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THE EFFECT OF INCOME SMOOTHING ON LOAN LOSS PROVISIONS WITH AUDIT QUALITY AS A MODERATING VARIABLE: INDONESIA EVIDENCE

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Abstract: *The purpose of this study is to prove whether there is an effect of income smoothing on loan loss provisions in Islamic banks in Indonesia and aims to see whether audit quality in Islamic banks in Indonesia can strengthen or weaken the impact of income smoothing on LLP. The dependent variable LLP in this research divides into three, (i) LLP of Islamic Banks, (ii) LLP of sale and purchase agreements, and (iii) LLP of partnership contract agreements. The sample in this study was Islamic banks in Indonesia from 2013 to 2018. The methodology in this study was panel data regression analysis (panel regression analysis) and Moderate Regression Analysis (MRA). The results of the analysis are, first income smoothing has a significant positive relationship with the dependent variable LLP of Islamic banks. Second income smoothing has a significant relationship with the dependent variable LLP sale and purchase agreement, and LLP in the partnership contract agreement. Third Audit quality undermines the relationship weaken Islamic bank income smoothing and LLP, LLP sales and purchase agreements, and LLP partnership contract agreements.*

Keywords: Loan loss provisions, Income smoothing, Banks, Islamic banking

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Introduction

Indonesia is a country with the largest Muslim population in the world. Quoted from Miller (2009) today, the Muslim population in Indonesia reaches approximately 207 million. The large number implies that around 13% of Muslims in the world live in Indonesia. The majority of the Muslim population in Indonesia lives on several islands such as (i) Sumatra, (ii) Java, (iii) Kalimantan (coastal areas), (iv) Sulawesi, (v) Lombok, (vi) Sumbawa, and (vii) Maluku. The establishment of Bank Muamalat Indonesia in the 1990s in Indonesia became a pioneer of intermediary institutions that connected the public to invest and save with sharia principles. Optimally as well as being a solution for Islamic society in avoiding the activities of conventional banks that are in opposition to Islamic norms such as (i) *riba* (ii) speculative activities (*maysir*), (iii) unclear and dubious activities (*ghahar*), illegal activities according to the principle of Islam (*bathil*) and not lawful (*haram*).

Table 1: Credit and NPL of Commercial Banks to Non-Bank Third Parties (billion)

Information	2015	2016	2017	2018
Total loans	3,903,926	4,199,713	4,548,155	5,092,584
Loan growth/years		7.58%	8.30%	11.97%
Total NPL	93,761	120,301	107,891	118,666
NPL growth/ years		28.3%	-10.3%	10.0%

Source: Indonesian Banking Statistics -Vol.17 No.1, December 2018

Table 2: Credit and NPL of Islamic Banks to Non-Bank Third Parties (billion)

Information	2015	2016	2017	2018
Total financing	153,967	177,481	189,789	202,298
Financing growth/years		15.27%	6.93%	6.59%
Total NPF	7,458	7,834	9,030	6,598
NPF growth/ years		5.04%	15.27%	-26.93%

Source: Indonesian Banking Statistics -Vol.17 No.1, December 2018

According to banking statistics published by OJK in 2018, Islamic banks in Indonesia experienced significant total financing growth from 2015 to 2018. Total 2015 Islamic bank loans worth 153,967 billion increased to 202,298 billion in 2018, Islamic banks total financing to increase in 4 years from 2015 to 2018 amounted to 31.39%.

On the other hand, Islamic banks have a significant decline in the graph of bad loans or non-performing financing from 2017 with an NPF value of 9,030 billion to 6,598 billion. Islamic bank NPF decreased in 2018 by 26.93% while conventional banks experienced a 10% increase in bad credit or non-performing loans in 2018. The fact of the difference in the growth of bad loans between conventional banks and Islamic banks strengthened the statement that financing contracts in Islamic banks and conventional banks have a different justification of risk.

Islamic banks have different principles with conventional banks. Based on Indonesia Law No. 10 of 1998, Commercial Banks are financial institutions that carry out business activities conventionally or based on sharia principles, which in their activities provide services in payment traffic. Sharia principles are agreements that are in accordance with Islamic law that refer to the *Qur'an* and *Al-Hadist* between banks and other parties who play a role in financing activities or other activities that are in accordance with sharia principles.

