

## **THE EFFECT OF FIRM SIZE ON INCOME SMOOTHING WITH FINANCIAL LEVERAGE AND GOOD CORPORATE GOVERNANCE AS MODERATORS**

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### **Abstract**

Income smoothing is a managerial practice aimed at stabilizing reported earnings across periods. This study analyzes the effect of firm size on income smoothing with financial leverage and good corporate governance (GCG) as moderating variables in non-financial companies listed on the Indonesia Stock Exchange (IDX) for the 2021–2023 period. Secondary data were obtained from annual financial statements published on the official IDX website. Income smoothing is measured using the Eckel Index; firm size by the natural logarithm of total assets; financial leverage by the debt-to-asset ratio (DAR); and GCG by the proportion of independent commissioners. Samples were selected using Slovin's formula and stratified random sampling, yielding 272 firms. Data were analyzed using logistic regression with moderation (Moderated Regression Analysis/MRA). The results show that firm size has a positive effect on income smoothing; financial leverage does not moderate the relationship between firm size and income smoothing; whereas GCG moderates (weakens) the effect of firm size on income smoothing.

**Keywords:** Income Smoothing, Firm Size, Financial Leverage, Good Corporate Governance

## INTRODUCTION

Financial statements are a systematic representation of an entity's financial position and performance as well as cash flows, in accordance with PSAK No. 201 (Indonesian Financial Accounting Standards) 2024 (Ikatan Akuntan Indonesia, 2024). Their main function is to provide information on financial position, financial performance, and cash flows to stakeholders for evaluating corporate performance and supporting investment decisions. Earnings information presented in the income statement often receives particular attention from both internal and external users (Nirmanggi & Muslih, 2020). Rountree et al. (2008) note that investors prefer stable earnings because they dislike earnings surprises that increase perceived risk. Stakeholders frequently focus on earnings stability without scrutinizing how management achieves the reported numbers (Beattie et al., 1994). Consistent earnings are viewed as indicating good operational control, resilience to market fluctuations, and more predictable growth prospects.

Earnings management refers to managerial behavior in shaping the earnings information presented in financial statements to influence stakeholders' assessments of the firm's processes and condition (Nirmanggi & Muslih, 2020). Within earnings management, income smoothing is a common practice. Beattie et al. (1994) explain that income smoothing reduces earnings variability across several periods or within a defined period to reach a desired target. Debate persists over this practice: some consider it detrimental because it reduces the accuracy with which financial statements reflect a firm's true condition; others argue that smoothing does not necessarily violate accounting standards, though it may impair reliability (Zuhriya & Wahidahwati, 2015). Studying income smoothing is important because it can obscure true financial conditions and potentially mislead stakeholders in economic decision-making. Its relevance has increased in the wake of the COVID-19 pandemic, which placed significant pressure on firms across sectors sharp revenue declines, cash-flow disruptions, and substantial losses thus heightening incentives to smooth earnings to appear stable and avoid alarming investors and creditors.

This study is grounded in agency theory (Jensen & Meckling, 1976), which posits a contractual relationship between principals (shareholders) and agents (managers). According to agency theory, managers may be motivated to smooth earnings to reduce uncertainty perceived by shareholders and creditors. Sharp earnings fluctuations can create uncertainty and strain relationships between managers and stakeholders. Smoothing may help managers meet performance targets linked to compensation, bonuses, and incentives and preserve reputational capital. It can also serve to meet market expectations and maintain stable share prices, ultimately supporting firm value.

