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RELATIONSHIP BETWEEN EARNINGS MANAGEMENT AND EXECUTIVE COMPENSATION: EVIDENCE FROM SAUDI STOCK EXCHANGE (TADAWUL)

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ABSTRACT

The present study looks at the association between managers' usage of earnings management and executive compensation. It also intends to create a model that explains and predicts this link in the context of the Saudi financial market from 2014 through 2019. The study discovers a statistically significant linear association between earnings management and the allowances granted by executives. This shows that senior directors may intentionally alter financial reports to maximize their pay. Furthermore, these allowances have been found to be predictive of the earnings management regression equation. In addition to executive allowances, the study highlights other elements that influence profit management, such as firm performance and cash flow. Agency theory presents reasons that aid in understanding these results. Management wants to maximize its advantages by earning more money, even if doing so comes at the price of other stakeholders' interests. By strengthening the board of directors' and its committees' oversight of top management performance, the study suggests lowering the likelihood of subjective judgment. It also recommends tying CEO pay to business performance and profitability in order to reduce conflicts of interest between owners and management.

KEYWORDS: Executive compensation, Earnings Management, Financial Statement; Incentives; Saudi Stock Exchange.

1. INTRODUCTION

The Effect of Additional Bonuses on Accounting Decisions" is one of the most significant accounting studies ever written. It was the first scientific work to highlight the gravity of profits management concerns (Shubita et al., 2025). Healy authored it in 1985 (Healy, 1985) shown that there is a linear link between declared profits and managers' compensation value; as profits rise, managers' compensation value rises "due to the size of the growth in profits (Almasria et al., 2024). "This association, however, does not persist long since eventually earnings will not increase to the amount where managers can receive the remuneration they want. At this moment, managers specifically decide to alter accounting practices in order to control profits and return the profits climb dramatically until the target compensation is obtained. The findings of Healy's study (1985) demonstrate that executives in businesses make decisions concerning accounting standards and accounting substitutes to maximize their reward based on earnings.

As of December 2019, Saudi Stock Exchange (SSE) is the ninth largest stock market over the world, the largest financial market in both the North Africa and Middle East district; with a market capitalization of 9,025 billion SAR (2,405 billion USD) (Tadawul Annual Statistical Report, 2019). The market capitalization at the end of 2023 amounted to 11,259.32 billion SAR (3,002.49 billion USD), an increase of 13.98% compared to the end of the previous year (Tadawul Annual Statistical Report, 2023).

Compensation provided for motivating the Board of Directors (BoD) members and the Executive Management to make the business successful and develop it in the long term (Lutfi et al., 2024). The remuneration policy must be consistent with the strategy, objectives of the company, the size, nature and degree of risks (Corporate Governance Regulations - Saudi Capital Market Authority - 2017 - Article 59).

After the collapse of the Saudi Stock Exchange (Tadawul) in 2006, often referred to as the "Black Saturday" crash, and the subsequent collapses in global financial markets in 2007 (the beginning of the Global Financial Crisis), public and regulatory scrutiny intensified globally. In Saudi Arabia, the dramatic loss of investor wealth led to widespread allegations of manipulation of information and financial statements. This crisis immediately attracted the attention of policy makers, supervisory and regulatory bodies (such as the Capital Market Authority - CMA), who were compelled to

investigate the causes of the instability and the integrity of corporate financial reporting. The stock market collapse intensified researchers' focus on financial reporting irregularities, prompting them to investigate the underlying causes and link executive actions to market consequences.

Early evidence from the Alsehaly study (2006) showed that Saudi managers actively manipulate their compensation and benefits (entitlements) to achieve specific profit goals. This suggested that executive pay serves as a powerful incentive for managers to use accounting discretion to secure bonuses and other benefits.

The Habbash and Alghamdi study (2015) reinforced this, detailing multiple motives for Earnings Management (EM) among Saudi executives. These include: preventing reported losses, boosting wages by hitting profit targets, increasing stock prices for personal financial benefit, and securing bank loans by improving the company's apparent health. Their work established EM as a versatile practice used for various self-interested objectives.

Collectively, a substantial body of literature supports the finding that EM is widespread in the Saudi financial market. The Alfadhael and Jarraya study (2021) confirmed that EM is a deliberate act used to obscure a company's true performance for motives like obtaining administrative rewards or enhancing the company's public image (known as impression management). This research clearly emphasizes that EM is a conscious, intentional manipulation driven by executive self-interest and the desire to control external perceptions.

