INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN BUSINESS & SOCIAL SCIENCES
Vol 16, Issue 9, (2026) E-ISSN: 2222-6990

The Moderating Role of Political Connections on the Relationship between Internal Audit Function and Earnings Management in Saudi-Listed Companies

Naif Obaid T. Aldhafeeri*, Maheran Zakaria, Murugan Batumalai
Lincoln University College, Malaysia
*Corresponding Author Email: naif-obaid2011@hotmail.com

DOI Link: http://dx.doi.org/10.6007/IJARBSS/v16-i9/29057
Published Date: 21 September 2026

Abstract
This study examines whether political connections condition the effectiveness of the internal audit function (IAF) in constraining earnings management (EM) among Saudi-listed non-financial companies. Drawing on agency theory and resource dependence theory, the study conceptualises IAF as an internal governance mechanism that reduces information asymmetry and managerial opportunism. At the same time, political connections represent an external resource and power mechanism that may weaken the disciplinary consequences of formal governance. The study adopts a quantitative, cross-sectional survey framework involving chief audit executives, internal audit managers, and senior finance officers. The source manuscript reports 132 usable responses and applies mean-centred ordinary least squares regression, interaction analysis, simple-slope analysis, bootstrapping, and Johnson–Neyman analysis. Importantly, the numerical results are simulated rather than obtained from verified empirical observations. Within the simulation, IAF is negatively associated with EM ($\beta = -0.421$, $p < .001$), political connections are positively associated with EM ($\beta = 0.238$, $p < .001$), and the IAF × PC interaction is positive and significant ($\beta = 0.176$, $p = .004$). The interaction adds 3.5% to explained variance. Simple slopes show that the negative IAF–EM relationship is strongest at low political-connection levels ($\beta = -0.597$) and weakest at high levels ($\beta = -0.245$), an attenuation of approximately 59%. The study contributes a contextual governance perspective by proposing that formal internal controls may operate differently under strong informal political embeddedness.
Keywords: Internal Audit Function, Political Connections, Earnings Management, Corporate Governance, Agency Theory, Resource Dependence Theory, Saudi Arabia

Introduction

Corporate governance mechanisms are designed to reduce conflicts arising from the separation of ownership and control and to strengthen accountability in financial reporting. Within this architecture, the internal audit function assures internal controls, risk management, and governance processes and can therefore constrain opportunistic managerial reporting (Fama & Jensen, 2019; Grant, 2017). Earnings management is important in this context because managerial discretion over accounting choices may be used to influence reported performance and stakeholders' perceptions (Beyer et al., 2019).

However, the effectiveness of formal governance may depend on the institutional environment in which it operates. In emerging markets, firms may cultivate relationships with powerful external actors to obtain resources, contracts, financing, and regulatory access. Political connections can therefore create economic benefits while also shifting incentives for corporate monitoring (Claessens et al., 2008; Domadenik et al., 2016).

The source study positions Saudi Arabia as a relevant setting because corporate-governance reforms coexist with continuing political embeddedness in business relationships (Alqahtani, 2020; Zerban, 2017). Previous research has examined internal audit quality and earnings management as well as political connections and earnings management, but the moderating role of political connections in the IAF–EM relationship remains comparatively underexplored (Prawitt et al., 2009; Jihan et al., 2025).

This study consequently examines whether political connections weaken the negative relationship between the internal audit function and earnings management in Saudi-listed non-financial companies. It integrates agency theory, which explains internal audit's monitoring role, with resource dependence theory, which explains the resource and protection benefits associated with political ties.

Problem Statement and Research Gap

The literature generally expects effective internal audit to reduce earnings management by strengthening monitoring, reducing information asymmetry, and increasing the likelihood that opportunistic reporting will be detected. However, formal governance mechanisms may not have equal influence across organisations. Political connections may alter the costs and benefits of managerial reporting decisions because politically connected firms can obtain external resources and may face different levels of scrutiny.

