

Debt, Profitability, and Firm Size and Their Effects on Income Smoothing

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Abstract:

This research is classified as quantitative research to test the hypothesis, and is intended to examine whether there is an influence of the independent variables, namely debt, profitability, and company size on the dependent variable, namely income smoothing practices. The debt variable is proxied by the debt equity ratio, profitability is proxied by return on assets, and company size is proxied by total assets. Meanwhile, income smoothing practices are dummy variables that indicate the presence or absence of income smoothing practices based on the Eckel index. This study took a population of all companies on the Indonesia Stock Exchange (IDX) listed in the infrastructure sector, wired telecommunication service sub-industry, and obtained 21 companies. The sampling method used non-probability purposive sampling and obtained 15 companies as samples. The data used is a type of secondary data, in the form of company financial report data for the period 2015-2024. To test the effect of debt, profitability, and company size on income smoothing practices, logistic regression was used. The results of the logistic regression indicate that debt, profitability, and company size simultaneously do not affect income smoothing practices. Meanwhile, partial testing shows that of the three independent variables used, only one independent variable influences income smoothing practices, while the other two independent variables do not. The independent variable that influences income smoothing practices is company size, and the independent variables that do not influence income smoothing practices are debt and profitability

Keywords: Income Smoothing, Debt, Profitability, Firm Size

INTRODUCTION

Financial statements reflect a company's financial condition and provide essential information needed by stakeholders (Alexander, 2019). Financial statements serve as an essential means for companies to obtain financial information as a basis for decision-making (Bhaskoro & Suhardianto, 2020). The success of a company largely depends on the availability of accurate and effective financial information presented in financial statements (Gautam & Madhavi, 2024).

Parties interested in financial statements, as users of corporate financial reports, include management, shareholders, investors, creditors, suppliers, government, customers, competitors, employees and their representatives, investment analysts, community representatives, and the public (McLaney & Atrill, 2016; Britton & Waterston, 2010). These parties can be categorized into two groups: internal and external parties. Internal parties refer to company management, while all other parties are classified as external. Management, as internal users of financial statements, has broad access to the preparation of financial reports (Elliot & Elliot, 2011). In contrast, external users have

limited access to company information and depend solely on the financial statements disclosed to the public.

Each stakeholder may have different interests and expectations regarding financial reports. Management, for instance, aims to present financial statements that reflect strong operational performance. However, management is also aware that company performance is not always consistently favorable (Alviandy & Handojo, 2024). This situation can encourage management to engage in earnings management in order to achieve certain objectives or incentives. Earnings management can be broadly categorized into accrual earnings management and real earnings management (Zurriah et al., 2025). Management has discretion over accounting policy choices and changes in accounting estimates within the framework of accounting standards, which can be utilized to manage accrual-based earnings (Gu, 2025). Meanwhile, real earnings management involves actions taken through operational activities, which can be carried out at any point during the reporting period (Arum S et al., 2024).

Earnings management may take various forms (Comporek, 2025). Management can either increase or decrease reported earnings depending on its objectives. One common form is income smoothing, where earnings are adjusted to appear more stable over time. Through this practice, companies aim to present a consistent pattern of earnings growth, which may create a more favorable perception among external stakeholders. However, similar to other forms of earnings management, income smoothing can reduce the quality of financial information and potentially mislead stakeholders in making decisions.

Previous studies on income smoothing have explored a variety of factors that may influence this practice, including ownership structure (such as institutional or family ownership), profitability (measured by return on assets (ROA) and return on equity (ROE)), cash holdings, stock prices, debt ratios, dividend payout ratios, audit committees, firm size, firm value, company growth, tax planning, firm age, and managerial ownership (Sari & Amanah, 2017; Anwar & Chandra, 2017; Oktoriza, 2018; Handoyo & Fathurrizki, 2018; Herdjiono et al., 2019; Pradipta & Susanto, 2019; Megarani et al., 2019; Ernayani et al., 2020; Anwar & Gunawan, 2020; Wijaya et al., 2020; Abogun et al., 2021; Chandra et al., 2022; Surya & Arnan, 2022; Suyono et al., 2023; Khzer & Sabir Jaf, 2023; Alviandy & Handojo, 2024; Stewart & Siahaan, 2024; Gunawan & Yanti, 2025; Nafiria & Kholilah, 2026). Based on this background, this study aims to examine the effects of debt, profitability, and firm size on income smoothing. The sample used in this study consists of companies listed on the Indonesia Stock Exchange (IDX), particularly those in the infrastructure sector, within the Wired Telecommunication Services Sub-Industry.

