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Related Party Transactions and Audit Fees: Indian Evidence

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ABSTRACT

We examine the effect of related party transactions (RPTs) on audit fees in Indian public companies. RPTs can be used to manipulate financial statements as well as transfer wealth between firms and their related parties, and the presence of RPTs increases audit risk. We find that related party sales are associated with 17.4 percent increase in audit fees, indicating that such transactions increase the audit risk and require significant additional audit effort.

Keywords: auditing, audit risk; audit fees; related party transactions; corporate governance.

JEL Classifications: G34; M41; M42.

I. INTRODUCTION

We examine the association between related party transactions (RPTs) and audit fees in Indian public companies. This study is motivated by: (a) the potential of RPTs for manipulation of financial statements as well as the transfer of wealth between firms and related parties; (b) high audit risks associated with RPTs; and (c) the significant presence of RPTs in emerging countries, such as India. We study a panel of 3,597 firm-year observations from 1,125 firms during 2016-2019 and find that related party sales and related party loans are associated with significantly higher audit fees for Indian firms.

Previous research documents that managers engage in earnings manipulation activities using related party sales of goods/services (Jian and Wong 2010) and that RPTs are associated with lower stock returns (Kohlbeck and Mayhew 2010) and future restatements (Kohlbeck and Mayhew 2017). Thus, evidence from prior studies suggests that RPTs increase the risk to investors and creditors through the inefficient use of resources or through low quality financial reporting.

Hence, it is logical to expect that RPTs should be associated with higher audit fees. However, prior evidence on such association is not consistent. For example, Kohlbeck and Mayhew (2017) find that firms engaged in RPTs in general pay lower audit fees, but "tone at the top RPT" firms that subsequently restate pay higher audit fees. Some other studies on RPTs report mixed evidence about the association between different types of RPTs and audit fees (Habib, Jiang, and Zhou 2015; Fang, Lobo, Zhang, and Zhao 2018).

This study focuses on Indian public companies to study the relationship between RPTs and audit fees. India provides a good setting to examine these issues because of the significant presence of RPTs among Indian companies. Irregularities involving RPTs, such as undervalued transactions with related parties, circular transactions, diversion or siphoning of funds, occur frequently in India (OECD 2014). Insiders in emerging economies often find avenues through

which to misuse RPTs for personal gain (Chauhan, Lakshmi, and Dey 2016) due to weak investor protection, poor law enforcement, inadequate disclosure, and financial opacity (Chakrabarti, Megginson, and Yadav 2008; Fan, Wei, and Xu 2011; Narayanaswamy, Raghunandan, and Rama 2012). Therefore, RPTs are of significant concern to investors, regulators, and other stakeholders (SEBI 2020).

Additionally, corporate governance issues in India differ from developed economies due to unique issues such as concentrated ownership and pyramidal business groups (Narayanaswamy et al. 2012; Armitage, Hou, Sarkar, and Talaulicar 2017). Controlling shareholders own a significant stake in publicly listed Indian firms and, as such, influence the decision-making in these companies. It precipitates a form of agency conflict between large (controlling) and small (minority) shareholders—i.e., the principal-principal problem (Young, Peng, Ahlstrom, Bruton, and Jiang 2008; Bhaumik and Selarka 2012)—rather than the conventional agency problems between managers and shareholders prevalent in developed countries (Jensen and Meckling 1976; Fama and Jensen 1983). Thus, the Indian setting makes RPTs a major corporate governance concern (SEBI 2020; Li 2021) and an interesting avenue to examine the association between RPTs and audit fees.

Using data from publicly listed Indian firms, we examine the effect of RPTs on audit fees. After the spectacular failure of Satyam Computer Services Ltd. (hereafter Satyam) in 2009, India had many legal and regulatory changes related to RPTs during 2010-2015, such as the Companies Act 2013, which overhauled the standards of financial disclosure – especially for RPTs. Hence, we focus on the years 2016-2019 in our analyses and find that related party sales are positively associated with audit fees.

We then examine if the association between RPTs and audit fees differs for various types of firms. We classify our sample into various subsamples based on size, auditor type, business group affiliation, and controlling shareholder ownership. Across all partitions, we find

that related party sales are associated with higher audit fees. This is consistent with the argument presented in previous research that compared to other RPTs, related party sales are complex and more difficult to audit, requiring more significant effort (Kohlbeck and Mayhew 2017; Fang et al. 2018). Thus, auditors charge a premium for such transactions for taking more risk and putting additional effort even for firms with higher levels of external monitoring. In addition, we find that related party lending is associated with higher audit fees for smaller firms and for non-Big 4 audit clients.

Overall, our results suggest that related party sales transactions are important elements of audit risk that leads to higher levels of audit fees. Our results align with findings reported in previous research by Jian and Wong (2010) and Greiner, Kohlbeck, and Smith (2017). Jian and Wong (2010) show that managers use (a) related party sales to prop-up earnings and as a substitute to accrual-based earnings management, and (b) related party loans to transfer wealth from firms to related parties. This complements the results in Greiner et al. (2017) showing that auditors charge a significant risk premium for earnings manipulation. Our results also highlight that results and inferences from corporate governance and auditing settings based on data from developed countries must be applied with caution in the context of emerging economies such as India with their unique institutional and governance challenges.

The next section provides the background. This is followed by a discussion of related literature and development of the research question. After a description of method and results, the paper concludes with a summary and discussion.

II. BACKGROUND

Related Party Transactions in India

RPTs are transactions between a firm and related parties, such as controlling shareholders, managers, executives, directors, key management personnel, relatives, and entities under their control. Emerging economies, such as India, are characterized by relatively

higher incidence of RPTs (Chauhan et al. 2016; Li 2021). The involvement of RPTs in high-profile accounting frauds around the world, including India, has led to increased awareness among investors and regulators about the risks associated with RPTs.[1]

In India, the Satyam fraud is a watershed event. The fraud, which came to light in 2009, highlighted the inadequate handling of RPTs by the board and auditors. This led to significant changes in the law and corporate governance regulations, and increased awareness of India's corporate governance issues among stakeholders (Narayanaswamy et al. 2012, 2015; OECD 2012, 2014; Brown, Daugherty, and Persellin 2014). The Satyam scandal led to calls for systemic change in regulatory norms concerning the auditing and disclosure of RPTs in India. The regulatory framework around RPTs underwent significant changes after the enactment of *The Companies Act of 2013* (*The 2013 Act*) and SEBI's *Listing Obligations and Disclosure Requirements Regulations 2015* (*LODR*).

The 2013 Act, *LODR*, and the *Indian Accounting Standard* (*Ind AS*) regulate the governance and disclosure of RPTs in Indian listed companies. The above regulations require listed Indian companies to disclose details of RPTs, such as the name of the related entity/individual, description of the relationship, amount, and nature of RPTs.

The 2013 Act marked a significant shift from a government approval-based regime to shareholder approval and disclosure-based regime.[2] It required disclosure of RPTs, and their justification, in the Annual Report by the Board of Directors. It prohibited companies from extending any loan/guarantee/security to any of its directors (or person or entity in whom director is interested). Moreover, RPT related information must be placed before the board for

[1] RPTs were involved in major accounting scandals such as Enron, WorldCom, Adelphia, and Tyco in in USA (Gordon, Henry, Louwers, and Reed 2007), Schneider Rundenwerke, Parmalat, and Bermer Vulkan in Europe, and Kangsai Group and Baan Company in Asia (Bennouri, Nekhili, and Touron 2015).

