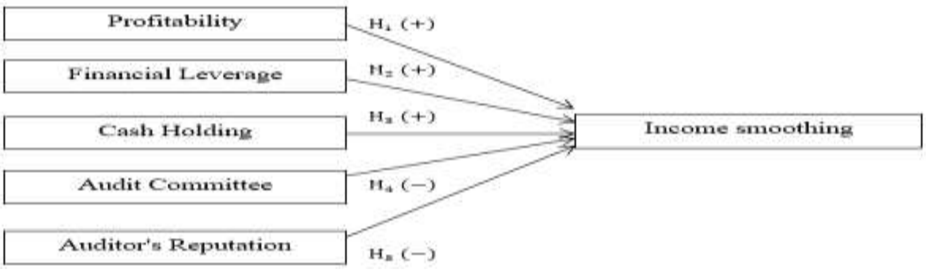

Fig. 1 Conceptual framework

III. RESEARCH METHODS

This research was conducted on the property, real estate, and building construction companies listed on the Indonesia Stock Exchange 2016-2019. The reason this research uses 2016-2019 is that from 2016 to 2018 purchases in the property sector have decreased. As a result, company profits decline and of course affect managers' decisions in maintaining the company's financial performance. Therefore, company management tends to carry out income smoothing practices to reduce profit fluctuations in an unfavorable period since 2016.

In this study, to determine companies that practice income smoothing and companies that do not practice income smoothing, it can be calculated using the Eckel index. If the Eckel index value is <1, then the company is classified as doing income smoothing practice which is given a value of 1 whereas if the Eckel index value is ≥ 1, then the company is classified as not doing income smoothing practice which is given a value of 0. predicting profit and estimating costs, and this index does not only use a period of one year but uses a period of several years(Eckel, 1981).. Profitability is a description of the company's ability to generate profits or a measure of the effectiveness of company management. Profitability can be proxied by ROA because of the assumption that the return obtained by investors on investment is based on net profit after tax. The higher the ROA level, the better the company's prospects and the more effective the management of the company's assets.

Financial leverage can be proxied by DAR because it can measure how much the company's assets are financed by debt and how much debt the company has on asset management. Cash holding is cash on hand or available for investment in physical assets and distribution to investors. Companies usually make a policy to hold cash to protect the company from cash shortfalls(Martínez-Sola et al., 2018).The audit committee is a committee formed and responsible to the board of commissioners in helping to carry out the duties and functions of the board of commissioners. The number of audit committees consists of at least three members, namely one independent commissioner who serves as chairman of the audit committee, while the other two members are independent parties from outside the company. Auditor's reputation is a measure that shows the quality of the audit results of the company's financial statements, which can be proxied by the size of a public accounting firm. The auditor's reputation can be proxied by a dummy variable, where if the company's financial statements are audited by a public accounting firm that is part of the Big Four, it will be given a value of 1, whereas if the company's financial statements are audited by a non-Big Four public accounting firm then it will be given a value of 0

The population in this study were 60 companies in the property, real estate, and building construction sectors listed on the Indonesia Stock Exchange in 2016-2019. The method of determining the sample in this study is nonprobability sampling using the purposive sampling technique. The criteria for determining the sample in this study are property, real estate, and building construction companies listed on the Indonesia Stock Exchange and published complete and consecutive annual financial reports in the 2016-2019 period. Based on these criteria, the sample size is 51 companies.

IV. RESULTS AND DISCUSSION

The data analysis technique used in this study was logistic regression analysis. Logistic regression analysis is used because the dependent variable in this study is in the form of non-metric or category and the assumption of the multivariate normal distribution cannot be fulfilled so there is no need to assume data normality because the independent variables used in this study are a mixture of continuous (metric) and categorical (non -metric).