LITERATURE REVIEWS

Agency Theory

Agency theory explains that when one or more individuals (principals) enter into a contract with another party (agent) to perform services on their behalf, which involves delegating decision-making authority, there is a strong possibility that the agent will not always act in the best interests of the principal (Jensen & Meckling, 1976). In a corporate context, the principal typically refers to the owners or shareholders, while the agent refers to professional managers who are entrusted with running the company

This relationship is governed by a contractual arrangement in which both parties seek to maximize their respective benefits. Agency theory highlights the relationship between principals (shareholders) and agents (managers), where managers are given

authority to make decisions regarding financial reporting and the management of company assets (Chandra et al., 2022). However, this relationship does not only involve the principal and the agent. It also indirectly affects other stakeholders who are interested in the company's performance, particularly its financial performance. These stakeholders include external parties such as creditors, tax authorities, investors, suppliers, employees and their representatives, as well as other related parties.

In pursuing their respective objectives, principals and agents may have different, and sometimes conflicting, interests. Principals expect agents to take actions that maximize shareholder wealth. In reality, however, managers (agents) may prioritize their own interests and choose actions that benefit themselves rather than maximizing the wealth of shareholders (principals) (Megarani et al., 2019).

Earnings Management

As the party responsible for managing the company, management has a strong incentive to present favorable financial performance. When actual performance particularly in terms of reported earnings does not meet expectations, management may be motivated to engage in earnings management. These expectations may arise from management itself, shareholders, creditors, investors, and other stakeholders concerned with the company's financial performance. Earnings management refers to managerial intervention in the financial reporting process, either through the selection of accounting policies or through real actions, with the intention of influencing reported earnings in a way that may mislead stakeholders and serve the personal interests of management (Komala et al., 2022).

According to Positive Accounting Theory, there are three main motivations for earnings management: the bonus plan hypothesis, the debt covenant hypothesis, and the political cost hypothesis (Watts & Zimmerman, 1990). The bonus plan motivation arises when management compensation is tied to reported earnings, encouraging managers to increase earnings in order to maximize their bonuses. The debt covenant motivation occurs when management attempts to meet financial expectations set by creditors and investors, prompting them to manage earnings to avoid violations of contractual agreements. Meanwhile, the political cost motivation relates to efforts to minimize tax burdens or avoid regulatory scrutiny, leading management to adjust reported earnings accordingly.

Earnings management can be broadly classified into accrual-based earnings management and real earnings management (Gu, 2025). Accrual-based earnings management involves the use of managerial discretion in selecting accounting policies and estimates. In contrast, real earnings management is carried out through actual business activities and operational decisions (Darmawan et al., 2019; Wijoyo & Firmansyah, 2021). In practice, earnings management can take several forms, including income smoothing (Abogun et al., 2021), aggressive accounting (Nguyen & Thi Duong, 2022), cookie jar accounting, big bath accounting (Comporek, 2025).

Income Smoothing

Income smoothing can be defined as a method used by management to reduce abnormal fluctuations in earnings through various accounting techniques or transactions (Alviandy & Handojo, 2024). It can be classified into natural income smoothing and intentional smoothing. Intentional smoothing is further divided into real income smoothing and artificial income smoothing (Eckel, 1981; Schipper, 1989). Income smoothing often arises from the belief that consistently growing earnings over time meet market expectations and are viewed positively by stakeholders. As a result, when significant

fluctuations in earnings occur, management may attempt to smooth reported income to maintain stability

Income smoothing tidak identik dengan tindakan penipuan, manipulasi, atau distorsi terhadap laporan keuangan, tetapi lebih pada memanfaatkan peluang yang muncul dalam prinsip-prinsip akuntansi alternatif dari transaksi yang diterima dan selisihnya (Kasim et al., 2022). Income smoothing is generally categorized as a form of accrual-based earnings management, where managerial discretion in selecting accounting policies is used to stabilize reported earnings over time. This practice aims to create favorable perceptions among shareholders, investors, creditors, and other stakeholders regarding the company's financial performance.

