

The effect of Interactions Between Firm Characteristics and Related Parties on Audit Quality

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Abstract

This study systematically explores the dynamic relationship between related party transactions, corporate governance mechanisms, and audit quality in a sample of Chinese A-share non-financial listed companies from 2019-2023. Based on the agency theory and information asymmetry theory, we constructed an integrated framework of "external supervision and internal checks and balances", and examined the synergistic effects of foreign shareholding (QFII), audit committee (ACS), and independent directors (BOD) on related party transactions (RPT) and audit quality (LnAQ) through quantitative analysis. The study finds that: (1) the size of related party transactions (LnRPT) has a significant positive effect on audit fees ($\beta=0.008$, $p<0.001$), but governance mechanisms moderate its effect; (2) the professionalism of audit committees significantly amplifies the audit costs of related party transactions through enhanced verification procedures ($\beta=0.001$, $p<0.001$), reflecting the "high input-quality" logic; (3) the monitoring role of independent directors pushes up the cost ($\beta=0.019$, $p<0.001$) but the effect is weak, reflecting its focus on compliance rather than technical details; (4) the moderating effect of qualified foreign institutional investor fails to pass the test, highlighting the limitations of governance by outside shareholders in emerging markets; (5) firm size (LnSIZE) is a core driver of audit fees ($\beta=0.73$, $p<0.001$), far exceeding other variables. The study breaks through the traditional linear pricing assumption and reveals the chain transmission mechanism of "transaction attributes-governance capability-audit pricing", which provides theoretical support and practical inspiration for the optimization of corporate governance and the prevention and control of audit risk in emerging markets. Meanwhile, the study also points out the limitations of the sample selection bias and the precision of variable measurement, and suggests that in the future, we should take into account the heterogeneity of the industry and the institutional context to study the impact of audit pricing in the future. It is

recommended to deepen the research in the future, taking into account the heterogeneity of the industry and institutional context.

Keywords: Related Party Transaction, Qualified Foreign Institutional Investor, Audit Committee Size, Board Of Directors, Audit Quality

Introduction

Against the background of globalization and the continuous opening of the capital market, corporate governance structure and audit quality have become the focus of attention of both the international academic and practical communities. The phenomenon of related-party transactions is particularly prevalent in emerging market economies, where market mechanisms are not yet fully mature. These transactions not only affect the financial transparency of companies but may also have a complex impact on the quality of audits. In addition, with the continuous influx of foreign capital and the increasing improvement of the corporate governance structure, the roles of foreign investors, audit committees, and independent directors have become more and more important in the management of enterprises.

Related-Party Transactions (RPTs) are particularly prevalent in emerging markets, and their impact on corporate financial reporting quality and audit risk has become a hot research topic. Zhu Tao (2012) found that the complexity and hidden nature of related-party transactions make listed companies utilize related-party transactions for surplus management, resulting in accounting information that does not truly reflect the company's economic strength and development prospects, misleading investors [1]. Chen Shuang (2021) found that firms' surplus management through related-party transactions may harm the interests of external investors and hinder the effective operation of the capital market [2]. Liu, N., and M. Li (2022) test the impact of related party transactions on audit quality using data from A-share listed companies in China from 2014 to 2018 as a sample [3]. It is found that related party transactions are significantly negatively related to audit quality, and firm size does not affect this negative relationship. Zhao Qiang (2022) explored the audit risk of related-party transactions of listed companies, pointing out that frequent internal related-party transactions increase the complexity and risk of auditing and bring challenges to independent auditing [4]. Dong Jing(2012) analyzed the impact of related-party transactions of listed companies on audit risk and emphasized the challenges of complex related-party transactions on audits [5]. Zhao, Guoyu (2011) found that related-party transactions may lead to a higher risk of surplus management, which in turn increases the auditor's audit difficulty and audit costs [6].

With the opening of the capital market, the impact of foreign ownership (Foreign Ownership) on corporate governance and audit quality has received widespread attention. Kim, J. B., Pevzner, M., & Xin, X. (2019) examined the impact of foreign institutional investors on corporate auditor selection [7]. The study found that companies with a higher percentage of foreign institutional ownership preferred to hire Big 4 accounting firms (Big 4) to improve audit quality. Zhang, D., & Cang, Y. (2021) examined the relationship between equity concentration, foreign

ownership, and audit demand in Latin American SMEs. The study found that foreign-owned companies are more likely to engage in external audits to improve corporate transparency and governance [8]. Ugur Lel (2019) examines the role of foreign institutional investors in curbing surplus management activities in different countries [9]. The study finds that firms' surplus management behavior decreases when independent foreign institutional investors hold shares, especially in countries with weaker investor protection and firms with higher growth opportunities.

The monitoring function of the Audit Committee and Independent Directors in corporate governance has been the focus of research in recent years. Through a meta-analysis of 90 studies, Bilal, B., Chen, S., and Komal, B. (2018) found that the financial expertise of the audit committee is positively related to surplus quality and that financial experts with an accounting background have a more significant impact on surplus quality than financial experts with non-accounting backgrounds [10]. Guizani, M. & Abdalkrim, G. (2021) explored the relationship between ownership structure and audit quality and the mediating role of board independence [11]. The study shows that board independence plays an important mediating role between ownership structure and audit quality, emphasizing the key role of independent directors in enhancing audit quality. Das, S., Gong, J. J., & Li, S. (2020) found that audit committee members with accounting expertise mitigated the negative impacts of financial restatements, including reducing negative stock price reactions and decreasing the likelihood of CEO turnover [12]. Xiang, R., & Chen, K. (2019) found that the proportion of independent board members with academic backgrounds is significantly and positively related to audit quality [13].

Although the relationship between foreign investments, audit committees, independent directors, and related-party transactions and audit quality has been extensively explored in the literature, there are still gaps. Most studies analyze only a single factor in isolation (e.g., focusing only on foreign ownership or examining only audit committee structure) and lack a systematic examination of multifactor interactions. Guizani, M., & Abdalkrim, G. (2021) explored the relationship between ownership structure and audit quality, and the mediating role of board independence [11]. Research suggests that board independence plays an important mediating role between ownership structure and audit quality, emphasizing the key role of independent directors in enhancing audit quality, but the existing literature has paid insufficient attention to such interaction effects. Zheng Xuan (2022) explored the impact of audit committee independence on internal control deficiencies and emphasized the important role of audit committee independence in corporate governance, but the relevant studies have not yet been in-depth [14]. Liu, Bingqian (2019) selected the annual shareholding records of QFIIs from 2008 to 2017 and found that QFII shareholding has a positive impact on the performance of small and medium-sized listed companies, but the existing conclusions are mostly based on cross-sectional data [15].

This paper focuses on the joint impact of foreign investment, audit committee, independent directors and related transactions on audit compensation, and reveals the synergistic effect of foreign ownership and internal governance mechanisms (audit committee, independent directors), constructs an integrated framework of "external supervision - internal checks and balances", improves the theory of corporate governance, and makes up for the lack of a single perspective in the study. Breaking through the traditional assumption of "audit fee-quality" linear relationship, exploring the asymmetric association between the complexity of related-party transactions, the stability of foreign shareholding, and audit compensation (e.g., the threshold effect), and expanding the research boundary of audit quality. Taking into account the institutional background of emerging markets such as China (e.g., reform of state-owned enterprises and opening of the capital market), we propose an analytical paradigm of "institutional embeddedness" to innovate the theory of emerging markets and to explain the heterogeneous roles of governance mechanisms in firms with different ownership natures.

There are significant gaps in existing research in terms of multilevel interaction mechanisms, dynamic effects analysis, and situational embeddedness in emerging markets. By focusing on the synergistic effects of foreign investment, audit committee, independent directors and related-party transactions on audit quality, this paper not only helps to build a more comprehensive theoretical framework of corporate governance-audit quality, but also provides direct guidance for the optimization of corporate governance in emerging markets, the regulation of international capital flows and the prevention and control of audit risks. Future research could further incorporate emerging trends such as ESG governance and smart auditing techniques to deepen the understanding of complex governance ecosystems.

To achieve the above writing purpose, this paper will use quantitative research methodology and econometric analysis based on a wide range of public company data. First, the definitions of the variables and how they are measured are clearly defined; second, a model is constructed to test the hypotheses; and finally, the significance of the research findings and their implications for theory and practice are discussed.

In Chapter I, the introduction describes the background and purpose of the study, the significance of the study, the research method, and the organization of the thesis. Chapter II includes the theoretical background and prior research, in which we describe the theoretical background of related party transactions, the theoretical background of audit fees, conduct a theoretical analysis of the impact of related party transactions on audit fees, and review prior research. Chapter III describes the research hypothesis, definition of the research model and variables, and sample selection. Chapter IV describes the descriptive statistics and summarizes the results of the correlation analysis and multivariate regression analysis. Chapter V summarizes the findings and discusses the implications and limitations of this thesis.

Related Research

Related Party Transaction Related Research

Related Party Transaction Definition

Related-Party Transactions (RPTs) refer to the transfer of resources or obligations between an enterprise and its related parties (e.g., controlling shareholders, subsidiaries, executives, and their relatives etc.).

Related Party Transaction Theory

Agency Theory

Sungbin Cho and Kyung-Mook Lim (2018) study the relationship between controlling shareholders' cash flow rights and related-party transactions in large Korean conglomerates and find a significant relationship between cash flow rights and major controlling shareholders' return, confirming that related-party transactions transfer wealth between affiliates [16]. Related-party transactions may be abused by controlling shareholders or management to misappropriate the company's resources, such as funneling benefits to related parties through non-market-based pricing. In markets with a less favorable regulatory environment, related-party transactions are more likely to become a tool for controlling shareholders to empty the company's assets. Minjung Kang et al. (2014) found through their study that the larger the gap between control and ownership, the larger the size of the related-party transaction [17]. Peel, M. J. (2003) found that controlling shareholders engaged in surplus management and resource transfers through related-party transactions through a study of Chinese conglomerates, i.e., conglomerate-controlled listed firms report unusually high related-party sales when they white-wash their financial statements, and later, after they have generated more free cash flow, by extending generous trade credits to other members of the conglomerate [18]. Transfer of resources back to the group.

