

# The Contradictory Effects of Political Connections and Social Relationships on the Role of Government Internal Auditors

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## Abstract

*Previous research has revealed that political connections and social relationships between auditors and their clients often lead to a decline in audit quality. In light of the growing interest in understanding the economic implications of political connections, this paper aims to review empirical studies in the accounting and finance domain that investigate the impact of political connections on the ability of internal auditors to detect fraud. This study adopts a qualitative case study approach, utilizing semi-structured interviews within an internal audit organization in Makassar City, where strong political connections are evident. Our findings indicate that while political connections may enable auditors to detect fraud, they often refrain from reporting it to avoid potential losses and safeguard public interests. Additionally, although social relationships with clients are expected to enhance auditors' competence in detecting fraud, these relationships may simultaneously compromise the independence of internal auditors. This research provides valuable insights for policymakers, standard setters, and regulators to better understand the contradictory effects of political connections on audit quality and fraud detection.*

**Keywords:** *Political Connection, Social Network, Government Internal Auditor, Fraud.*

## Introduction

Internal auditors face role ambiguity; on one hand, they act as overseers responsible for assessing and improving the effectiveness of risk management, control, and governance processes. On the other hand, they are also perceived as advisors to management, providing recommendations for improvement and efficiency. The close role of internal auditors with local governments can create complex relationships, particularly regarding political connections and social relationships. Consequently, there are public rumors suggesting that government internal auditors operate to fulfill “requests” from regional secretaries. This raises doubts about their professionalism and independence, compounded by the prevalence of “financial crime” scandals involving government officials.

Government internal auditors have seen their influence diminished with the presence of external bodies like the Corruption Eradication Commission (KPK). The dual oversight resulting from the KPK's presence subjects internal auditors to stricter monitoring. The KPK focuses on preventing and prosecuting corruption, adding pressure on internal auditors to ensure transparency and accountability. As the KPK holds the authority to investigate and prosecute corruption cases, internal auditors may feel a loss of autonomy, potentially becoming hesitant to make decisions without considering potential KPK interventions. Although often referred to as “governance watchdogs” (Roussy, 2013), the benefits of internal audits remain unproven since the exact role of the Inspectorate (the internal audit body of the Indonesian government) is unclear.

As Larsson (2005) suggests, actors' actions are not solely driven by interest-based dominance. Instead, the success of actors' constellations is conditioned by established institutions such as existing laws, regulations, or political powers that shape their collective identities and cognitive and normative conceptions. Accordingly, the presence of the Inspectorate can be seen as a response to the need for oversight and accountability within the structure of local governments. Often, the policies and decisions made by the Inspectorate are influenced by political interests.

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The academic literature, however, highlights both the advantages and disadvantages for organizations and individuals in leveraging political connections, often leading to varied conclusions. For instance, a study by Wahab et al. (2015) examined how political affiliations affect auditor independence. Their findings revealed that politically connected firms face unique challenges that can compromise auditor independence and increase audit and non-audit costs. Political connections can create scenarios where auditors detect irregularities but choose not to report them to protect public interests and avoid potential repercussions. Furthermore, politically connected firms often receive government bailouts despite the absence of clear financial distress indicators, which can hinder auditors' ability to perform their duties effectively. These dynamics raise concerns about the integrity of the audit process and the potential erosion of auditor independence.

The relationship between auditors' social connections and the quality of financial reporting has also garnered significant attention. A study by DeFond et al. (2024) analyzed how these social networks impact audit quality and the associated risks of financial reporting failures. Their findings indicate that strong local networks among auditors can enhance their competence, leading to improved financial reporting practices and reduced risks of reporting failures. Conversely, strong connections within the client business community increase the likelihood of auditors interacting with client management, which can compromise their independence (He et al., 2017). Furthermore, members of the client's network may exert pressure on auditors to permit clients to engage in non-standard reporting, posing additional threats to auditor independence.

