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The Effect of Profitability and Leverage on Income Smoothing Moderated By Audit Quality (Case Study of Manufacturing Companies In Basic and Chemical Industry Sectors 2019-2022)

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ABSTRACT: This study uses a quantitative method in the form of associative. The population in this study are manufacturing companies in the basic industry and chemical sectors listed on the Indonesia Stock Exchange 2019-2022. The research period used is 4 years of observation, namely from 2019-2022. The sample was determined using the purposive sampling technique. Hypothesis testing in this study uses logistic regression. The results showed that profitability had no significant effect on income smoothing and leverage had a positive and significant effect on income smoothing. The results also show that audit quality is able to weaken the influence of profitability on income smoothing, and audit quality can weaken the influence of leverage on income smoothing. This result gives the implication that the higher the leverage, the higher the income smoothing carried out by the company. These results provide information that the high practice of profit equalization due to high profitability and high leverage will be further reduced if the company has a high audit quality.

KEYWORDS: Profitability, Leverage, Income Smoothing, Audit Quality

I. INTRODUCTION

The large number of companies listed on the Indonesia Stock Exchange has resulted in an increasing number of investors investing their funds in the company, so that financial reports are part of the financial reporting process that can provide useful information in making business decisions for the company (Natalie & Astika, 2016) especially having an important role in assessing the performance of a company so that interested parties can find out the company's financial condition (Kasmir, 2014). Interested parties are especially interested in the company's profit information, therefore it can often trigger management to generate maximum profits quickly. Various actions taken by management so that the profit results can be accepted by investors, one of which is changing the profit value (Fahmi, 2014:521). In achieving its goals, management usually has several ways to change the profit value, including manipulating profits in a period such as income smoothing.

The reason management practices income smoothing is because a company wants to increase the value of the company which results in the company having a low risk of uncertainty, increase the company's stock price, and to satisfy its own interests, such as getting compensation and maintaining a position. Income smoothing can also be interpreted as reducing the fluctuation of profits generated by the company from year to year by moving high income to less profitable periods. The practice of income smoothing is no stranger to every company, but it is difficult to detect and users of information are not aware of the existence of income smoothing practices in the financial statements of each company, therefore it can cause errors in decision making (Masyithoh, 2017).

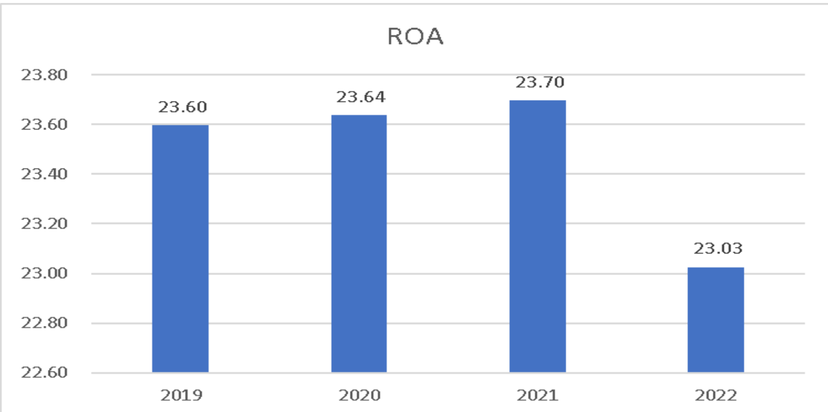
Income smoothing is related to the agency theory approach as a based theory. Based on agency theory, income smoothing arises due to the relationship between the agent and the principal. This agency relationship arises because one party (principal) gives a mandate to another party (agent) to act in accordance with the interests of the principal and carry out certain tasks in accordance with the agreed work contract. Management actions to smooth income are generally based on various reasons, both to satisfy the interests of the company's owners, such as increasing the value of the company, so that the assumption arises that the company in question has a low risk of increasing the company's stock price or to satisfy its own interests (opportunistic) such as getting bonuses and maintaining its position. So even though management has goals and reasons, the practice of smoothing income results in inadequate disclosure in the financial statements. This is because management changes information on the financial statements, so that users of the financial statements do not obtain accurate information that users of the financial statements need to be aware of the information presented in the financial statements (Darma et al., 2018).

Income smoothing is the reduction of profit variability between a series of profit amounts that arise due to differences between the amount of profit that should be reported and the expected profit (Belkaoui 2012:193). According to Fatimah, et al. (2019) income smoothing includes the use of certain techniques that aim to reduce or increase the amount of profit. Herry (2017) added that income smoothing is classified into operating manipulations and accounting manipulations. It can be concluded that income smoothing is one of the common profit management practices carried out by company managers to reduce profit fluctuations that are expected to have a beneficial effect on evaluating management performance.