Firm Size

Firm size reflects the scale of a company and can be used to classify firms into categories such as micro, small, medium, and large enterprises based on indicators such as sales, total assets, equity, market share, number of employees, or other relevant measures (Oktoriza, 2018; Ispriyahadi & Abdulah, 2021). Large firms are generally more attractive to investors, creditors, and other stakeholders because they are perceived to have greater resources and stronger capabilities. They are also considered more resilient in facing economic challenges compared to micro, small, and medium-sized enterprises. Consequently, investors and creditors tend to perceive investments in large firms as less risky than those in smaller firms.

Debt

In financing their operations, companies not only rely on funds contributed by shareholders but also commonly obtain financing through debt. The higher the level of debt a company has, the greater the risk it bears. As a company's risk increases, investors tend to demand higher returns as compensation (Indrawan & Damayanthi, 2020). To assess the level of debt-related risk, financial ratios are typically used, one of which is the debt-to-equity ratio (DER), which compares total debt to total equity. A high DER can place significant pressure on management, as investors may perceive the company as high-risk and therefore expect higher returns on their investments.

In practice, many companies treat debt financing as an alternative source of funding and prioritize raising capital through the issuance of new shares in the capital market (Handoyo & Fathurrizki, 2018). This is because debt financing imposes fixed obligations in the form of interest payments that must be made periodically, regardless of whether the company is generating profits or incurring losses. In contrast, equity financing does not create such fixed financial burdens, as dividend payments to shareholders including new shareholders are typically made only when the company earns a profit

Companies with high levels of debt generally face greater pressure compared to those with lower debt levels. Financial statement users tend to monitor highly leveraged firms more closely due to the associated risks. Under such conditions, management in highly leveraged firms may have stronger incentives to engage in income smoothing practices compared to firms with lower levels of debt.

Profitabilitas

The primary objective of a business organization is to generate profit. Management, as the party responsible for running the company, is expected to achieve this goal while still considering ethical standards and broader social responsibilities. Profitability refers to a company's ability to generate income (Gibson, 2009). and serves

as a key indicator for stakeholders in evaluating company performance, both internally and externally (Oktoriza, 2018). Stakeholders are highly sensitive to the level of profit generated by a company. Shareholders are particularly concerned with profit because dividend distributions depend on the amount of earnings generated. Investors consider profitability as a key factor before making investment decisions, while creditors focus on profit levels to ensure that interest payments and debt obligations can be met on time.

When a company faces pressure in generating profit, management may be motivated to engage in income smoothing in order to align reported earnings with stakeholder expectations. A company's ability to generate profit is typically measured using financial ratios such as net profit margin (NPM), return on equity (ROE), and return on assets (ROA) (Ispryahadi & Abdulah, 2021). Net profit margin (NPM) measures the proportion of net income relative to total sales, return on equity (ROE) compares net income to shareholders' equity, and return on assets (ROA) reflects net income relative to total assets. In general, companies with lower profitability tend to face greater pressure compared to those with higher profitability. Financial statement users are more likely to closely monitor firms with lower profit levels. Consequently, firms with lower profitability may have a higher tendency to engage in income smoothing practices compared to firms with stronger profitability.

Hypothesis Development

A balanced capital structure between debt and equity is generally considered desirable for a company. Firms with disproportionately high levels of debt relative to equity tend to bear significant interest burdens, which can create pressure on their ability to generate profits. Under such circumstances, management may be incentivized to engage in income smoothing in order to ensure that reported earnings meet the expectations of various stakeholders..