[2] Sections 177 (audit committee), 185 (loans to directors), 186 (loan and investment by the company), and 188 (related party transactions) of *The 2013 Act* are relevant for RPTs.

approval. However, arm's length RPTs (including loans) in the "ordinary course of business" are exempted from board approval and only require audit committee approval; RPTs that are not at arm's length must be approved by shareholders.[3]

In November 2019, SEBI constituted a Working Group to review and recommend polices around RPTs. The group submitted its report in January 2020 (SEBI 2020). Based on this report, SEBI widened the definitions and scope of related parties and RPTs.[4]

Auditing Standards for RPTs in India

The 2013 Act requires auditors to comply with their responsibilities in *Standard on Auditing 550* (*Related Parties*).[5] As in the US, Indian auditing standards also require auditors to identify related party relationships and RPTs.[6] Further, auditors must evaluate and respond to potential risk of material misstatements due to RPTs and identify fraud risk factors. Auditors are required to declare in the auditors' report that all RPTs comply with the disclosure norms. In addition, *The 2013 Act* requires companies to file financial statements of all domestic and foreign subsidiaries. These changes are intended to prevent the misuse of RPTs using foreign subsidiaries located in tax havens.

III. RELATED LITERATURE AND RESEARCH QUESTION

Alternate Perspectives of RPTs

There are two alternate views of RPTs: the efficient contracting perspective and the shareholder expropriation perspective. Under the efficient contracting view, RPTs are

[3] *The Companies (Amendment) Act 2017* relaxed the restriction about RPT loans if the loans are utilized for the principal business activities by the borrower.

[4] The revised LODR defines any person or entity either forming the promoter group or holding a 10% stake in the company as a "related party". This new definition will come into effect from April 1, 2023.

[5] *Standards on Auditing* by the Institute of Chartered Accountants of India (ICAI) is the Indian version of International Standards of Auditing (ISA) with some modifications.

[6] Public Company Accounting Oversight Board (PCAOB) in *AS 2410: Related Parties*, requires auditors to "obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements."

necessary business transactions that "fulfill the rational economic demands" of the company (Gordon, Henry, and Palia 2004). Ryngaert and Thomas (2012) argue that related parties' superior information about a company and willingness to share that private information could make RPTs efficient by optimizing internal resource allocation and reducing transaction costs. Similarly, Khanna and Yafeh (2007) argue that RPTs could be cheap and efficient in underdeveloped economies where the costs of transactions between unrelated parties are high. Consistent with this view, prior research provides evidence of efficient transfer of inter-corporate loans between related entities, i.e., transfer of cash from financially stronger firms to support the financially constrained firms (Gopalan, Nanda, and Seru 2007; Buchuk, Larrain, Muñoz, and Urzúa 2014). Similarly, prior research also provides evidence of reciprocal relationship, also known as "co-insurance," among related parties, i.e., firms reciprocate favors among themselves in a time of need (Fisman and Wang 2010; Jia, Shi, and Wang 2013).[7]

The shareholder expropriation perspective of RPTs is that it provides opportunities to managers and other related parties, such as controlling shareholders and directors, to expropriate minority shareholders. Supporting this view, previous research documents that RPTs are used to manipulate earnings (Jian and Wong 2010; Lo, Wong, and Firth 2010) and transfer wealth between the firm and related parties (Johnson, La Porta, Lopez-de-Silanes, and Shleifer 2000; Djankov, La Porta, Lopez-de-Silanes, and Shleifer 2008). RPTs are prone to abuse by insiders who are in control of decision making. As such, RPTs may facilitate the expropriation of minority shareholders and tunneling of funds from a firm to controlling shareholders (Cheung, Rau, and Stouraitis 2006). In such transactions, controlling shareholders benefit at the expense of others (Jiang, Lee, and Yue 2010); this damages shareholder value

[7] Prior research argues that greater efficiency in loan transactions could be due to their higher traceability compared to other RPTs (Jiang et al. 2010), better regulatory requirements in certain economies (Buchuk et al. 2014), and fear of the negative spill-over effect of default by a group firm on the rest of the business group (Gopalan et al. 2007). On the other hand, related party sales and purchases of goods, services, or assets could be carried out purely for commercial purposes.

(Lo et al. 2010). Moreover, concentrated ownership, weak investor protection, and poor law enforcement in emerging economies might make RPTs prone to misuse by controlling shareholders (Chauhan et al. 2016).

Thus, RPTs can enhance value through efficient contracting or be used for expropriation by controlling shareholders. In addition to the positive and negative aspects of RPTs, the fact that the controlling shareholders occupy key managerial positions in most Indian firms makes RPTs an interesting area of research (Armitage et al. 2017).

RPTs and Audit Risk

All RPTs are not necessarily expropriative (Ryngaert and Thomas 2012). However, challenges associated with identifying and disclosing RPTs and their potential to be used by managers for opportunistic purposes can affect audit fees (Gordon et al. 2004).[8] In addition to increased audit risk and client business risk, increased audit effort associated with RPTs contributes to higher audit fees. Prior research shows that auditors account for audit and business risk (in the form of damaged reputation, litigation risk, etc.) while setting the audit fees (Houston, Peters, and Pratt 1999; Johnstone 2000; Lyon and Maher 2005).

Previous research provides mixed evidence on the relationship between RPTs and audit fees. Kohlbeck and Mayhew (2017), using US data, show that RPTs are negatively associated with audit fees; however, the association is positive in firms with "tone at the top RPT" that subsequently restate. Using data from China, Habib et al. (2015) show that operating RPTs such as related party sales and purchases of goods/services are negatively associated with audit fees; however, non-operating RPTs such as related party loans are positively associated with audit fees. In contrast, Fang et al. (2018) find that related party assets sales are positively

[8] The American Institute of Certified Public Accountants (AICPA) terms RPTs "difficult to audit" because of the complexity involved in identifying related parties, reliance on managerial disclosure of RPTs, and the difficulty in tracking RPTs by internal controls (AICPA 2001).

associated with audit fees in China but related party loans or sales are not significantly associated with audit fees.

RPTs can be of various types, such as loans given or borrowed, guarantees extended, sale or purchase of goods and services, sale or purchase of assets, etc. The audit risk associated with each type varies because the motive behind transactions between related parties depends on the type of transactions and the counterparty (Kohlbeck and Mayhew 2017). Based on prior research (Fang et al. 2018), we broadly categorize RPTs into sales and purchase of goods and services, loans, guarantees, sales and purchases of assets and equity. The following section discusses the audit risk associated with each type and the effect on audit effort.

Related Party Sales / Purchases of Goods and Services

Jian and Wong (2010) provide evidence that managers use related party sales of goods and services as a substitute for accrual-based earnings management, particularly cash-based related sales. Previous research shows that manipulating earnings using related party sales helps the firm avoid reporting losses, boost earnings before the initial public offerings (IPO) or rights issues, and maintain the listing status (Jian and Wong 2010; Aharony, Wang, and Yuan 2010). Since manipulating earnings increases the audit risk, a higher level of earnings management significantly increases the audit effort and fees (Schelleman and Knechel 2010).

Related party purchases of goods and services can also be used to prop-up earnings by applying a discount on items purchased from related entities, leading to reduced cost of goods sold. However, related party purchases pose a lower level of risk than related party sales. This is because the sale of goods and services immediately affects net income while purchases affect the net income only when the sales occur later (Fang et al. 2018). Moreover, Fang et al. (2018, 79) note that "there is greater room for the overstatement of sales than for the understatement of cost of goods sold because the latter cannot be zero." Supporting these arguments, Jian and Wong (2010) demonstrate that only related party sales are significantly associated with

earnings management while the relationship between related party purchases and earnings management is statistically insignificant. Thus, despite the potential risk of both types, related party sales appear to pose higher audit risk.