One example of an income smoothing case in the basic chemical industry sector occurred at PT. Tiga Pilar Sejahtera Tbk (AISA). Reported from the website kontan.co.id, it was stated that on Tuesday, March 26, 2019, the public accounting institution Ernst & Young (EY) had issued an audit regarding alleged violations committed by AISA's old management. One of the important points disclosed by EY in the disclosure of information related to the comparison between internal data and the audited 2017 Financial Report was the alleged overstatement, including in the accounts receivable, inventory, and fixed assets of the AISA Group of IDR 4 trillion and in the sales account of IDR 662 billion and IDR 329 billion in earnings before interest and taxes from the food entity. The cause of this overstatement was due to financial problems. Furthermore, as reported by the website www.cnbcindonesia.com, it was also stated that the rice run by PT Tiga Pilar Sejahtera Food Tbk (AISA) is no longer operating so that the company loses potential revenue of Rp 2 trillion per year, whereas previously the rice business could contribute 50% of revenue. This condition is a problem for TPS Food, thus triggering the management to maintain the performance of the company's financial statements so that they continue to look good by practicing income smoothing.

There are several factors that can influence management in implementing income smoothing practices, namely company size, good corporate governance, CSR, leverage and profitability. In this study, two factors were chosen as the main focus, namely profitability and leverage. The first factor is profitability. Profitability is the company's ability to obtain net profit in relation to sales, total assets, and equity (Tala and Karamoy, 2017). Profitability is a ratio that can be used to measure a company's ability to generate profits from its normal business activities (Hery, 2017: 312). In general, the profitability value of a company can be used as an indicator to measure a company's performance. So the relationship between profitability and income smoothing practices is when the profitability obtained by a small company in a certain period of time will trigger the company to carry out income smoothing practices by increasing previously obtained income so that it will show stable shares to retain existing investors. Pradnyandari & Astika (2019) also found that profitability has a positive effect on income smoothing practices. This means that the positive sign is that the higher the profitability, the higher the income smoothing practices that occur and vice versa, the lower the profitability, the lower the income smoothing practices. This study uses Return On Asset as a proxy for the profitability variable. Return On Asset (ROA) is used to measure the effectiveness of a company in generating profits by utilizing its assets. The results of a study conducted by Ratnaningrum (2016) stated that profitability has a negative effect on income smoothing. However, the results of this study differ from the results of a study conducted by Dewi and Latrini (2016) which stated that profitability has a positive effect on income smoothing. The results in this study also differ from the results of a study conducted by Jariah (2016) which stated that profitability has no effect on income smoothing. In a study conducted by Putro (2016), ROA has a positive effect on earnings management. The results prove that if the company's performance is good or bad, it will trigger managers to act opportunistically by increasing or decreasing accounting profit.

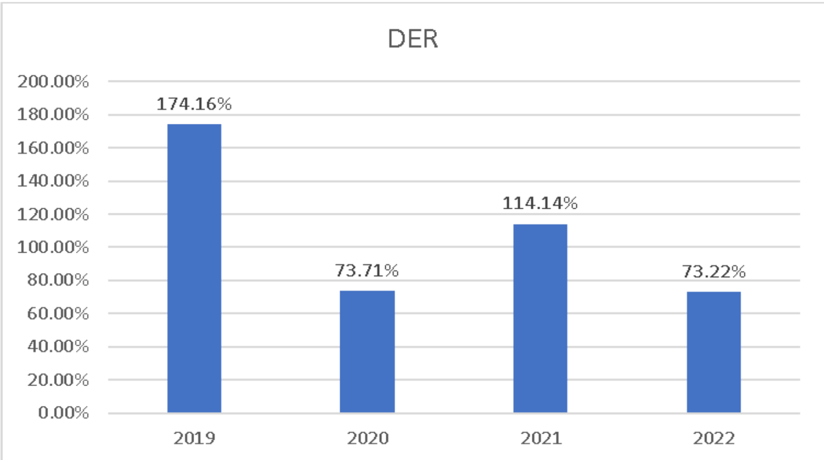
The profitability phenomenon in manufacturing sector companies shows a significant decline from 2021 to 2022, which can be seen in the following Figure.