Finally, looking at studies such as those of Al-Moghawli (2010), Alsuhaibani (2012) and others, we find that they agree on the existence of a motive to increase the compensation or reward received by executive directors. This consensus points to the compensation contract as a central driver of EM, validating the core tenet of Agency Theory that financial incentives are the most powerful inducement for executives to act opportunistically and manipulate the reported financial results.

This study seeks, through the experimental approach, to verify the existence of an association between EM and the compensation of companies listed on the Saudi Stock Exchange.

2. THEORETICAL FRAMEWORK

The definition most commonly cited in studies of earnings management is that of Healy and Wahlen (1999), which states that EM occurs when CEOs apply verdict in financial outputs and in constructing

financial transactions to amend reporting to either deceive certain stakeholders about the firm's performance or to impact pledged consequences that are dependent on reported accounting records. Based on this explanation, CEOs have an interest in reporting a high level of earnings, by using their discretionary power to influence the compensation and incentives they receive. Schipper (1989) also defines earnings management as an intentional intervention in the financial reporting process with the aim of obtaining some gains. In the same direction, Holland and Ramsay (2003), indicates that earnings management is "a choice of accounting policies by the economic unit to achieve certain management objectives." In the same direction, studies (DeFond and Jiambalvo, 1994 and McNichols, 2000) are moving.

The literature offers many definitions of earnings management. These definitions agree that earnings management is an intervention by the economic unit aimed at achieving certain purposes, including influencing the compensation received by executive managers.

2.1. Relationship between Earnings Management and Executive Compensation:

Discussions about the relationship between executive compensation and Earnings Management have received a great deal of research, due to the sensitivity of the topic and its connection to the relationship between management and ownership governed by agency theory.

Agency theory provides explanations that contribute to understanding the issue of executive compensation. Executives, by linking the interests of the principal (owners) and the interests of the agent (management), where it is assumed that it is necessary to link executive management compensation to the company's performance. According to a study (Fama, 1980), the existence of a weak link between executive director salaries and company performance was attributed to a defect in determining executive director incentives. This study recommended reducing the conflict of interest between owners and management by linking management wages to the company's performance. In addition, the agency theory provides a number of ways and methods to reduce agency costs, including reducing the size of the board of directors and granting greater independence to the board of directors in decision-making, which is achieved by increasing the number of independent members on the board of directors (Yermack, 1996). In contrast, organizational theorists believe that agency theory

suffers from some shortcomings in explaining executive management compensation (Jensen and Murphy, 1990), as they focused mainly on the authority of executive managements, and adopted a theory called the theory of administrative dominance. They concluded that executive directors, through their influence on the board of directors, are in a position to determine their compensation. They pointed to a number of factors that increase management authority, such as the management's tenure, management ownership, board size, company size, and other factors. Between the two opposing positions of these two theories, we find the theories of supervision and resources. Corporate governance mechanisms provide a way to deal with agency problems. That is, the main goal of corporate governance is to deal with agency problems, according to the study (Meckling and Jensen 1976) the board of directors represents the interests of shareholders (the principal), while management (the agent) represents its goals of achieving its interests, so the goals of management and the board of directors is different. Many studies believe that the compensation paid to executive management reduces agency problems and reduces the cost of agency (Kee and Pillay, 2003), that is, executive management compensation ensures the achievement of management's interests (the agent), and thus management is keen to protect the interests of shareholders. On the other hand, a number of researchers believe that the relationship between management compensation and company performance will solve agency problems between the manager and the agent, as this link leads to increased risk sharing between the two parties (Saleh et al., 2025). However, this method will lead to an unlimited increase in agency costs and make management only care about the company's short-term performance, thus ignoring long-term growth (Lin, 2011). In addition to the above, other studies such as Tosi (2009) provide another explanation, which shows that the controlling party affects executive compensation. In companies controlled by owners, executive management compensation affected by company performance, while in companies cont.

Studies (Duarte 2015; Harvey et al. 2020 and González-Sánchez et al. 2021) indicate that increasing executive compensation may lead to opportunistic habits among executives, particularly if the compensation policy includes flexible benefits or advantages. Additionally, Panda and Leepsa (2017) also deduced that lacking reward might lead managers to use his/her decision-making power to

his advantages. However, Pepper and Gore (2015) presented a new approach, the behavioral agency theory. This approach, regarding executive compensation, which this compensation linked to certain goals and performance levels. In the same direction, (Bebchuk et al. 2002) see that the power of the board of directors in companies can affect executive compensation by linking it to the results and goals achieved. Dias et al. (2024) also in a systematic review revealed that compensation and its suitability for directors can motivate them to maximize investors return and improve businesses' performance.