Several studies have found that debt influences income smoothing practices (Handoyo & Fathurrizki, 2018; Alviandy & Handojo, 2024). However, other studies report no significant relationship between debt and income smoothing (Sari & Amanah, 2017; Anwar & Chandra, 2017; Oktoriza, 2018; Megarani et al., 2019; Wijaya et al., 2020; Ernayani et al., 2020; Stewart & Siahaan, 2024; Nafiria & Kholilah, 2026). Based on these mixed findings, the following hypothesis is proposed:

H₁ : Debt has an effect on income smoothing practices.

Firms with higher profitability are generally less likely to engage in income smoothing compared to firms with lower profitability. However, it is still possible for highly profitable firms to smooth earnings by reducing reported profits (income decreasing). Conversely, firms with lower profitability may engage in income smoothing by increasing reported profits (income increasing) to meet stakeholder expectations..

Regarding the relationship between profitability and income smoothing, several studies have found a significant effect (Sari & Amanah, 2017; Oktoriza, 2018; Herdjiono et al., 2019; Anwar & Gunawan, 2020; Wijaya et al., 2020; Khzer & Sabir Jaf, 2023). In contrast, other studies suggest that profitability does not significantly influence income smoothing (Anwar & Chandra, 2017; Handoyo & Fathurrizki, 2018; Ernayani et al., 2020; Chandra et al., 2022; Stewart & Siahaan, 2024; Alviandy & Handojo, 2024; Nafiria & Kholilah, 2026). Based on these findings, the following hypothesis is formulated:

H₂ : Profitability has an effect on income smoothing practices.

Large firms generally generate higher profits compared to micro, small, and medium-sized enterprises. Given their relatively strong financial position, large firms may

have less incentive to engage in income smoothing to increase reported earnings. However, to maintain earnings stability, large firms may still engage in income smoothing by reducing reported profits (income decreasing).

Several studies have found that firm size affects income smoothing practices (Anwar & Chandra, 2017; Oktoriza, 2018; Pradipta & Susanto, 2019; Ernayani et al., 2020; Anwar & Gunawan, 2020; Wijaya et al., 2020; Surya & Arnan, 2022; Khzer & Sabir Jaf, 2023; Stewart & Siahaan, 2024; Nafiria & Kholilah, 2026). However, other studies report no significant relationship between firm size and income smoothing (Sari & Amanah, 2017; Handoyo & Fathurrizki, 2018; Herdjiono et al., 2019; Gunawan & Yanti, 2025; Alviandy & Handoyo, 2024). Based on these findings, the following hypothesis is proposed:

H₃ : Firm size has an effect on income smoothing practices.

RESEARCH METHODOLOGY

This study is classified as quantitative research aimed at testing hypotheses. The population consists of companies listed on the Indonesia Stock Exchange (IDX) in the infrastructure sector, specifically within the wired telecommunication services sub-industry (sub-industry codes J311, J312, and J321), totaling 21 companies. The sampling method used is non-probability purposive sampling, where samples are selected based on specific criteria. The criteria applied in this study are: (i) companies listed on the IDX during the 2015–2024 period; (ii) companies that have complete financial statements for the 2015–2024 period published on the IDX website (www.idx.co.id); and (iii) companies with complete financial data required for the purposes of this study.

Based on these criteria, a total of 15 companies were selected as the research sample. This study uses secondary data in the form of company financial statements. The data consist of financial statements from 15 companies over a 10-year period (2015–2024), resulting in a total of 150 firm-year observations.

The study employs four variables, consisting of one dependent variable and three independent variables. The dependent variable is income smoothing (IE), while the independent variables include debt (DR), profitability (RA), and firm size (UP). The operational definitions of each variable are as follows:

1. Income Smoothing (IE) is measured using the Eckel Index (Eckel, 1981) which is calculated as the ratio of the coefficient of variation of changes in net income to the coefficient of variation of changes in sales. The formula is presented as follows:

$$IE = \frac{CV\Delta I}{CV\Delta S}$$

Where:

- IE = Eckel Index used to detect the presence or absence of income smoothing
- I = Total income before tax for each year
- S = Total sales for each year
- ΔI = Change (increase/decrease) in income before tax in year t compared to year t–1
- ΔS = Change (increase/decrease) in sales in year t compared to year t–1