Based on the above, we expect auditors to charge relatively higher fees for related party sales. We expect any such association with audit fees to be weaker in the case of related party purchases.

Related Party Loans and Borrowings

Related party lending plays a significant role in the internal capital markets of emerging economies, since such loans can be used to efficiently transfer funds to financially weaker firms (Gopalan et al. 2007; Fisman and Wang 2010; Buchuk et al. 2014). Conversely, related party loans are a potential channel for tunneling funds to the related parties and are likely to influence audit risk significantly. Jiang et al. (2010) provide evidence of siphoning off funds from listed companies to controlling shareholders, and that principal and interest on most of these loans were never paid back. Apart from lower recovery and minimal interest payment, these loans carry a higher risk of default (La Porta, Lopez-de-Silanes, and Zamarripa 2003). Moreover, related party loans are also used to tunnel funds in the post-IPO period after boosting earnings before the IPO through related party sales (Aharony et al. 2010; Jian and Wong 2010). Fang et al. (2018) argue that insiders could overstate related party loans in the company books if they intend to default on the loan. Thus, we expect that related party loans to increase the audit risk.

In comparison, related party borrowings are less likely to pose a serious threat since it puts the funds of related parties at risk. However, Kohlbeck and Mayhew (2017) argue that borrowings from certain related parties such as directors, officers, and shareholders may have an opportunistic motive and increase the audit risk.

Based on the above, we expect a significant positive association between related party lending and audit fees. We expect the association to be weaker in the case of related party borrowing.

Related Party Guarantees Given and Taken

Similar to related party lending and borrowing, related party guarantees may significantly influence the audit risk. Loan guarantees for the debt taken by related parties could substantially increase the company's business risk due to the potential risk of default (Berkman, Cole, and Fu 2009). Loan guarantees by listed companies to related parties significantly increase when a family member sits on the board or becomes a senior executive in the company (Chen, Arnoldi, and Na 2015). Thus, we argue that related party guarantees would influence the audit risk.

Similar to related party borrowings, loans of the company that are guaranteed by certain related parties, such as directors, officers, and shareholders, may have an opportunistic motive. Additionally, guarantees obtained from related parties may indicate a poor financial condition of the company, which may affect the audit risk.

Related Party Sales/Purchases of Assets and Investments

Compared to other RPTs, the buying and selling of assets and investments between related parties is less frequent but more significant in value. Cheung, Qi, Rao, and Stouraitis (2009) show that listed firms acquire assets at a higher price than the "fair" value (similar arm's length transactions) from related parties but sell at a price lower than the fair value. It suggests that the acquisition and sale of assets will likely increase audit risk and require greater audit effort. Fang et al. (2018) argue that, since these transactions affect net income but do not have any impact on operating income, firms are less likely to prefer these transactions for earnings manipulation. Hence, audit risk associated with related party sales and purchases of assets/investments is expected to be lower than other RPTs.

Research Question

Transactions between related parties would require greater audit effort for better scrutiny, i.e., the auditor mitigates the risk through increased effort. Additionally, an auditor would charge a premium for absorbing the risk originating from RPTs. Since RPTs are a convenient tool which managers use for opportunistic purposes, such as manipulating earnings or transferring wealth between related entities, we expect that auditors are likely to put more effort and levy higher risk premia, leading to higher audit fees. The above arguments suggest a positive association between RPTs and audit fees. However, as discussed in the prior section, the extent of the association between RPTs and audit fees need not be uniform across all types of RPTs. Thus, our research question is:

RQ: Is there a significant association between various types of RPTs and audit fees in Indian public companies?

IV. METHOD

Data

We obtain necessary data on Indian companies listed on National Stock Exchange (NSE) from the Auditors Database, maintained by PRIME Database Group, and Prowessdx by the Centre for Monitoring Indian Economy (CMIE).[9] As discussed earlier, the enactment of *The 2013 Act*, followed by the SEBI's listing requirements in LODR, led to stricter regulatory requirements for RPTs. These regulations became effective from fiscal year 2016. Hence, we select 2016-2019 as our period of study. Following prior research, we remove the financial (National Industrial Classification [NIC] codes 64-69) and utility sectors (NIC codes 35-38) firms from the sample. Our sample consists of an unbalanced panel of 3,597 firm-year observations from 1,125 firms.

[9] These databases, equivalent to Compustat in the United States (US), have been a primary source of data collection for academic research on Indian companies (Gopalan et al. 2007; Bertrand et al. 2002).

Empirical Model

We used the following regression model to examine the relationship between audit fees and RPTs in Indian firms.

$$LNAF_{it} = \beta_0 + \beta_1 RPT\_SALES_{it} + \beta_2 RPT\_PURCH_{it} + \beta_3 RPT\_LOANS_{it} + \beta_4 RPT\_BORROWINGS_{it} + \beta_5 RPT\_GUARGIV_{it} + \beta_6 RPT\_GUARTKN_{it} + \beta_7 RPT\_FAINVSALES_{it} + \beta_8 RPT\_FAINVPURCH_{it} + \beta_9 SIZE_{it} + \beta_{10} ACREC_{it} + \beta_{11} INVENTORY_{it} + \beta_{12} LEV_{it} + \beta_{13} QUICK_{it} + \beta_{14} ROA_{it} + \beta_{15} BIG4_{it} + \beta_{16} INITIAL_{it} + \beta_{17} JOINT\_AUDIT_{it} + \beta_{18} CSO_{it} + \beta_{19} BG_{it} + \beta_{20} IO_{it} + Industry\ Fixed\ Effects + Year\ Fixed\ Effects + error$$

The variables are defined as follows:

LNAF = Natural logarithm of audit fees paid to the auditors;

RPT_SALES = 1 if there is related party sales of goods & services, 0 otherwise;

RPT_PURCH = 1 if there is related party purchases of goods & services, 0 otherwise;

RPT_LOANS = 1 if there is related party loans, 0 otherwise;

RPT_BORROWINGS = 1 if there is related party borrowings, 0 otherwise;

RPT_GUARGIV = 1 if there is related party guarantees provided, 0 otherwise;

RPT_GUARTKN = 1 if there is related party guarantees received, 0 otherwise;

RPT_FAINVSALES = 1 if there is related party sales of assets and investments, 0 otherwise;

RPT_FAINVPURCH = 1 if there is related party purchases of assets and investments, 0 otherwise;

SIZE = Natural logarithm of total assets (measured in millions of Indian rupees);

ACREC = Total accounts receivables divided by total assets;

INVENTORY = Total inventory divided by total assets;

LEV = Total debt divided by total assets;

QUICK = Current assets minus inventories divided by current liabilities;

ROA = Net income divided by total assets;

BIG4 = 1 if the firm is audited by one of the big four firms, 0 otherwise;

INITIAL = 1 if it is a first-year audit (initial year audit), 0 otherwise;

JOINT_AUDIT = 1 if more than one statutory auditor audits the firm, 0 otherwise;

CSO = The proportion of controlling shareholders ownership;

BG = 1 if the firm is affiliated with a business group, 0 otherwise; and

IO = The proportion of institutional ownership.