Political connections and social relationships can significantly influence the interplay between auditors' social networks and audit quality. While such connections may facilitate the concealment of financial irregularities by leveraging influence over local government officials, the overall effect appears to be beneficial. Auditors with strong ties in both business and government are still capable of reducing the likelihood of clients engaging in financial misreporting. This suggests that the increased competence derived from social connections outweighs the potential threats to auditor independence. The dual role of political connections underscores the complexity of the audit landscape within the Regional Inspectorate, particularly in Makassar City, South Sulawesi.

#### *Theoretical Framework and Proposition Development*

The conceptual framework of this study is grounded in Role Theory by Katz and Kahn (1978). Role theory is a theoretical framework used to understand individual behavior within organizational contexts, where individuals are required to perform multiple roles. This theory examines the interactions and relationships between individuals as well as the personal characteristics that shape a set of roles within specific contexts, thereby enhancing potential for analysis and explanation. Role theory elucidates the role conflict faced by internal auditors by highlighting how individuals within organizations are required to perform various roles that may conflict with one another. In the context of internal auditors, this theory aids in identifying potential conflicts and ambiguities between their diverse roles, such as serving as both guardians and facilitators. This is particularly relevant as internal auditors operate in complex and ever-changing environments that can influence their behavior in role-conflict situations.

Based on the conceptual framework of role theory, it can be understood that the behavior of internal auditors is influenced not only by their professional responsibilities but also by the social norms and expectations within the organization (Roussy, 2013). Internal auditors interact with various stakeholders within the organization, including management and the board of directors. Political connections emerge from these relationships, where auditors may need to negotiate between fulfilling their auditing duties and maintaining favorable relationships with powerful stakeholders. This dynamic of power can affect auditors' objectivity and transparency (Wahab et al., 2015), leading to diminished financial reporting quality (Chaney et al., 2011) and potentially concealing information about takeovers to mask poor performance (Johnson & Mitton, 2003).

Close relationships with the government may lead auditors to disregard stringent auditing standards to retain clients and mitigate litigation risks. Additionally, auditors' economic dependence on political

connections may result in reduced objectivity and integrity in audit assessments. This study posits that the political connections of internal auditors in the Regional Inspectorate of Makassar City will hinder their ability to detect and prevent fraud. This assumption aligns with findings by Salehi (2020), which highlight that political connections in companies have created significant disparities in financial reporting quality, with politically connected firms exhibiting lower reporting quality compared to others.

Thus, the first proposition of this study is as follows:

**Proposition 1:** The stronger the political connections of internal auditors with management and other stakeholders, the greater the likelihood that auditors will adapt to political expectations and interests within the organization.

Gopal et al. (2012) proposed incorporating social networks into fraud detection frameworks. According to their findings, fraud often requires access to resources and the connections that link these resources, making social networks a potentially integral component of fraud detection mechanisms. Social relationships refer to the connections formed between individuals or groups within a social context, encompassing both formal and informal interactions. Close interpersonal relationships between auditors and auditees can create conflicts of interest. When auditors maintain favorable or personal relationships with auditees, they may feel reluctant to disclose negative or critical findings. This reluctance can lead auditors to overlook issues that should be reported, thereby undermining their independence.

This study posits that the social relationships maintained by auditors in the Regional Inspectorate of Makassar City may reduce their ability to detect and prevent fraud. This assumption aligns with Annelin's (2023) findings, which suggest that when auditors identify closely with their clients or auditees, it can threaten their independence and lead to a decline in the quality of financial reporting. Therefore, the second proposition of this study is as follows:

**Proposition 2:** The stronger the social networks of internal auditors with management and other stakeholders, the greater the likelihood that auditors will adapt to the expectations of stakeholders within the organization.

## Methodology

This study aims to advance existing knowledge by providing empirical evidence from the Regional Inspectorate, the internal audit organization of Makassar City. A case study approach was adopted to deeply explore the complex issues related to political connections and social networks in internal auditors. This qualitative research approach provides a suitable method to examine why political connections and social networks can pose threats to the independence and competence of internal auditors in detecting and preventing fraud. The objective of a case study is to investigate contemporary phenomena in real-life contexts, particularly when the boundaries between the phenomenon and the context are unclear (Rowley, 2002). Case studies are particularly useful for answering 'how' and 'why' questions and can be applied in exploratory, descriptive, or explanatory research (Yazan, 2015). The research design was developed based on the information required to address the study's objectives.