Three strands of literature are particularly relevant. First, stronger internal audit quality has been associated with lower discretionary accruals and more cautious financial reporting (Prawitt et al., 2009). Second, political connections may provide preferential access to finance, contracts, and regulatory resources (Claessens et al., 2008; Luu & Ngo, 2019). Third, political connections have been linked to agency costs and audit-quality considerations (Khan et al., 2016). This gap raises the question of whether political connections alter the effectiveness of internal audit itself.

The study addresses three questions: (1) Does IAF reduce EM? (2) Do political connections increase EM? and (3) Do political connections weaken the negative IAF–EM relationship?

Literature Review

Internal Audit Function and Earnings Management

From an agency perspective, internal audit is a monitoring mechanism that reduces information asymmetry and strengthens the board's capacity to detect managerial opportunism. The source study identifies audit committee effectiveness, internal audit quality, staff qualifications, resources, and compliance monitoring as important elements of an effective IAF. Prior evidence cited in the manuscript links stronger internal audit quality with lower earnings-management indicators (Prawitt et al., 2009).

However, internal audit effectiveness is not independent of organisational conditions. Audit committee competence, regulatory enforcement, management support, and institutional strength can affect whether audit recommendations translate into effective control. In emerging markets, political influence may add another contextual factor (Almaqtari et al., 2020; Kim & Lu, 2013).

H1: Internal audit function negatively affects earnings management.

Political Connections and Earnings Management

Political connections can help firms manage dependence on powerful external actors. They may facilitate access to government contracts, finance, or regulatory support, but these advantages may also create governance costs when political protection reduces market discipline. The source manuscript therefore treats political connections as a double-edged mechanism (Claessens et al., 2008; Khan et al., 2016).

Politically connected firms may face lower expected costs of opportunistic reporting when regulatory or stakeholder pressure weakens. The source study consequently predicts a positive relationship between political connections and earnings management.
H2: Political connections positively affect earnings management.

Political Connections as a Moderator

The central proposition is that political connections reduce the marginal effectiveness of internal audit. When political ties are weak, managers are more dependent on formal monitoring and may face stronger consequences for ignoring internal audit recommendations. When political ties are strong, external protection and access to resources may reduce the perceived costs of non-compliance.

This argument combines agency theory and resource dependence theory. Agency theory explains why IAF should constrain EM, whereas resource dependence theory explains how political embeddedness can change the environment in which that monitoring operates.
H3: The interaction between IAF and political connections significantly affects earnings management.

H4: Political connections moderate the IAF–EM relationship such that the negative effect of IAF on EM is weaker when political connections are strong.

Theoretical Foundation and Conceptual Framework

Agency Theory

Agency theory explains conflicts generated by the separation of ownership and control. Managers may pursue private objectives, including opportunistic financial reporting, when monitoring is imperfect. Internal audit reduces information asymmetry and strengthens oversight, thereby increasing the expected cost of earnings manipulation (Fama & Jensen, 2019; Grant, 2017).

Resource Dependence Theory

Resource dependence theory emphasises organisational dependence on external resources and the strategic relationships firms develop to manage that dependence. Political connections can provide access to government resources and protection. However, the same relationships may generate governance costs if they weaken the disciplinary effects of formal control systems.

Integrated Framework

The framework positions IAF as the predictor, EM as the outcome, and PC as the moderator. The interaction IAF × PC captures the proposition that political embeddedness changes the strength of internal-audit monitoring.

Hypothesis	Relationship	Expected direction
H1	IAF → EM	Negative
H2	PC → EM	Positive
H3	IAF × PC → EM	Positive interaction
H4	PC moderates IAF → EM	Negative effect attenuated at high PC

Methodology

Research Design and Sampling

The study uses a quantitative cross-sectional survey design. The target population comprises non-financial companies listed on the Saudi Stock Exchange (Tadawul), while financial companies are excluded because of their distinctive regulatory and reporting environment. The source study reports that 200 non-financial companies were selected and questionnaires were directed to chief audit executives, internal audit managers, and senior finance officers.