Puromo (2017) stated that there are two general parts of the contract in Islamic banks. First *Tabarru'*, *Tabarru'* is a social contract, which is a contract carried out to help and solely to expect the blessing and reward of Allah SWT, so that in this contract at all there is no element in seeking a return and is not for commercial purposes. *Tabarru*'s contract consists of (i) *Qard*, (ii) *Wadi'ah*, (iii) *Wakalah*, (iv) *Kalafah*, (v) *Rahn*, (vi) *Hibah*, (vii) *Waqf*. The second part is

Tijarah for-profit transactions, which is a contract that is intended to find and get profits where it is harmonious, and all the conditions have been fulfilled.

Tijarah contract is a contract that is generally carried out on Islamic banks. The *tijarah* contract divides into two parts, the first part is natural certainty, namely the sale and purchase contract such as (i) *murabahah*, (ii), *salam*, (iii) *istishna* and (iv) *ijarah* while the second part is natural uncertainty or partnership contract consists of (i) *musyarakah* and (ii) *mudharabah*. Each contract in an Islamic bank has different risk justification and different characteristics. The Islamic Financial Accounting Standards Board (DSAKS) has set the accounting standards of each contract in Islamic Financial Accounting Standards or SAKS.

According to Abdullah (2012), the sale and purchase contract has several risks. First possibility of counterparty risk faced by Islamic banks, especially in *istishna*' contracts and *salam*, risk of transaction failure related to the quality of goods and delivery time. Second default risk, such as the risk of failure of payments by buyers to pay in full or on time. Third risks that arise due to unilateral cancellation of the contract by the buyer or buyer so that the bank must bear the risk. The partnership contract agreement also has several risks divided into three risk groups (i) Funded business risk (Business risk), (ii) Risk of reduced *mudharabah* and *musyarakah* financing (Shrinking risk), (iii) Risk of lousy character from *mudharib* (Character risk).

Loan Loss Provisions (LLP) are reserve funds to faced the risk of losses by the banking industry. LLP reserve to faced risk of loss cause of productive asset activities (Fitriana and Arfianto, 2015). LLP has a relationship with bank financing activities and will have an impact on total credit in the balance sheet.

Development of regulations for commercial banks began in 1988 with the formation of Basel I. Based on Basel I regulations, LLP calculation uses the formula 1.25% of risk-weighted assets on level 2 capital. Basel I regulations provide freedom to regulators in each country to apply percentage limits, which is suitable to be applied in their country. Basel I regulations reap a variety of criticisms because Basel I regulations were too loose, the parties made proposals for changes to regulations to Basel II in 1999. Basel II was published in 2004 and implemented in 2007. After the implementation of Basel II there was a financial crisis in 2007/2008, so Basel II regulation was criticized and demands for amendment. The Basel II amendment to Basel 2.5 changed the way capital was calculated to deal with market risk and increase the percentage of capital. The latest evolution of the Basel Regulations occurred in 2009 with the publication of Basel III regulations. Basel III regulates the provision of LLP based on the system of "expected through the cycle of loan loss provisions." This reserve system anticipates estimated losses and requires banks and financial institutions to set LLP based on creditor characteristics that can describe credit performance, in other words, Basel III regulations provide flexibility to determine the estimated loss reserves at each bank.

Indonesia has implemented the establishment of LLP based on PSAK 55 regulations (revised 2006). The establishment of LLP aims as a substitute for PPAP (Penyisihan Pencadangan Aset Produktif) specifically to improve the prudent banking principle. The primary difference between the LLP and PPAP is the principle of establishing these two provisions. The establishment of the PPAP is Rule-Based, regulations issued by Bank Indonesia decide making provision is in accordance with the percentage set for each credit quality of the charge. On the

Volume:6 Issues: 32 [March, 2021] pp. 96 - 111]
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other hand, the establishment of an LLP provision is carried out based on the Principle-Based so that banks can only form an LLP provision if there is objective evidence that the debtor is experiencing impairment or a decrease in credit value. The mechanism for establishing an LLP provision is contained in PBI No. 14/15 / PBI / 2012. The establishment of an LLP is based on an evaluation by each bank of its debtors, this results in each bank has a different policy informing the provision of reserves.