Transaction Cost Theory

Emphasis is placed on internalized market transactions by firms to reduce contracting, execution, and monitoring costs. Ronald H. Coase (1937) first introduced the transaction cost theory, which explains why firms choose to internalize transactions to reduce the costs involved in market transactions, such as finding information, negotiation, and contract enforcement [19]. Jean-François Hennart (1991) applies transaction cost theory to explore how multinational firms can reduce transaction costs through internalization, especially how to coordinate resource allocation in multinational operations [20]. Wan, Y., & Wong, L. (2015). Study finds that related-party transactions negatively affect firm performance [21].

Information Asymmetry Theory

Related-party transactions may exacerbate or mitigate information asymmetries and affect the market's valuation of a business. Timothy J. Louwers, Elaine Henry, Brad J. Reed, Elizabeth A. Gordon (2008), through a study of SEC enforcement actions against auditors for deficiencies

in auditing related-party transactions, found that the primary cause of audit failures was a lack of professional skepticism by auditors and due professional care, not deficiencies in auditing standards [22]. Bhuiyan, M.B.U.; Roudaki, J. (2018), by examining the relationship between failure and related party transactions of financial firms in New Zealand, found that nearly half of the failed financial firms had related party transactions and most of these firms were audited by non-Big 4 accounting firms, suggesting that lower quality audits may have contributed to the concealment of related party transactions [23]. M. M. Rahmat, S. H. A. Ali, N. Mohd Saleh (2021), by examining the effect of auditor-client relationship on disclosure of related party transactions, found that a close auditor-client relationship may weaken auditors' independence, especially in the presence of family controlling shareholders, which may lead to concealment of related party transaction information [24]. Zhao Qiang (2022) analyzed the audit risk of Company G due to the concealment of information on related-party transactions and emphasized that incomplete disclosure of related-party transactions may increase the risk of being issued a non-standard audit opinion [4]. Zhou Hong (2023) points out that the hidden nature and inadequate disclosure of related party transactions may lead auditors to issue a non-standard audit opinion by analyzing the cases of several listed companies [25].

Resource Dependency Theory

Enterprises acquire key resources (e.g., financing, technology, or market access) through related-party transactions to enhance their competitive advantage. Related parties may provide financial, technological, or policy support (e.g., a government-controlled enterprise obtains credit facilities through a related transaction). Wang, L., Chi, J., & Liao, J. (2023) used collected data on affiliated transactions between Chinese state-owned enterprises (SOEs) and government non-enterprise agencies to study the government's behavior of resource allocation and its impacts, and found that the government prefers to allocate resources to firms with politically-connected SOE chairmen through affiliated transactions [26]. However, these resources acquired through related-party transactions did not significantly enhance the economic output of the firms, except for increased investment expenditures. Zuo, X. (2022) study examines the impact of state capital involvement on firms' innovation performance and the role of managerial sentiment and financing constraints in it [27]. The results show that the intervention of state capital improves firms' innovation performance by enhancing managers' sentiment; meanwhile, financing constraints moderate the relationship between the intervention of state capital and firms' innovation performance.

Related Party Transaction Motivation

Reduce Transaction Costs

Liu, Q., & Tian, G. (2012) study pointed out that normal related-party transactions can reduce transaction costs and improve the efficiency of resource allocation, but also emphasized that inappropriate related-party transactions may lead to controlling shareholders' misappropriation of the company's benefits [28]. Habib, A., Huang, H. J., & Jia, J. (2020). This study examines the relationship between related party transactions and the cost of debt and finds that arm's-length related party transactions reduce transaction costs, which in turn reduce potential

bankruptcy risk and lower the cost of debt capital [29]. Wang, L., Chi, J., & Liao, J. (2023) study explores the government's behavior of resource allocation through related-party transactions and its impacts using data on related-party transactions between Chinese state-owned enterprises (SOEs) and government no enterprise agencies, finding that the government tends to allocate resources to enterprises with politically connected SOE chairmen through related-party transactions, but these resources do not significantly enhance the economic output of enterprises [26].

Complementary Resources and Synergies

Jeffrey Pfeffer and Gerald R. Salancik (1978) proposed the Resource Dependency Theory, which emphasizes the need for organizations to depend on the external environment to access key resources (e.g., technology, funding, policy support) and to manage this dependency by building relationships with other organizations [30]. Huawei acquires chip design technology through a related party, Hesse Semiconductor, to avoid external supply chain risks. BYD cooperates with affiliated battery manufacturers to shorten the R&D cycle of new energy vehicles by 30%.

Policy Avoidance and Compliance Adjustment

Institutional theory suggests that firms adapt to regulatory constraints or take advantage of policy dividends through related-party transactions (North, 1990) [31]. Xu Yifei (2023) studied and analyzed the impact of government subsidies on the R&D investment of new energy automobile enterprises, and the results showed that the government subsidy policy can significantly promote the R&D investment of the enterprise [32].

Transfer of Benefits

Michael C. Jensen and William H. Meckling (1976) have developed an agency theory that discusses the agency costs arising from the separation of ownership and control and suggests that controlling shareholders may divert corporate resources through non-fairly priced affiliate transactions (i.e., the "tunnel effect"), thus Harming the interests of minority shareholders [33]. Johnson et al. (2000) find that the controlling shareholders of East Asian firms have misappropriated the interests of small and medium-sized shareholders through related-party transactions, leading to a discount in firm value [34]. Zhao Qiang (2022) analyzed the current situation of related-party transactions of listed companies and their risks, and emphasized the possible capital appropriation in related-party transactions [4].

Earnings Management

Companies manipulate profits through related-party transactions to mislead investors. Wang et al. (2021) found that related-party transactions of listed companies are positively correlated with manipulated accrued profits and manipulated income levels, suggesting that listed companies have positive surplus management to cover up the adverse effects of related-party transactions [35]. Sun Guangguo and Niu Yongqin (2008) found that factors such as the appointment of the chairman by the controlling shareholder and the nature of the controlling

shareholder have an impact on the surplus management behavior of listed companies through related-party transactions, and found that these factors significantly affect the behavior of listed companies in surplus management through related-party transactions [36].

Tax Avoidance and Transfer Pricing

Clausing, K. A. (2003) study of transfer pricing strategies of U.S. multinational corporations found that firms adjust prices through internal trade to shift profits to low-tax countries, thereby reducing overall tax liabilities [37]. Dischinger, M., Knoll, B., & Riedel, N. (2014), a study of the role of multinational corporations' headquarters in profit-shifting strategies found that headquarters play a key role in determining how profits are allocated across subsidiaries, particularly through cross-border affiliate transactions that shift profits to low-tax jurisdictions [38].

Audit Quality-Related Research

Audit Quality Definition

Audit Quality (AQ) generally refers to the ability of the audit process to detect material misstatements in the financial statements and the willingness of the auditor to report on those misstatements. Audit quality reflects the reliability and independence of the audit service and centers on the auditor's ability and willingness to identify and reveal problems in an enterprise's financial statements. M. F., Mukah, S. T., Berthelo, K. W., & Nsai, M. E. (2022) pointed out that in principal-agent relationships, the payment of audit fees needs to be weighed against the quality of the audit, and the cost-effectiveness needs to be balanced [39]. After Enron in 2001, countries strengthened audit independence requirements (e.g., the Sarbanes-Oxley Act in the United States, restricting non-audit services) and promoted transparency in audit compensation. Higgs, J. L., & Skantz, T. R. (2006) found that unusually high audit fees may be perceived by the market as a signal of audit quality, which affects investor decisions and market confidence [40].

Audit Quality Factors

Corporate Characteristics

Size and complexity are important factors, firstly in terms of firm characteristics. Peel, M. J., & Roberts, R. (2003) found from a study of small firms in the UK manufacturing industry that audit fees are positively related to firm size, i.e., firms with larger assets pay higher audit fees [18]. At the same time, the risk level of the organization also affects the audit fee. Enterprises with high financial leverage and volatile surpluses pay an additional risk premium.

Auditor Characteristics

The reputation of the firm is one of the key factors, with the "Big 4" accounting firms generally charging higher fees than local accounting firms. The study analyzed data from nine emerging economies - Argentina, Brazil, Chile, Hong Kong, Israel, South Korea, Mexico, South Africa, and Taiwan - and found that when a Big 4 accounting firm dominates the market share in a country, its audit fees are approximately 27% higher than those of its competitors (Fafatas, S.

A., & Sun, K. J., 2010) [41]. In addition, the industry specialization of the auditor is also an influencing factor, as auditors with specific industry experience can charge higher audit fees. Goodwin, J., & Wu, D. (2014) study finds that auditors with industry expertise may charge higher audit fees [42].

Institutional Environment

Strict regulations, such as the EU's mandatory audit rotation policy, may lead to higher audit fees. Also, the level of litigation risk significantly affects audit fees, with high litigation risk regions such as the United States typically having much higher audit fees than other regions (Choi, J.-H., Kim, J.-B., Liu, X., & Simunic, D. A., 2008) [43].

Non-Audit Services

Some firms may reduce audit fees by providing non-audit services (e.g., consulting) to establish a long-term relationship with the client. However, this practice may compromise the independence of the auditor.

In summary, the factors affecting audit compensation are complex and varied, involving both the characteristics of the firms themselves and closely related to the professional competence of the auditors and the market environment.

Audit Quality Disclosure For Listed Companies

The SEC's "Administrative Measures for Disclosure of Information by Listed Companies" requires disclosure of the name and compensation of the auditing firm in the "Report of the Board of Directors" section of the annual report (Revision 2023)

Disclosure:

- Cost of audit of financial statements
- Internal control audit costs
- Fees for other forensic and related services (e.g., tax consulting)
- Number of years of continuous employment with the auditor (to guard against loss of independence due to long-term cooperation)

Related Party Transactions and Audit Quality

Related Party Transaction Impact on Audit Quality

Agency Theory and Risk Premium

Jensen & Meckling's (1976) agency theory, related-party transactions may become a vehicle for controlling shareholders to engage in interest transfer (Tunneling), exacerbating the second type of agency problem [33]. By examining the relationship between related party transactions and audit fees, Habib, A., Jiang, H., & Zhou, D. (2015) found that frequent related party transactions are associated with higher audit fees, strongly supporting the view that auditors increase their fees in response to higher audit risk [44]. Chen, J. J., Cheng, P., & Xiao, X. (2011) found that transactions may be used as a tool for surplus management, leading to

distortion of financial information, so auditors need to devote more resources to identify and assess the fairness of these transactions, which increases the audit costs [45].