Respondents for the case study were selected based on the research objectives, questions, propositions, and theoretical context, considering accessibility (whether the required data could be collected from individuals or the organization under study), resources (whether sufficient resources were available to support travel, data collection, and other analysis costs), and the time available. The target population comprised all internal auditors in the Makassar City Regional Inspectorate, totaling 42 individuals.

Throughout the study, data were gathered from interviews, organizational data from the Inspectorate, and current policy documents related to the Inspectorate to achieve triangulation. Triangulation involves the use of more than one data collection technique or research method, either simultaneously or sequentially, to capture different dimensions of the same phenomenon (Denzin & Lincoln, 1994, p. 215).

This research was conducted at the Makassar City Regional Inspectorate Office, located at Jl. Teduh Bersinar No.7, Gunung Sari, Makassar City, South Sulawesi. According to Makassar Mayor Regulation No. 81 of 2016, the Regional Inspectorate of Makassar City is "an oversight element of regional government administration, led by an Inspector who reports directly to the Mayor through the Regional Secretary." The Inspectorate is headed by an Inspector who has direct responsibility to the Mayor through the Regional Secretary, serving as a liaison between the Inspectorate and the Mayor. The Inspectorate is tasked with overseeing the administration of regional governance, ensuring that all policies and programs comply with applicable regulations.

## Findings

During semi-structured interviews conducted through Focus Group Discussions (FGDs), researchers posed questions to internal auditors at the Makassar City Regional Inspectorate. The aim was to gain deeper insights into the practices, challenges, and experiences of auditors in carrying out their duties. These questions were designed to directly explore the auditors' perspectives.

How do you define professional skepticism in the context of your role as an internal auditor in detecting fraud? To what extent do you feel capable of applying it?

The Focus Group Discussion (FGD) findings revealed that the auditors at the Makassar City Regional Inspectorate have a strong understanding of professional skepticism and its importance in detecting fraud. While they expressed confidence in their ability to apply it, challenges persist, particularly regarding social interactions and organizational support.

Professional skepticism is an auditor's attitude that involves a questioning mind and a critical evaluation of audit evidence. This means that auditors do not simply accept information or explanations from management but instead ask questions to obtain reasons, evidence, and confirmation regarding the issue in question. This attitude is crucial to ensure that auditors can detect potential fraud, as fraud is often concealed by perpetrators." (Makassar City Regional Inspectorate Auditor, 2024)

Professional skepticism is considered a vital component of the audit process, requiring auditors to remain alert to the possibility of fraud and not assume management is entirely honest." (Makassar City Regional Inspectorate Auditor, 2024)

Professional skepticism is a critical component of an internal auditor's work in detecting fraud. By adopting the appropriate skeptical mindset, auditors can enhance their ability to identify fraudulent activities and uphold the integrity of the audit process. Applying professional skepticism not only aids in detecting errors or fraud but also contributes to the overall quality of the audit outcomes.

Often, we (auditors) have to interact with the auditees, who may have vested interests or specific agendas. This can create tension and conflict, especially when auditors uncover issues or fraud." (Makassar City Regional Inspectorate Auditor, 2024)

Sometimes we (auditors) face pressure from management to produce more favorable reports or to withhold certain findings. This can impact auditor independence." (Makassar City Regional Inspectorate Auditor, 2024)

Auditors generally feel that they can effectively apply professional skepticism in their work. However, some auditors acknowledged challenges in maintaining a skeptical attitude when dealing with management or clients who enjoy high levels of trust.

Have there been situations where you felt your professional skepticism was compromised? If yes, please explain.

Audit practices require auditors to examine financial reports for errors or fraud while adhering to predetermined time budgets. When we (auditors) are under time pressure or face an extremely high workload. In such conditions, auditors may feel rushed and have insufficient time for in-depth analysis, which can reduce their professional skepticism.” (Makassar City Regional Inspectorate Auditor, 2024). The findings indicate that time constraints and heavy workloads can challenge auditors' ability to maintain professional skepticism, potentially affecting the depth and quality of their audit analyses.