2.2. Literature Review and Hypothesis Building

Earnings management is defined as the deliberate distortion of benefits to present a different reality, adjust the financial statements meaning, or affect the decision makers to take informed decisions. In addition, Schipper (1989) defines EM as a deliberate mediation in the financial statements preparing process with the aim of achieving some private gains. However, Healy and Wahlen (1999) believe that managers practice EM by applying their self-valuation in the transfer and processing of financial information to modify the financial results with the aim of giving owners an incorrect impression or influencing any promised procedures based on financial outputs. Rosenfeld (2000) found that EM procedures influence the profits shown in the statements, do not accomplish actual economic values, and it may essentially lead to long-continuing damages. Husni et al. (2021) also see EM as the accounting techniques used to prepare financial statements that show a positive observation of the business's activities and the company financial position.

In this part of the study, we seek to understand the motivations behind EM practices among managers, as one of the agency parties that govern the relationships between the various parties in the company.

The main motives for earnings management are capital market motives, managerial compensation motives and lending motives (Healy, 1985; Schipper (1989); Healy and Wahlen (1999); McNichols, 2000; Alsehali, 2006; Habbash and Alghamdi, 2015 and Alfadhael and Jarraya, 2021).

This work seeks to investigate the association between EM, CEOs' compensation, as compensation considered one of the most important elements that motivate CEOs to manipulate elements of reports, and financial motivates (DeFond and Jambalvo, 1994; McNichols, 2000 and Alsultan, 2017).

Holland & Ramsay (2003) aimed to investigate the earnings management practices of Australian companies and the motives of CEOs to achieve high levels of revenues. The results of the study revealed that Australian companies manage earnings to ensure positive results and sustainable earnings. Cheng and Warfield (2005) sought to investigate the relationship between earnings management and CEO incentive and stock grant plans. The study concluded that companies with ownership incentives seek to increase their profits more. In the same direction, the results of the study (Warfield Terry and Qiang, 2005) indicate that CEOs who receive high ownership incentives are more likely to adopt earnings management practices. Bergstresser and Philippon, (2006) also sought to test the relationship between CEO incentives and earnings management in the New York Stock Exchange and concluded that there is a positive relationship between incentives and earnings management. According to (Alsultan, 2017), compensation is one of the most important elements that motivate managers to manipulate elements of reports and financial statements. Assenso-Okofu et al. (2021) found a positive relationship between CEO compensation and earnings management. The study concluded that managers might engage in earnings management to increase their compensation. In the same vein. Sun (2021) found that managers who receive higher incentive payments tend to engage in higher earnings management. HUSNI et al. (2021) found that CEO cash compensation had a positive effect on discretionary accruals. Farouk and Ahmed (2023) found that CEO pay increases the level of earnings management.

Scarce research has concentrating on EM practices in Saudi firms. Since this study seeks to verify the existence of a association between EM and the compensation of executive directors of companies listed on the Saudi Stock Exchange, we will seek in this aspect to review the studies that examine this matter. Alsehali (2006), who examined the relationship between total receivables and EM incentives, indicates that Saudi company managers manipulate benefits. A study conducted by Habbash and Alghamdi (2015) sought to explore the motives of EM in companies listed on the Saudi stock market. The results revealed that four main incentives for Saudi CEOs to manage earnings are increasing compensation, reporting reasonable profit and avoiding loss, obtaining a bank loan, and increasing the stock price. Al-Thuneibat et al. (2016) show that there is no linear statistical significance between companies' compliance with corporate governance

requirements and EM practices. Alhadab and Al-Own (2019) observed that Saudi companies practice EM in the areas of timing, classification, estimation, and disclosure, and that the practices are not consistent with generally accepted accounting principles. Aydin and Khan (2020) study, examined the impact of incentive structure provided to senior executives and corporate governance culture, on the performance of listed companies in Saudi Arabia, found a positive association between corporate performance, expressed by return on assets (ROA) and return on equity (ROE), and senior executive remuneration, especially basic pay. The study (Alfadhael, and Jarraya, 2021) indicates that earnings management is a deliberate act intended to hide the actual activity of the company for management-specific motives such as management rewards or improving the company's image. The results of Leal et al. (2023) indicate that CEOs use discretionary benefits to increase compensation. Kazma and Valax (2024) revealed how CEOs in GCC-listed companies resort to unethical earnings management practices during times of financial loss and financial distress.