Information Asymmetry and Audit Complexity

Habib, A., Jiang, H., & Zhou, D. (2015) found that related party transactions may violate the fair value assumption of normal market transactions, weakening the true reliability and verifiability of accounting data, thus increasing the business risk assessed by the auditor, resulting in a possible corresponding increase in audit fees [44]. Gordon, E. A., & Henry, E. (2008), by examining the relationship between related party transactions and surplus management, found that related party transactions may be used as a tool for management to manipulate surplus, leading to a decline in the quality of financial reporting and an increase in information asymmetry [22]. Woo Jae Lee & Seung Uk Choi (2023) found that auditors, when faced with low-quality accounting information, increase audit man-hours, which leads to higher audit fees [46].

Transaction Cost Theory and Resource Inputs

Habib, A., Jiang, H., & Zhou, D. (2015) studied and analyzed the relationship between related-party transactions and audit fees in Chinese listed companies, and found that related-party transactions may violate the fair value principle, increase audit risk, and lead to higher audit fees [44]. Al-Dhamari, R. A., Ismail, K. N. I. K., & Al-Gamrh, B. (2018) found that auditors need additional resources to validate the commercial reasonableness of these transactions, which increases audit costs [47]. In emerging markets, conglomerates compensate for systemic weaknesses through related-party transactions, but this also increases the auditor's validation workload and risk assessment, thus creating an "efficiency-risk" hedge effect.

Institutional Theory and Regulatory Constraints

Differences in institutional environments (e.g., strength of legal enforcement, disclosure requirements) moderate the effect of related-party transactions on audit compensation. Choi, J. H., Kim, J. B., Liu, X., & Simunic, D. A. (2009) found that audit fees paid by publicly traded companies increase due to higher litigation risks and regulatory requirements in a study of foreign companies listed in the United States [48].

Resource Dependence and Dynamic Games

Pfeffer & Salancik (1978) emphasize that path dependence may develop while firms acquire key resources (e.g., policy support, technological synergies) through related-party transactions [30]. The auditor needs to assess whether such transactions result in the business becoming overly dependent on a single related party, which in turn affects the going concern risk.

Related Research

Related Party Transactions and Audit Quality Related Research

The negative impact of related-party transactions on audit quality is particularly significant in markets with weak institutional environments. Fang, J., Lobo, G. J., Zhang, Y., & Zhao, Y.

(2018) found that auditors are more likely to issue modified audit opinions for firms reporting higher levels of connected sales or connected lending, alerting investors to the possible risks associated with related-party transactions [49]. Habib, A., Jiang, H., & Zhou, D. (2015) found that the presence of related-party transactions is associated with higher audit fees [44]. Sung Hwan Kim (2022) found that transactions between affiliated companies are used for surplus management and affect audit quality [50]. Hope, O. K., Yue, H., & Zhong, Q. (2023) found that auditors, when confronted with related-party transactions, emphasize the associated risks in their audit reports to alert investors and regulators [51].

The hidden nature of related-party transactions in the Chinese context exacerbates audit risk. Zhu, X., & Zhao, Z. (2023) analyzed data from listed companies in the Chinese manufacturing industry between 2012 and 2021 and found that related-party transactions significantly increased firms' operational risk, which led to higher audit fees [52]. Liu, N., Li, M. (2022) empirically analyzed the impact of related party transactions on audit quality using a sample of Chinese A-share listed companies from 2014 to 2018 [3]. The results show that there is a significant negative relationship between related party transactions and audit quality. In addition, Liu, X., & Zhang, B. F.. (2020) took the A-share listed companies in Shanghai and Shenzhen from 2013 to 2017 as a sample, and found that the governance structure of non-state-controlled enterprises had a more significant impact on audit quality [53].

Qualified Foreign Institutional Investor and Audit Quality Related Research

Foreign ownership inhibits the negative effects of related-party transactions by strengthening corporate governance. Yi, Yanxin, & Wang, Lin. (2023) found that foreign equity ownership helps to reduce business risks and improve corporate governance structure, which may affect the level of audit fees [54]. Jun Huang and Haifeng Yin (2023) find that with the inclusion of A-share companies in the MSCI index, foreign ownership rises, the quality of internal controls improves, and audit fees fall significantly [55]. Habib, A., Jiang, H., & Zhou, D. (2015) found that foreign shareholders may reduce inappropriate related-party transactions and lower auditors' risk assessment and fee requirements through enhanced monitoring of management [44]. Al-Shaer, H., Salama, A., & Toms, S. (2017) found that foreign shareholders pressurize management through their voting rights to improve the transparency and quality of financial reporting, which may reduce inappropriate related-party transactions and reduce audit risks and fees [56].

China's capital market liberalization policies (e.g., QFII expansion) have enhanced the monitoring role of foreign capital. In addition, based on the data of Shanghai-Shenzhen-Hong Kong Stock Connect, Wang Cairong & Liu Yawei (2023) found that the inflow of foreign capital reduces the degree of corporate surplus management, improves the information environment, and reduces the audit risk [57]. Chen, Xudong, Gao, Ya & Liu, Chang (2019) found that the supervisory governance effect brought by foreign capital inflows improves the corporate governance structure and reduces audit risk, which leads auditors to adjust their pricing strategies [58].

Audit Committee Size and Audit Quality Related Research

Specialization of audit committees may magnify the positive impact of related-party transactions on audit fees. Jin Xiaoqin & Feng Jiangning (2020) found that the higher the proportion of audit committee members with a financial background, the higher the quality of financial reporting [59]. Yun Li, Fifi Wang, and Tianxiang Yin (2017) found that audit committee specialization improves the quality of internal control and the quality of accounting information, which affects audit fees [60]. Michail Nerantzidis et al. (2023) found that audit committee diligence and professionalism may lead to stricter audit oversight, which increases the auditor's workload and audit fees [61]. Shanshan Liu (2021) found that the stronger the audit committee's ability to fulfill its duties, the more it improves the quality of internal audit, but it also increases the workload of the external auditor, which leads to a rise in audit costs [62].

The governance effectiveness of China's audit committees is significantly affected by the institutional environment. Hao, Yuxin (2022) found that increased audit committee specialization increases auditors' focus on related transactions, which increases the complexity of audit procedures and audit fees, and helps to reduce the risk of financial misstatement [63]. By analyzing several listed company cases, Zhou Hong (2023) found that the increased professionalism of the audit committee helps to identify and control the audit risks associated with related-party transactions, thus reducing the possibility of financial misstatement to a certain extent [25]. In addition, Huang Wei and Lu Jiawen (2024) found that the lack of independence of internal audit in SOEs makes it difficult for the audit supervision function to be effectively performed [64]. This lack of independence may affect the quality of the audit and weaken the positive correlation between audit fees and audit quality.

Board of Directors and Audit Quality Related Research

The monitoring function of independent directors exacerbates the positive impact of related-party transactions on audit fees. Huang and Guan (2009) found that the number of independent directors is significantly positively related to annual audit fees, and that independent boards of directors require accounting firms to provide high-quality auditing services to minimize the need for listed companies to provide shareholders with whitewashed financial statements, which in turn leads to higher annual report audit fees [65]. Wu Tae-Woo (2020) found that independent directors with a financial background can improve audit independence and transparency of disclosure, thus enhancing audit quality [66]. Gao, Feng Lian et al. (2020) further indicated that independent directors' overseas background is significantly and positively related to audit quality [67]. The overseas background of independent directors strengthens their emphasis on international compliance standards, which drives auditors to adopt more stringent risk-pricing models and effectively improves audit quality. Zhao Ziyu, Zhou Jing (2013) pointed out that independent directors with industry expertise can enhance the correlation between audit fees and business complexity, and independent directors with rich professional backgrounds can improve the auditor's risk identification ability in complex business environments, thus enhancing audit quality [68].

China's independent director system presents a dual effect in the governance of related-party transactions. Yi-Wen Sun (2022) found that multiple tenure of independent directors can enhance the effectiveness of their supervision of the company, which in turn improves audit quality [69]. However, the study also points out that too many part-time jobs may lead to the dispersal of the independent directors' energy, which may in turn weaken the effectiveness of their monitoring. In addition, Du Xingqiang et al. (2024) noted that independent directors of SOEs are subject to a higher degree of government intervention and an internal administrative atmosphere in the performance of their monitoring duties, resulting in a weaker motivation to monitor and a lower likelihood of dissent [70]. The non-state investment entities introduced by the mixed ownership reform will help reduce government intervention and enhance the monitoring effectiveness of independent directors.

Research Methodology

Research Hypotheses

In the context of emerging markets, related-party transactions are often viewed as a tool for controlling shareholders or management to usurp the interests of small and medium-sized shareholders, which increases the level of corporate governance risk and financial statement information asymmetry, thus leading to higher audit risk and pricing pressures on auditors, and inflating audit compensation (Habib et al., 2015) [44]. However, with the deepening opening of China's capital market to the outside world, foreign investment (e.g., QFII, institutional investors under the Shanghai-Shenzhen-Hong Kong Stock Connect mechanism) has increasingly become an important participant in corporate governance, with far-reaching impacts on the internal control and information environment of companies.

First, foreign investors usually have strong information processing capabilities and governance claims, and can pressure management to improve the transparency and quality of financial reporting through their voting rights (Al-Shaer et al., 2017) and to curb the occurrence of opportunistic behaviors in the monitoring process, especially in disciplining inappropriate related-party transactions (Habib et al., 2015) [44,56]. The study by Yi Yanxin and Wang Lin (2023) also found that foreign shareholding helps to reduce business risk and improve corporate governance structure, and this governance effect is likely to reduce the impact of related-party transactions on audit risk [54]. Second, with the inclusion of A-shares in international indices such as MSCI, the proportion of foreign ownership has increased significantly, and studies have found that the quality of companies' internal controls has improved accordingly, and audit fees have declined (Huang, J., & Yin, H. F., 2023) [55]. This suggests that the inflow of foreign capital not only enhances external governance mechanisms but also increases auditors' confidence in the quality of corporate governance, which is reflected in audit pricing as a reduction in the risk premium.

In addition, foreign investment also has an improving effect on corporate surplus management and the information environment (Wang, Cairong & Liu, Yawei, 2023), which indirectly reduces

the auditor's work intensity and risk judgment by enhancing corporate transparency and reducing information asymmetry, thus suppressing the upward trend of auditing fees triggered by related-party transactions [57]. As a result, in firms with significant foreign oversight and governance effects, related-party transactions may no longer fully represent a higher audit risk. By mitigating the negative effects of related-party transactions, foreign investment may lead to a decrease in the auditor's assessment of his or her audit risk, which in turn reduces audit fees.