Our dependent variable is the natural logarithm of audit fees (*LNAF*). Our independent variables are various types of RPTs: related party sales of goods and services (*RPT_SALES*), related party purchases of goods and services (*RPT_PURCH*), related gross lending (*RPT_LOANS*), related gross borrowings (*RPT_BORROWINGS*), related guarantees given (*RPT_GUARGIV*), related guarantees taken (*RPT_GUARTKN*), related party sales of fixed assets and investments (*RPT_FAINVSALES*), and the related party purchases of fixed assets and investments (*RPT_FAINVPURCH*).[10]

We control for factors that might influence the audit fees, such as firm size, audit complexity, firm-specific factors, auditor characteristics, and ownership characteristics. We use natural logarithm of total assets as our measure of client size (*SIZE*). We account for audit risk and audit complexity of clients by including total accounts receivables as a proportion of total assets (*ACREC*) and total inventory as a proportion of total assets (*INVENTORY*) as controls.[11] We control for firm-specific factors such as leverage (*LEV*), liquidity (*QUICK*), and

[10] The presence of RPTs increases the audit risk (reflecting the potential risk of earnings manipulation and transfer of wealth). In addition, any RPT irrespective of magnitude requires additional audit effort (given additional disclosure requirements). Hence, we use binary measures of RPTs as independent variables. As part of robustness tests, we also use continuous measures of RPTs (rupee value of RPTs as a proportion of total assets).

[11] As part of sensitivity tests, we also use alternate proxies for audit complexity such as foreign earnings (measured as total earnings through exports of goods and services as a proportion of total sales) and the number of business segments (measured as the square root of the number of business segments).

profitability (*ROA*). Additionally, audit fees paid by the clients are likely to be higher if the auditor is one of the Big 4 firms or jointly auditing the client with another statutory auditor. Thus, we include indicators for audit firm type (*BIG4*) and whether the client has more than one statutory auditor (*JOINT_AUDIT*). We also control for initial year audits (*INITIAL*).

In emerging economies, organizational forms such as concentrated ownership and business groups are prevalent due to the need to protect large shareholders' interests from inefficiencies, such as institutional voids, market failures, high transaction costs, and weak law enforcement (Khanna and Palepu 1999; Khanna and Rivkin 2001). These organizational forms exercise significant control over managerial decision-making and can influence the association between RPTs and audit fees. Hence, we include controlling shareholders ownership (*CSO*) and business group affiliation (*BG*). Further, as part of additional analyses, we split the sample based on *BG* and separately run the model for companies that are part of a business group and companies that are standalone. Since institutional investors play a significant role in corporate governance (McCahery, Sautner, and Starks 2016), we control for institutional ownership (*IO*). Finally, following prior research (Kohlbeck and Mayhew 2017; Fang et al. 2018), we include industry and year fixed effects and cluster the standard errors by firm.

V. RESULTS

Descriptive Statistics

Table 1 reports the descriptive statistics of our sample of 3,597 observations from 1,125 firms. The continuous variables are winsorized at 1% and 99%. The mean and median values of control variables are generally consistent with prior research on Indian companies.

Panel B of Table 1 presents the mean values of binary variables. Related party sales (purchases) are present in about 70% (65%) of the observations. Further, 44.6% (24.2%) of the observations have related party loans (borrowings) to (from) related parties. Related party guarantees given or taken are much less frequent (present in 19.8% and 5.8 percent of

observations, respectively). Nearly 16% of observations report selling assets and investments to related parties, while 36.1% of the observations report purchasing assets and investments from related parties. We observe that the transactions that are more likely to be expropriative such as sales, lending, and guarantees given, are significantly higher than purchases, borrowings, and guarantees obtained.

The data show that BIG4 auditors audit 26.8% of observations in our sample. While this proportion is much lower than those reported in the US or other developed countries, it is in line with those reported by prior studies using Indian data (e.g., Narayanaswamy et al. (2012)). Another notable feature of the data is that 22.2% of the observations are initial-year audits. This is primarily because mandatory auditor rotation, required by *The 2013 Act*, became relevant for the first time during the study period. More than one auditor audited about 5.2% of the observations in our sample. Finally, consistent with prior research on Indian companies (e.g., Chauhan, Dey, and Jha 2016), more than half of the observations are affiliated with business groups.

Panel C of Table 1 reports yearly mean values of variables used in this study. We find that the audit fees remain stable over the sample period. Among the eight types of RPTs, we see an upward trend in related party borrowing. Other kinds of RPTs remain steady over the sample period. In the last two years of our sample period (2018 and 2019), auditor characteristics differ from the first two years (2016 and 2017). The proportion of clients with a Big 4 auditor is higher in 2018 and 2019; also, the *INITIAL* measure is higher in 2018. This shift is explained by the fact that *The 2013 Act* provided a five-year transition period for the mandatory auditor rotation requirement.

Regression Results

Table 2 reports the results from regression analyses examining the effect of RPTs on audit fees. To address the potential heteroskedasticity and autocorrelation problems, we cluster

the standard errors by firm. The overall model is statistically significant at $p < 0.01$, and the adjusted R^2 is 73%.

We find that the coefficient on *RPT_SALES* is positive and significant (coefficient = 0.16, t-statistic = 4.89). The regression estimate indicates that audit fees for firms engaged in related party sales are 17.4% higher than for firms without such transactions. This is consistent with prior research (Greiner et al. 2017) that shows that firms engage in earnings manipulation activities using related party sales of goods/services, increasing audit risk. Transactions with greater risk require more significant audit effort; auditors mitigate the risk through increased audit effort, resulting in higher audit fees.

The coefficient of *RPT_PURCH* is not significant in the regression. Auditors likely consider these transactions as innocuous. These findings are consistent with prior research (Fang et al. 2018) that shows that related party purchases of goods/services are less likely to be expropriative because purchases do not immediately affect the company's net income.

The coefficient on *RPT_LOANS* is positive and statistically significant at $p < 0.01$ (coefficient = 0.10, t-statistic = 3.75). The regression estimate indicates that audit fees are 10.5% higher for firms that extend loans to related parties in comparison with those that are not engaged in such transactions. Similarly, the coefficient on *RPT_FAINVPURCH* is positive and statistically significant (coefficient = 0.10, t-statistic = 3.99), indicating that audit fee is 10.5% higher for firms purchasing assets and investments from related parties than those which do not buy assets and investments from related entities. This is consistent with prior research that provides evidence that publicly listed firms acquire assets at a premium while selling assets at a price lower than comparable arm's length transactions (Cheung et al. 2009). The coefficients of *RPT_BORROWINGS*, *RPT_GUARGIV*, *RPT_GUARTKN*, and *RPT_FAINVSALES* are not significant.

Turning to our control variables, consistent with our expectations and prior research, firm size and complexity are positively associated with audit fees. We find that liquidity (quick ratio) is negatively associated with audit fees, indicating that clients with greater liquidity pose a lesser audit risk. Leverage is negatively associated with audit fees, indicating that audit risk is lower for the clients with higher debt in their capital structure. This is consistent with the literature on the monitoring role of debt (Gul and Tsui 2001). Audit fees are higher for firms audited by Big 4, and if there are multiple statutory auditors, but lower for initial year clients. Finally, firms affiliated with business groups and higher institutional ownership pay higher audit fees.

Additional Analyses

We partition the data into sub-samples based on client size, auditor type, business group affiliation, and controlling shareholder ownership to examine if the relationship between RPTs and audit fees varies across various firm-specific factors.

Client Size

Larger firms tend to have higher and more complex RPTs and thus would require more significant audit effort. Additionally, Hwang, Chiou, and Wang (2013) show that larger firms have a higher incentive to manage earnings using RPTs than smaller firms. Conversely, larger firms are under greater scrutiny of the press and regulators. Therefore, it is an empirical question if the relationship between RPTs and audit fees differs depending upon the firm size. We partition our sample into large (total assets greater than median value) and small (total assets smaller than median value) sub-samples.

Table 3 presents the results for both large and small subsamples. In both the small and large client sub-samples, there is a positive association between RPT sales and audit fees (although the association is marginal ($p < .10$) in the large client sub-sample).