When reviewing the literature in the Saudi context, we find that previous studies have not discussed the relationship between EM and executive compensation empirically. For example, the study by Habbash and Alghamdi (2015) sought to discover the motives for earnings management practices, and these motives not subjected to an empirical study. The study by Alfadhael, and Jarraya (2021) followed the same direction. While Al-Thuneibat et al. (2016) sought to study the relationship between companies' compliance with corporate governance requirements and earnings management practices. This study highlights the gaps in the existing literature.

Based on the review of previous studies and the results they reached, the study seeks to verify, through the empirical approach, the validity of the following hypotheses:

H1: There is a statistically significant relationship between CEO compensation and earnings management practices in the Saudi stock market.

H2: Earnings management has the ability to explain and predict the regression equation for CEO compensation.

3. RESEARCH DESIGN AND METHOD

3.1 Research Data Analysis:

The hypotheses of this research were tested by investigating the earnings management practices of firms listed on the Saudi Stock Exchange and examining the relationship between earnings

management and executive compensation.

3.2 Study community and sample:

The study population consists of companies listed on the Saudi Stock Exchange during the period of this study (2014-2019), totaling 205 companies. The study does not cover subsequent years to exclude the potential impacts of the Corona pandemic (COVID-10) on the performance of financial markets. Many studies indicate the effects of the COVID-19 on the Saudi Stock Exchange. (Chaouachi and Chaouachi (2020): Tissaoui et al (2021): ALZYADAT and ASFOURA (2021)).

The study sample selected according to the following criteria:

- Excluding financial sectors: Companies listed in the financial sectors (banks and insurance) were excluded due to the different nature of these sectors, and the different methods of measuring earnings management practices in them. It amounts to 39 companies.
- Listing during the study period: Companies that not listed during the study period (2014-2019) excluded. Alternatively, those that excluded from listing in any of the study years.

According to the above criteria, the study sample consisted of 70 companies listed on the Saudi Stock Exchange, and the sample was distributed across various non-financial sectors in the Saudi Stock Exchange.

3.3 Study Data and Variables:

This study seeks to test the relationship between earnings management practices and executive compensation of companies listed on the Saudi Stock Exchange.

Data on earnings management practices (the independent variable) is collected from the published financial statements of companies listed on the Saudi Stock Exchange. Earnings management practices measured by calculating the Discretionary Accruals calculated using the Modified Jones (1995) Model, which has used in many studies such as (GARFATTA, 2021). (240) regression equations were obtained representing the study sample consisting of (70) companies during the study years (6) years.

The variable compensation of executive directors of companies listed on the Saudi Stock Exchange calculated at their real values based on the reports of the Board of Directors. The low-impact compensation elements that represented low percentages of the total compensation of CEOs excluded, as in-kind benefits represented (1.18%), a percentage of profits represented (0.4%), granted

shares (0.03%), and board/committee attendance (0.5%). The end-of-service bonus also excluded due to its association in earlier and later periods. Table (1) shows the independent, dependent and control variables of the study.

Table 1: Study variables.

Study variables		Symbol	Measurement method	Previous studies
Executive Compensation	Salaries	SA	Real Variables: Represents the amount of compensation received by executives	Abdalkrim (2019)
	Allowances	AL		
	Regular Bonus	PR		
	Incentive Plans	IP		
Earnings Management	Discretionary Accruals	DAC	Real Variable: Discretionary benefits calculated using the Modified Jones (1995) model.	GARFATT A (2021) and Grada (2022)
Controlling Variables	Company Size	LOG-TA	Real Variable: Calculate the natural logarithm of total assets	Lobo and Zhou (2001)
	Total Debt/Total Assets	TDA	Real Variable: Divide total debt by total assets.	DeFond and Jiambalvo (1994) and Sweeney (1994)
	Return on Assets	ROA	Real Variable: Divide net income by total assets.	McNichols(2002) and Kothari et al.(2005)
	Operating Cash Flow to Revenue Ratio	CFO	Real Variable: Percentage of dividing operating cash flow by revenue.	Becker et al.(1998)

Prepared by the researcher.