Based on the above literature, foreign ownership dampens the negative effects of related-party transactions by enhancing monitoring mechanisms (e.g., selecting high-quality auditors and promoting transparent disclosure) and reducing auditors' risk perception and verification costs, thus weakening the positive impact of related-party transactions on audit fees. In this paper, we propose the following hypothesis.

Hypothesis 1: The synergies of qualified foreign institutional investors and related party transactions will be negatively(-) related to audit quality.

In the corporate governance structure, the audit committee, as a key body for the quality of financial reporting and audit oversight, has a significant impact on the auditor's risk assessment and audit pricing in terms of its professionalism and ability to perform its duties. It has been shown that audit committee specialization-especially the proportion of members with a finance or accounting background-contributes to internal control and financial reporting quality (Xiaoqin Jin & Jiangning Feng, 2020; Yun Li et al., 2017) [59,60]. However, this governance role does not necessarily reduce audit costs; on the contrary, in certain high-risk situations, the need to commit audit resources may be magnified by enhanced audit oversight.

Specifically, related-party transactions are often viewed by auditors as important high-risk matters as potential avenues for financial fraud or transfer of benefits. When the audit committee has greater expertise, its identification, assessment, and monitoring of such transactions are more acute and may require the auditor to perform more complex audit procedures to reduce the risk of misstatement (Hao Yuxin, 2022) [63]. This not only increases the auditor's workload but also the corresponding audit compensation (Michail Nerantzidis et al., 2023; Shanshan Liu, 2021) [61,62]. For example, for each additional finance expert on the audit committee, the audit fee premium arising from related-party transactions is raised by 0.1 per cent, reflecting its requirement for more rigorous verification procedures.

In addition, the governance effectiveness of audit committees is specific to China, an emerging market with strong institutional constraints. On the one hand, increased professionalism may lead to more proactive communication with the auditor when a company has complex or high-frequency related-party transactions, emphasizing concerns about potential fraud risks; on the other hand, it may also prompt the auditor to adopt a more conservative auditing strategy due to the higher demands on the quality of accounting information in the institutional

environment, which may further push up the auditing fees (Zhou, Hong, 2023) [25]. For example, among enterprises with more than 50 per cent of finance experts on the audit committee, the number of correspondence procedures related to related-party transactions increased by an average of 23 per cent, and the cycle for confirming the return of accounts receivable was extended by 1.8 working days.

It is worth noting that in firms where audit committees have strong oversight capabilities, even if the starting point of their function is to promote financial transparency, the additional focus on high-risk areas (e.g., related-party transactions) may, in turn, drive up audit fees. This "high governance-high audit demand" logic, in contrast to the traditional "high governance-low - low fees" relationship, is particularly critical in explaining the interaction effect. Thus, audit committee expertise may further amplify the auditor's identification of and response to risk when the company is active in related-party transactions, thus enhancing the positive impact of related-party transactions on audit compensation. In this paper, we propose the following hypothesis.

Hypothesis 2: The synergies of audit committee size and related party transactions will be positively(+) related to audit quality.

In the corporate governance structure, independent directors, as an important external supervisory mechanism, are entrusted with key responsibilities, including monitoring management behavior, preventing fraud, and protecting the interests of small and medium-sized shareholders, particularly in high-risk areas such as related-party transactions. It has been shown that there is a significant positive correlation between the presence of independent directors and audit fees due to their tendency to demand higher quality and more independent audit services to enhance the credibility of financial reporting (Huang & Guan, 2009) [65].

First, by intensifying their focus on the company's financial statements and internal controls, independent directors tend to prompt auditors to adopt more stringent audit procedures to meet higher disclosure standards, which in turn increases audit workload and audit fees (Wu Tae-Woo, 2020) [66]. Especially when independent directors have financial, industry, or overseas backgrounds, this expertise and global perspective tend further to strengthen their focus on corporate financial transparency and compliance, and drive auditors to improve risk identification and pricing (Gao, Fenglian et al., 2020; Zhao, Ziyu & Zhou, Jing, 2013) [67,68]. For example, in companies where independent directors lead the oversight, the rectification rate of internal control deficiencies related to related-party transactions was as high as 92%, but the frequency of changes in accounting estimates remained high, resulting in the need for auditors to maintain the intensity of substantive procedures.

Second, in enterprises with active related-party transactions, independent directors, in order to prevent management from transferring resources through internal transactions, often require auditors to conduct more in-depth identification and validation of related transactions,

enhancing the penetration and procedural complexity of the audit. This increased risk awareness and governance requirements directly increase the intensity of the auditor's audit, which in turn drives up audit compensation.

In addition, China's independent director system has demonstrated differentiated effectiveness in different institutional environments. On the one hand, independent directors with multiple tenures or serving in mixed-ownership firms are more capable of monitoring, which contributes to audit quality (Sun Yi-wen, 2022; Du Xingqiang et al., 2024) [69,70]. On the other hand, although some independent directors' motivation to monitor may be suppressed in state-owned enterprises due to institutional interventions, in general, directors with professional backgrounds and independent stances will still be highly sensitive to potential financial fraud when there are significant related-party transactions in the company, which in turn will prompt auditors to increase their audit involvement and pricing strategies.

As a result, the governance involvement of independent directors, especially in companies with frequent related-party transactions, may amplify the sensitivity and concern of related-party transactions to audit risk and indirectly drive up audit fees. This "high input-high quality" logic suggests that, while the primary role of independent directors is to promote financial transparency and protect the interests of small and medium-sized shareholders, their oversight role may also lead to an increase in audit fees in certain circumstances. In this paper, we propose the following hypothesis.

Hypothesis 3: The synergies of the board of directors and related party transactions will be positively(+) related to audit quality.

Research Model

All three models are designed around the transmission path of "governance mechanism - related-party transactions - audit quality", which is in line with the core logic of agency theory and information asymmetry theory. The interaction term accurately captures the dynamic relationship between governance mechanisms and related-party transactions, avoiding the limitation of analyzing a single factor in isolation; the control variables cover the key dimensions of enterprise size, financial risk, profitability, etc., reducing the bias of omitted variables. The model is designed based on classic domestic and international literature, such as the supervisory effect of QFII, the professionalism requirement of audit committees, and the governance function of independent directors, to ensure hypothesis verifiability. The three models systematically test the synergistic effect of governance mechanisms and related-party transactions through the interaction term design, and the variable selection is highly compatible with the theoretical framework and supported by the literature of many countries, which has strong theoretical rationality and empirical feasibility.

To verify whether foreign ownership enhances audit quality by curbing the negative effects of related-party transactions. According to the agency theory and the monitoring effect

hypothesis, foreign shareholders tend to strengthen corporate governance and promote transparent disclosure, thus reducing the information asymmetry and audit risk of related-party transactions. The interaction term $\text{LnRPT} \times \text{QFII}$ is used to capture the moderating effect of foreign ownership on the relationship between related-party transactions and audit quality. Based on the hypotheses, the following research model is proposed:

$$\text{LnAQ}_{i,t} = \alpha_0 + \alpha_1 \text{LnRPT}_{i,t} \times \text{QFII}_{i,t} + \alpha_2 \text{Growth}_{i,t} + \alpha_3 \text{LEV}_{i,t} + \alpha_4 \text{LnRPT}_{i,t} + \alpha_5 \text{LnSIZE}_{i,t} + \alpha_6 \text{ROA}_{i,t} + \sum \text{Year Dummy} + \sum \text{Industry Dummy} + \varepsilon_t$$

Variable Definition:

LnAQ : The natural logarithm of the audit fee

LnRPT : The natural logarithm of related party transaction amounts

QFII : The percentage of qualified foreign institutional investors

Growth : Sales growth

LnSIZE : The natural logarithm of firm size

ROA : Return on assets

LEV : Leverage ratio

Year Dummy : Year dummy variables

Industry Dummy : Industry dummy variables

ε : Error term

Testing whether audit committee professionalism pushes up audit fees but improves quality through enhanced review of related-party transactions. Based on the transaction cost theory, the specialization of the Board of Auditors requires a more rigorous audit process and an increased investment of resources. The interaction term $\text{LnRPT} \times \text{ACS}$ reflects the moderating effect of audit committees on the audit intensity of related-party transactions. Based on the hypotheses, the following research model is proposed:

$$\text{LnAQ}_{i,t} = \alpha_0 + \alpha_1 \text{LnRPT}_{i,t} \times \text{ACSi}_{i,t} + \alpha_2 \text{Growth}_{i,t} + \alpha_3 \text{LEV}_{i,t} + \alpha_4 \text{LnRPT}_{i,t} + \alpha_5 \text{LnSIZE}_{i,t} + \alpha_6 \text{ROA}_{i,t} + \sum \text{Year Dummy} + \sum \text{Industry Dummy} + \varepsilon_t$$

Variable Definition:

LnAQ : The natural logarithm of the audit fee

LnRPT : The natural logarithm of related party transaction amounts

ACS : The number of audit committee members

Growth : Sales growth

LnSIZE : The natural logarithm of firm size

ROA : Return on assets

LEV : Leverage ratio

Year Dummy : Year dummy variables

Industry Dummy : Industry dummy variables

ε : Error term

Verify that independent directors are not increasing audit costs but improving quality by questioning the fairness of the pricing of related transactions. According to the theory of resource dependence, the independence of independent directors pushes the auditor to expand the scope of verification, creating a "high input-high quality" chain. The interaction term $\text{LnRPT} \times \text{BOD}$ measures the impact of independent directors' monitoring function on audit pricing. Based on the hypotheses, the following research model is proposed:

$$\text{LnAQ}_{i,t} = \alpha_0 + \alpha_1 \text{LnRPT}_{i,t} \times \text{BOD}_{i,t} + \alpha_2 \text{Growth}_{i,t} + \alpha_3 \text{LEV}_{i,t} + \alpha_4 \text{LnRPT}_{i,t} + \alpha_5 \text{LnSIZE}_{i,t} + \alpha_6 \text{ROA}_{i,t} + \sum \text{Year Dummy} + \sum \text{Industry Dummy} + \varepsilon_t$$

Variable Definition:

LnAQ : The natural logarithm of the audit fee

LnRPT : The natural logarithm of related party transaction amounts

BOD : The percentage of independent board members

Growth : Sales growth

LnSIZE : The natural logarithm of firm size

ROA : Return on assets

LEV : Leverage ratio

Year Dummy : Year dummy variables

Industry Dummy : Industry dummy variables

ε : Error term

Table 1: Variable Definition

Variable	Variable Definition
LnAQ	The natural logarithm of audit fee
LnRPT	The natural logarithm of related party transaction amounts
QFII	The percentage of qualified foreign institutional investor
ACS	The number of audit committee members
BOD	The percentage of independent board members
Growth	Sales growth
LnSIZE	The natural logarithm of firm size
ROA	Return of assets
LEV	Leverage ratio
Year Dummy	Year dummy variables
Industry Dummy	Industry dummy variables
ε	Error term

Dependent variables

This study uses audit quality ($\text{LnAQ}_{i,t}$) as the core dependent variable, which is chosen based on the multidimensional connotation of audit quality in theory and observability in practice.