Some literature has discussed the relationship between earnings management and LLP in the banking industry. Othman and Mersni (2014) prove that the primary motivation of bank managers in conducting revenue management is to minimize income volatility in a certain period. Income smoothing and LLP studies in Australia have been conducted by (Cummings and Durrani, 2016). The results of the study state that (i) banks increase reserves to anticipate credit growth in the future, (ii) banks make a partial allocation of profits from capital investment to form reserves of credit losses in the future and (iii) banks do income smoothing high. Some studies that support the statement that banks use LLP as a tool for conducting income management in the long run (Anandarajan, *et al.*, 2003; Laeven and Majnoni, 2003; Taktak, 2011; Taktak, 2013; Ali *et al.*, 2015; Curcio *et al.*, 2015; Ozili, 2017; Ozili and Outa, 2018; Wijayanti and Diyanty, 2017; Abu-serdaneh 2018; Yaziz *et al.*, 2018; Simper, *et al.*, 2020). This research found several studies with different results stating that bank managers did not use LLP as an earnings management practice (Ahmed, *et al.*, 1999; Leventis, 2013; Adzis *et al.*, 2016; Beatty *et al.*, 2020).

This study uses audit quality variables as moderating variables. Kanagaretnam *et al*. (2010) state that there is a negative relationship between audit quality and LLP. Ozili (2017) states that the audit statement from the auditors of The Big 4 has superior quality and can hinder income smoothing activities.

The purpose of this study is to prove the effect of income smoothing on LLP and aim to see whether audit quality in Islamic banks in Indonesia can strengthen or weaken the relationship between income smoothing and LLP. The dependent variable in this study is divided intone the main dependen variabel and two additional dependen variabels, namely (i) the variable LLP of the Islamic bank, (ii) the variable LLP in the sale and purchase agreement, and (iii) the dependent variable in the partnership contract agreement. The general LLP variable is a provision established to overcome the risk of capital investment activities in Islamic banks. Second dependent variable is the LLP in the sale and purchase contract, which is the provision of buying and selling contract activities such as contracts (i) *murabahah*, (ii), *salam*, (iii) *istishna* and (iv) *ijarah*. The third dependent variable is the LLP in the partnership contract, namely the provision established to deal with the risks of the partnership contract activity consisting of (i) m*usharaka* and (ii) *mudharabah*.

Development of Hypotheses

Income Smoothing against LLP

The flexibility in determining LLP gets a response from company managers to utilize LLP as a means of income smoothing activities. According to Warsidi and Pramuka (2007), based on agency theory, principals are interested in increasing financial results or the value of their investments in the company. Whereas the agent is assumed to receive financial compensation with the provisions accompanying the realization of compensation. The interests of each party in the agency contract are one of the factors that cause income smoothing behavior.

Income smoothing occurs when managers have a keen interest in managing income to look good financially. There are several motivations for making income smoothing. First, the research of Anandarajan *et al.* (2003) has proven that the capital market creates a profit for banks to smooth the reported income. The purpose of this view is that if smooth earnings can reduce earnings variability, low-profit variability will affect stock price fluctuations and have an impact on reducing stock return volatility while investors prefer lower stock return volatility.

Second, the cause of income smoothing behavior is the need to avoid oversight by regulators and political commentators on company profits. Income smoothing behavior is also for leveling profits, mainly large profits that report excessive profits (Burgstahler and Dichev, 1997). Third, Marciukaityte and Park (2009) research state that bank competition is also a motivation for income smoothing behavior. The short term impact of income smoothing in a competitive environment is that it can help companies look prosperous, while the long term impact of income smoothing behavior can reduce a company's ability to compete.

Ozili (2017) examined the practice of establishing loan loss provisions in European banks during the period 2004 to 2013. The results of the study stated that banks in Europe practice earnings management. Ozili (2017) investigated the relationship of loan loss provisions with income smoothing, audit quality and procyclicality to banks in Africa, the results of the study stated that banks in Africa did income smoothing and were procyclical, on the other hand, audit quality variables had no relationship to LLP.

Taktak (2011) testing income smoothing activities using loan loss provisions in 79 Islamic banks in 19 countries during the period 2001 to 2006. The results of this study proved that 70% of Islamic banking in the study carried out income smoothing activities. Ali *et al.* (2015) analyzed the relationship of loan loss provisions to capital management, earnings management and signaling in 12 conventional banks and 4 Islamic banks in Malaysia during the period 1996 to 2011, the results of this study proved that Islamic banks carry out income smoothing activities.

Based on the results of previous studies there is a positive relationship between income smoothing and LLP, the higher the income smoothing value indicates the higher utilization of LLP to reduce the impact of poor financial performance. So that in this study, the hypotheses that the researchers submitted were as follows:

H1: There is a positive relationship between income smoothing and LLP

The difference of Income Smoothing Relationship to LLP in Sharia Bank by The Contract.