In addition to using several control variables such as company size, which was expressed by calculating the natural logarithm of total assets, cash flows by calculating the ratio of operating cash flow to revenues, debt, which was expressed by the ratio of total debt to total assets, and performance, which was expressed by return on assets.

4. DATA ANALYSIS AND RESULTS

This section reviews the statistical analysis methods that are consistent with the content of the study with the aim of answering the study questions related to the impact of executive compensation on the earnings management practices policy, where we will start with descriptive analysis, correlation analysis between variables, and finally we will use multiple regression analysis.

4.1. Descriptive Analysis:

Table (2) shows the results of the descriptive analysis of the independent, dependent and control variables of the study, where the descriptive analysis includes the arithmetic mean, standard deviation, highest and lowest value, data homogeneity and normal distribution.

Table 2: Descriptive statistics for the study variables.

	420	2568.233	3526.456	0	13022	1.867792	5.489632
	420	423.4214	1109.902	0	4222	2.694281	8.86794
	420	4785.464	2884.438	936	12354	1.125385	3.785138
	420	1219.238	1090.931	0	3799	0.8813476	2.942753
	420	0.0539163	0.0560757	-0.01119	0.22869	1.697634	5.74177
	420	0.002339	0.002518	-0.00670	0.01745	0.940047	7.38082
	420	0.2184357	0.17588	0	0.658317	0.367660	2.089796
	420	0.076367	0.061625	0.00188	0.21725	0.860620	2.78327
	420	8.200908	1.600289	4.404216	13.08119	0.758075	3.708791

Prepared by the researcher based on the Stata program.

Table (2) shows that there is a significant variation in salaries (SA), periodic bonuses (PR), allowances (AL) and average incentive plans (IP). This variation confirms that the companies in the study sample follow different compensation policies. As the table shows, the average discretionary accruals (DAC), which expresses earnings management practices, was about 0.054, and this ratio ranged between -0.0112 as a minimum and 0.229 as a maximum. This indicates the presence of negative and positive earnings management practices in the companies in the study sample.

Table (2) also shows a significant variation in the ratio of operating cash flow to revenue (CFO), total debt to total assets (TDA), return on assets (ROA) and logarithm of total assets (LOG-TA). This variation in the control variables of the study attributed to the

sample size and the different sectors in which the sample was distributed.

From Table (2), we notice that the values of the standard deviation (SD) of the data, which measures the homogeneity of the data or the clustering of data around the arithmetic mean, indicate that the data are homogeneous for all study variables.

The measures (skewness and kurtosis) used to test the normal distribution of the data. We note that the data follows the normal distribution according to the two measures, as the values of skewness for the variables are less than three. In addition, the values of kurtosis for the variables are less than 10, as shown in Table (2).

4.2 Data validity tests for normal distribution

To verify the validity of the data for statistical analysis, the following tests used:

- Multicollinearity Test:

To verify the absence of linear interference between the independent and control variables. The Tolerance coefficient was calculated and the Variance Inflation Factor (VIF) found for each variable to show the effect of the correlation between the variables, as the variable considered to have linear interference if the value of the VIF coefficient is greater than 10 or the value of the Tolerance coefficient (1/VIF) is less than 0.10.

Table 3: Variance Inflation Factor test.

Variables	VIF	1/VIF
PR	1.36	0.613546
IP	1.51	0.662872
SA	1.79	0.559598
AL	1.56	0.639615
COF	1.15	0.869719
TDA	1.22	0.820065
ROA	1.14	0.875916
LOG-TA	1.40	0.716725
VIF	1.39	

Prepared by the researcher based on the Stata program.

According to result, from the table (3). The value of the VIF coefficient for all independent and control variables does not exceed 1.79, the value of the 1/VIF coefficient is not less than 0.55, which confirms that the study model does not face the problem of linear interference, and accordingly, the validity of the study data for statistical analysis can be judged.

Hausman specification test

In the case of Panel Data, the Hausman specification test used to compare between the fixed effects model and the random effects model. Table () shows that the test results on the dependent and control variables created two models, as follows

Table No. 4: Hausman specification test results.

H0: difference in coefficients not systematic.	
Chi2(8)	1.41
P>chi2	0.9941

Prepared by the researcher based on the Stata program.

From Table (4), the value of chi2 is not significant, which means that it is preferable to use the random effects model.