The figure shows that the profitability of Manufacturing Companies in the Basic Industry and Chemical Sector from 2019 to 2021 has been stable and increasing, but in 2022 there was a decrease in the average ROA to 23.03 percent. Furthermore, drastic changes in the company's profitability can certainly affect various actions and reactions from the company, which can trigger opportunities for income smoothing practices.

Another factor that can affect the practice of income smoothing in a company is leverage. The use of debt will determine the level of leverage of the company because by using more debt than equity, the fixed burden borne by the company is high which will ultimately cause profits to decrease. The greater the company's debt, the greater the risk faced by investors, and investors will tend to ask for a higher level of profit. As a result of these conditions, companies tend to practice income smoothing. Leverage can be interpreted as the use of assets of a fund. The greater the leverage indicates that the funds provided by the owner to finance the company's investment are getting smaller, or the level of debt used by the company is increasing. The debt ratio can be used to assess the extent to which the company uses borrowed money (Damayanti et al., 2019).

The leverage phenomenon in manufacturing sector companies shows fluctuations with a significant decrease in the DER ratio in 2022, which can be seen in the following Figure.



The figure shows leverage in manufacturing companies in the basic and chemical industry sectors. From 2019 to 2022 there was a fluctuation, but in 2022 there was a decrease in the average DER to 73.22%. Furthermore, drastic changes in the company's leverage can certainly affect various actions and reactions from the company, which can lead to opportunities for income smoothing practices.

The use of leverage in a company can increase the company's profit, but if something happens that is not as expected, the company can experience losses equal to the percentage of expected profit, or even greater. According to Riyanto (2016:375), leverage is a ratio that measures the extent to which debt is used by a company, which is described through the relationship between the company's debt and capital or assets. Usually, companies will report higher profits to maintain the company's reputation in the public eye. This is done because a high leverage ratio is generally difficult to obtain additional funds from external parties, because external parties will assess that the company will be threatened with failure to pay debts.

This result is supported by research conducted by (Utari and Sari, 2016) that leverage has a positive effect on earnings management. In this study, leverage is proxied by the Debt-to-Equity Ratio (DER). The results of previous studies conducted by Roslita & Daud, (2019); Fandriani & Tunjung (2019); Thoharo & Andayani (2018); Indrawan & Damayaanthi (2020); Ekadjaja, Chuandra, & Margarita (2020) found that the debt-to-equity ratio had a significant positive effect on earnings management. This is different from the results of research by Aditya and Sufiyati (2021) which showed that profitability did not have a negative effect on income smoothing, and financial leverage had a negative and significant effect on income smoothing in manufacturing companies on the Indonesia Stock Exchange (IDX) for the period 2016-2018.

There are still inconsistent research results, therefore researchers add moderating variables to show the direct influence in this study, strengthening or weakening. Referring to the contingency theory, there are other factors that influence the direct influence in the study, and this study refers to audit quality. Where audit quality depends on the big four or non-big four auditors will provide different results on the influence of ROA and DER on income smoothing. According to the research of Pujilestari and Herusetya (2013) regarding the influence of audit quality on real transaction profit management - strategic income recognition, it states that in the Sensitivity and Robustness tests, audit quality is able to moderate significantly positive income smoothing.

This study is a development of a study conducted by Annisa & Hapsoro (2017), which examined the effect of audit quality, leverage, and growth on the implementation of earnings management. In this study, there are several main differences compared to the study by Annisa & Hapsoro (2017). The main difference lies in the independent variables used. In this study, the profitability variable was added and the growth variable was removed. The decision to exclude the growth variable was based on several reasons. First, this study only covers a three-year observation period, so that growth between companies is not significantly visible. Second, this study focuses on companies in the basic and chemical industry sectors, which show relatively similar growth characteristics, so that differences in growth between companies in the sample are less relevant. In addition, another difference lies in the dependent variable used. Previous studies used earnings management in general as the dependent variable, while in this study, we focus on only one form of earnings management, namely income smoothing.

This selection is based on the fact that management tends to be more interested in implementing income smoothing compared to other forms of income management. This is because the stability of earnings resulting from income smoothing is considered more attractive by investors, because companies with stable profits are usually considered better and more reliable. This study aims to determine and analyze the effect of profitability and leverage on income smoothing, as well as to analyze the role of audit committee quality in moderating the effect of profitability and leverage on income smoothing.