The related party loans are strongly associated with the small-client group's audit fees, but not in the large client group. Since it is relatively easier to identify value opportunistic related party loans than related party sales (Jiang et al. 2010), to the extent there is greater external monitoring and/or better corporate governance at larger firms, related party loans may not increase audit fees at larger firms. On the other hand, external monitoring in smaller firms is relatively lower, and thus auditors charge higher fees for related party loans.

Additionally, the association between related party purchases of assets & investments and audit fees is positive and significant in the large-client group but not in the small client group. Since the sale and purchase of assets & investments between related parties is substantial in value and lower in frequency than the other RPTs, it is likely to occur more in large clients than in small groups. In smaller clients, such transactions may not pose a significant audit risk.

Auditor Type

Due to reputation concerns, the monitoring quality of Big 4 audit firms can be higher than that of non-Big4 firms. Therefore, we partition the sample based on auditor type (Big 4 or not). Table 4 reports the regression results of both subsamples. A notable feature is that, as with the client size-based partition in Table 3, there is a significant positive association between related party sales and audit fees for Big 4 and non-Big 4 clients.

However, the results for other RPTs differ across the two groups. In the non-Big 4 sub-sample, related party loans and RPTs involving the purchase of assets and investments are positively associated with audit fees. In the Big 4 sub-sample, related party purchases of goods & services are negatively associated, and RPTs involving the purchase of assets and investments are positively associated with audit fees (although the association is marginal).

Business Group

Bertrand, Mehta, and Mullainathan (2002) document that controlling shareholders of business group affiliated firms are more likely to engage in tunneling (i.e., shifting wealth from

firms with low cash flow rights to those with high cash flow rights). Additionally, Nagar and Sen (2016) show that family firms are more engaged in classification shifting—a form of earnings management—than non-family firms. Hence the association between RPTs and audit fees can differ for standalone and business group affiliated firms. Hence, we classify our sample into standalone (non-BG) and business group affiliated (BG) subsamples.

Table 5 presents the results of both subsamples. As in Tables 3 and 4, there is a significant association between related party sales and audit fees in both types of firms. Further, in the standalone firms' subsample, related party loans, related party borrowing, and related party purchases of assets and investments are associated with higher audit fees. In the business group subsample, related party loans, related party guarantees taken, and related party purchases of assets and investments are positively associated with audit fees. Related party borrowings is negatively associated with audit fees. Borrowing from business group firms is often part of the regular business transactions where firms raise funds from the internal capital market (Gopalan et al. 2007), so they may be less likely to lead to higher audit fees. We find a marginal positive association between guarantees taken and audit fees. Taking guarantees by a business group firm could be perceived as a signal of poor financial condition, resulting in higher audit fees.

Controlling Shareholder Ownership

Controlling shareholders (also known as promoters in India) own a significant stake (often more than 50%) in many publicly listed Indian companies and influence the decision-making in these companies. Prior studies provide evidence that controlling shareholder ownership is associated with the expropriation of minority shareholders using RPTs (Berkman et al. 2009). Further, the presence of controlling shareholders in board and audit committees is related to adverse governance outcomes, such as the deterioration of firm performance (Jameson, Prevost, and Puthenpurackal 2014). On the other hand, Jiang et al. (2010) show that

earnings manipulation is significantly higher in firms with multiple controlling shareholders than those with a single controlling shareholder. Hence, the association between RPTs and audit fees may differ depending on the extent of controlling shareholder ownership. Therefore, we partition our sample into Low-*CSO* (*CSO* smaller than median value) and High-*CSO* (*CSO* equal or larger than median value) subsamples.

Table 6 presents the results of the subsample. Related party sales, related party loans, and related party purchases of assets and investments are associated with higher audit fees in both the Low-*CSO* and High-*CSO* subsamples. The groups differ in the association between related party guarantees given and audit fees. The association is significantly positive in the Low-*CSO* subsample but not in the High-*CSO* subsample.

Type of Related Party

Different related parties may have divergent motives behind engaging in RPTs. Kohlbeck and Mayhew (2010) provide evidence that market perception differs for RPTs with different types of related parties. They show that RPTs with directors, officers, and shareholders are viewed negatively and generally associated with lower firm valuation. Thus, audit risk (and, in turn, the association between audit fees and RPTs) may differ depending on the counterparty to the transaction. Following Kohlbeck and Mayhew (2017), we partition RPTs into two types: *RPT_DOS*, i.e., RPTs with directors, officers, and shareholders, and *RPT_INVESTEE*, i.e., RPTs with subsidiaries, associates, and joint ventures[12].

Table 7 reports the regression results. Column 1 presents the association between all RPTs and audit fees. We find that the coefficient on RPT is positive and significant, indicating that auditors levy higher fees on the firms engaged in RPTs than those not involved in such transactions. In Column 2, both types of RPTs, *RPT_DOS* and *RPT_INVESTEE*, are

[12] Categorization of RPTs based on related party type is provided in Appendix 2.

significantly positively associated with audit fees. It suggests that auditors impose a premium for firms engaged in RPTs irrespective of the type of related parties.

Column 3 further classifies RPTs based on the type of RPTs and the identity of the related party. We find that only related party sales and related party loans are associated with audit fees irrespective of the type of related party.

Magnitude of Related Party Transactions

In our primary analyses, we used dichotomous variables for RPTs. This is because from an auditor's perspective, the existence of RPTs creates additional work (and, additional risk). As part of additional analyses, we also use continuous measures of RPTs.

Table 8 reports the mean annual rupee value of RPTs (as a proportion of total assets), in the sub-sample of observations with non-zero RPTs. On average, RPTs are 23.1% of total assets. In terms of rupee value, 8.7% of these transactions took place with directors, officers, and shareholders, while the remaining RPTs, i.e., 14.4%, were with subsidiaries, associates, and joint ventures. On average, related party sales and purchases of goods and services, as a proportion of total assets, is 0.072 and 0.039, respectively. Other types of RPTs are relatively smaller in magnitude.

Table 9 presents the results when we use the magnitude of RPTs as the variables of interest. Related party sales is positively associated with audit fees both in the full sample and in the two size-based partitions—consistent with the primary analyses reported earlier. When we partition by size, we find that for large clients only related party sales are positively associated with audit fees. Related party loans are positively associated with higher audit fees, but the results are significant only in the small client sample.

VI. SUMMARY AND CONCLUSIONS

Related party transactions (RPTs) pose significant challenges to auditors because of the complexity involved in identifying related parties, reliance on managerial disclosure of RPTs,

and the difficulty in tracking RPTs by internal controls. Due to such challenges and the potential of RPTs to be used for opportunistic purposes, such as earnings manipulation and transfer of wealth between related parties, the presence of RPTs significantly increases the audit risk. This study examines the impact of various types of RPTs on audit fees in Indian firms. Evidence from India is particularly interesting given the increasing importance of India in the global economy, and the prevalence of RPTs in emerging economies such as India.

Using data from 1,125 Indian firms (3,597 observations) during the years 2016 to 2019, we find consistent evidence that related party sales are associated with higher audit fees. Depending on partitions (based on size, auditor type, business group, controlling shareholder ownership), some other types of RPTs (loans, guarantees, purchases of assets/investments) are associated with higher audit fees. These results are consistent with prior research that shows that related party sales are used for propping earnings (Jian and Wong 2010) and transfer of wealth (Jiang et al. 2010) in emerging economies, and that RPTs can serve as "red flags" for future financial reporting problems (Kohlbeck and Mayhew 2017).

Our findings are at variance with results reported from the US, and other countries, about the association between RPTs and audit fees. As such, they also reinforce the point made by Narayanaswamy et al. (2012, 2021) about the unique aspects of Indian corporate governance and the need for caution when transferring results from other countries to Indian settings.