Rafsanjani (2016) states that the *Fukhaha* have classified the *Tijarah* contract in the books of *fiqh* in accordance with the forms of financial contract known from the beginning of the application of Islamic Sharia at the time of Prophet Muhammad SAW so that the grouping can be used as a reference for developing financial contracts in accordance with sharia principles. Rafsanjani (2016) classifies the *Tijarah* contract into two parts. First, the sale and purchase agreement consisting of (i) *Salam*, (ii) *Istishna'*, (iii) *murabahah*, (iv) *Ijarah*, (v) *Ba'i Al-Wafa*, (vi) *Ba'i Bidhamanil Ajil*, (vii) *Ba'i Inah*, (viii) *Ba'i Tawarruq*, (iix) *Ba'i Al-Dayn*. Second, the partnership agreement includes (i) *mudarabah*, (ii) *Musyarakah*, (iii) *Muzara'ah*, (iv) *Musaqah*, (v) *Mugharasah*.

The characteristics of a sale and purchase agreement are carried out in connection with the transfer of ownership of goods or objects (transfer of property). The level of bank profit in the sale and purchase contract is determined at the beginning and becomes part of the price of the goods sold. The form of sale and purchase agreement applied to Islamic banks in Indonesia generally consists of (i) *Murabahah*, (ii) *Salam*, (iii) *Ishtisna* and (iv) *ijarah* (Purnomo, 2017). Characteristics of partnership contracts or agreements of cooperation between fund providers and fund managers with an agreement to share profits and losses of funds. The partnership agreement contained in Islamic banks consists of (i) *musyarakah* and (ii) *Mudharabah*.

According to Abdullah (2012), the sale and purchase agreement has several risks. First, there is a possibility of counterparty risk faced by Islamic banks, especially in *istishna'* contracts and *salam*, there is a risk of transaction failure related to the quality of goods and delivery time. Second, Risk of default (default risk), namely the risk of failure of payments by buyers to pay in full or on time. Third, Risks that arise due to unilateral cancellation of the contract by the buyer or buyer so that the bank must bear the risk. The partnership contract agreement also has several risks divided into three risk groups (i) Funded business risk (Business risk), (ii) Risk of reduced mudharabah and musyarakah (Shrinking risk) financing, (iii) Risk of lousy character from mudharib (Character risk)

Based on the description of differences in characteristics and risks in the sale and purchase contract and partnership agreement above, hence there are different characteristics and risks in the two groups of contracts, so the second hypothesis in this study is as follows:

*H*2: There is a difference in the income smoothing relationship with LLP in the sale and purchase contract agreement compared to the partnership contract agreement.

Audit Quality as a Moderating Variable

Auditor quality in this study was measured based on the size of the Public Accounting Firm. Size of the public accounting firm in this study divides into two. They are Big 4 and Non-Big 4. There were four auditor companies included in the big four groups such as Deloitte Touche Tohmatsu, Ernst & Young Global, KPMG International, and Pricewater Coopers (Darwin, 2012). Ozili (2017) states that the audit statement from the auditors of The Big 4 has superior quality and can hinder income smoothing activities.

Good audit quality is expected to weaken income smoothing activities in Islamic banks in Indonesia. So that audit quality is predicted to reduce income smoothing actions. Based on the description above, the hypothesis related to audit quality in Islamic banks is :

*H*3: Audit quality in Islamic banks weakens the income smoothing relationship with the LLP.

Volume:6 Issues: 32 [March, 2021] pp. 96 - 111]
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Data and Methodology

Data

The population in this study were all Islamic banks in Indonesia during the period 2013 - 2018.

Table 3: Sharia Bank List 2013-2018 As a Research Sample

No.	Company
1.	BCA Syariah
2.	BNI Syariah
3.	BRI Syariah
4.	Jabar Banten Syariah
5.	Maybank Syariah
6.	Muamalat Indonesia
7.	Panin Syariah
8.	Bukopin Syariah
9.	Syariah Mandiri
10.	Syariah Mega Indonesia
11.	Victoria Syariah
12.	Tabungan Pensiunan Nasional Syariah

Source: Bank Indonesia

The data used in this study are secondary data obtained from the company's website and the Indonesia Stock Exchange website. The data collection method used in this study is the documentation method. The documentation method in this study is to collect company financial statement data obtained on each company website and collect gross domestic product data or Indonesian GDP obtained from the world bank website.

Methodology

The analytical method used to test the hypothesis in this study is panel data regression (panel regression analysis) and moderate regression analysis (MRA). Ghozali (2011) aims at moderating regression analysis to find out whether the moderating variable will strengthen or weaken the relationship between the independent variable and the dependent variable. Data in this study were processed using Eviews version 9 software.