II. LITERATURE REVIEW

Agency theory by Jensen & Meckling (1976) states that an agency relationship is a contract involving one or more company owners (principal/s) who are involved with managers (agents) to provide some services on their behalf by involving the delegation of some decision-making authority to the manager (agent). If both parties want to maximize benefits, then there is good reason to believe that the manager (agent) does not always act in accordance with the wishes of the company owners (principal/s). The separation between the company managers and the company owners is common in companies in the form of limited liability companies listed on the capital market. The relationship between the company managers or management and its owners is related to what is called agency theory.

In agency theory, an agency relationship arises when one or more principals employ another person (agent) to provide a service and then delegate decision-making authority to the agent. The relationship between the principal and agent can lead to a condition of asymmetrical information because the agent is in a position to have more information about the company than the principal, assuming that individuals act to maximize their own interests, then the imbalance of information they have will encourage the agent to hide some information that is not known to the principal. In such an imbalanced condition, the agent can influence the figures presented in the financial statements by conducting earnings management (Darma et al., 2018).

III. RESEARCH METHODS

This study uses a quantitative method in the form of associative. Associative research is a study that investigates the relationship between independent variables and dependent variables. The associative research method is causal (cause and effect) to determine the effect of profitability and leverage on income smoothing which is moderated by audit quality. This study was conducted at a basic chemical industry manufacturing company that has gone public in Indonesia. The time period for this study was from 2019-2022. The reason for choosing a basic chemical industry manufacturing company that has gone public in Indonesia as a place for research is because there is a phenomenon of profitability that has decreased significantly in chemical industry manufacturing companies and there are drastic changes in company leverage that affect various actions and reactions from chemical industry companies, which can create opportunities for income smoothing practices. This study uses secondary data from basic and chemical industry manufacturing companies listed on the IDX in 2019-2022.

The Income smoothing variable in this study is measured using a dummy variable. The dummy variable will be obtained from the Eckel index results. If the Eckel index value ≥ 1, then the company is declared not to be smoothing income and is given the code 0. Conversely, if the Eckel Index value <1, then the company is smoothing income and is given the code 1. The company's profitability is measured using Return on Asset (ROA). ROA is usually used by companies to measure their ability to generate profits using the assets they have. According to Fahmi (2016:127) the leverage ratio is used to measure how much a company is financed with debt. The use of debt that is too high will endanger the company because the company will fall into the extreme leverage category, namely the company is trapped in a high level of debt and it is difficult to release the debt burden.

Audit quality (M) can be interpreted as the extent to which the auditor examines the financial statements. According to the Public Accountant Professional Standards (SPAP), auditors who carry out audits can be said to be qualified if they meet the standards in carrying out audits. DeAngelo (1981) argues that the size of the public accounting firm represents audit quality (auditor independence). If there is an error in the auditor's reporting, it is likely to lose all clients. In this study, audit quality is measured using the size of the KAP where the auditor works, which is distinguished between KAPs affiliated with the Big Four KAPs and non-Big Four KAPs. In accordance with the research of Minerva, et al., (2020) in this study using the big four auditors in Indonesia. The list of KAPs used as a benchmark for audit quality will be proxied by dummy variables, as follows:

1: if the company uses the Big Four KAP

0 : if the company does not use the Big Four KAP

The population in this study is manufacturing companies in the basic and chemical industry sectors listed on the Indonesia Stock Exchange 2019-2022. The period used is 4 years of observation in order to obtain good results when using the latest data with a period of three years.

According to Sugiyono (2019:133) purposive sampling can be interpreted as taking samples or data sources through consideration. The sampling criteria in this study are as follows:

1) Manufacturing companies in the basic and chemical industry sectors listed on the IDX for the 2019-2022 period.
2) Manufacturing companies in the basic and chemical industry sectors that submit annual reports in Rupiah currency for the period 2019-2022. The financial reports presented must be in Rupiah currency, they cannot use foreign currencies because the exchange rate fluctuates, thus showing unstable figures.
3) Manufacturing companies in the basic and chemical industry sectors that did not experience losses in their finances and made a profit from 2019-2022. Because this study uses the profitability variable, which shows the profit obtained by the company, so that if the company experiences a loss, it does not comply with the criteria of the profitability variable studied.
4) Manufacturing companies in the basic and chemical industry sectors that publish complete annual financial reports with complete data related to income smoothing, profitability, leverage and audit quality variables during the observation years from 2019-2022.

The collected data were then analyzed using descriptive statistical tests, classical assumption tests and logistic regression tests. The classical assumption tests carried out include normality tests, multicollinearity tests, heteroscedasticity tests, and autocorrelation tests. Then to answer the moderation hypothesis, this study uses moderated regression analysis testing because it adds a moderating variable to its testing. Moderated Regression Analysis (MRA). MRA is used in this study to analyze Audit Quality as a variable that moderates the influence between the dependent variable Income smoothing on the independent variables Profitability (X1) and Leverage (X2).