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Table 1: Descriptive Statistics

Panel A: Continuous Variables

Variable	N	Mean	St. Dev.	Q1	Q2	Q3
LNAF	3,597	14.190	1.301	13.300	14.220	15.040
SIZE	3,597	9.214	1.503	8.191	9.119	10.200
ACREC	3,597	0.197	0.149	0.080	0.168	0.270
INVENTORY	3,597	0.161	0.130	0.069	0.132	0.219
LEV	3,597	0.314	0.303	0.094	0.258	0.426
QUICK	3,597	0.850	0.811	0.366	0.647	1.019
ROA	3,597	0.033	0.102	0.001	0.033	0.084
CSO	3,597	0.551	0.151	0.465	0.571	0.672
IO	3,597	0.111	0.128	0.004	0.062	0.180

Panel B: Binary Variables

Variable	N	Mean
BIG4	3,597	0.268
INITIAL	3,597	0.222
JOINT_AUDIT	3,597	0.052
BG	3,597	0.525
RPT_SALES	3,597	0.698
RPT_PURCH	3,597	0.649
RPT_LOANS	3,597	0.446
RPT_BORROWINGS	3,597	0.242
RPT_GUARGIV	3,597	0.198
RPT_GUARTKN	3,597	0.058
RPT_FAINVSALES	3,597	0.160
RPT_FAINVPURCH	3,597	0.361

Panel C: Yearly Average of Variables

Variable	2016	2017	2018	2019
Number of Firms	841	886	894	976
LNAF	14.204	14.181	14.194	14.169
SIZE	9.211	9.231	9.236	9.182
ACREC	0.196	0.194	0.201	0.197
INVENTORY	0.163	0.155	0.158	0.166
LEV	0.342	0.324	0.303	0.290
QUICK	0.823	0.842	0.848	0.882
ROA	0.025	0.036	0.034	0.036
CSO	0.551	0.549	0.547	0.557
IO	0.109	0.111	0.115	0.109
BIG4	0.244	0.243	0.291	0.290
INITIAL	0.051	0.100	0.651	0.086
JOINT_AUDIT	0.068	0.070	0.036	0.036
BG	0.551	0.538	0.518	0.497
RPT_SALES	0.713	0.686	0.696	0.697
RPT_PURCH	0.662	0.630	0.650	0.655

RPT_LOANS	0.444	0.428	0.443	0.466
RPT_BORROWINGS	0.225	0.226	0.248	0.267
RPT_GUARGIV	0.180	0.200	0.208	0.202
RPT_GUARTKN	0.057	0.058	0.057	0.060
RPT_FAINVSALES	0.171	0.157	0.157	0.156
RPT_FAINVPURCH	0.390	0.332	0.370	0.355

Note: The variables are defined as in Appendix 1. St. Dev. = Standard Deviation; Q1 = 25th Percentile; Q2 = Median; Q3 = 75th Percentile.

Table 2: Audit Fees and Related Party Transactions

	DV: *LNAF*	
Variable	Coefficient	t-stat.
RPT_SALES	0.16	4.89***
RPT_PURCH	-0.03	-1.15
RPT_LOANS	0.10	3.75***
RPT_BORROWINGS	-0.02	-0.59
RPT_GUARGIV	0.02	0.52
RPT_GUARTKN	0.05	1.00
RPT_FAINVSALES	-0.01	-0.21
RPT_FAINVPURCH	0.10	3.99***
SIZE	0.52	42.12***
ACREC	0.19	1.90*
INVENTORY	0.44	3.89***
LEV	-0.20	-3.45***
QUICK	-0.06	-3.28***
ROA	0.03	0.23
BIG4	0.69	26.89***
INITIAL	-0.11	-3.29***
JOINT_AUDIT	0.21	4.46***
CSO	0.20	1.93*
BG	0.12	4.56***
IO	0.86	6.68***
Constant	8.76	66.02***
Industry Fixed Effects	Yes	
Year Fixed Effects	Yes	
Std. Error Clustered by Firm	Yes	
Observations	3,597	
Adjusted R^2	0.73	
F Statistic	190.50***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1. DV = dependent variable; *LNAF* = natural logarithm of audit fees.

Table 3: Classification by Client Size

Variable	**DV: *LNAF***			
	Small Clients (1)		Large Clients (2)	
	Coefficient	t-stat.	Coefficient	t-stat.
RPT_SALES	0.16	3.66***	0.09	1.84*
RPT_PURCH	-0.07	-1.59	0.03	0.70
RPT_LOANS	0.16	4.06***	0.05	1.41
RPT_BORROWINGS	-0.01	-0.19	-0.02	-0.44
RPT_GUARGIV	0.04	0.65	0.02	0.45
RPT_GUARTKN	0.07	0.86	-0.03	-0.52
RPT_FAINVSALES	-0.09	-1.64	0.04	1.10
RPT_FAINVPURCH	0.06	1.47	0.16	4.82***
SIZE	0.56	22.22***	0.50	24.64***
ACREC	0.15	1.03	0.04	0.30
INVENTORY	0.37	2.25**	0.43	2.72***
LEV	-0.09	-1.24	-0.47	-4.77***
QUICK	-0.09	-3.46***	-0.002	-0.06
ROA	-0.02	-0.09	-0.09	-0.38
BIG4	0.87	21.62***	0.58	17.26***
INITIAL	-0.07	-1.31	-0.14	-3.26***
JOINT_AUDIT	0.12	1.14	0.21	3.86***
CSO	0.55	3.69***	-0.14	-1.00
BG	0.11	2.93***	0.09	2.50**
IO	1.27	5.23***	0.50	2.95***
Constant	8.12	30.61***	9.35	45.54***
Industry Fixed Effects	Yes		Yes	
Year Fixed Effects	Yes		Yes	
Std. Error Clustered by Firm	Yes		Yes	
Observations	1,799		1,798	
Adjusted R^2	0.51		0.62	
F Statistic	37.90***		58.76***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. Our sample is classified into small-client (column 1) and large-client subsamples (column 2). Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1. DV = dependent variable; *LNAF* = natural logarithm of audit fees.

Table 4: Classification by Auditor Type

Variable	**DV: *LNAF***			
	Non-BIG4 (1)		BIG4 (2)	
	Coefficient	t-stat.	Coefficient	t-stat.
RPT_SALES	0.15	4.01***	0.12	1.99**
RPT_PURCH	-0.03	-0.75	-0.09	-1.94*
RPT_LOANS	0.13	3.95***	0.04	1.00
RPT_BORROWINGS	-0.01	-0.29	-0.04	-0.98
RPT_GUARGIV	0.06	1.39	-0.02	-0.47
RPT_GUARTKN	0.08	1.24	-0.07	-0.88
RPT_FAINVSALES	-0.003	-0.06	0.02	0.36
RPT_FAINVPURCH	0.15	4.44***	0.07	1.75*
SIZE	0.53	35.62***	0.46	21.59***
ACREC	0.22	1.93*	0.17	1.03
INVENTORY	0.42	3.27***	0.33	1.73*
LEV	-0.14	-2.22**	-0.34	-2.85***
QUICK	-0.06	-2.50**	-0.09	-3.42***
ROA	0.21	1.16	-0.45	-1.78*
INITIAL	-0.11	-1.62	-0.13	-2.89***
JOINT_AUDIT	0.19	1.58	0.20	3.35***
CSO	0.22	7.04***	0.05	0.24
BG	0.11	0.71	-0.01	-0.35
IO	1.08	10.14***	0.57	2.03**
Constant	8.45	49.38***	10.63	60.97***
Industry Fixed Effects	Yes		Yes	
Year Fixed Effects	Yes		Yes	
Std. Error Clustered by Firm	Yes		Yes	
Observations	2,634		963	
Adjusted R^2	0.61		0.70	
F Statistic	85.01***		47.91***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. Our sample is classified into non-BIG4 (column 1) and BIG4 subsamples (column 2). Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1. DV = dependent variable; *LNAF* = natural logarithm of audit fees.