This study uses two models. Model one is a model used to test the effect of income smoothing on LLP. Model two is a model that is used to test the role of moderating variables, namely audit quality in influencing the income smoothing relationship with LLP. Then it can be formulated as follows:

Model

$$LLP_{it} = \alpha + \beta_1 IS_{it} + \beta_2 CAR_{it} + \beta_3 NPF_{it} + \beta_4 NIM_{it} + \beta_5 LDR_{it} + \beta_6 BOPO_{it} + \beta_7 GDP_{it} + e_{it}$$

Information:

Volume:6 Issues: 32 [March, 2021] pp. 96 - 111]
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LLP_{it}	: reserve for LLP divided by total assets
αIS_{it}	: earning before tax and provision divided by total assets
$\alpha BIG4_{it}$	: Dummy for the type of independent auditor company. 0 if the auditor not in The Big 4
αCAR_{it}	: capital ratio level 1 divided by risk-weighted assets
αNPF_{it}	: Non-performing financing divided by total credit
αNIM_{it}	: Net interest income divided by average earning assets
αLDR_{it}	: Total credit divided by total deposits + capital
$\alpha BOPO_{it}$	: Total operating expenses divided by total operating income
αGDP_{it}	: Real GDP growth
e_{it}	: error

Results and Discussion

Descriptive analysis

This study conducted a descriptive analysis of several variables. First, the dependent variable is the LLP in the Islamic Bank. Second, the variable independent is income smoothing. Third, the moderating variable is audit quality (BIG 4). Fourth, the control variable consists of capital adequacy ratio, non-performing loan, net interest margin, loan to deposit ratio, operating expense to income, gross domestic product. Descriptive analysis in this study was carried out from 2013 to 2018.

Table 4: Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
LLP Islamic Banks	70	-0.0081	0.0878	0.0124	0.0156
LLP Sale& Purchase	70	0.0000	0.2700	0.0289	0.0370
LLP Partnership	70	0.0000	0.2113	0.0220	0.0367
EBTP	70	-0.2309	0.0134	0.0160	0.0494
CAR	70	0.1110	0.8592	0.2269	0.1396
NPL	70	0.0000	0.2204	0.0402	0.0366
NIM	70	0.0080	0.1828	0.0740	0.1045
LDR	70	0.7187	1.0540	0.8994	0.0755
BOPO	70	0.6240	1.4330	0.9115	0.1262
GDP	70	0.0490	0.0560	0.0512	0.0022
Variabel	**N**	**Minimum**	**Maximum**	**Modus**	**Std. Deviation**
The Big 4	48				
Non the big 4	22				
Valid N	70	0.0000	1.0000	1.000	0.4675

Information:
IS = Income smoothing, BIG4 = audit quality, IS * BIG4 = independent variable IS and Moderate Audit Quality Variable, CAR = capital adequacy ratio, NPL = Non performing loan, NIM = Net interest margin, LDR = Loan to deposit ratio, BOPO = Operating costs against operating income, GDP = Gross domestic product.

Source: Publication report, which is processed

Volume:6 Issues: 32 [March, 2021] pp. 96 - 111]
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Table 4 shows the maximum LLP ratio of partnership contracts in 70 observations of 21.1%. LLP value is determined by the bank manager if there is objective evidence. Several previous studies revealed that the magnitude of LLP value of a bank could signal to investors about the level of the bank's ability to deal with credit risk. The maximum LLP ratio of a sale and purchase contract is 27% and an average of 2%. The average LLP ratio of buying and selling agreements is higher than the average LLP ratio of partnership contracts by conditions in Indonesia, Islamic banks tend to be more active in providing LLP service products for sale and purchase contracts compared to LLP partnership contracts.

The ratio of earnings before tax and provision (EBTP) to Islamic banks reaches a maximum value of 1.3%, while the audit quality score reaches an average of 0.016 with a maximum value of 0 and a minimum of 1 so that it can conclude that most Islamic banks in Indonesia already have good audit quality. Following BI regulation No. 06/10 / PBI / 2004, the percentage of minimum CAR is 8%. The average CAR of Islamic banks in the period 2013-2018 was 22.7%, and all Islamic banks in Indonesia had reached the minimum set by BI.