4.3. The relationship between executive compensation and earnings management:

To test the relationship between executive compensation and Discretionary Accruals (DAC), correlation analysis used between the study variables. Table (5) shows the correlation coefficient matrix. The correlation coefficients between the independent and control variables and the dependent variable were close in terms of strength and direction of the relationship. As the correlation matrix shows a positive (direct) relationship between the independent variable, Discretionary Accruals (DAC), and the dependent variable, allowances (AL), and the control variables, the ratio of operating cash flow to revenues (COF) and return on assets (ROA).

The correlation matrix shows a positive correlation between the dependent variable Allowances (AL) and the independent variable Discretionary Accruals (DAC), in addition to a positive correlation between the dependent variable Allowances (AL) and the control variable Logarithm of Asset Size (LOG-TA). The correlation matrix shows a direct relationship between the independent variable Discretionary Accruals (DAC) and the control variables Operating Cash Flow to Revenue (CFO) and Return on Assets (ROA). The correlation matrix also shows a direct relationship between the dependent variable Salaries (SA) and the modified effect variable Adoption of International Financial Reporting Standards (IFRS). The correlation relationships between the variables are at (P<0.01), indicating the existence of multiple linear relationships between the research variables.

Table (5): Correlation matrix between the research variables.

										IFRS
PR	1									
IP	0.0787	1								

SA	0.473 7*	0.340 5*	1						
AL	0.276 2*	.0380 1*	0.384 1*	1					
DAC	0.019 5	0.006 1	0.072 2	0.102 0*	1				
CFO	- 0.076 2	0.030 2	0.014 6	0.029 5	0.091 6*	1			
TDA	0.05	- .0374	- .0133	- 0.013	0.043 7	- 0.161 *	1		
ROA	*0.03 1	- 0.013 9	- 0.061 6	0.035 6	0.200 3*	0.156 5*	0.004 3	1	
LOG-TA	0.025	0.018 8	0.035	0.097 4*	0.075 9	0.286 8*	0.438 3*	0.090 7*	1

Prepared by the researcher based on the Stata program.

According to the results shown by the correlation analysis, the study concludes with the following results:

- There is a statistically significant relationship between the allowances received by executive directors (AL) and Discretionary Accruals (DAC) in the Saudi Stock Exchange.
- There is no statistically significant relationship between the salaries received by executive directors (SA) and Discretionary Accruals (DAC) in the Saudi Stock Exchange.
- There is no statistically significant relationship between the incentive plans for executive directors (IP) and Discretionary Accruals (DAC) in the Saudi Stock Exchange.
- There is no statistically significant association between the Regular bonuses (PR) received by executive directors and Discretionary Accruals (DAC) in the Saudi Stock Exchange.
- There is a statistically significant relationship between the allowances received by executive directors (AL) and the Company Size (LOG-TA).

4.4. Interpreting the Relationship between Executive Compensation and Earnings Management:

To measure the impact of executive compensation on earnings management practices, the study used regression analysis. Table (6) shows the results of the regression analysis, through which the second hypothesis of the study was tested.

Table (6) shows the regression model that helps explain the relationship between Discretionary Accruals and executive compensation. The regression analysis provided a model to explain the relationship between the study variables.

The slope values (β) for the independent variables salaries (SA), periodic bonuses (PR) and incentive plans (IP) are not statistically significant, so the hypotheses for these variables rejected. The slope value ($\beta=1.877$) for the independent variable allowances (AL) is positive, which indicates a direct relationship with the dependent variable Discretionary Accruals (DAC), which is statistically significant at a significant level of ($p<0.1$). The regression model also shows that the slope value ($\beta=0.175$) for the control variable return on assets (ROA) is positive, which indicates a direct relationship with the dependent variable Discretionary Accruals (DAC), which is statistically significant at a significant level of ($p<0.01$). The table also shows that the value of the square of the correlation coefficient (R Square) according to the regression model is (0.07), meaning that the dependent variable in the study model (Discretionary Accruals) explains the variance in the independent variable (allowances received by executives). The table also shows the coefficients of the regression model, which help in obtaining the equation of the regression line.

Table (6): Regression analysis model of the relationship between executive compensation and Discretionary Accruals.

VARIABLE	(t) DAC
IP	43.17
PR	1,170
SA	3,504
AL	1,877*
CFO	1.208
TDA	0.0144
ROA	0.175***
LOG-TA	0.000805
Constant	0.0204
2014.year	0.00471
2015.year	0.0182*
2016.year	0.00560
2017.year	0.0324***
2018.year	0.0335***
2019.year	0.0519***
R-squared	0.070
Observations	420

Prepared by the researcher based on the Stata program.