Table 5: Classification by Business Group Affiliation

Variable	**DV: *LNAF***			
	Non-*BG* (1)		*BG* (2)	
	Coefficient	t-stat.	Coefficient	t-stat.
RPT_SALES	0.17	3.60***	0.12	2.82***
RPT_PURCH	-0.01	-0.21	-0.04	-1.12
RPT_LOANS	0.12	3.00***	0.07	2.05**
RPT_BORROWINGS	0.08	1.88*	-0.08	-2.08**
RPT_GUARGIV	-0.001	-0.01	0.04	0.98
RPT_GUARTKN	-0.09	-1.04	0.12	1.83*
RPT_FAINVSALES	0.03	0.61	-0.02	-0.52
RPT_FAINVPURCH	0.10	2.34**	0.11	3.31***
SIZE	0.52	25.91***	0.51	31.82***
ACREC	0.01	0.07	0.48	3.44***
INVENTORY	0.46	2.98***	0.29	1.85*
LEV	-0.20	-2.54**	-0.15	-1.83*
QUICK	-0.08	-3.19***	-0.04	-1.34
ROA	0.03	0.16	0.12	0.59
BIG4	0.67	14.50***	0.70	21.60***
INITIAL	-0.13	-2.69***	-0.09	-2.10**
JOINT_AUDIT	0.37	5.11***	0.09	1.61
CSO	0.42	2.83***	-0.16	-1.04
IO	0.92	7.17***	0.73	4.07***
Constant	8.74	37.06***	9.04	55.45***
Industry Fixed Effects	Yes		Yes	
Year Fixed Effects	Yes		Yes	
Std. Error Clustered by Firm	Yes		Yes	
Observations	1,709		1,888	
Adjusted R^2	0.67		0.74	
F Statistic	70.89***		109.40***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. Our sample is classified into non-BG (column 1) and BG subsamples (column 2). Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1. DV = dependent variable; *LNAF* = natural logarithm of audit fees. *BG* = Business Group.

Table 6: Classification by Controlling Shareholder (Promoters) Ownership

Variable	**DV: *LNAF***			
	Low-*CSO* (1)		High-*CSO* (2)	
	Coefficient	*t*-stat.	Coefficient	*t*-stat.
RPT_SALES	0.18	3.94***	0.12	2.58***
RPT_PURCH	-0.04	-0.88	-0.04	-0.86
RPT_LOANS	0.11	3.19***	0.08	2.10**
RPT_BORROWINGS	-0.01	-0.32	-0.02	-0.49
RPT_GUARGIV	0.11	2.58***	-0.07	-1.41
RPT_GUARTKN	0.01	0.11	0.10	1.40
RPT_FAINVSALES	-0.05	-1.04	0.02	0.49
RPT_FAINVPURCH	0.08	2.14**	0.14	3.93***
SIZE	0.51	29.07***	0.52	28.03***
ACREC	-0.06	-0.42	0.40	3.02***
INVENTORY	0.39	2.52**	0.46	2.77***
LEV	-0.24	-3.27***	-0.17	-1.70
QUICK	-0.05	-1.81*	-0.08	-2.68***
ROA	-0.23	-1.24	0.36	1.39
BIG4	0.63	17.09***	0.74	19.55***
INITIAL	-0.10	-1.99**	-0.13	-2.78***
JOINT_AUDIT	0.14	2.08**	0.28	4.53***
CSO	0.36	1.96*	0.54	1.72*
BG	0.16	4.59***	0.09	2.38**
IO	0.73	4.62***	1.01	3.77***
Constant	8.78	43.91***	8.44	30.19***
Industry Fixed Effects	Yes		Yes	
Year Fixed Effects	Yes		Yes	
Std. Error Clustered	Yes		Yes	
Observations	1,800		1,797	
Adjusted R^2	0.74		0.72	
F Statistic	105.60***		91.49***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. Our sample is classified into Low-*CSO* (column 1) and High-*CSO* subsamples (column 2). Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1. DV = dependent variable; *LNAF* = natural logarithm of audit fees; *CSO* = Controlling Shareholder Ownership.

Table 7: Classification based on Related Party Type

Variable	DV: *LNAF*					
	(1)		(2)		(3)	
	Coefficient	*t*-stat.	Coefficient	*t*-stat.	Coefficient	*t*-stat.
RPT	0.19	4.46***				
RPT_DOS			0.11	4.30***		
RPT_INVESTEE			0.18	6.33***		
DOS_SALES					0.09	3.15***
DOS_PURCH					-0.06	-2.08**
DOS_LOANS					0.06	1.91*
DOS_BORROWINGS					0.02	0.73
DOS_GUARGIV					0.01	0.10
DOS_GUARTKN					0.14	2.28**
DOS_FAINVSALES					-0.01	-0.13
DOS_FAINVPURCH					0.04	0.95
INVESTEE_SALES					0.15	4.54***
INVESTEE_PURCH					0.002	0.06
INVESTEE_LOANS					0.06	1.98**
INVESTEE_BORROWINGS					-0.08	-1.84*
INVESTEE_GUARGIV					0.01	0.16
INVESTEE_GUARTKN					-0.12	-1.68*
INVESTEE_FAINVSALES					-0.01	-0.24
INVESTEE_FAINVPURCH					0.10	3.53***
SIZE	0.53	43.92***	0.52	42.64***	0.51	41.49***
ACREC	0.17	1.75*	0.15	1.56	0.18	1.78*
INVENTORY	0.38	3.39***	0.42	3.75***	0.43	3.82***
LEV	-0.24	-4.12***	-0.22	-3.89***	-0.20	-3.47***
QUICK	-0.07	-3.48***	-0.06	-3.21***	-0.06	-3.30***
ROA	0.08	0.53	0.09	0.60	0.05	0.36
BIG4	0.72	27.91***	0.70	27.27***	0.68	26.57***
INITIAL	-0.11	-3.12***	-0.11	-3.30***	-0.11	-3.16***
JOINT_AUDIT	0.22	4.75***	0.22	4.86***	0.22	4.58***
CSO	0.23	2.30**	0.23	2.24**	0.20	1.96*
BG	0.12	4.68***	0.12	4.84***	0.12	4.84***
IO	0.93	7.25***	0.95	7.40***	0.85	6.63***
Constant	8.61	63.71***	8.69	65.28***	8.78	64.98***
Industry Fixed Effects			Yes		Yes	
Year Fixed Effects			Yes		Yes	
Std. Error Clustered			Yes		Yes	
Observations	3,597		3,597		3,597	
Adjusted R^2	0.73		0.73		0.73	
F Statistic	216.70***		214.10***		164.40***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. *DOS*_XX indicates RPTs with directors, officers, and shareholders. *INVESTEE_XX* indicates RPTs with subsidiaries, associates, and joint ventures. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1. DV = dependent variable; *LNAF* = natural logarithm of audit fees.