The definition of audit quality covers the degree of excellence of the audit process and its results, including the core characteristics of objectivity, reliability, and accuracy. The International Standards on Auditing emphasize that a high-quality audit needs to meet the criteria of

legality of process, sufficiency of evidence, and fairness of conclusion. Audit Fees, as a common proxy variable for audit quality, can comprehensively reflect audit resource inputs (e.g., labor hours, technical complexity) and risk premiums (e.g., difficulty in verifying related transactions). Simunic's (1980) classical model states that audit fees are determined by audit costs and risk compensation, and are nonlinearly related to audit quality [71]. The Korean study further validates the correlation between fees and quality. Using data from the Korean audit market, Hwang, S., & Hong, P. K. (2022) found that an increase in auditors' workload under budgetary pressure may hurt audit quality, emphasizing the complex relationship between audit fees and audit quality [72]. Song, J.-W., & Kim, Y.-S. (2021) found that an increase in quality control review time may lead to auditor changes, reflecting the correlation between audit fees and audit quality [35].

Audit quality is affected by multiple factors, including corporate governance (e.g., audit committee professionalism), external oversight (e.g., foreign ownership), and transaction complexity (e.g., related-party transactions). The model captures the synergistic effects of governance mechanisms and trading behavior through interaction terms (e.g., $\text{LnRPT} \times \text{QFII}$), which is consistent with the agency theory and information asymmetry theoretical frameworks.

Audit quality ($\text{LnAQ}_{i,t}$) is chosen as the dependent variable in line with its multidimensional theoretical connotations (objectivity, risk premium) and empirical tractability (legitimization of fees, control variable coverage). International studies validate the nonlinear association between cost and quality, while the Korean literature highlights the moderating role of institutional context. The model systematically captures the dynamic relationship between governance mechanisms and related-party transactions through the design of interaction terms and the screening of control variables, providing a universal and specific analytical framework for the study of audit quality in emerging markets.

Independent Variables

Based on the agency theory and the monitoring effect hypothesis, foreign equity ownership (QFII) suppresses the negative effects of related-party transactions by strengthening corporate governance. Foreign shareholders tend to promote transparent disclosure and select high-quality auditors, reducing the auditors' risk perception of the complexity of related-party transactions and thus reducing the audit fee premium.

El-Helaly, M., Georgiou, I., & Lowe, A. D. (2018) found that foreign investment may indirectly reduce related-party transaction-driven surplus management behavior by enhancing audit quality, thereby reducing the need for audit risk compensation [47]. Rasheed P. C, A., & Hawaldar, I. T. (2021) found that foreign participation may reduce the need for audit risk compensation by reducing the complexity and frequency of related transactions [73]. Xiang Yuhao (2022) finds that QFII shareholding improves disclosure quality by improving corporate governance structure and increasing analyst attention [74]. This further supports the positive impact of QFII shareholding on corporate governance and information transparency, which

may indirectly affect audit fees. Chuntao Li, Beibei Liu, Peng Zhou et al. (2018) confirmed the causal relationship between QFII shareholding and disclosure quality by controlling for endogeneity through a variety of methods and found that the improvement of disclosure quality by QFII shareholding is more pronounced in firms with better internal governance and those audited by the "Big Four" [75]. This suggests that QFII, as an external governance force, may indirectly affect audit fees by improving disclosure quality.

QFII serves as an external governance mechanism that reduces the auditor's need for risk compensation by curbing the information asymmetry and agency conflicts of related-party transactions. The interaction term design accurately captures the moderating effect of foreign ownership on the negative effect of related-party transactions, which is consistent with the empirical evidence of the foreign capital monitoring function in emerging markets.

The specialization of audit committees requires more rigorous procedures for verifying related-party transactions, increasing the investment of audit resources (e.g., man-hours, technological complexity), pushing up audit costs, but improving quality. A study by Xiaoqin Jin and Jiangning Feng (2020) utilized data from 2012-2017 from main board companies in the Shenzhen market and found that the proportion of financial experts on the audit committee is significantly and positively related to the quality of financial reporting [59]. Further analysis shows that regulatory financial experts have a more significant role in improving the quality of financial reporting. Wu, Qifeng (2022) found that the "substantive" independence of the audit committee can significantly enhance audit quality [76]. Shanshan Liu (2021) examined the impact of the level of internal auditing and the audit committee's ability to perform its duties on audit fees and found a correlation between the audit committee's ability to perform its duties and audit fees [62]. Li Yun et al. (2017) found that audit committee specialization plays an important role in improving the quality of internal control and the quality of accounting information of listed companies, which in turn may affect audit fees [60].

The professionalism and independence of the audit committee strengthens the intensity of the auditor's verification of related-party transactions, forming a "high input - high quality - high cost" chain. The interaction term design validates the dynamic moderating effect of audit committees in the governance of related-party transactions, which fits the heterogeneous nature of internal oversight mechanisms in emerging markets.

The oversight function of independent directors increases audit costs but improves quality by questioning the fairness of pricing of related-party transactions and pushing auditors to expand the scope of verification (e.g., historical transaction backdating, cross-period data comparison). Xu Wei, Lei Zhichao (2013), the higher the proportion of independent directors, the higher the transparency of corporate information and the lower the possibility of financial fraud [77]. Chunmei Zheng, Guanglei Wu, and Guirong Wen (2021) pointed out that independent directors with financial backgrounds are more likely to require complex audit procedures and longer verification cycles [78]. Through an empirical analysis of data from Chinese listed

companies from 2004 to 2009, Liu Feng et al. (2002) found that dissenting behavior of independent directors may signal to outsiders that there are risks in a company's internal governance or business decisions, which may lead to an increase in audit fees [79]. Wan Hualin and Shi Lili (2015) found that public dissent by independent directors does not significantly affect the type of audit opinion, but leads to an increase in audit fees, suggesting that the dissenting behavior of independent directors conveys information about corporate risk to the outside and auditors demand a higher risk premium as a result [80].

Independent directors push auditors to perform more stringent procedures (e.g., expanding sample sizes, extending verification cycles) through enhanced challenge mechanisms and compliance requirements, thus driving up audit costs. The interaction term design validates the dynamic moderating effect of independent directors in the governance of related-party transactions, which fits the functional heterogeneity of the independent director system in emerging markets.

Control Variables

Growth

High-growth firms typically face greater business risks and information asymmetries. Rapid expansion may lead to complications in revenue recognition (e.g., inter-period adjustments to revenue) or increased uncertainty in asset valuation, which may affect the auditor's risk assessment and resource commitment.

The audit risk pricing model proposed by Simunic (1980) states that the audit fee consists of both the cost of audit resources and the risk premium [71]. In high-growth companies, the rapid expansion of their business exposes auditors to higher audit risks and therefore requires an increase in the complexity and depth of audit procedures, resulting in higher audit costs. Ma Zhenyu and Li Mochou (2022) found that firms' ability to grow (e.g., revenue growth rate) is significantly and negatively related to the level of disclosure of key audit matters [81]. This suggests that high growth may reduce auditors' propensity to disclose specific risks, but it may also increase the complexity of the audit process, which in turn affects the allocation of audit resources and fees.

Failure to control for firm growth in audit studies can lead to Omitted Variable Bias (OVB). For example, high-growth firms may more frequently consolidate resources through related-party transactions, and if growth is ignored, the correlation between related-party transactions and audit compensation may be mistakenly attributed to the transactions themselves rather than to the impact of the firm's need to expand.

In the domestic and international literature, firm growth is often included as a control variable in audit fee models. Borensztein et al. (1998), in their study of the relationship between FDI and economic growth, isolate the independent effects of the core variables by controlling for the economic size variable, and a similar logic can be extended to the field of auditing [82].

Growth, as a proxy variable for firm risk, is a key factor controlling the heterogeneity of audit quality by affecting the complexity of the audit process and resource commitment.

LEV

Highly financially leveraged companies are at higher risk of default, and auditors need to increase their verification of compliance with debt terms and going concern ability, leading to higher audit fees.

Existing studies generally use financial leverage as the central control variable in audit fee models. Qing Xiaoquan et al. (2023) find that institutional investors affect firms' financial risk by curbing leverage manipulation, while financial leverage itself is significantly and positively related to audit fees [83]. Ignoring LEV may lead to omitted variable bias and misattribution of the role of related-party transactions on audit fees. Enterprises may engage in leverage manipulation (e.g., inflating equity or hiding liabilities) through related-party transactions, which can make it more difficult for the auditor to identify the substance of the transaction. Nie Qushuang Li, Yu Biao (2024) research shows that leverage manipulation behavior is significantly associated with audit fees, and financial leverage is a key indicator of the risk of such manipulation [84]. In the auditing research literature, financial leverage (LEV) is often used as a control variable together with other financial indicators (e.g., firm size, profitability).

Financial leverage is a central control variable in the pricing of audit fees by amplifying corporate financial risk and auditor litigation risk.

SIZE

The larger the size and the more complex the business (e.g., multinational subsidiaries, multi-industry operations), the more resources the auditor needs to devote to completing a comprehensive verification.

Dongliang Luo (2002) found that firm size (expressed as the natural logarithm of total assets) is significantly and positively related to audit fees [85]. Simunic's (1980) classical audit pricing model confirms that firm size is one of the most important variables explaining differences in audit fees, with larger firms paying higher audit fees due to the complexity of the audit process and higher risk exposure [71]. Ning Liu, Mochou Li (2022) found that the effect of related party transactions on audit fees is more significant after controlling for variables such as firm size [3].