After excluding incomplete responses and outliers, the source manuscript reports 132 usable responses, corresponding to a 66% response rate. The reported sample was considered adequate for a regression model containing IAF, PC, and the interaction term.

Measurement

All constructs were measured on a five-point Likert scale. IAF was represented by eight items covering audit committee effectiveness, internal audit quality, and compliance monitoring. PC was measured with six items concerning ties between board members or executives and government or political entities. EM was represented by seven items focusing on discretionary accruals and income smoothing.

Vol. 16, No. 9, 2026, E-ISSN: 2222-6990 © 2026

Construct	Items	Focus	Source basis
IAF	8	Audit committee; audit quality; compliance monitoring	Prawitt et al. (2009); Grant (2017)
PC	6	Government/political ties; preferential treatment	Luu & Ngo (2019); Jihan et al. (2025)
EM	7	Discretionary accruals; income smoothing	Beyer et al. (2019); Zerban (2017)

Analytical Procedures

The source study assesses reliability and validity using Cronbach's alpha, composite reliability, AVE, the Fornell–Larcker criterion, and HTMT. The authors mean-centred the variables before constructing the interaction term. We then used hierarchical OLS regression to test direct and interaction effects, followed by simple-slope analysis. Robustness checks included 5,000-resample bootstrapping, Johnson–Neyman analysis, and quadratic specifications.

Because the source document explicitly states that the numerical findings are simulated, treat all results in this rewritten article as illustrative until tested with actual observations.

Results

Measurement Properties

The source manuscript reports Cronbach's alpha values of 0.874 for IAF, 0.831 for PC, and 0.856 for EM. Composite reliability values were 0.889, 0.852, and 0.871, while AVE values were 0.534, 0.512, and 0.547. All reported HTMT values were below 0.85.

Construct	α	CR	AVE	HTMT range
IAF	0.874	0.889	0.534	0.374–0.512
PC	0.831	0.852	0.512	0.374–0.443
EM	0.856	0.871	0.547	0.443–0.512

Descriptive Statistics

Reported means were 3.84 (SD = 0.72) for IAF, 3.21 (SD = 0.89) for PC, and 2.95 (SD = 0.81) for EM. IAF was negatively correlated with EM ($r = -0.458$, $p < .001$), while PC was positively correlated with EM ($r = 0.389$, $p < .001$). IAF and PC were positively correlated at a modest level ($r = 0.312$, $p < .01$).

Construct	Mean	SD	IAF	PC	EM
IAF	3.84	0.72	—	0.312**	−0.458***
PC	3.21	0.89	0.312**	—	0.389***
EM	2.95	0.81	−0.458***	0.389***	—

Structural and Moderation Results

The full regression model was statistically significant, $F(3, 128) = 18.472$, $p < .001$, and explained 30.2% of the simulated variance in EM. Adding IAF × PC increased R^2 by 0.035, $F(1, 128) = 6.412$, $p = .004$.

Path	β	SE	t	p	95% CI
IAF → EM	−0.421	0.072	−5.847	< .001	[−0.564, −0.278]
PC → EM	0.238	0.072	3.297	< .001	[0.095, 0.381]
IAF × PC → EM	0.176	0.070	2.532	.004	[0.058, 0.294]

Simple-Slope Analysis

The negative IAF–EM relationship became progressively weaker as political connections increased. At low PC (−1 SD), $\beta = -0.597$ ($p < .001$); at mean PC, $\beta = -0.421$ ($p < .001$); and at high PC (+1 SD), $\beta = -0.245$ ($p = .008$). The difference between the low- and high-PC slopes was $\Delta\beta = 0.352$, equivalent to an approximately 59% reduction in the magnitude of the IAF effect.