Table 1.Hosmer and Lemeshow Test Results

Step	Chi-square	Df	Sig.
1	10,452	8	0,235

Based on Table 1, it shows that the chi-square value is 10.452 with a significance value of 0.235. This shows that the significance value is 0.235 > 0.05 so that this research model is able to predict the value of the observation and it can be accepted because it matches the observation data.

Table 2. Comparison Results of -2 Log Likelihood

-2 Log likelihood awal (Block Number = 0)	-2 Log likelihood akhir (Block Number = 1)
280,427	268,966

Based on Table 2, shows that the initial -2 Log-Likelihood (-2LL) value is 280.427 and after entering the independent variable, the final -2 Log-Likelihood (-2LL) value has decreased to be 268.966. A decrease in the value of -2 Log-Likelihood (-2LL) indicates that the regression model is said to be good or the hypothesized model is per the data.

Table 3. Results of the Coefficient of Determination (Nagelkerke R Square)

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	268,966[a]	0,055	0,073

Based on Table 3, it shows that the Nagelkerke R Square value is 0.073 or equal to 7.3 percent. This shows that income smoothing practice, can be explained by profitability, financial leverage, cash holding, audit committee and auditor reputation by 7.3 percent, while the remaining 92.7 percent is explained by other variables outside. this research model.

Table 4. Results of the Classification Matrix

	Observed	Predicted PL: With income smoothing	Predicted PL: Without income smoothing	Predicted: Percentage Correct
Step 1	PL Without income smoothing	34	57	37,4
	With income smoothing	33	80	70,8
	Overall Percentage			55,9

Based on Table 4, shows that showing the strength of the regression model to predict the possibility of companies not doing income smoothing practices is 37.4 percent. This shows that out of the 91 observations that do not perform income smoothing, 34 are predicted not to carry out income smoothing practices, while the remaining 57 are predicted to carry out income smoothing practices. The power of the regression model to predict the possibility of companies doing income smoothing practices is 70.8 percent. This shows that out of the 113 observations that carry out income smoothing, 33 of the observations are predicted not to practice income smoothing, while the remaining 80 are predicted to carry out income smoothing practices.

Table 5. Logistic Regression Test Results

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1	ROA	-0,062	0,032	3,688	1	0,055	0,940
	DAR	-0,004	0,008	0,215	1	0,643	0,996
	CH	0,051	0,022	5,094	1	0,024	1,052
	KA	0,278	0,366	0,575	1	0,448	1,320
	RA	-0,629	0,358	3,074	1	0,080	0,533
	Constant	-0,208	1,133	0,034	1	0,855	0,812

The coefficient value of the profitability variable which is proxied by Return on Assets (ROA) of -0.062 means that if the company's profitability increases by one unit, the possibility of the company doing income smoothing practices will decrease by 0.062, assuming the other variables are constant. Based on the test results, it shows a significant value of profitability (ROA) of 0.055 > 0.05 so that **H1 is rejected** and it can be concluded that profitability does not affect income smoothing practices.This indicates that the high or low level of profitability does not affect management actions in carrying out income smoothing practices. Profitability does not affect management's actions in carrying out income smoothing practices because the amount of profit earned by the company under study is smaller than the total assets of the company so that the level of company profitability in this study is assumed to be quite low. This low level of profitability makes it difficult for management to delay or accelerate company profits and tends not to practice income smoothing.Puspitasari & Putra (2018)which states that companies that practice excessive income smoothing will be in the public spotlight and may endanger the company's credibility. Revinsia et al. (2019)andIndrawan & Damayanthi (2020)who found that profitability did not affect income smoothing practices.

The coefficient value of the financial leverage variable, which is proxied by the Debt to Total Asset Ratio (DAR) of -0.004, means that if the company's financial leverage increases by one unit, the possibility of the company practicing income smoothing will decrease by 0.004 assuming the other variables are constant. Based on the test results, it shows the significant value of financial leverage (DAR) of 0.643 > 0.05 so that **H2 is rejected** and it can be concluded that financial leverage does not affect income smoothing practices.This shows that the high or low level of financial leverage does not affect management actions in implementing income smoothing practices. Financial leverage does not affect management's actions in carrying out income smoothing practices because the company can pay off its obligations by using assets owned by the company without depending on the profits generated by the company. The level of financial leverage of the companies under study is still assumed to be quite good because the number of company assets is more than the total debt of the company so that companies tend not to practice income smoothing.Ernayani et al. (2020)who found that financial leverage did not affect income smoothing practices.