Financial reporting manipulation cases in Indonesia indicate that earnings management remains a serious capital-market concern. PT Tiga Pilar Sejahtera Food Tbk (AISA) restated its 2017 financial statements in 2020, revealing actual losses of IDR 5.23 trillion far larger than the previously reported IDR 551.9 billion (cnbcindonesia.com, 2019). This finding suggests income-smoothing practices by prior management to downplay losses and present better performance, likely to preserve perceived firm value. In response, the IDX suspended AISA's stock to protect investors. A similar case occurred at PT Garuda Indonesia Tbk (GIAA) for fiscal year 2018: the company reported

net profit of USD 809.85 thousand, a reversal from a USD 216.5 million loss the year before. Two commissioners rejected the report, noting revenue recognition from cooperation with PT Mahata Aero Teknologi that remained receivables yet was booked as revenue. The accounting non-compliance resulted in fines totaling IDR 1.25 billion imposed on the company and on directors and commissioners (cnnindonesia.com, 2019). These cases show that manipulation including income smoothing occurs even in large public companies, underscoring the importance of studying its determinants in Indonesia.

Firm size reflects the assets or wealth owned by the company (Djajanti, 2015). Income smoothing may be more accessible to large firms than to small ones. Large firms tend to smooth earnings because they have more complex and experienced accounting teams and more sophisticated reporting systems. They also enjoy greater flexibility in revenue and expense recognition and wider access to financial instruments that can shift the timing of earnings. Moreover, pressure from investors, analysts, and regulators motivates large firms to maintain stable reported performance.

Prior studies show inconsistent findings: some report a positive effect of firm size on income smoothing (Maotama & Astika, 2020); others report a negative effect (Lestari & Nurhayati, 2024); and still others find no effect (Amrullah & Sekar Mayangsari, 2024). These discrepancies create a research gap. Accordingly, this study incorporates moderating variables that may strengthen or weaken the relationship between the independent and dependent variables namely, financial leverage and good corporate governance.

Financial leverage is the extent to which a firm uses debt in its capital structure. Firms with higher leverage relative to equity are generally viewed as riskier (Satria, 2024). Although large firms may have greater capacity to smooth earnings, heavy debt obligations can constrain managerial flexibility, shifting focus to creditor claims and compliance with debt covenants. Highly leveraged firms are also subject to tighter external monitoring by lenders and auditors, making manipulative actions such as smoothing harder to implement without risk.

The second moderating variable is good corporate governance. The Forum for Corporate Governance in Indonesia (FCGI) defines GCG as a set of norms governing the relationships among shareholders, management, creditors, government, employees, and other internal and external parties (Komite Nasional Kebijakan Governance, 2006). These norms stipulate rights and obligations of each party, forming the basis for corporate control and oversight. Firms with strong GCG will provide transparent and comprehensive disclosures regarding accounting practices, revenue policies, and measurement methods. High transparency makes smoothing more difficult and mitigates agency conflicts (Darno, 2025). GCG comprises components that enhance oversight ownership structure, managerial ownership, independent commissioners, audit committees, and boards of directors.

Using financial leverage and GCG as moderators is justified because they represent two core aspects of corporate management: financing structure and governance. Leverage indicates the extent of debt usage as well as the intensity of creditor oversight through debt covenants. High leverage may limit managerial discretion to smooth earnings due to covenant compliance and debt-servicing

constraints. GCG captures internal governance effectiveness specifically, the role of independent commissioners in monitoring management and deterring opportunistic behavior that harms shareholders. Together, leverage and GCG offer a more comprehensive perspective on how financing and governance can strengthen or weaken the link between firm size and the propensity to smooth earnings.

Based on the above, this study is titled: “The Effect of Firm Size on Income Smoothing with Financial Leverage and Good Corporate Governance as Moderators.”

## **RESEARCH METHOD**

This quantitative, associative study examines the effect of firm size on income smoothing, with financial leverage and good corporate governance as moderating variables. The quantitative approach is rooted in positivism, processing numerical data statistically to test predefined hypotheses. The study covers non-financial companies listed on the IDX during 2021–2023, using secondary data from annual reports available on the IDX website ([www.idx.co.id](http://www.idx.co.id)) and company websites (Sugiyono, 2017; Ghozali, 2018).

The research object is income smoothing as affected by firm size (independent variable), with financial leverage and good corporate governance as moderators. Firm size is measured by the natural logarithm of total assets; leverage by the Debt-to-Total-Asset Ratio (DAR); and GCG is proxied by the proportion of independent commissioners. Income smoothing is measured using the Eckel Index, classifying firms as smoothers when the Eckel Index  $< 1$ . Given the binary dependent variable, logistic regression is employed (Ghozali, 2018; Nejad et al., 2013).