Non-Performing Loans or NPLs are the credit ratios obtained by comparing the total non-performing loans with the total loans disbursed. The maximum NPL value in this study was 22.04%. Bad credit interest rates are considered healthy if below 5%. A high NPL value in a company can describe a bank that has a large financial risk. Net Interest Margin is the ratio specified in Circular Letter No. 3/30 / DPNP as a ratio that measures bank profitability. The average NPL value in Islamic banks is 0 , 0402 or 4.02% with a standard deviation of 3.66%. Descriptive analysis testing on the third control variable, namely *net interest margin* or NIM shows a minimum value of 0 , 0080 or 0.8% with a maximum value of 18.28%. The test results show that the NIM of Islamic banks in Indonesia during the 2013-2018 period showed a value of 7.4% with a standard deviation of 10.45%.

Loan to Deposit Ratio is used as an indicator of a bank's liquidity in meeting short-term or maturing obligations. The recommended percentage of LDR in PBI ranges from 85% - 100 %. the lowest LDR value is 0.7187 or 71.87%, which is at Islamic banks in 2017, while the maximum value is 1.1054 or 110.54%. The average LDR at Islamic banks is 89 , 94 with a standard deviation of 7.55%. BOPO variable test results showed a minimum supply of 0 , 6240 or 62.4%, while a maximum value of 1.4331 or 143.31%. The average BOPO of Islamic banks from 2013 to 2018 was 91.15% with a standard deviation of 12.62%.

The growth rate of gross domestic product is denoted by ΔGDP. ΔGDP is not only used to control business cycle fluctuations but is also used as a proxy for procyclicality. The average GDP value of 0.0512 or 5.1% with a maximum value of 5.6% in 2013 and a minimum value of 0.49 or 4.9% in 2015. BIG 4 is a variable that indicates the audit quality of the study sample. Determination of the value of audit quality using a dummy variable with number 1 indicates the audit quality is good (The Big 4) and 0 indicates the audit quality is not good (non the big 4). Descriptive analysis test results show that the value 1, the big 4 is the most common value that appears in testing mode.

Volume:6 Issues: 32 [March, 2021] pp. 96 - 111]
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Income smoothing and LLP in Islamic Bank

The t-test or partial test is conducted to determine whether there is an individual or partial influence of the independent variables on the dependent variable in this study. The test results show that the independent income smoothing variable has a significant positive effect on the LLP dependent variable on Islamic banks in Indonesia during the 2013-2018 period.

Table 5 Test Results Variable Dependent LLP of Islamic Banks

Variabel	CKPN Islamic Banks	LLP Sale& Purchase	LLP Partnership
EBTP	0.211638 ***	0.390123**	0.227503*
	(2.528581)	(2.120558)	(1.815809)
CAR	-0.003089	-0.153116*	-0.010402
	(-0.056854)	(-1.850956)	(-0.019376)
NPL	0.131911*	-0.083300	0.136091
	(1.909695)	(-0.508593)	(0.380587)
NIM	0.190745**	0.046356	-0.379407
	(2.119665)	(0.271702)	(-1.321807)
BOPO	-0.035920	0.138392**	1.739012
	(-0.538671)	(1.343543)	(1.482792)
GDP	0.780255	-0.369357	0.287543
	(1.258267)	(-0.656285)	(0.345904)
C	0.046774	0.032419	-1.476724
	(0.854932)	(0.388126)	(-0.903810)
Total obs.	**72**	**72**	**72**

Information:
***** = significance at the level of 1%. ** = significance at the level of 5%. * = significance at the level of 10%.**
IS = Income smoothing, BIG4 = audit quality, IS * BIG4 = independent variable IS and Moderate Audit Quality Variable, CAR = capital adequacy ratio, NPL = Non performing loan, NIM = Net interest margin, LDR = Loan to deposit ratio, BOPO = Operating costs against operating income, GDP = Gross domestic product.
Source: Publication report, which is processed

Income smoothing practices through CKPN in Islamic banks

Table 5 shows the significance value of the EBTP variable with the three dependent variables. T test results on the independent variable EBTP and Islamic bank LLP as dependent variable have a significant effect with a significance level of 1 % . Table 5 shows that the EBTP variable has a coefficient value of 0.211638 with a positive significance direction. It was concluded that EBTP had a positive effect on LLP of Islamic banks, each increase of 1% of EBTP would increase the LLP of Islamic banks by 21 ,1 %. The results of this test indicate that Islamic banks use LLP as a means of income smoothing. Every 1% increase in income smoothing will affect increasing LLP by 21.1%. Several previous studies support the results of this study. Taktak (2011) proves that 70% of 76 Islamic banks in 19 countries carry out income smoothing activities. Ali et al. (2015) conducted a study on 14 conventional banks and 4 Islamic banks in Malaysia between 1996 and 2011. The results of this study proved that Islamic banks carry out income smoothing activities using loan loss provisions. Ozili (2017) states that banks in Europe practice earnings management in the formation of Provision Loan Loss.