According to the results shown by the regression analysis model, the study concludes with the following results:

- The allowances received by executives (AL) have the ability to explain and predict the regression equation of Discretionary Accruals (DAC).
- The salaries received by executives (SA) do not

have the ability to explain and predict the regression equation of Discretionary Accruals (DAC).

- The incentive plans for executives (IP) do not have the ability to explain and predict the regression equation of Discretionary Accruals (DAC).
- The Regular bonuses received by executives (PR) do not have the ability to explain and predict the regression equation of Discretionary Accruals (DAC).
- The return on assets rate (ROA) has the ability to explain and predict the regression equation of Discretionary Accruals (DAC).

5. DISCUSSION AND CONCLUSIONS

The study achieved the following results:

- Testing the relationship between executive compensation and earnings management:

The results of the study indicate that there is a statistically significant relationship between the allowances received by executive directors and discretionary benefits in companies listed on the Saudi Stock Exchange during the years covered by the study. This result is consistent with the results of the studies of Habash and Al-Ghamdi (2015) and Al-Sultan (2017), which indicated that increasing the wages received by directors is one of the incentives that drive executives to manage earnings. It is consistent with the results of (Duarte 2015; Harvey et al. 2020 and Gonzalez Sanchez et al. 2021) which indicate that increasing executive compensation may lead to opportunistic practices among executives, especially when the compensation policy includes variable values or bonuses.

- Interpreting the relationship between executive compensation and earnings management:

The results of the study provide a model to explain the relationship between discretionary benefits and executive compensation. The researcher believes that this model used to predict earnings management practices.

Agency theory provides explanations that contribute to understanding these results, as management seeks to maximize its benefits by obtaining greater compensation, even if this done at the expense of the interests of other stakeholders. Agency Theory explains that management (the agent) is inherently motivated to maximize their personal welfare, which often involves seeking greater overall compensation, including salary, bonuses, and non-cash discretionary benefits (such as overly generous retirement plans, personal use of company assets, or executive life insurance). This

pursuit of self-interest, however, can come at the expense of the principals' interests, namely maximizing long-term shareholder value.

According to the study (Fama, 1980), the existence of a weak link between executive salaries and company performance is attributed to a flaw in determining executive incentives. A key contributor to this agency conflict is the existence of a weak link between executive salaries and actual company performance. When compensation structures are flawed or poorly aligned with genuine value creation, executives may not be sufficiently rewarded for legitimate success or penalized for poor performance. This disconnect creates a powerful incentive for management to engage in earnings management.

The model proposed by the researcher suggests that a high volume of discretionary benefits, particularly when coupled with performance-based compensation structures (like bonuses tied to reported income), signals management's strong motivation to "hit the numbers." Earnings management, the strategic manipulation of reported financial results to meet targets, becomes the mechanism used by managers to trigger their bonuses and justify their elevated compensation and perks, regardless of the firm's underlying economic health. Consequently, the model uses the observable relationship between these two components of executive reward (compensation and discretionary benefits) as a predictor of the hidden accounting practices (earnings management) driven by the desire to maximize personal wealth and obscure the weak link between their pay and genuine performance.

Based on the above, the study concludes that:

- The concept of earnings management refers to the use of personal judgment and estimation by managers in preparing financial reports and in structuring transactions to change financial reports either to mislead some stakeholders about the company's basic economic performance or to influence contractual outcomes based on published financial reports.
- There is a statistically significant linear relationship between earnings management and the executive directors, which is an indication of the deliberate intervention of executive directors to change financial reports in order to increase the allowances they receive.
- Executive compensation has the ability to explain and predict the regression equation of

earnings management.

- There are other variables that have an impact on earnings management, such as company performance and cash flows.
- Agency theory provides explanations that contribute to understanding these results, as management seeks to maximize its benefits by obtaining greater compensation, even if this is done at the expense of the interests of other stakeholders.

5.1. Practical Implications of the Study Results

The section provides the practical implications of the study findings on the policymakers, financial market regulating bodies, as well as boards of directors within the Kingdom of Saudi Arabia.