The Makassar City Regional Inspectorate must ensure that auditors are not pressured to complete audits within unrealistic deadlines and that management does not impose limitations on the scope of auditors' work.

How do you manage pressure in challenging audit situations? Are there any forms of support you need from the organization?

One of the most common pressures faced by auditors is time constraints during the audit process. Auditors often encounter tight deadlines for completing audits, especially when required to meet specific reporting schedules. This pressure may stem from management demands or regulatory requirements mandating that audit reports be submitted within a certain timeframe.

In difficult audit situations, I usually try to stay focused on the facts and available data. However, I sometimes feel the need for support from management to allow more time for the audit process.” (Makassar City Regional Inspectorate Auditor)

“From my experience, having a mentor on the team is very helpful. A mentor can provide guidance and emotional support when we face challenging situations. Organizations can facilitate mentoring programs to enhance this support.” (Makassar City Regional Inspectorate Auditor)

Mentors can offer guidance on best practices in auditing, analytical techniques, and approaches for handling complex situations. During stressful times, such as when facing time pressures or conflicts with clients, mentors can provide the necessary emotional support. This support helps auditors feel more confident and capable of overcoming the challenges they face.

How do you perceive the issue of auditor independence at the Inspectorate? What challenges do you face in maintaining independence during audits?

As the internal supervisory auditors of government (APIP), the Inspectorate plays a critical role in ensuring accountability and transparency in regional financial management. The Regional Inspectorate operates within the structure of local government agencies (OPD) and reports to the regional head through the regional secretary. This arrangement can compromise independence, as auditors may feel pressured to withhold findings that could negatively impact the regional head.

Sometimes, personal relationships with certain individuals in the organization can influence how we (auditors) conduct audits. We need to maintain distance to remain objective.” (Makassar City Regional Inspectorate Auditor)

I believe that transparency in the audit process is very important. However, there is uncertainty about how management will respond to the audit findings. This makes me hesitant to disclose all findings.” (Makassar City Regional Inspectorate Auditor).

Auditors expressed concerns about maintaining independence, especially when their findings might conflict with the interests of key stakeholders. They emphasized the need for transparency and organizational support to safeguard their objectivity and integrity during the audit process.

Close relationships between auditors and auditees, both socially and professionally, can impact auditor objectivity (Amara & Khelif, 2020). Auditors with personal ties to clients may find it challenging to remain



critical. I agree. Additionally, I feel that personal relationships with colleagues and other individuals in the organization can affect our objectivity." (Makassar City Regional Inspectorate Auditor)

He et al. (2017) argue that social bonds can undermine audit quality, suggesting that such ties may lead to poorer audit outcomes, higher audit costs, and impaired financial reporting evaluations. This issue arises when auditors fail to issue modified audit opinions despite irregularities, indicating a compromised monitoring process. These findings highlight how social relationships can foster reluctance to challenge financial reporting policies, ultimately harming the audit process. However, when social relationships exist within audit teams, they can be beneficial in complex audit environments that require diverse expertise (Amyar et al., 2019). Nonetheless, this diversity also creates a paradox between the need for team heterogeneity and the ability to achieve team cohesion.

Auditors with political connections may gain better access to critical information regarding policies, regulations, and potential risks within the organization, aiding more effective audit planning. However, political connections can compromise auditor independence. When influenced by political ties, auditors may hesitate to disclose findings that could harm certain parties.

Indeed, there are situations where critical audit findings are not reported due to fear of the negative impact on political relationships. This clearly undermines independence." (Makassar City Regional Inspectorate Auditor). There are also cases where auditors are compelled to cooperate with individuals holding political connections, which can lead to compromises in the audit process. (Makassar City Regional Inspectorate Auditor)

However, I also see the positive side. Political connections can help us gain support when facing challenges in the audit process. This can facilitate smoother communication with management." (Makassar City Regional Inspectorate Auditor)

Auditors' connections may stem from social networks, familial ties, or prior professional relationships, which can introduce bias in decision-making. While these connections can assist in accessing information and garnering support, maintaining independence and objectivity is crucial to ensuring the reliability of audit outcomes.