Volume:6 Issues: 32 [March, 2021] pp. 96 - 111]
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Differences Influence of Income Smoothing Against LLP Contract *Tijarah* Purchase and LLP Contract *tijarah* Partnership

T test results of EBTP as the independent variables and LLP as the dependent variable in purchase significant influence with significance level of 5% , while the dependent variable contract *tijarah* partnership with a significant influence 10% significance level . Table 5 in the LLP of the sale and purchase agreement shows that the EBTP variable has a coefficient of 0.390123 with a positive significance direction. The results of the analysis state that EBTP has a positive effect on LLP of the sale and purchase agreement, each increase of 1% of EBTP will increase LLP of Islamic banks by 39 %. The EBTP variable in the LLP column of the partnership *tijarah* agreement shows a value of 0.227503 with a significance level of 10%. The results of the analysis state that there is a variable EBTP that has a potential effect on the LLP of the partnership *tijarah* agreement , each increase of 1% EBTP, the LLP of the partnership *tijarah* agreement will increase by 22.7%.

The results of this test show that there is a significant positive effect with different levels of significance, so it can be concluded that income smoothing activities in Islamic banks and the two groups of *tijarah* contracts in Islamic banks. The results of this study are in accordance with previous research Ozili (2017) that banks use LLP to increase or decrease profits in order to reduce fluctuations in corporate profits.

The test results of table 4.12 show that the CAR variable as a control variable has a probability value above 10%. The analysis result states that CAR has no effect on LLP. *Non-Peforming Loan* or NPL control variables and *net interest margin* or NIM have coefficient values of 0.190745 and 0.190745 with significance values of 10 % and 5% , so it can be concluded that NPL and NIM variables have a positive effect on LLP of Islamic banks. . NPL is a ratio of bad loans, the results of this analysis state that an increase in bad loans to Islamic banks is related to an increase in LLP. S ach 1% increase in NPLs then an increase LLP Islamic banks by 13.2% , while the NPL and LLP test results on the second contract in this study stated there is no significant relationship.

NIM or *net interest margin* is a ratio that is used to measure the profitability of the banks. The analysis result states that there is a positive significant relationship between profitability and LLP. If bank profitability increases, there is a large turnover of funds , so that it will affect the formation of bank losses. Each increase of 1% NIM then sya bank LLP Riah will increase by 19%. The variable *net interest margin* , *loan to deposit ratio and Gross domestic product* in this study have a probability value exceeding the 10% and 5% significance limits , so this test proves that the NIM , LDR and GDP variables do not affect the dependent variable LLP of Islamic banks .

Regression analysis Table 5 that states there is no difference in the relationship between *income smoothing* of the *contract tijarah* purchase and *contract tijarah* partnership strengthened by the results of the test *chow* . Ghozali (2018) states the *chow* test formula is as follows.

$$\mathrm{F} = \frac{(RRS_1 - RRS_2)/k}{(RRS_2)/(n1 + n2 - 2k)}$$

Information:

N : Number of observations,

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K : Number of categories,
: Residual sum of squares category 1, and
: Residual sum of squares category 2.

The hypothesis in this test is as follows:
H 0: β 1 = 0 (there is no difference in the relationship between income smoothing and LLP in the sale and purchase agreement and partnership agreement contracts)
H 1: β 1 ≠ 0 (there is a difference in the relationship between income smoothing and LLP in the sale and purchase agreement and partnership agreement contracts)

Guidelines that will be used in drawing conclusions of the chow test are as follows:
a. If the value $F_{count} < F_{table}$ means H0 is accepted.
b. If value $F_{count} > F_{table}$ means H 0 is rejected.
The test results using the Chow Test formula are explained as follows.

$$F = \frac{(0{,}316576 - 113{,}7364)/2}{113{,}7364/(72+72)-4}$$

$$F = \frac{-56{,}692000}{0{,}812143}$$

$$F = -69{,}805453$$

The *chow* test results show that the calculated F value obtained a value of -69 , 80 with an F table value of 3.98 (df 1 = 1, df 2 = 70) at a significance level of 5%. Calculated F value <F table value, so it can be concluded that there is no difference in the relationship of income smoothing to LLP in the sale and purchase agreement and partnership agreement contracts .

Audit Quality in Islamic Banks Accommodates The Income Smoothing Relationship with LLP.