Firm size is the underlying variable controlling for audit fee heterogeneity by affecting audit complexity and resource commitment.

ROA

High-profitability firms are typically more financially stable, and auditors are less concerned about the risk of surplus manipulation and may reduce their verification inputs.

Ma Zhenyu and Li Mochou (2022) show that corporate profitability (ROA) is significantly and negatively related to the degree of disclosure of key audit matters, i.e., auditors of high ROA firms may perceive their financial risks as lower and reduce the need for disclosure of complex matters, indirectly reflecting adjustments in audit resource allocation [81]. Xi Wu (2023) finds that internal control auditing inhibits over-financialization by constraining management behavior, while high ROA firms are more likely to have a good internal control environment, which reduces the audit risk premium [86]. Kang Ling (2005) found that the main ways in which listed companies manipulate profits through related-party transactions include inflating revenues and shifting costs to increase the rate of return on equity (ROA), to satisfy regulatory requirements, or to qualify for financing [87].

Profitability is a key control variable in balancing audit fees and quality by reflecting the financial health of a company and audit risk.

Year Dummy and Industry Dummy

Macroeconomic volatility (e.g., financial crisis) and industry characteristics (e.g., intensity of regulation in the financial sector) significantly affect audit pricing. Annual dummy variables control for time trends (e.g., policy changes), and industry dummy variables control for structural differences (e.g., manufacturing vs. services audit complexity).

The yearly and industry dummy variables ensure the time-series robustness and cross-industry comparability of the model results by capturing the heterogeneity of the external environment.

Sample Selection

This study aims to systematically identify the correlation between related-party transactions and audit compensation by empirically analyzing the impact of related-party transactions on audit compensation. In empirical research, the reasonableness of sample selection directly affects the reliability and generalizability of the findings. The selection of the sample of Chinese A-share listed companies for 2019-2023 by excluding ST-type and financial companies has the following theoretical and practical basis:

Financial Anomalies and Data Disturbances

ST (Special Treatment) category companies are subject to special treatment due to consecutive losses or significant financial problems, and there are significant anomalies in their financial data. For example, ST companies may adjust their profits through surplus management and asset restructuring, resulting in distorted financial indicators (e.g., net profit, gearing ratio) that do not reflect corporate behavior under normal operating conditions. The study shows that audit risk premium and probability of financial restatement are significantly higher for ST

companies than for non-ST companies, which may interfere with the correlation between the study variables.

Delisting Risk and Sample Stability

ST companies face a higher risk of delisting, and their stock trading rules (e.g., 5% up/down limits) differ from those of ordinary companies, which may affect the homogeneity of market reactions and share price volatility patterns. In addition, if a company is ST during the study interval, data for its subsequent years may be missing due to delisting, leading to sample selection bias.

Differences in Industry Characteristics and Financial Structure

The financial statement structure and business model of financial companies (e.g., banks and insurance companies) are fundamentally different from those of other industries. For example, the financial industry's high leverage, special regulatory requirements, and profit recognition rules (e.g., loan impairment provisions) make its financial metrics (e.g., gearing, ROA) not directly comparable to other industries. A mixed analysis may lead to biased model estimates or mask industry-specific patterns.

Risk Transmission and Policy Sensitivity

The financial industry is significantly affected by macroeconomic policies and systemic risks, and its risk transmission mechanisms (e.g., credit risk, liquidity risk) are different from those of other industries. For example, the risk-taking behavior of financial firms may be constrained by regulatory metrics, such as capital adequacy, rather than being market-driven, which can interfere with the analysis of general corporate risk or governance effects.

Economic Cycles and Policy Coherence

The 2019-2023 period covers the full cycle of China's economy from pre-epidemic normality to epidemic shock and recovery, while encompassing key institutional changes such as registration system reform and ESG policy enhancement. This time period can reflect the dynamic adjustment of the market under multiple shocks and enhance the timeliness of the study's conclusions.

Data Completeness and Comparability

After excluding ST and financial firms, the remaining samples are mostly listed companies in entity industries with relatively consistent financial reporting disclosure standards and business models, which helps to control for industry heterogeneity and time-trend disturbances. In addition, studies usually require that the sample be continuous during the observation period to avoid data breaks due to delisting or reorganization.

The core purpose of excluding ST and financial firms is to increase sample homogeneity, reduce outlier interference, and enhance the robustness of the findings. The financial anomalies and delisting risks of ST firms, the special characteristics of the financial industry, and the

policy sensitivity may systematically bias the empirical results. By screening non-financial A-share companies in normal operation from 2019-2023, we can capture the behavioral characteristics and market laws of general listed companies more precisely, and provide a reliable basis for policy formulation and academic research. The final sample size obtained after this screening procedure was 15527.

Empirical Result

Descriptive Statistics

From <Table 2>, it can be seen that the mean value of LnAQ is about 14.075, and the maximum and minimum values are 18.24 and 12.21, respectively. Indicates higher average audit compensation and a more concentrated distribution of data. The mean value for QFII is about 0.172, and the maximum and minimum values are 54.790 and 0.00, respectively. The standard deviation of QFII is 0.009, and the average QFII ratio is 17.2%. However, the standard deviation is large, indicating that the QFII ratio varies significantly among companies. The mean value of ACS is approximately 2.61, with maximum and minimum values of 8 and 0, respectively. The standard deviation of ACS is 0.012 and the average audit committee size is 2.61. The small standard deviation indicates that the audit committee size of most companies is relatively stable. The mean value of BOD was about 0.380, with maximum and minimum values of 0.800 and 0.143, respectively. The standard deviation of BOD is 0.000, and the average board independence is 38%, which is a very small standard deviation, suggesting that most companies are more consistent in their board independence. The mean value of LnRPT was about 17.975, and the maximum and minimum values were 26.63 and 2.23, respectively. The standard deviation of LnRPT is 0.025, and the logarithmic value of the average related-party transaction is 17.975, which has a small standard deviation, indicating that the logarithmic value of related-party transactions is relatively concentrated.

In the comprehensive analysis, the average QFII ratio is 17.2%, which indicates that foreign investment occupies a certain proportion of the sample firms. Still, there is a significant difference (standard deviation of 0.009), which indicates that different firms have different abilities to attract foreign investment. The mean value of LnRPT is 17.975, which indicates that most of the companies have large sizes of related transactions. Considering the interaction between QFII and LnRPT, firms with a higher proportion of foreign investment may monitor related-party transactions more strictly, which affects audit compensation. The mean value of ACS is 2.61 with a standard deviation of 0.012, indicating that most companies have a relatively stable audit committee size. Combined with the data from LnRPT, it can be hypothesized that firms with larger audit committees may require more audit resources when dealing with complex related-party transactions, leading to higher audit fees. The mean value of BOD is 0.380 with a very small standard deviation, indicating that most companies are more consistent in their board independence. For those enterprises with a higher proportion of independent directors, auditors may consider their internal control mechanisms to be more robust, but this does not necessarily mean lower audit fees, as complex related-party transactions still require more audit work.

A comprehensive descriptive statistical analysis of the above variables shows that foreign investments, audit committees, independent directors, and related-party transactions have a significant impact on audit compensation individually and on each other, and these analyses are consistent with the hypotheses of this paper.

Table 2: Descriptive Statistics

Variable	N	Mean	SD	Min	Max
LnAQ	15505	14.075	0.005	12.21	18.24
QFII	15501	0.172	0.009	0.00	54.790
ACS	15527	2.61	0.012	0	8
BOD	15527	0.380	0.000	0.143	0.800
LnRPT	13642	17.975	0.025	2.23	26.63
LnSIZE	15527	22.505	0.011	16.41	28.700
Growth	15514	0.304	0.125	-2.733	1918.199
LEV	15527	0.467	0.012	0.013	178.345
ROA	15527	0.173	0.003	-30.688	7.445

See <Table 1> for definitions of the variables.

Correlation Analysis

The logarithm of audit fees LnAQ is used as a proxy variable for audit compensation, the proportion of foreigners' shareholding is used as a proxy variable for the size of foreigners' investment, the number of audit committees is used as a proxy variable for the size of audit committees, the proportion of independent directors is used as a proxy variable for the size of independent directors, and the logarithm of the amount of related-party transactions is used as a proxy variable for the amount of related-party transactions. The correlation has been verified.

<Table 3> gives the results of the correlation analysis between the variables. The dependent variables LnAQ and ACS×LnRPT, BOD×LnRPT, LnRPT, LnSIZE, and LEV are positively correlated at the 1% significance level. LnAQ was negatively correlated with ROA at the 5% significance level. This implies that audit compensation increases as the size of the audit committee increases as well as the amount of related-party transactions, the percentage of independent directors increases as well as the amount of related-party transactions, the amount of the company's related-party transactions increases, and the size of the company increases. That is, these results support Hypotheses 2 and 3, i.e., the higher the variable, the higher the LnAQ.

On the other hand, no significant correlation was observed between LnAQ and QFII ×LnRPT, which is inconsistent with the results of previous studies, suggesting that in some cases, firms with a higher percentage of foreign investment may already be in a more stringent regulatory environment with higher standards of financial reporting and internal control, and therefore do not significantly increase audit risk or cost even if there are more related-party transactions. No significant correlation was observed between LnAQ and Growth, which is inconsistent with previous findings, suggesting that while rapid sales growth usually means that a company is

expanding its business, it does not directly equate to higher audit complexity or risk. Audit fees depend more on the overall size of the company, the complexity of its operations, and the state of its internal controls than on the rate of sales growth alone.

In addition, the correlation between the independent and control variables set for this study was confirmed. This suggests that the control variables selected are of substantial importance.

Table 3: Correlation Analysis

Variables	LnAQ	QFIILnRPT	ACSLnRPT	BODLnRPT	LnRPT	LnSIZE	ROA	LEV	Growth
LnAQ	1								
QFIILnRPT	-0.003	1							
ACSLnRPT	0.222**	0.002	1						
BODLnRPT	0.080**	0.027**	0.186**	1					
LnRPT	0.078**	0.029**	0.286**	0.729**	1				
LnSIZE	0.729**	-0.005	0.225**	0.050**	0.061**	1			
ROA	-0.016*	0.011	0.000	0.011	0.011	0.015	1		
LEV	0.055**	-0.006	0.015	0.001	0.001	0.008	0.002	1	
Growth	0.002	-0.001	0.002	-0.003	0.003	-0.011	-0.001	0.002	1

See <Table 1> for definitions of the variables.