IV. ANALYSIS RESULTS AND DISCUSSION

Manufacturing companies in the basic and chemical industry sectors in this study were selected using purposive sampling techniques according to the established criteria. Based on the sample selection criteria, there were 42 manufacturing companies in the basic and chemical industry sectors that submitted annual reports in Rupiah currency for the 2019-2022 period, then there were 34 manufacturing companies in the basic and chemical industry sectors that did not experience losses in their finances and made a profit from 2019-2022 and there were 23 manufacturing companies in the basic and chemical industry sectors that published complete annual financial reports with complete data related to income smoothing, profitability, leverage and audit quality variables during the observation years from 2019-2022. Based on the sample selection, the companies selected as samples were 67 companies, with 4 years of research observation, so that the total sample for the four years of research was 268 observation data.

Descriptive Statistical Test Results

	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*
ROA	268	12,7300	30,9400	23,4888	5,5119
DER	268	0.0020	29,5830	1,0903	2,8653
KA	268	0.0000	1,0000	0.3843	0.4873
Income smoothing	268	0.0000	1,0000	0.7350	0.4421

The Profitability variable in this study is measured using the ROA ratio, and has a minimum value of 12.73 which occurred in the ASII company in 2020 and the highest (maximum) Profitability is 30.94 which occurred in the KLBF company in the 2022 period. Profitability has an average value of 23.4888 with a standard deviation value of 5.5119. This means that there is a difference in the Profitability value studied from its average value of 5.5119. The standard deviation value of Profitability is lower than the average value, meaning that Profitability in the 67 manufacturing companies studied during the 2019-2022 period is even or the difference in Profitability data between one company and another is not high.

The leverage variable in this study is measured using the DER ratio, and has the lowest leverage value (minimum) of 0.0020 which occurred in the KLBF company during the 2022 period and the highest Leverage (maximum) is 29.5832 which occurred in the FASW company during the 2019 period. Leverage has an average value of 1.0903, with a standard deviation value of 2.865. This means that there is a difference in the Leverage value studied from its average value of 2.865. The standard deviation value of Leverage is higher than the average value, meaning that the distribution of Leverage values in the 67 manufacturing companies studied during the 2019-2022 period is uneven or the difference in leverage data between one company and another is relatively high.

The audit quality variable in this study is measured using a dummy variable, namely if the company uses a Big Four KAP, it is given a code of 1 and if the company does not use a Big Four KAP, it is given a code of 0. The standard deviation value of audit quality is 0.48735, this value is higher than the average value of 0.3843. This shows that the distribution of audit quality data is uneven or the difference between one data and another is quite high. This is because most of the companies studied tend not to use a Big Four KAP and only a small number use a Big Four KAP. In more detail, the frequency of companies conducting audit quality can be seen in the following table.

Audit Quality Frequency Test Results

	Frequency	*Percent*
Non KAP Big four	165	61.6
Big four KAP	103	38.4
Total	268	100.0

The data in Table 5.4 shows that the number of observations that did not use the Big Four KAP was 165 observations and those that used the Big Four KAP were 103 observations.

The Income smoothing variable in this study is measured using a dummy variable, namely if the company performs Income smoothing, it is given a code of 1 and if the company does not perform Income smoothing, it is given a code of 0. The standard deviation value of Income smoothing is 0.44212, this value is lower than the average value of 0.7351. This shows that the distribution of Income smoothing data is even or the difference between one data and another is not high. This is because most of the companies studied tend to do income smoothing and only a small number do not do Income smoothing. In more detail, the frequency of observations that do Income smoothing can be seen in the following table.

Income Smoothing Frequency Test Results

	Frequency	***Percent***
Not Doing Income Smoothing	71	26.5
Performing Income Smoothing	197	73.5
Total	268	100.0

The data in the table shows that the number of observations that did not carry out income smoothing was 71 observations and those that did carry out income smoothing were 197 observations.

Test Results Hosmer and Lemeshow

Step	***Chi-square***	**df**	***Sig.***
1	27,901	8	0.000

The Chi Square value in the Table obtained a value of 27.901, this value when compared with the Chi Square Table value for degrees of freedom (DF) 8 at a significance level of 0.05 is 14.067. The Chi Square value of Hosmer and Lemeshow calculated 27.901> Chi Square table 14.067 or a significance value of 0.000 less than 0.05, thus accepting H0, which indicates that the model can be accepted and hypothesis testing can be done because there is a significant difference between the model and its observation value.