To test the third hypothesis of this study using sub-group analysis. The results of the sub-group analysis are explained in the following table:

Table 6: ***Homogizer* Moderation Regression Results**

Model	Beta coefficient			Prob. F-stat	F		SSR
1	0,194 * (4,155)			0,000	17.26	.2002	0.084
2		.158 * (3,16)		0.002	9.97	0.1750	0.064
3			1,065 * (12.18)	0,000	148.3 6	.8812	0.003
N	71	49	22				

Source: Data processing output with r*eviews* version 10

Test results in the table above the R-Squared value between model 2, the company audited by T he B ig 4 and model 3 , the companies audited by Non T he B ig 4 . The R-Squared value of the company audited by T he B ig 4 is 0.1750 or 17.5%, while the company that is not audited by The Big 4 has an R- Squared value of 0.8812 or 88.1%. This means that the influence of income smoothing on LLP in Islamic banks is stronger in companies that are not audited by The Big 4 compared to companies that have audited the Big 4 .

The second way to determine the direction of the influence of moderation is to do subgroup regression using the Chow test . The test results using the Chow Test formula are explained as follows:

$$F = = \frac{0{,}084976-(0{,}064071+0{,}002999)/_{2}}{(0{,}064071+0{,}002999)/_{71-4}}$$

$$F = \frac{0{,}0089}{0{,}001}$$

$$F = 8{,}943656$$

Chow test states that the value of F count obtained at 8.943656 to the value of F table 3 , 39 (DF1 = 1, DF2 = 69) at the 5% significance level. Calculated F value > F table , so it can be concluded that the audit quality variable weakens the relationship of *income smoothing* and CKPN of Islamic banks.

Conclusion, Implications, Limitations and Sugestion

Conclusion

The purpose of this study is to prove whether the islamic bank in indonesian using LLP as a tool in the activity income smoothing and to determine whether the quality of the audit on the islamic bank in indonesia can weaken the relationship between income smoothing and LLP. This research using the secondary data from financial report of islamic bank period 2013 to 2018. Based on data processing, three conclusions were obtained. First, there is a positive influence between income smoothing and LLP of islamic banks. Second, there is no difference between the effect of income smoothing on LLP contract tijarah sale and partnership and the effect of income smoothing on LLP of contract tijarah partnership with directions signification positive.

Third, the results of the analysis of sub-grups by using a method of analysis of regression moderation homogizer and the chow test stated that variabel audit quality weaken the relationship income smoothing and CKPN in islamic banks.

Implications

The results of the research it provides implications:

1. LLP is a reserve which is formed by the manager as principles of prudence in the face of risk or as pudent banking principles. Islamic bank is a bank that is trusted by most large public indonesia as an intitution intermediary which drain investing public with the principles of sharia are optimal as well be a solution for the people of Islam in avoiding the activity of banks conventionally are bersebrangan with the norms of Islam such as (i) *riba* (ii) activities of speculative (*maysir*), (iii) activities that are not clear and doubt (*ghahar*), activities which are not valid according to the principles of Islam (*false*) and is not *kosher* (*unclean*). The result of this study reveal that thre is incom smoothing activity in islamic bank by utilizing LLP. Activities *income smoothing* that occurs may be just including the activity of usury which is forbidden by the fatwa DSN-MUI which is set in the year 2012 related to the method of smoothing earnings or *income smoothing* fund the third .

2. Results of the study is to prove that the audit quality weaken the relationship between income smoothing and LLP in islamic bank, regard this indicates that the KAP quality tend to have a source of power human or human -quality high that can detect the presence of *fraund* are contained in the report of financial clients.

Limitations

DSN-MUI has formed *fatwa* which regulate the method of smoothing earnings or income smoothing fund the third DSN-MUI *Fatwa* 87/DSN-MUI/XII/2012 state that the method of smoothing earning in agreement *mudharaba* not be done if implementation lead to a tendency practice of usury shrouded in which the rewards are given no attention to the result of the real. This research does not study further related whether income smoothing accurs in the *mudharaba* contract.

Suggestion

Based on into infinity in the research and the limitations that have been disclosed , the advice given researchers are as follows this :

1. Researchers in the future that will come need to search more about the intent of the behavior of *usury* which are not allowed to be done in accordance with the DSN-MUI which is set in the year 2012 regarding the method of smoothing earnings or *income smoothing* fund the third.
2. Researchers suggest to the DPS to provide care that is more related to the recording of statements finance in particular the establishment of CKPN. It it is based on the principles of sharia which avoids the practice of usury in the *agreement mudaraba* .

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