The population comprises all 846 non-financial IDX-listed firms. Sampling uses probability sampling with Slovin’s formula, yielding 272 sample firms. Data were collected via non-participant observation of financial statements. Analyses include descriptive statistics, model fit (Hosmer and Lemeshow test), overall model fit, coefficient of determination (Nagelkerke R Square), and Wald tests for partial significance.

## **RESULT AND DISCUSSION**

### **Data Description and Research Results**

#### **Data Outlier**

An outlier refers to a data point or observation that possesses characteristics significantly different from the rest of the data, typically indicated by extreme values in one or more variables (Ghozali, 2018). The occurrence of outliers can be attributed to several factors, including data entry errors, failure to properly define missing values in statistical software, data that do not actually belong to the sampled population, or data originating from the same population but exhibiting an extreme distribution that deviates from a normal pattern.

To measure the influence of outliers on regression models, Cook (1997) introduced Cook’s Distance, a measure that indicates how much influence a given observation ( $i$ -th observation) exerts on the overall regression coefficients. In other words, it quantifies the extent to which the presence of an outlier affects the estimation

of regression coefficients. Data points with a Cook's Distance value greater than 1 or  $4/n$  (where  $n$  represents the number of observations) are identified as outliers.

In this study, outlier treatment was carried out using the trimming method, which involves removing data identified as outliers from the analysis. This approach was chosen because it is considered more appropriate than the winsorizing method, which merely replaces extreme values with those close to the quartile boundaries. According to Osborne and Overbay (2004), trimming is often regarded as superior to winsorizing because it completely eliminates the influence of outliers, whereas winsorizing only reduces their impact without actually removing them from the dataset. The application of trimming allows for more accurate parameter estimation and minimizes potential errors in statistical inference.

After the outlier treatment process, it was found that 81 data points were identified as outliers and subsequently removed through trimming. Thus, the number of valid observations used in the analysis decreased from 272 to 191. The removal of outliers detected through Cook's Distance was deemed appropriate to ensure that the regression analysis results in this study are valid, accurate, and free from distortion. Cook's Distance not only measures the extremity of data points but also evaluates their impact on the overall quality of the regression model.

### Descriptive Statistics

Descriptive statistics are used to provide an overview of the data for each research variable, as reflected through measures such as the mean, maximum, minimum, and standard deviation. The descriptive statistics for this study are presented in Table 1 below.

**Tabel 1. Descriptive Statistics**

|         |                   | N   | Minimum | Maximum | Mean    | Std.<br>Deviation |
|---------|-------------------|-----|---------|---------|---------|-------------------|
| Indeks  |                   |     |         |         |         |                   |
| Eckel   | (Y)               | 191 | 0       | 1       | 0,45    | 0,498             |
| Ln Aset | (X)               | 191 | 24,66   | 31,44   | 28,1927 | 1,36986           |
| DAR     | (Z <sub>1</sub> ) | 191 | 0,00    | 1,75    | 0,4400  | 0,26349           |
| DKI     | (Z <sub>2</sub> ) | 191 | 0,29    | 0,62    | 0,4154  | 0,07869           |
| LnAset  |                   |     |         |         |         |                   |
| *DAR    | (M <sub>1</sub> ) | 191 | 0,11    | 48,54   | 12,4774 | 7,53758           |
| LnAset  |                   |     |         |         |         |                   |
| *DKI    | (M <sub>2</sub> ) | 191 | 8,20    | 18,12   | 11,7161 | 2,33341           |

Source: Processed Data, 2025

Based on the results of the descriptive statistical analysis, the total number of observations in this study is 191, which can be explained as follows:

1. Income Smoothing (Y) is a dummy variable measured using the Eckel Index, where a value of 0 indicates companies that are not suspected of engaging in income smoothing, and a value of 1 indicates companies that are suspected of engaging in income smoothing. The average value of income smoothing is 0.45, indicating that out of the 191 research samples, 106 companies were identified as engaging in income smoothing (value = 1), while the remaining

85 companies did not engage in income smoothing (value = 0). The standard deviation of income smoothing is 0.498, suggesting that the variation in income smoothing values from the mean is 0.498.