PC level	Conditional β	SE	t	p	95% CI
Low (−1 SD)	−0.597	0.112	−5.330	< .001	[−0.819, −0.375]
Mean	−0.421	0.072	−5.847	< .001	[−0.564, −0.278]
High (+1 SD)	−0.245	0.092	−2.663	.008	[−0.427, −0.063]

Robustness Checks

The source study reports that 5,000-resample bootstrapping produced a 95% confidence interval of [0.058, 0.294] for the interaction coefficient. Johnson–Neyman analysis indicated that the negative IAF–EM effect remained significant below approximately 1.84 standard deviations above the mean PC level and became non-significant beyond that point. Quadratic terms for IAF and PC were not significant.

Hypothesis Testing

Hypothesis	Evidence	Decision
H1	$\beta = -0.421$, $p < .001$	Supported in simulation
H2	$\beta = 0.238$, $p < .001$	Supported in simulation
H3	$\beta = 0.176$, $p = .004$; $\Delta R^2 = .035$	Supported in simulation
H4	Slope weakens from −0.597 to −0.245 as PC rises	Supported in simulation

The simulated analysis supports all four hypotheses. H1 indicates a negative IAF–EM relationship, H2 a positive PC–EM relationship, H3 a significant interaction, and H4 a directional moderation in which political connections attenuate the governance effect of internal audit.

Discussion

The simulated pattern is consistent with the theoretical expectations of the integrated framework. The negative IAF–EM relationship is consistent with agency theory because stronger monitoring should reduce information asymmetry and managerial opportunism (Prawitt et al., 2009; Grant, 2017). The positive PC–EM relationship is consistent with resource dependence theory, as political ties provide resources and protection that reduce the expected costs of opportunistic behaviour (Claessens et al., 2008; Khan et al., 2016; Jihan et al., 2025).

The most important result is the moderation effect. The positive interaction coefficient indicates that the negative association between internal audit and earnings management becomes less negative as political connections rise. If replicated with actual data, this would imply that the effectiveness of formal internal governance depends partly on external political embeddedness.

The findings also support a broader institutional interpretation: official governance mechanisms and informal power structures may coexist, and the latter can condition the former's effectiveness. Political connections do not necessarily eliminate internal governance; rather, they may reduce its marginal disciplinary effect.

Theoretical and Practical Implications

Theoretical Implications

The framework extends the agency perspective by emphasising that monitoring effectiveness is conditional, not uniform. It also adds a governance-cost dimension to resource dependence theory: political connections can generate valuable resources while simultaneously weakening internal control effectiveness. More broadly, governance research in emerging markets should consider both formal mechanisms and informal institutions.

Practical Implications

For regulators, the study suggests enhanced transparency concerning political affiliations and government relationships if future empirical evidence confirms the simulated pattern. For audit committees and internal auditors, the findings emphasise independence, professional scepticism, adequate resources, direct board access, documentation, and escalation of significant issues.

External auditors may treat political embeddedness as a governance-risk indicator and apply heightened professional scepticism in areas susceptible to earnings management, including revenue recognition, accrual estimates, and related-party transactions. Investors may likewise consider political connections when assessing financial-reporting risk.
Boards should balance the resource benefits of political connections against their potential governance costs. Conflict-of-interest policies, related-party transaction controls, and safeguards for board independence can help prevent political relationships from weakening financial-reporting oversight.

Limitations

The most important limitation is that the numerical findings are simulated rather than verified empirical observations. Consequently, the coefficients, significance levels, and model-fit statistics cannot be interpreted as evidence about the actual population of Saudi-listed companies.

The cross-sectional design also limits causal inference, while self-reported measures may introduce social-desirability and common-method concerns. The sample is restricted to non-financial Saudi-listed companies, limiting generalizability. In addition, political connections are multidimensional, and survey indicators may not capture their strength, duration, reciprocity, or indirect forms.

Future Research

Future studies should replace the simulated results with actual firm-level observations and combine validated survey measures with archival indicators of earnings management and political connections. Longitudinal designs would strengthen causal inference and permit analysis of changes surrounding governance reforms and political events.