Nagelkerke R Square Test Results

Model Summary			
Step	*-2 Log likelihood*	*Cox & Snell R Square*	*Nails R Square*
1	272.168a	0.131	0.192
a. Estimation terminated at iteration number 6 because parameter estimates changed by less than .001.			

The test results in the table above provide results where the Nagelkerke R Square value is 0.192. This means that the variation of income smoothing in manufacturing companies in the basic and chemical industry sectors listed on the Indonesia Stock Exchange for the 2019-2022 period can be significantly influenced by the variables of profitability, leverage, audit quality, X1.M interaction and X2.M interaction by 19.2 percent, while the remaining 80.8 percent is explained by other factors not explained in the research model.

Logistic Regression Test Results

Variables	**Regression Coefficient (B)**	**Sig.**	**Conclusion**
Profitability(X1)	0.300	0.655	No Significant Impact
Leverage(X2)	0.277	0.004	Significant Positive
Audit quality (M)	-0.111	0.758	Negative Not Significant
X1.M Interaction	-0.271	0,000	Moderation weakens
X2.M Interaction	-0.423	0.009	Moderation weakens

The results of the t-test calculation in the table show that the regression coefficient value of X1 or Profitability is 0.300 with a significance level of 0.655 more than 0.05. This shows that profitability does not have a significant effect on income smoothing in manufacturing companies in the basic and chemical industry sectors listed on the Indonesia Stock Exchange in 2019-2022. So the hypothesis that profitability has a positive effect on income smoothing is rejected.

The results of the t-test calculation in the table show that the regression coefficient value of X2 or Leverage is 0.277, which is positive with a significance level of 0.004 less than 0.050. This shows that leverage has a positive and significant effect on income smoothing in manufacturing companies in the basic and chemical industry sectors listed on the Indonesia Stock Exchange in 2019-2022. So the hypothesis that leverage has a positive effect on income smoothing is accepted.

The significance value of the moderation variable (β2) Audit quality is 0.758 (non-significant) and the significance value of the interaction variable between Profitability and Audit quality (β3) is significant at 0.000, this indicates that the moderation variable is a pure moderation type. The results of the moderation regression analysis show that the value of the profitability variable is significantly positive and the interaction variable of profitability with audit quality is significantly negative, indicating a relationship in the opposite direction so that it is concluded that the audit quality variable is a moderating variable that weakens the positive effect of the influence of profitability on income smoothing.

The significance value of the moderation variable (β2) of audit quality is 0.758 (non-significant) and the significance value of the Interaction variable between Leverage and Audit Quality (β3) is significant at 0.009, this indicates that the moderation variable is a pure moderation type. The results of the moderation regression analysis show that the value of the leverage variable is significantly positive and the interaction variable of leverage with audit quality is significantly negative, indicating a relationship in the opposite direction so that it is concluded that the audit quality variable is a moderating variable that weakens the positive effect of leverage on income smoothing.

The Effect of Profitability on Income Smoothing

The results of the regression analysis show that Profitability statistically has no significant effect on income smoothing (H1 is accepted). This means that the high or low Profitability of a company will not affect the Income smoothing action in the company. This is because profit is not an important measure for investors to determine investment, but investors pay more attention to the risks they will face. Stable profits are preferred by investors because they tend to have small risks and the income obtained is more stable. Companies with good profitability will give a good signal to investors, so companies tend not to do income smoothing. The results of this study support the signal theory but do not support the agency theory.

Based on agency theory, profitability describes the difference in goals between the principal and the agent, where each individual wants to take action according to their respective desires, this is done in order to improve their welfare. The principal as a shareholder wants to achieve a high level of profitability every year in order to increase his wealth, while the agent as a manager is motivated to improve his welfare in order to meet his economic needs by carrying out income smoothing properly. Profitability shows a company's ability to make a profit. Generally, a high profitability value can provide more confidence for investors to invest in the entity (Wulan & Nabhan, 2021).

Furthermore, the results of the profitability study on income smoothing are supported by the behavioral accounting theory. According to behavioral accounting theory, income smoothing or income smoothing is a form of behavioral accounting in the financial reporting aspect, where income smoothing is part of income management caused by management having private information for their own benefit. The scope of income management includes the selection of accounting methods, estimates, clarifications and formats used in mandatory disclosures, so they are not influenced by profitability.