- CV = Coefficient of variation, calculated as the standard deviation divided by the mean
 CVΔI = Coefficient of variation of changes in income before tax
 CVΔS = Coefficient of variation of changes in sales

The value of the Eckel Index (IE) is used to determine whether a company is likely engaging in income smoothing. If $IE < 1$, the company is indicated to engage in income smoothing. Conversely, if $IE \geq 1$, the company is not indicated to engage in income smoothing. To capture the presence or absence of income smoothing, a dummy variable—ISI (Income Smoothing Indicator)—is used. The variable takes a value of 0 if there is no indication of income smoothing and 1 if income smoothing is indicated.

2. Debt (DR) is proxied by the debt-to-equity ratio (DER), which is calculated using the following formula (Wijaya et al., 2020):

$$DR = \frac{\text{Total Debt}}{\text{Total Equity}}$$

3. Profitability (RA) is proxied by the return on assets (ROA) ratio, which is calculated using the following formula (Herdjiono et al., 2019):

$$RA = \frac{\text{Net income before tax}}{\text{Total Asset}}$$

4. Firm size (UP) is measured using the natural logarithm of total assets, which is calculated using the following formula (Gunawan & Yanti, 2025):

$$UP = \text{Ln} (\text{Total Asset})$$

The effect of debt (DR), profitability (RA), and firm size (UP) on income smoothing practices (ISI) is tested using logistic regression analysis. Prior to the analysis, a goodness-of-fit test and an overall model fit test are conducted to ensure the adequacy of the logistic regression model. Data processing is carried out using the IBM SPSS Statistics.

$$\text{Ln} \frac{\text{ISI}}{1 - \text{ISI}} = \beta_0 + \beta_1 \text{DR} + \beta_2 \text{RA} + \beta_3 \text{UP} + \epsilon$$

Where:

- ISI = probability of engaging in income smoothing practices
 DR = debt, proxied by the debt-to-equity ratio (DER)
 RA = profitability, proxied by return on assets (ROA)
 UP = firm size, proxied by the natural logarithm of total assets
 β = logistic regression coefficients
 Ln = natural logarithm
 ϵ = error term (residual)

RESULTS AND DISCUSSION

The goodness-of-fit test for the logistic regression model was conducted using the Hosmer and Lemeshow test, as presented in Table 1. The results show a significance value of 0.563, which is greater than 0.05. This indicates that the logistic regression model fits the data well and is appropriate for further analysis.

Table 1
Results of the Hosmer and Lemeshow Test

Step	Chi-Square Value	df	Sig.
1	6,756	8	0,563

(Source: Data processed, 2026)

Table 2 shows the results of the overall model fit test of the logistic regression model :

Table 2
-2 Log Likelihood

Step	Initial -2 Log Likelihood Block Number 0	-2 Log Likelihood Block Number 1	Cox & Snell R Square	Nagelkerke R Square
1	56,567	50,082	0,060	0,144

(Source: Data processed, 2026)

The results of the -2 Log Likelihood ($-2LL$), as presented in Table 2, show that the $-2LL$ value in block number 1 decreases compared to the $-2LL$ value in block number 0. This indicates that the logistic regression model improves after the inclusion of the independent variables. In other words, the overall model fit test suggests that the logistic regression model is appropriate for use. The Omnibus Test of Model Coefficients, as presented in Table 3, shows the simultaneous effect of the independent variables—debt (DR), profitability (RA), and firm size (UP)—on the income smoothing indicator (ISI).

Table 3
Omnibus Test of Model Coefficients

Step	Step	Nilai Chi-square	Df	Sig.
1	Step	6,484	3	0,090
	Block	6,484	3	0,090
	Model	6,484	3	0,090

(Source: Data processed, 2026)

Table 4 presents the results of the partial effects of the independent variables—debt (DR), profitability (RA), and firm size (UP)—on the income smoothing indicator (ISI).