Researchers should distinguish accrual-based from real earnings management and examine whether political ties affect these forms differently. Comparative studies across Saudi Arabia, the United Arab Emirates, Qatar, Malaysia, Indonesia, and other emerging markets could identify institutional boundary conditions.

Qualitative interviews with chief audit executives, internal auditors, audit committee members, and board directors could illuminate mechanisms through which political relationships influence audit independence, escalation of findings, and managerial reporting decisions. Future models may also test board independence, institutional ownership, foreign ownership, Big Four auditing, and executive compensation as complementary or substitutive governance mechanisms.

Conclusion

This rewritten study examines political connections as a contextual factor in the relationship between the internal audit function and earnings management in Saudi-listed non-financial companies. The integrated framework combines agency theory and resource dependence theory to explain why internal audit should constrain earnings management and why political embeddedness may weaken that effect.

The source manuscript’s simulated results show a negative IAF–EM relationship, a positive PC–EM relationship, and a significant positive interaction. The simple-slope pattern indicates that the constraining effect of internal audit is strongest when political connections are low and weakest when they are high. These findings offer a theoretically meaningful illustration of context-dependent governance effectiveness.

Nevertheless, the results must remain explicitly classified as simulated until actual observations are collected and analysed. Empirical validation is essential before using the findings to support regulatory, managerial, or investment decisions.

References

Aiken, L. (1991). Multiple regression: Testing and interpreting interactions. Sage.

Almaqtari, F., Hashed, A. (2020). Impact of corporate governance mechanisms on financial reporting quality. Problems and Perspectives in Management.

Alqahtani, A. (2020). Accounting disclosure and corporate governance mechanisms in the Kingdom of Saudi Arabia. Victoria University repository.

Aouadi, I., Sbai, H., Hussainey, K., Chetouan, I. (2026). Uncovering the association between corporate social responsibility and earnings management in an emerging economy. Journal of Applied Accounting Research.

Beyer, A., Guttman, I., & Marinovic, I. (2019). Earnings management and earnings quality: Theory and evidence. The Accounting Review.

Claessens, S., Feijen, E., & Laeven, L. (2008). Political connections and preferential access to finance. Journal of Financial Economics.

Domadenik, P., Prašnikar, J., & Svejnar, J. (2016). Political connectedness, corporate governance, and firm performance. Journal of Business Ethics.

Estrin, S., & Prevezer, M. (2011). The role of informal institutions in corporate governance. Asia Pacific Journal of Management.

Fama, E., & Jensen, M. (2019). Separation of ownership and control. Corporate Governance.

Grant, B. (2017). The role of internal auditing in corporate governance: A Foucauldian analysis. Accounting, Auditing & Accountability Journal.

Jihan, F., Setiawan, D., & Aryani, Y. (2025). Political connection and real earnings management: The moderating role of audit quality and foreign ownership. Jurnal Reviu Akuntansi Dan Keuangan.

Khan, A., Mihret, D., & Muttakin, M. (2016). Corporate political connections, agency costs and audit quality. International Journal of Accounting & Information Management.

Kim, E., & Lu, Y. (2013). Corporate governance reforms around the world and cross-border acquisitions. Journal of Corporate Finance.

Luu, N., & Ngo, L. (2019). Entrepreneurial orientation and social ties in transitional economies. Long Range Planning.

Peterson, R., & Kim, Y. (2013). On the relationship between coefficient alpha and composite reliability. Journal of Applied Psychology.

Podsakoff, P., MacKenzie, S., Lee, J. (2003). Common method biases in behavioural research: A critical review and recommended remedies. Journal of Applied Psychology.

Prawitt, D., Smith, J., & Wood, D. (2009). Internal audit quality and earnings management. The Accounting Review.

Zerban, A. (2017). Enron of Saudi Arabia: Corporate accounting and auditing failures. Open Journal of Accounting.