5.2. Policymakers and Financial Market Regulators

Regulatory authorities, policymakers and financial market regulators have a significant role of reducing agency conflicts and curbing earnings management by regulating the activities, developing better reporting standards, and increasing investor enlightenment. To minimize opportunistic managerial behavior, first, regulators may reinforce corporate governance systems and enforce regulations that enhance accountability, transparency and ethics. These actions involve the establishment and observance of the regulations of governance, such as having independent board, good internal controls, and adherence to financial reporting regulations.

Second, it is necessary to enhance financial reporting quality and reliability. This can be attained by the regulators by constantly revising and updating accounting standards to decrease ambiguity and restrict managerial discretion in financial reporting. More understandable standards can aid in the fact that the financial statements can be good representations of the economic performance of a firm and minimize chances of earnings manipulation.

Third, the regulatory bodies ought to increase effectiveness of external auditing through encouraging enhanced professional standards, perpetual education, and increased auditing standards. Enhancing the capacity of the auditors to identify the earnings management practices will make financial reports to be more credible and discourage opportunistic managerial behavior.

Lastly, it is essential to raise awareness and financial literacy of investors. Education programs and disclosure obligations can assist investors to

learn more about financial reports, detect possible signs of earnings manipulation, and make more responsible decisions regarding investments.

5.3. Boards of Directors

Board of directors have a central governance role of minimizing agency conflicts and mitigating earnings management through enhancing corporate oversight, changing managerial interests towards shareholders, and facilitating transparency. Proper oversight by the board, especially independent audit and governance committees, assists in ensuring that there is strict monitoring in the processes of financial reporting and performance of the management. Active monitoring minimizes chances of discretion by the managers that may result in opportunistic financial reporting (Alshdaifat et al., 2024).

The boards also can prevent conflicts of interest through the development of executive compensation systems that focus on the long-term company performance as opposed to the accounting performance in the short-run (Mansour et al., 2024). The earning manipulation incentive is lowered by associating financial managerial incentives with sustainable financial performance and shareholder value.

Besides, boards also help in the minimization of information asymmetry between information disclosure to the management and the shareholders. Promoting open communication and providing integrity of the financial disclosures boards can help to build trust, increase accountability and ensure that the financial reports show the true picture of the economic state of the firm.

5.4. Contributions and Limitations

This study also makes useful contributions from a theoretical perspective, as it contributes to providing empirical evidence on the impact of executive compensation on earnings management. It also contributes to the literature on earnings management by focusing on the relationship between executive compensation and earnings management. In addition, this study aims to fill the gap in empirical evidence in emerging economies and markets such as Saudi Arabia, regarding the relationship between executive compensation and earnings management. However, caution is required in interpreting the results, as the results of this study can only be generalized to markets where compensation and ownership structures are similar to those of Saudi Arabia. Based on the results of this study, future research and studies can develop and complement the current work.

It also contributes to the literature on earnings management by focusing on the relationship between executive compensation and earnings management. While prior studies have broadly established the existence of earnings management, this research provides granular detail by investigating a primary underlying incentive mechanism: the structure and magnitude of executive pay. This focus helps refine theoretical models that explain managerial behavior and provides a clearer understanding of the specific conditions under which manipulation is most likely to occur.

In addition, this study aims to fill the gap in empirical evidence in emerging economies and markets such as Saudi Arabia, regarding the relationship between executive compensation and earnings management. Western-centric research often dominates corporate finance literature; however, the regulatory environment, governance practices, and ownership structures (e.g., concentrated family or government ownership) in emerging markets like Saudi Arabia can differ significantly. By providing evidence from this unique institutional context, the study addresses a critical geographical limitation in the existing literature, making its findings relevant for international finance

and regulation.

However, caution is required in interpreting the results, as the results of this study can only be generalized to markets where compensation and ownership structures are similar to those of Saudi Arabia. This limitation stems from the specific institutional features of the Saudi market. For instance, if the market features high levels of state-owned enterprises or highly concentrated family ownership, the agency dynamics might differ substantially from those in markets characterized by dispersed ownership (like the US or UK). Therefore, applying these findings directly to dissimilar markets without further investigation risks drawing inaccurate conclusions.

Based on the results of this study, future research and studies can develop and complement the current work. The findings serve as a foundation, suggesting several avenues for follow-up research. For example, subsequent studies could explore the effectiveness of specific governance mechanisms (e.g., independent boards or audit committee expertise) in moderating the relationship found here, or they could examine how recent regulatory changes in the region affect both executive pay practices and earnings management over time.

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