The coefficient value of the cash holding variable (CH) is 0.051 which means that if the company's cash holding increases by one unit, the possibility of the company doing income smoothing practices will increase by 0.051, assuming the other variables are constant. Based on the test results, it shows a significant value of cash holding (CH) of 0.024 < 0.05 so that **H3 is accepted** and it can be concluded that cash holding has a positive effect on income smoothing practices.This shows that the higher the level of the company's cash holding, the higher the management's actions in implementing income smoothing practices. Cash holding affects management actions in implementing income smoothing practices. Cash holding is very easy to withdraw and controlled by managers because it is liquid so that cash can be easily hidden and used for income smoothing practices. Investors can judge the performance of company managers from their ability to keep the increase in cash in the company stable. The action taken by company managers to keep cash to remain stable is to practice income smoothing. The results of this study can support the agency theory which explains that the conflict between management (agents) and shareholders (principals) creates the desire of both parties to hold the company's cash (cash holding). Shareholders (principals) expect the cash to be distributed in the form of dividends, while management (agents) want to hold cash to minimize external funding and company operations.

The coefficient value of the audit committee variable (KA) of 0.278 means that if the company's audit committee increases, the possibility of the company doing income smoothing practices will increase by 0.278 assuming the other variables are constant. Based on the test results, the audit committee (KA) significance value is 0.448 > 0.05 so that **H4 is rejected** and it can be concluded that the audit committee does not affect income smoothing practices.This shows that the number of audit committees does not affect management's actions in implementing income smoothing practices. The number of audit committees does not affect management's actions in implementing income smoothing practices because the audit committee is not formed independently so that the internal control monitoring carried out by the audit committee is ineffective which results in the practice of income smoothing still happening.

The coefficient value of the auditor's reputation variable (RA) of -0.629 means that if the company's auditors' reputation increases, the possibility of the company doing income smoothing practices will decrease by 0.629, assuming the other variables are constant. Based on the test results, it shows the significant value of auditor reputation (RA) of 0.080 > 0.05 so that **H5 is rejected** and it can be concluded that the auditor's reputation does not affect income smoothing practices.This shows that the reputation of the Public Accounting Firm does not affect management's actions in implementing income smoothing practices. The reputation held by the Public Accounting Firm does not affect management's actions in implementing income smoothing practices.

V. CONCLUSION

Profitability does not affect the income smoothing practices of property, real estate, and building construction companies listed on the Indonesia Stock Exchange in 2016-2019. This indicates that the high or low level of profitability does not affect management actions in carrying out income smoothing practices. Financial leverage does not affect the income smoothing practices of property, real estate, and building construction companies listed on the Indonesia Stock Exchange in 2016-2019. This shows that the high or low level of financial leverage does not affect management actions in implementing income smoothing practices. Cash holding has a positive effect on the income smoothing practices of property, real estate, and building construction companies listed on the Indonesia Stock Exchange in 2016-2019. This shows that the higher the level of the company's cash holding, the higher the management's actions in implementing income smoothing practices. The audit committee does not affect the income smoothing practices of property, real estate, and building construction companies listed on the Indonesia Stock Exchange in 2016-2019. This shows that the number of audit committees does not affect management actions in implementing income smoothing practices. Auditor's reputation does not affect the income smoothing practices of property, real estate, and building construction companies listed on the Indonesia Stock Exchange in 2016-2019. This shows that the reputation held by the Public Accounting Firm does not affect management actions in implementing income smoothing practices.

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