These results support Jariah's (2016) research which states that profitability has no effect on income smoothing. These results are also in accordance with Yoe & Hastuti's (2023) research which states that the level of profitability cannot determine whether a company carries out income smoothing or not. Furthermore, these results support Dharma's (2023) research which found that profitability is not a driving factor in the practice of income smoothing. These results are not in line with research by Setyaningsih et al., (2021), Purnamasari & Fachrurrozie (2020); Islak et al. (2019), Annisa & Hapsoro (2017), Tsuroyya & Astika (2017), Thoharo & Andayani (2018), and Rasinih & Munandar (2016) which found that profitability has a positive effect on income smoothing. A stable level of profitability will provide confidence to investors, because investors tend to choose stable profits in a company to invest in because the company has good performance in generating profits

The Effect of Leverage on Income Smoothing

The results of the regression analysis show that leverage has a positive and significant effect on Income smoothing (H2 is accepted). This means that the higher the leverage, the higher the Income smoothing carried out by the company. This is because the higher the level of Financial Leverage which describes the liabilities owned by a company, the greater the risk that will be borne by the company. Investors will prefer companies with low leverage levels because they have lower risk levels. This is what triggers companies to do income smoothing.

The results of this study are in accordance with agency theory which states that managers have information asymmetry towards external parties of the company such as creditors and investors which occurs when managers have more internal company information than external parties. Referring to using the assumption of risk averse, investors and creditors want to invest or lend their capital if the company has a high leverage ratio. This condition can make managers use the information they know to manipulate financial reports to retain investors by taking income smoothing actions.

Furthermore, the results of the income smoothing study influenced by leverage are supported by behavioral accounting theory. According to behavioral accounting theory, behavioral aspects in financial reporting include income smoothing behavior and the reliability of accounting information and the relevance of accounting information for investors. Income smoothing is part of earnings management caused by management having private information for their own benefit, in other words, the level of leverage can affect management's actions in carrying out income smoothing actions (Setyaningsih, et al. 2021)

These results support previous studies conducted by (Roslita & Daud, 2019; Fandriani & Tunjung, 2019; Thoharo & Andayani, 2018; Indrawan & Damayaanthi, 2020; Ekadjaja, Chuandra, & Margarita, 2020) which found that the debt-to-equity ratio has a significant positive effect on earnings management. The higher the DER, the greater the debt composition compared to the total equity, of course investors tend to view it from the negative side because the high debt composition of the company will bear high interest burdens so that the company's reported profits will tend to be low. If left alone, investors will certainly not be interested in investing their capital in the company, therefore managers try to ensure that investors still want to invest their capital by carrying out earnings management by reducing interest expenses which reduce the company's profits so that the company's interest expense ratio will look low and the company's profit level becomes high.

Based on the debt covenant hypothesis, companies that are in a position of being threatened with violating debt covenants tend to choose management methods that have an impact on increasing profits. This is to maintain their reputation in the eyes of external parties. Companies that have high leverage due to the amount of debt being greater than assets are suspected of smoothing because the company is threatened with default (unable to pay off its obligations when due). So, the company makes policies that can increase income. The greater the company's debt, the greater the risk faced by investors, so investors will ask for a higher level of profit, as a result the company tends to smooth profits.

The Effect of Profitability on Income Smoothing is Moderated by Audit Quality

The results of the analysis show that the audit quality variable is a moderating variable that weakens the positive effect of profitability on income smoothing. This result means that the high practice of income smoothing due to high profitability will reduce the practice of income smoothing if the company has high audit quality. This is because audit quality is one of the variables that tends to be used to explain variations in disclosure in the company's annual report. This study examines audit quality measured using a dummy variable, which is given code 1 = Big four KAP, and given code 0 = Non-Big KAP, to examine the quality of the observer's probability of detecting errors or fraud in the customer account system and examine the probability reflected in KAP compliance, independence. Audit rules, audit control, supervisory capacity, auditor performance, acceptance and monitoring of change, customer cooperation and professional support (Yoewono & Verenathan 2023).

Based on agency theory, profitability describes the difference in goals between the principal and the agent, where each individual wants to take action according to their respective desires, this is done in order to improve their welfare. The principal as a shareholder wants to achieve a high level of profitability every year in order to increase his wealth, while the agent as a manager is motivated to improve his welfare in order to meet his economic needs by carrying out income smoothing properly. Profitability shows a company's ability to make a profit. Generally, a high profitability value can provide more confidence for investors to invest in the entity (Wulan & Nabhan, 2021). Companies with high ROA will encourage management to carry out income smoothing so that the reported profit is stable or does not experience a significant increase.