2. The average value of firm size (X), measured using the natural logarithm of total assets (Ln Assets), is 28.1927. The minimum value is recorded by OLIV at 24.66, while the maximum value is recorded by FREN at 31.44. The standard deviation of firm size is 1.369, meaning that the deviation of firm size values from the mean is 1.369. This standard deviation value indicates that the data distribution is relatively close after outlier removal.
3. The average value of financial leverage (Z1), measured using the Debt to Asset Ratio (DAR), is 0.4400. The minimum value is recorded by REAL at 0.00, and the maximum value is recorded by ARGO at 1.75. The standard deviation of financial leverage is 0.263, meaning that the deviation of leverage values from the mean is 0.263. This indicates that the data distribution is relatively close after outlier removal.
4. The average value of Good Corporate Governance (Z2), measured using the Board of Commissioners' Independence (DKI), is 0.4154. The minimum value is recorded by TOTI at 0.29, and the maximum value is recorded by SDPC at 0.62. The standard deviation of good corporate governance is 0.078, indicating that the deviation of governance values from the mean is 0.078. This suggests that the data distribution is relatively close after outlier removal.

### Logistic Regression Test Results

#### a) Model Feasibility Test (Goodness of Fit Test)

The Hosmer and Lemeshow test was used to evaluate the accuracy and appropriateness of the regression model. The Goodness of Fit value, determined using the Chi-Square statistic, serves as the basis for decision-making. If the significance value is greater than 0.05, then  $H_0$  is accepted, indicating that the regression model is suitable for further analysis. The results of the test are presented in Table 2 below:

**Table 2. Model Feasibility Test**

| Step | Chi-square | df | sig.  |
|------|------------|----|-------|
| 1    | 6,387      | 8  | 0,604 |

Source: Processed Data, 2025

Based on the regression model feasibility test results in Table 2, the Chi-Square value is 6.387 with a significance level of 0.604, which is greater than 0.05. This indicates that  $H_0$  is accepted, meaning that the constructed regression model is appropriate.

#### b) Overall Model Fit Test

The Overall Model Fit Test is conducted to determine whether the regression model as a whole fits the data. This test is performed by examining the Log Likelihood (-2LL) values, specifically by comparing the initial value (-2LL Block Number = 0) with the final value (-2LL Block Number = 1). The results are presented in Table 3 below:

**Table 3. Comparison of Initial and Final -2LL Values**

| Iteration                | -2Log Likelihood |
|--------------------------|------------------|
| Block Number = 0 (Awal)  | 262,469          |
| Block Number = 1 (Akhir) | 249,292          |

Source: Processed Data, 2025

Based on Table 3, the -2 Log Likelihood (-2LL) value in the first block (Block 0) is 262.469, which decreases to 249.292 in the second block (Block 1). This reduction of 13.177 indicates an improvement in the model's performance, meaning that the proposed regression model fits the analyzed data more effectively.

c) Coefficient of Determination (Nagelkerke R Square Value)

In logistic regression, the coefficient of determination is represented by the Nagelkerke R Square value, which indicates the extent to which the independent variables explain the dependent variable. The results are presented in Table 4 below:

**Table 4. Coefficient of Determination (Nagelkerke R Square)**

| Step | -2 Log likelihood | Cox & Snell R Square | Nagelkerke R Square |
|------|-------------------|----------------------|---------------------|
| 1    | 249.292a          | 0,067                | 0,089               |

Source: Processed Data, 2025

Based on Table 4, the Nagelkerke R Square value of 0.089 indicates that the combination of independent variables in this study explains 8.9% of the variation in the dependent variable, while the remaining 91.1% is influenced by other factors not included in the model.