Table 8: Rupee Value of RPTs (as a proportion of total assets)

Variable	2016	2017	2018	2019	All Years
Number of Firms	841	886	894	976	3597
RPT_Rs	0.227	0.227	0.240	0.227	0.231
RPT_DOS_Rs	0.100	0.082	0.093	0.073	0.087
RPT_INVESTEE_Rs	0.128	0.145	0.148	0.154	0.144
RPT_SALES_Rs	0.071	0.068	0.071	0.078	0.072
RPT_PURCH_Rs	0.037	0.034	0.039	0.045	0.039
RPT_LOANS_Rs	0.024	0.024	0.022	0.026	0.024
RPT_BORROWINGS_Rs	0.010	0.013	0.015	0.015	0.013
RPT_GUARGIV_Rs	0.043	0.050	0.044	0.027	0.041
RPT_GUARTKN_Rs	0.030	0.027	0.022	0.022	0.025
RPT_FAINVSALES_Rs	0.003	0.003	0.003	0.005	0.004
RPT_FAINVPURCH_Rs	0.009	0.008	0.025	0.009	0.013

Notes: This table presents the average yearly rupee value of RPTs as a proportion of total assets. *DOS*_XX indicates RPTs with directors, officers, and shareholders. *INVESTEE_XX* indicates RPTs with subsidiaries, associates, and joint ventures. The variables are defined as in Appendix 1.

Table 9: Rupee value of RPTs (as a proportion of assets) and Audit Fees

Dependent Variable: *LNAF*

Variable	All Firms (1)		Small Clients (2)		Large Clients (3)	
	Coefficient	*t*-stat.	Coefficient	*t*-stat.	Coefficient	*t*-stat.
RPT_SALES_Rs	0.27	3.58***	0.22	2.35**	0.45	3.67***
RPT_PURCH_Rs	0.06	0.46	-0.22	-1.16	0.23	1.14
RPT_LOANS_Rs	0.59	1.98**	1.29	3.21***	-0.04	-0.08
RPT_BORROWINGS_Rs	0.52	1.32	0.56	1.03	0.18	0.36
RPT_GUARGIV_Rs	0.06	0.36	0.05	0.21	-0.01	-0.07
RPT_GUARTKN_Rs	0.11	0.70	0.34	1.41	-0.31	-1.78*
RPT_FAINVSALES_Rs	1.41	1.14	2.02	0.87	1.79	1.30
RPT_FAINVPURCH_Rs	0.76	1.54	0.34	0.39	1.18	1.76*
SIZE	0.54	45.65***	0.58	23.55***	0.51	25.63***
ACREC	0.21	2.12**	0.18	1.21	0.10	0.73
INVENTORY	0.46	3.95***	0.43	2.55**	0.43	2.55**
LEV	-0.24	-4.13***	-0.13	-1.76*	-0.51	-5.13 ***
QUICK	-0.07	-3.82***	-0.09	-3.76***	-0.02	-0.62
ROA	0.12	0.77	0.03	0.17	-0.09	-0.36
BIG4	0.71	27.71***	0.89	22.17***	0.59	17.63***
INITIAL	-0.11	-3.34***	-0.06	-1.24	-0.14	-3.23***
JOINT_AUDIT	0.23	4.98***	0.14	1.26	0.24	4.38***
CSO	0.19	1.87*	0.55	3.67***	-0.12	-0.83
BG	0.12	4.61***	0.11	2.95 ***	0.09	2.57**
IO	0.89	6.84***	1.27	5.11 ***	0.59	3.46***
Constant	8.66	63.58***	8.01	29.49 ***	9.37	44.79***
Industry Fixed Effects			Yes		Yes	
Year Fixed Effects			Yes		Yes	
Std. Error Clustered			Yes		Yes	
Observations	3,597		1,799		1,798	
Adjusted R^2	0.73		0.50		0.62	
F Statistic	187.20***		37.30***		57.66***	

Note: This table presents the results from regression analyses where *LNAF* is the dependent variable. Results for the full sample are presented in column 1. Our sample is partitioned into small-client (column 2) and large-client subsamples (column 3). Standard errors are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively. The variables are defined as in Appendix 1.

Appendix 1: Variable Definition

Variable	Description
LNAF	Natural logarithm of audit fees paid to the auditors
RPT	1 if the related party transactions are more than zero, 0 otherwise.
RPT_DOS	1 if the related party transactions with directors, officers, and shareholders are more than zero, 0 otherwise.
RPT_INVESTEE	1 if the related party transactions with subsidiaries, joint ventures, and associates are more than zero, 0 otherwise.
RPT_SALES	1 if the related party sales of goods & services are more than zero, 0 otherwise.
RPT_PURCH	1 if the related party purchases of goods & services are more than zero, 0 otherwise.
RPT_LOANS	1 if the related party loans are more than zero, 0 otherwise.
RPT_BORROWINGS	1 if the related party borrowings are more than zero, 0 otherwise
RPT_GUARGIV	1 if the related party guarantees provided are more than zero, 0 otherwise.
RPT_GUARTKN	1 if the related party guarantees received are more than zero, 0 otherwise.
RPT_FAINVSALES	1 if the related party sales of assets and investments are more than zero, 0 otherwise.
RPT_FAINVPURCH	1 if the related party purchases of assets and investments are more than zero, 0 otherwise
RPT_Rs	Related party transactions as a proportion of total assets
RPT_DOS_Rs	Related party transactions with directors, officers, and shareholders as a proportion of total assets
RPT_INVESTEE_Rs	Related party transactions with subsidiaries, joint ventures, and associates as a proportion of total assets
RPT_SALES_Rs	Related party sales of goods and services as a proportion of total assets
RPT_PURCH_Rs	Related party purchases of goods and services as a proportion of total assets
RPT_LOANS_Rs	Loans provided to related parties as a proportion of total assets
RPT_BORROWINGS_Rs	Loans borrowed from related parties as a proportion of total assets
RPT_GUARGIV_Rs	Guarantees provided to related parties as a proportion of total assets
RPT_GUARTKN_Rs	Guarantees taken from related parties as a proportion of total assets
RPT_FAINVSALES_Rs	Related party sales of assets and investments as a proportion of total assets
RPT_FAINVPURCH_Rs	Related party purchases of assets and investments as a proportion of total assets
SIZE	Natural logarithm of total assets (measured in millions of Indian rupees)
ACREC	Total accounts receivables divided by total assets
INVENTORY	Total inventory divided by total assets
LEV	Total debt divided by total assets
QUICK	Current assets minus inventories divided by current liabilities at the end of the current year

ROA	Net income divided by total assets of the previous year
BIG4	1 if the firm is audited by one of the big four firms, 0 otherwise
INITIAL	1 if it is a first-year audit (initial year), 0 otherwise
JOINT_AUDIT	1 if more than one statutory auditor audits the firm, 0 otherwise
CSO	The proportion of controlling shareholders ownership
BG	1 if the firm is affiliated with a business group, 0 otherwise
IO	The proportion of institutional ownership

Appendix 2: Categorization of RPTs based on Related Party Type

S. No.	Related Party Code	Related Party Type	Classification
1	300	Parties where Control Exists	DOS
2	200	Key Management Personnel	DOS
3	500	Relatives of Key Management Personnel	DOS
4	900	Entities over which KMP have control or significant influence	DOS
5	100	Holding Company	DOS
6	1000	Ultimate Holding Company	DOS
7	1300	Intermediate Holding Company	DOS
8	1500	All individuals having significant influence over company	DOS
9	1100	Promoters	DOS
10	1200	Shareholders	DOS
11	400	Subsidiary	INVESTEE
12	600	Fellow Subsidiary Company	INVESTEE
13	700	Associate	INVESTEE
14	800	Joint venture	INVESTEE
15	9000	Others	INVESTEE
16	9999	All Parties	-

Note: DOS = Directors, officers, shareholders, and other parties with significant influence over the company. INVESTEE = Subsidiaries, joint ventures, and associates.