Furthermore, the results of the profitability study on income smoothing are supported by the behavioral accounting theory. According to behavioral accounting theory, income smoothing is a form of behavioral accounting in the financial reporting aspect, where according to this theory, the control aspect is very important in an organization. The larger the organization, the more intensive control measures are needed, so that large companies tend to have high profitability, and the greater the level of profitability of the company, the greater the opportunity for income smoothing, but with the quality of the audit, the auditor as one of the keys (key success factors) in controlling the organization's operations will reduce the opportunity for income smoothing.

These results support previous studies by (Setyaningsih, R et al., 2021; Purnamasari & Fachrurrozie 2020; Sasvinorita & Meini., 2023; Safittri, W., et al. 2023; Yoewono & Verenathan 2023; Islak, et al. 2019; Rasinih & Munandar, 2016; Roslita, E., & Daud, A. 2019). High audit quality can also detect income smoothing actions carried out by management, so that managers will tend to limit the amount of income smoothing they want to do. The better the quality of the auditor, the lower the income smoothing practices carried out by the company. This is also in accordance with research conducted by Tussiana & Lastanti (2018) which states that audit quality weakens the relationship between profitability and earnings management.

The Effect of Leverage on Income Smoothing is Moderated by Audit Quality

The results of the analysis show that the audit quality variable is a moderating variable that weakens the positive effect of leverage on income smoothing. This result means that the high practice of income smoothing due to high profitability will decrease the practice of income smoothing if the company has high audit quality. This is because the audit can help manage errors that occur in the company, such as the discovery of a high level of leverage that can be caused by errors in the company's financial management or the strategy used is not appropriate by management so that the audit process can run smoothly. corrected. When management will carry out earnings management practices, it is limited by strict supervision from the auditor so that these errors can be resolved, the impact is that the company's performance and image are getting better in the eyes of shareholders and the public (Rismawati & Setiany, E., 2023).

The results of this study are in accordance with agency theory which states that managers have information asymmetry towards external parties of the company such as creditors and investors which occurs when managers have more internal company information than external parties. Referring to the use of the risk averse assumption, investors and creditors want to invest or lend their capital if the company has a high leverage ratio. This condition can make managers use the information they know to manipulate financial reports to retain investors by taking income smoothing actions.

Furthermore, the results of the study on income smoothing influenced by leverage are supported by behavioral accounting theory. According to behavioral accounting theory, behavioral aspects in financial reporting include income smoothing behavior and the reliability of accounting information and the relevance of accounting information for investors. Income smoothing is part of earnings management caused by management having private information for their own benefit. The level of leverage can affect management's actions in carrying out income smoothing actions, but with the quality of the audit, the auditor as one of the keys (key success factors) in controlling organizational operations will reduce the chances of income smoothing.

The results of this study are in line with Gusmiarni, Desnirita, & Soeparyono (2020). showed that the moderating variable of Audit Quality does not affect and weakens the relationship between Leverage and Earnings Management. High auditor quality or audited by Big 4 KAP, does not necessarily suppress the earnings management behavior carried out by the company. This is because managers have more information about the company than outside parties as described in information asymmetry, thus providing managers with the freedom to carry out earnings management (Nurjannah & Daulay 2019).

CONCLUSIONS

The results of the analysis show that profitability does not have a significant effect on income smoothing. This means that the high or low profitability of the company will not affect the existence of income smoothing in the company. Leverage has a positive and significant effect on income smoothing. This means that the higher the leverage, the higher the income smoothing carried out by the company. Audit quality weakens the effect of profitability on income smoothing. This result means that the high practice of income smoothing due to high profitability will further reduce the practice of income smoothing if the company has high audit quality. Audit quality weakens the effect of leverage on income smoothing. This result means that the high practice of income smoothing due to high leverage will further reduce the practice of income smoothing if the company has high audit quality.

Based on the analysis results, audit quality needs to be optimized because it will have a significant impact on reducing income smoothing in manufacturing companies in the basic and chemical industry sectors, because these variables can weaken the influence of leverage and profitability on income smoothing. The limitation of this research is that it only conducted testing for four years of the research period, so that the R Square value obtained tends to be small, which is 19.2 percent, so to obtain more accurate test results with a high R Square value, it is recommended for further researchers to add years of research period or conduct research on other manufacturing company sectors besides basic chemical industry manufacturing.

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