Table 4
Results of the Partial Effects of DR, RA, and UP on ISI

Step	Independen Variabel/ Konstanta	Sebelum Pandemi Covid-19			
		B	Wald	df	Sig.
1	DR	0,001	0,001	1	0,975
	RA	-0,601	0,665	1	0,415
	UP	0,370	6,167	1	0,013
	Constant	-5,764	3,225	1	0,073

(Source: Data processed, 2026)

The data presented in Table 3 show the results of the simultaneous testing of all independent variables—debt (DR), profitability (RA), and firm size (UP)—on the income smoothing indicator (ISI). Table 3 reports a p-value of 0.090, which is greater than 0.05, indicating that all independent variables simultaneously do not have a significant effect on the income smoothing indicator (ISI).

The results of the partial tests examining the effects of the independent variables—debt (DR), profitability (RA), and firm size (UP)—on the dependent variable, income smoothing indicator (ISI), are presented in Table 4. The data in Table 4 show that the p-value for the debt variable (DR) is 0.975, which is greater than 0.05, indicating that debt does not have a significant effect on income smoothing practices. Therefore, H_1 is rejected. This finding is consistent with the results of previous studies by Sari & Amanah (2017), Anwar & Chandra (2017), Oktoriza (2018), Megarani et al. (2019); Wijaya et al. (2020), Ernayani et al. (2020), Stewart & Siahaan (2024), dan Nafiria & Kholilah (2026) which also found that debt does not influence income smoothing. However, this result contradicts the findings of Handoyo & Fathurrizki (2018) dan Alviandy & Handojo (2024) yang menyatakan utang berpengaruh terhadap *income smoothing*.

The test results for the return on assets (RA) variable, as a proxy for profitability, shown in Table 4 indicate a p-value of 0.415, which is greater than 0.05. This suggests that profitability does not have a significant effect on income smoothing practices. Therefore, H_2 is rejected. This finding is consistent with studies by Anwar & Chandra (2017), Handoyo & Fathurrizki (2018), Ernayani et al. (2020), Chandra et al. (2022), Stewart & Siahaan (2024), Alviandy & Handojo (2024), dan Nafiria & Kholilah (2026). However, it differs from the findings of Sari & Amanah (2017), Oktoriza (2018), Herdjiono et al. (2019), Anwar & Gunawan (2020), Wijaya et al. (2020), Khzer & Sabir Jaf (2023) which suggest that profitability does influence income smoothing.

The partial test results for firm size, as presented in Table 4, show a p-value of 0.013, which is less than 0.05. This indicates that firm size has a significant effect on income smoothing practices. Therefore, H_3 is accepted. This result is consistent with prior studies by Anwar & Chandra (2017), Oktoriza (2018), Pradipta & Susanto (2019), Ernayani et al. (2020), Anwar & Gunawan (2020), Wijaya et al. (2020), Surya & Arnan (2022), Khzer & Sabir Jaf (2023), Stewart & Siahaan (2024), dan Nafiria & Kholilah (2026). However, this finding contradicts studies by Sari & Amanah (2017), Handoyo & Fathurrizki (2018), Herdjiono et al. (2019), Alviandy & Handojo (2024), dan Gunawan & Yanti (2025) which report that firm size does not significantly influence income smoothing practices.

CONCLUSION

The results of this study, using logistic regression analysis, indicate that simultaneously, debt, profitability, and firm size do not have a significant effect on income smoothing practices. However, the partial analysis shows that while debt and profitability do not influence income smoothing, firm size has a significant effect on income smoothing practices. This study has several limitations. First, the population and sample are limited to companies in the infrastructure sector, specifically the wired telecommunication services sub-industry (sub-industry codes J311, J312, and J321), which limits the generalizability of the findings to companies in other sectors and sub-industries listed on the Indonesia Stock Exchange (IDX). Second, the number of firms included in the study is relatively small, with a population of 21 companies and a sample of 15 companies, which may limit the robustness and generalizability of the results. Third, the study only includes three independent variables, which may result in a limited explanatory power when analyzed simultaneously. Therefore, future research is

recommended to expand the scope of the study by including a broader range of sectors and sub-industries, increasing the number of population and sample firms, and incorporating additional variables. Such improvements are expected to provide more comprehensive and generalizable findings..

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