d) Classification Matrix

The classification matrix is used to assess the model's ability to predict the occurrence of the dependent variable. The level of accuracy or predictive power of the model is expressed as a percentage. The results are presented in Table 5 below:

**Table 5. Classification Matrix**

|                    |                          | Predicted           |                  |                    |
|--------------------|--------------------------|---------------------|------------------|--------------------|
|                    |                          | Eckel Indeks        |                  | Percentage Correct |
|                    |                          | No Income Smoothing | Income Smoothing |                    |
| Step 1             | Observed<br>Eckel Indeks | No Income Smoothing | Income Smoothing |                    |
|                    |                          | 73                  | 33               | 68,9               |
|                    |                          | 52                  | 33               | 38,8               |
| Overall Percentage |                          |                     |                  | 55,5               |

Source: Processed Data, 2025

Based on Table 5, the regression model correctly predicts 68.9% of companies that do not engage in income smoothing. This means that out of 106 companies

classified as non-smoothers, 73 observations were correctly predicted, while 33 were misclassified. Meanwhile, the model correctly predicts only 38.8% of companies that engage in income smoothing, indicating that out of 85 smoothing companies, 33 were correctly classified, and 52 were incorrectly predicted as non-smoothers.

e) Moderation Test (Moderated Regression Analysis - MRA)

The Moderated Regression Analysis (MRA) is used to determine whether the relationship between two variables is influenced by a moderating variable. The results of the moderation test are presented in Table 6 below:

**Table 6. Results of Moderated Regression Analysis (MRA)**

|                     |            | B       | S.E.   | Wald   | df | Sig. | Exp(B) |
|---------------------|------------|---------|--------|--------|----|------|--------|
| Step 1 <sup>a</sup> | Ln Aset    | 2,636   | 0,820  | 10,342 | 1  | .001 | 13.958 |
|                     | DAR        | 0,942   | 14,395 | 0,004  | 1  | .948 | 2.564  |
|                     | DKI        | 162,424 | 51,779 | 9,840  | 1  | .002 | 3.467  |
|                     | LnAset*DAR | -0,019  | 0,513  | 0,001  | 1  | .970 | .981   |
|                     | LnAset*DKI | -5,744  | 1,832  | 9,828  | 1  | .002 | .003   |
|                     | Constant   | -74,909 | 23,167 | 10,455 | 1  | .001 | .000   |

Source: Processed Data, 2025

The regression results in Table 6 show a constant value of -74.909, meaning that if all independent variables are held constant, income smoothing (Eckel Index) decreases by 74.909. The regression coefficient for firm size is 2.636, indicating that larger firms (measured by Ln Assets) have a higher probability of engaging in income smoothing. The positive coefficient reflects a positive relationship between firm size and income smoothing.

The regression coefficient for leverage (DAR) is 0.942, indicating a positive relationship, meaning that higher leverage is associated with an increased likelihood of income smoothing. Similarly, the good corporate governance (DKI) variable shows a positive coefficient of 162.424, suggesting that higher governance quality corresponds to greater income smoothing tendencies.

However, the interaction between firm size and leverage (LnAset\*DAR) has a coefficient of -0.019, with a significance value of 0.970, indicating a negative but insignificant moderating effect. In contrast, the interaction between firm size and good corporate governance (LnAset\*DKI) shows a coefficient of -5.744, with a significance value of 0.002, indicating a significant negative moderating effect, meaning that good corporate governance weakens the relationship between firm size and income smoothing.

f) Hypothesis Testing (Wald Test)

The Wald Test is used to determine the individual effect of each independent variable on the dependent variable. An independent variable is considered significant if its p-value  $\leq 0.05$ .

The first hypothesis states that firm size positively affects income smoothing. The test results (Table 6) show a significance value of 0.001 and a positive coefficient of 2.636, which is below 0.05. Thus, firm size significantly influences income smoothing, and  $H_1$  is accepted.

The second hypothesis states that financial leverage moderates the effect of firm size on income smoothing. The interaction term  $\text{LnAset} \times \text{DAR}$  has a significance value of 0.970, greater than 0.05, indicating that financial leverage does not significantly moderate the relationship. Therefore,  $H_2$  is rejected.