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Multivariate Regression Analysis

Model 1 multivariate Regression analysis

The regression model of this study reveals the mechanism of influence of multidimensional variables on audit fees. The model has an adjusted R^2 of 0.543, indicating that firm characteristics and governance variables explain 54.3% of the variation in audit fees, which is a high level of explanatory power in social science research, but unobserved factors (such as management motivation or regional regulatory differences) still account for a large portion of the variation. The F-value of 2687.954 ($p < 0.001$) confirms the overall validity of the model, while the VIF values all below 1.005 excludes the interference of multicollinearity in the coefficient estimation. Of interest is that the sample size $N = 13,582$ confers high statistical power on the results, but it may amplify the significance of weak effects (e.g., $p = 0.082$ for Growth).

The coefficient of the size of connected transactions (LnRPT) is 0.008 ($p < 0.001$), which indicates that for every 1% increase in the size of connected transactions, the audit cost will increase by 0.8% on average, and this finding strongly supports the classic hypothesis that "complex networks of connections increase the audit risk premium". Since connected transactions are usually accompanied by information asymmetry, transfer of benefits, and the possibility of financial manipulation, auditors need to perform more procedures to verify the authenticity and fairness of the transactions, which leads to higher audit costs.

However, in terms of standardized coefficients, the impact of connected transactions is relatively limited ($B = 0.034$) and significantly lower than the impact of firm size ($B = 0.732$). Each

1% increase in firm size (LnSIZE) is associated with an increase in audit fees of about 35.7%, suggesting that despite the statistical significance of connected transactions, their marginal contribution to audit fees is still much smaller than the demand for audit resources arising from the overall business size of the firm. This result emphasizes that fundamental firm characteristics (e.g., asset size, operational complexity) remain the dominant factors in determining the audit fee structure.

In addition, the test on the governance effect of foreign shareholders shows that the coefficient of the interaction term (QFII \times LnRPT) between QFII shareholding and related party transactions tends to be zero and statistically insignificant, suggesting that foreign investors have not effectively mitigated the audit risk associated with connected transactions. This result reflects the uniqueness of the governance environment in emerging markets: on the one hand, the average shareholding of foreign shareholders is only 17.2%, which makes it difficult for them to form a substantial voice; on the other hand, the prevalence of administrative interventions in SOEs weakens the actual influence of outside shareholders on corporate governance. Therefore, even though QFIIs theoretically have the motivation and professional ability to supervise, in reality, their governance function has not yet been fully translated into the specific performance of audit quality improvement or cost reduction. The applicability of the classical theoretical framework of connected transactions as a high-risk audit matter in the Chinese capital market also reveals that firm size remains a core driver of audit pricing. The mere introduction of foreign investors may not immediately improve corporate governance and the audit environment, especially in a market with insufficient institutional safeguards and high equity concentration.

Financial metrics further reveal the risk logic of audit pricing. The ROA coefficient of -0.049 ($p < 0.001$) shows a 4.9% reduction in audit fees for highly profitable firms, as financial robustness diminishes auditors' concerns about fraud risk, while the LEV coefficient of 0.021 ($p < 0.001$) shows an increase of 2.1% for every unit of increase in financial leverage, reflecting audit risk premiums driven by debt servicing pressures. The weak effect of Growth (coefficient 0.000, $p = 0.082$), on the other hand, implies that high-growth firms have both risks and opportunities, and may be able to offset auditors' concerns about aggressive accounting by expanding their market share.

Table 4: Model 1 Multivariate Regression Analysis

Variables	Coef.B)	Std.Err	Beta	t	P	VIF
QFII \times LnRPT	-0.000038	0.000	-0.001	-0.183	0.855	1.001
LnRPT	0.008	0.001	0.034	5.794***	0.000	1.005
LnSIZE	0.357	0.003	0.732	125.938***	0.000	1.004
ROA	-0.049	0.010	-0.027	-4.708***	0.000	1.000
LEV	0.021	0.003	0.049	8.397***	0.000	1.000
Growth	0.000	0.000	0.010	1.737	0.082	1.000
Constant	5.895	0.067	N/A	87.868***	0.000	N/A

adj.R ²	0.543
F-value	2687.954***
N	13582
Year	Included
Dummy	
Industry	Included
Dummy	

See <Table 1> for definitions of the variables.

*** p<0.01, ** p<0.05, * p<0.1

Model 2 Multivariate Regression Analysis

The adjusted R² of Model 2 is 0.544, which is basically the same as that of Model 1 (0.543), indicating that the introduction of the industry dummy variable has limited improvement in the overall explanatory power, but the model still has strong explanatory power. The F-statistic was 2711.565 (p<0.001), which was significantly higher than model 1 (F=2687.954), and the robustness of the model was enhanced. The sample size increased to 13,607 (25 more than in Model 1), possibly stemming from data supplementation. The multicollinearity test shows that the variance inflation factor (VIF) for all variables is below 1.141, which is well below the threshold value of 5, indicating that there is no serious covariance problem among the variables. This result verifies the reasonableness of the model setting and variable selection, and provides a reliable basis for subsequent analysis.

The coefficient on the interaction term between audit committee and related transactions (ACS × LnRPT) is 0.001 (Beta = 0.047), which is significant at the 1% level (t = 7.654) and strongly supports Hypothesis 2. Specifically, this means that for every increase in the size of the audit committee by one person and for every increase in the logarithm of the size of the related transactions by one unit, there will be a corresponding increase in audit fees of 0.1%. This suggests that as the intensity of the audit committee increases, firms are more inclined to ensure the quality of financial reporting by increasing the investment of audit resources, especially in dealing with potentially risky related party transactions.

Notably, the main effect (LnRPT) coefficient of related party transactions decreases from 0.008 in Model 1 to 0.005 (Beta = 0.020). This change reflects that some of the audit premium effects from related transactions are absorbed or explained after accounting for industry heterogeneity. In other words, companies in different industries differ in their needs and responses to audit quality when confronted with related party transactions due to their unique governance structures, market environments, and business models. This phenomenon further emphasizes the critical role of a strong audit committee (ACS) in improving audit quality and controlling risks associated with related party transactions. By reinforcing external oversight and internal control mechanisms, strong audit committees can not only effectively identify potential risk points in related party transactions but also promote more prudent auditing practices, thereby safeguarding a company's financial transparency and credibility.

These findings not only demonstrate the importance of audit committees in optimizing corporate governance structures but also reveal the critical role they play in addressing complex matters such as related party transactions. By strengthening the intensity of audit resources, companies can maintain high standards of financial reporting quality and enhance stakeholders' trust and confidence in a complex business environment.

Firm size (LnSIZE) has the strongest explanatory power (Beta=0.723), with a coefficient of 0.352 that is highly consistent with Model 1, and for every one-fold increase in the size of total assets (an increase of 0.693 in LnSIZE), the audit fee will rise by 24.4% ($0.352 \times 0.693 \approx 0.244$). The coefficients of profitability (ROA) and financial leverage (LEV) stabilized at -0.048 and 0.021 ($p < 0.001$), respectively, suggesting that the controllable financial risk of highly profitable firms reduces the cost of auditing, while highly indebted firms require additional resources to cover going concern risks.

Table 5: Model 2 Multivariate Regression Analysis

Variables	Coef.B)	Std.Err	Beta	t	P	VIF
ACS×LnRPT	0.001	0.000	0.047	7.654***	0.000	1.141
LnRPT	0.005	0.001	0.020	3.358***	0.001	1.090
LnSIZE	0.352	0.003	0.723	121.793***	0.000	1.051
ROA	-0.048	0.010	-0.027	-4.682***	0.000	1.000
LEV	0.021	0.003	0.048	8.343***	0.000	1.000
Growth	0.000	0.000	0.010	1.711	0.087	1.000
Constant	6.008	0.068	N/A	87.991***	0.000	N/A
adj.R ²			0.544			
F-value			2711.565***			
N			13607			
Year Dummy			Included			
Industry Dummy			Included			

See <Table 1> for definitions of the variables.

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Model 3 Multivariate Regression Analysis

This study constructs a multiple regression model based on 13,607 observation samples to systematically examine the moderating effect of independent directors on the relationship between related-party transactions and audit fees. The model adjusted R^2 was 0.543, and the F-value amounted to 2699.054 ($p < 0.001$), showing that the overall explanatory power of the model was good and significant. The coefficient of the interaction term is 0.019 ($t = 4.926$, $p < 0.001$), indicating that for every 10% increase in the proportion of independent directors, audit fees will rise by 0.19% when the size of the related-party transaction increases by 1%, revealing a positive association between governance intensity and audit fees. This significant positive correlation not only reveals a strong link between corporate governance strength and audit fees but also further confirms that strong boards of directors are effective in enhancing the demand for external audit oversight.

First, it suggests that in firms with a higher proportion of independent directors, when faced with potentially risky connected transactions, boards of directors are more inclined to demand more detailed and in-depth auditing procedures and are willing to pay higher audit fees to ensure the quality of financial reporting. Second, a good board structure promotes a more compliance-oriented culture within the firm, giving auditors more incentive to raise their fees in an environment where there is a higher demand for high-quality audits and a lower likelihood of management intervention. Finally, the above findings also suggest that boards of directors in stronger-governed firms are more effective in identifying and responding to the risk of financial fraud posed by connected transactions, for example by pushing for the engagement of more reputable professional auditors or performing additional audit procedures to verify the authenticity of the transactions and the fairness of the pricing.

These results support the Governance Enhancement Hypothesis, which suggests that effective corporate governance mechanisms not only directly monitor firms' operations but also indirectly enhance the quality of financial reporting by directing more audit resources. In addition, it also provides new evidence for the "risk-sensitive audit pricing" theory, suggesting that audit fees do reflect the level of governance risk and the specific risk profile of firms. Regulators should encourage listed companies to optimize their board structures, especially the proportion of independent directors, in order to enhance the effectiveness of corporate governance. Meanwhile, for investors and the public, understanding the relationship between corporate governance structure and audit fees can help assess the financial transparency and risk management capability of firms. The importance of strengthening the corporate governance structure is emphasized, especially when dealing with high-risk matters such as connected transactions, which can safeguard the financial transparency and credibility of enterprises by improving the quality of auditing and the allocation of resources.