From a corporate perspective, political connections make it easier for firms to receive economic assistance from the government during financial difficulties (Tessema, 2020). Similarly, Rahman et al. (2023) documented that politically connected firms are more likely to secure bank loans and benefit from lower operating costs (Sun & Ai, 2020) compared to firms without such connections. This suggests that politically connected firms have less incentive to manage earnings than their counterparts, reducing the value of audits as a monitoring mechanism for these firms. Additionally, Rudyanto et al. (2023) found that politically connected firms tend to be more aggressive in tax planning, while firms without political connections exhibit a negative (positive) correlation with tax aggressiveness.

How do social relationships among auditors at the Inspectorate affect audit performance and effectiveness? What challenges do you face in maintaining these relationships?

Social relationships refer to connections formed between individuals or groups within a social context, encompassing both formal and informal interactions. In auditing, these relationships may occur between auditors and clients, audit committees, or other stakeholders.

I believe that good social relationships among auditors are crucial. When we support each other, we can share information and strategies that are helpful for the audit." (Makassar City Regional Inspectorate Auditor)

However, personal relationships can sometimes be problematic. For instance, if we are too close to colleagues, we may hesitate to critique them or report unfavorable findings." (Makassar City Regional Inspectorate Auditor)

Strong social connections between auditors and stakeholders, such as management and audit committees, can facilitate easier access to crucial information. These relationships enable auditors to obtain necessary data for audit analysis more quickly. Conversely, social connections can reduce auditors' professional skepticism. When auditors have close personal relationships with auditees, they may become less critical or overly trusting of the information provided.

Agreed. Sometimes, the pressure to maintain good relationships can interfere with our objectivity. We need to balance professionalism with building positive relationships. (Makassar City Regional Inspectorate Auditor)

Social relationships can create favoritism bias, where auditors may be more inclined to provide favorable judgments to individuals or entities with whom they have close ties. This bias can compromise auditor objectivity and diminish the integrity of the audit process.

## Conclusion

Political connections can influence auditors in several ways. First, political interests may lead auditors to detect fraud but refrain from reporting it to avoid reputational damage and protect public interests. Second, local governments may rescue public organizations without clear indications of financial distress, reducing auditor independence. Third, economic or social relationships between auditees and internal auditors may introduce unconscious bias, preventing impartial audits. Political connections can also impact the relationship between non-audit and audit fees, where politically connected companies tend to pay higher non-audit fees compared to non-connected firms.

These findings align with DeFond et al. (2024), who observed that strong political connections enable auditors to conceal clients' financial irregularities. A plausible explanation is that auditors with strong political ties may leverage their influence over local government officials to avoid regulatory scrutiny, thereby helping their clients conceal non-compliant financial reporting.

Conversely, while political connections often compromise auditor independence and may lead to unconscious bias, social networks can also be leveraged by auditors to detect fraud. Social network analysis can assist auditors in several ways. First, social networks can help identify fraudsters and uncover their connections by analyzing existing social interactions, such as friendships, shared interests, or financial exchanges. Additionally, auditors can use algorithmic approaches to detect hidden fraud networks by analyzing open social network information involving known suspects.

The challenging task of uncovering fraud amidst vast social networks and extensive connections requires a layered approach to effectively expose fraudulent behavior. Auditors must determine the sequence of constructing social network layers and decide the appropriate time to address specific issues.

## Limitations and Implications

This study has provided empirical evidence on the contradictory impacts of political connections and social networks held by internal auditors at the Makassar City Regional Inspectorate. However, certain limitations should be noted. The study did not differentiate or compare the strength of political connections among internal auditors.

Future research should better identify and distinguish types of political connections when examining their relationship with and influence on internal auditors' ability to detect fraud. Further studies could also explore the strength of political connections, including the level of closeness between auditors and political positions.

The findings of this study offer significant insights for policymakers, standard setters, and regulators in understanding the potential adverse effects of political connections on the quality of audit roles in fraud

detection. This research also provides valuable guidance for audit regulators to better identify and understand the benefits of audit quality and to seriously address policy issues affecting audit quality.

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