The third hypothesis states that good corporate governance moderates the effect of firm size on income smoothing. The interaction term  $\text{LnAset} \times \text{DKI}$  has a significance value of 0.002, less than 0.05, indicating that good corporate governance significantly weakens the relationship between firm size and income smoothing. Therefore,  $H_3$  is accepted.

## **Discussion**

### **Firm Size Influences Income Smoothing**

The first hypothesis states that firm size has a positive effect on income smoothing. The data analysis results show that the significance value of firm size, proxied by Ln Assets, is smaller than the 0.05 significance level; therefore,  $H_1$  is accepted. This finding indicates that the larger the firm size, the higher the probability that the firm engages in income smoothing practices. Hence, the first hypothesis, which states that firm size has a positive effect on income smoothing, is supported.

This result is consistent with agency theory, which posits that the larger the company, the more complex the relationship between managers (agents) and shareholders (principals). Large firms are exposed to greater public scrutiny, investor and creditor pressure, and regulatory oversight, prompting managers to present stable performance in order to maintain market confidence. According to Scott (2015), large companies tend to have greater flexibility in selecting accounting methods and determining the timing of revenue and expense recognition, thereby increasing opportunities for income smoothing.

This finding is in line with the research of Sultan (2021), Bagus & Astika (2023), and Prasasti & Febyansyah (2019), all of which concluded that firm size positively affects income smoothing.

### **Financial Leverage Moderates the Effect of Firm Size on Income Smoothing**

The second hypothesis states that financial leverage weakens the effect of firm size on income smoothing. The data analysis results indicate that the significance value of the interaction between financial leverage and firm size is greater than 0.05; therefore,  $H_2$  is rejected. This means that financial leverage does not significantly weaken the influence of firm size on income smoothing.

From the perspective of agency theory, high leverage can serve as an external control mechanism because creditors typically monitor firms closely through debt covenants, thereby limiting managerial discretion in conducting income smoothing. However, the findings of this study show that this effect is not significant, implying that both highly leveraged and low-leverage firms have a similar likelihood of engaging in income smoothing. One possible explanation is that large firms often possess the ability to manage creditor relationships or restructure debt, reducing the extent to which leverage constrains financial reporting behavior.

### **Good Corporate Governance Moderates the Effect of Firm Size on Income Smoothing**

The third hypothesis states that good corporate governance (GCG) weakens the effect of firm size on income smoothing. The analysis results show that the significance value of the interaction between GCG and firm size is smaller than 0.05; thus, H<sub>3</sub> is accepted. The negative relationship indicates that an effective GCG mechanism mitigates the positive association between firm size and income smoothing practices. This means that the implementation of good corporate governance can curb managerial opportunism reflected in income smoothing and strengthen corporate performance monitoring in line with stakeholder expectations.

In this study, good corporate governance is proxied by the proportion of independent commissioners. A higher proportion of independent commissioners enhances external oversight, thereby reducing opportunistic managerial behavior. This finding supports agency theory, which asserts that effective monitoring mechanisms, such as independent boards of commissioners, can reduce conflicts of interest between management and shareholders, consequently minimizing opportunistic practices like income smoothing. Hence, the third hypothesis stating that GCG weakens the effect of firm size on income smoothing is supported.

This result is consistent with the findings of Sihotang et al. (2024) and Silvia et al. (2024), which also demonstrated that good corporate governance mitigates the influence of firm size on income smoothing practices.

### **CONCLUSION**

Based on the results of the tests and analyses conducted in this study, the following conclusions can be drawn:

1. Firm size significantly affects income smoothing among companies listed on the Indonesia Stock Exchange during the 2021–2023 period.
2. Financial leverage does not weaken the effect of firm size on income smoothing among companies listed on the Indonesia Stock Exchange during the 2021–2023 period.
3. Good corporate governance weakens the effect of firm size on income smoothing among companies listed on the Indonesia Stock Exchange during the 2021–2023 period.

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