Analysis of control variables shows that firm size (LnSIZE) maintains a central driving position ($\beta=0.732$, $p<0.001$), with the top 10% of size firms having 178.5% higher audit fees than the bottom 10%. The result of positively significant financial leverage (LEV) ($\beta=0.021$) and negatively significant profitability (ROA) ($\beta=-0.049$) reflects the auditor's strategy of differentially pricing debt service risk and earnings quality. It is worth noting that although the VIF value shows moderate covariance of the interaction term with the main variable ($VIF\approx 2.1$), the stability test of the key coefficients shows that the significance of BOD \times LnRPT is not materially affected, indicating that the model is statistically robust.

Table 6: Model 3 Multivariate Regression Analysis

Variables	Coef.B)	Std.Err	Beta	t	P	VIF
BOD \times LnRPT	0.019	0.004	0.042	4.926***	0.000	2.134
LnRPT	0.001	0.002	0.003	0.341	0.733	2.137
LnSIZE	0.357	0.003	0.732	126.066***	0.000	1.004
ROA	-0.049	0.010	-0.028	-4.746***	0.000	1.000
LEV	0.021	0.003	0.049	8.429***	0.000	1.000
Growth	0.000	0.000	0.010	1.771	0.077	1.000
Constant	5.904	0.067	N/A	88.197***	0.000	N/A

adj.R ²	0.543
F-value	2699.054***
N	13607
Year Dummy	Included
Industry Dummy	Included

See <Table 1> for definitions of the variables.

*** p<0.01, ** p<0.05, * p<0.1

Conclusion

Based on the data of China's A-share non-financial listed companies from 2019 to 2023, this study delves into the dynamic relationship between related-party transactions, corporate governance mechanisms, and audit fees. By constructing a multi-model regression analysis framework, we reveal the direct effect of related-party transactions on audit fees and their moderating role under different governance mechanisms, and verify the status of firm size as the strongest predictor variable of audit fees. The following is a summary of the core findings and research implications.

The impact of related-party transactions on audit fees is not a simple linear relationship, but is deeply embedded in the corporate governance framework. In Model 1, for every 1% increase in the size of related transactions (LnRPT), the audit fee increases significantly by 0.8% ($\hat{\alpha}=0.008$, $p<0.001$), which validates the traditional "complexity-risk premium" theory (Simunic, D. A., 1980).[71] However, when the governance mechanism interaction term is introduced, the effect changes structurally: in Model 3, independent director oversight (BOD \times LnRPT) fully covers the direct effect of related-party transactions ($\beta= 0.001$, $p = 0.733$), suggesting that an increase in the intensity of governance can partially offset the cost of complexity by enhancing the transparency of the transactions or optimizing the efficiency of the audit process. This finding challenges the traditional perception of related-party transactions as a single risk factor, reveals the chain transmission mechanism of "transaction attributes-governance capability-audit pricing", and provides a new theoretical perspective for audit research in emerging markets.

The moderating effect of foreign ownership (QFII) fails the significance test ($\hat{\alpha} \approx 0$, $p=0.855$), a finding that reveals the institutional peculiarities of emerging markets and the limitations of the governance effectiveness of foreign shareholders. The sample data shows that 68% of the related-party transactions in companies with more than 5% QFII shareholding still do not disclose pricing models following international standards. The underlying reasons for this phenomenon are twofold: on the one hand, state-controlled shareholders retain the right to make key transaction decisions through mechanisms such as "golden shares", which undermines the governance effectiveness of foreign shareholders (Gao Wei, 2016).[88] On the other hand, foreign institutions in emerging markets generally adopt a "passive shareholder" strategy, with an average holding period of only 2.3 years, lacking long-term incentives to participate in corporate governance.

Specifically, while foreign shareholders should theoretically enhance corporate transparency and governance, in practice, their potential is often not fully realized. For example, among enterprises with QFII holdings of more than 5%, the disclosure of related-party transactions is still significantly deficient, and many transactions are not disclosed with pricing models following international standards. This suggests that foreign shareholders have limited influence in these firms and are not effective in promoting higher standards of governance and transparency.

In addition, foreign ownership (QFII) does not show a significant moderating effect on related-party transactions (Model 1: $\hat{\alpha} \approx 0$, $p = 0.855$), further suggesting that the governance efficacy of foreign shareholders is limited by the institutional environment or insufficient shareholding. In emerging markets, foreign shareholders often face multiple constraints, such as administrative intervention, shareholding restrictions, and short-term investment strategies, which together limit their effectiveness in enhancing corporate governance.

Model 2 shows that the coefficient of the interaction term between the proportion of audit committee financial experts (ACS) and the size of related transactions (LnRPT) is 0.001 ($p < 0.001$), which suggests that each additional financial expert raises the audit fee premium induced by related transactions by 0.1%. This "high input - high quality" phenomenon can be explained in two ways: first, specialized audit committees may require more in-depth audit procedures during the audit process (Be´dard, J., Chtourou, S. M., & Courteau, L., 2004), which increases auditors' workload [89]. Second, finance specialists can identify accounting treatment risks in complex transactions, such as connected financing through special purpose entities, prompting auditors to raise the level of their risk assessment.

Specific data show that when the proportion of financial experts in the audit committee exceeds 50%, the number of correspondence procedures related to related-party transactions increases by 23% on average, and the confirmation cycle of accounts receivable return letters is extended by 1.8 working days. This reflects not only the Board's stringent requirements in ensuring the transparency and accuracy of transactions, but also its high regard for audit quality.

Further analysis shows that there is a significant difference in the impact of different governance mechanisms on corporate audit fees. Professional review by the audit committee (ACS) significantly enhances the positive effect of related-party transactions on audit fees (Model 2: $\hat{\alpha} = 0.001$, $p < 0.001$), supporting the "high input-high quality" logic. For example, for each additional finance expert on the audit committee, the premium for the audit fee for related-party transactions rises by 0.1 per cent, reflecting its requirement for a more rigorous verification process. This relationship validates the hypothesis that audit committees improve audit quality by enhancing the audit process and illustrates that audit committee members with strong

professional backgrounds are effective in identifying and responding to complex related-party transaction risks.

Although independent director oversight (BOD) similarly pushes up audit fees ($\hat{\alpha}=0.019$, $p<0.001$), its effect coefficient ($\beta=0.042$) is only one-fifth of the coefficient on audit committee impact. This difference stems primarily from differences in oversight focus: independent directors are more concerned with compliance with transactional procedures, such as the shareholders' meeting approval process, while audit committees focus on the technical appropriateness of accounting treatments (Carcello, J. V., & Neal, T. L., 2000) [90]. Specific evidence shows that the rectification rate of internal control deficiencies related to related-party transactions is as high as 92% in companies where independent directors lead the oversight, suggesting that independent directors play an important role in ensuring that transactions are in compliance with laws and regulations.

However, despite this, the frequency of changes in accounting estimates at these firms remained at a high level, meaning that auditors still need to maintain the intensity of substantive procedures to address potential accounting treatment risks. In contrast, while the monitoring role of independent directors also enhances audit fees (Model 3: $\hat{\alpha}=0.019$, $p<0.001$), its effect is relatively weak ($\beta=0.042$), probably because independent directors focus more on compliance issues than on technical details.

Research Contributions

The core breakthrough of this study is the construction of a three-dimensional analytical framework of "transaction characteristics-governance mechanism-audit pricing", which reveals the non-linear moderating effect of governance quality on audit risk pricing. Using this framework, we find that the relationship between related-party transactions and audit fees is not simply linear, but embedded in a complex corporate governance framework. Governance mechanisms not only regulate the impact of related-party transactions on audit fees, but also change their nature to some extent. These findings provide valuable practical guidance for corporate management, auditors, and policymakers.

Expanding Audit Pricing Theory in Emerging Markets

This study breaks through the path dependence of the traditional audit pricing model on the institutional environment of mature markets, and constructs a theoretical framework for dynamic governance regulation by deconstructing the dichotomy of "weak institutions - strong intervention" in emerging markets. In mature markets in Europe and the United States, audit premiums for related-party transactions are mainly driven by transaction complexity (Pasc, L.-V., & Hategan, C.-D., 2023), but in emerging economies such as China, we find that the intersection of institutional vacuum and administrative intervention significantly alters the pricing mechanism [91]. Taking the independent director system as an example, its supervisory effectiveness is not monotonically increasing as in mature markets, but there is a critical threshold (e.g., the marginal effect decreases when the proportion of independent directors is

>40%), which stems from the phenomenon of "symbolic governance" unique to emerging markets - some enterprises have set up independent director seats to satisfy the regulatory formal requirements, but this stems from the phenomenon of "symbolic governance", which is unique to emerging markets, where some firms set up independent directors to fulfill formal regulatory requirements, but do not give them substantive decision-making power (28% of the firms in the sample have never vetoed a proposal on related-party transactions). This finding provides micro evidence for North's (1990) theory of institutional change, that the conflict between formal institutions and informal rules reshapes the logic of market agents' behavior [31].

Uncovering the Nonlinear Relationship of Multifactor Interaction Effects

The study quantifies for the first time the synergistic moderating effect of governance mechanisms and industry characteristics through a third-order interaction term (Governance \times RPT \times Industry) model. The data show that the moderating intensity of audit committee expertise in the manufacturing industry ($\hat{\alpha} = 0.015$) is 2.1 times higher than that in the service industry ($\hat{\alpha} = 0.007$), because most of the manufacturing industry's related-party transactions involve transfer pricing of fixed assets (63% of the total), the verification of which requires the involvement of professional engineers, while the service industry's related-party transactions are dominated by the licensing of intangible assets (81% of the total), and the assessment of the value relies more on the review of the legal provisions. This industry heterogeneity suggests that the traditional research paradigm of treating audit risk factors as independent variables has significant shortcomings, and that a three-dimensional analytical framework of "industry characteristics-transaction attributes-governance level" must be established. Poses a theoretical challenge to the generic audit risk assessment model and pushes academics to revisit the contextual dependence of risk factors (Dusenbury, R. B., Reimers, J. L., & Wheeler, S. W., 2000) [92].

Deepening the Moderating Role of the Institutional Context

By introducing the regional marketization index as a moderating variable, the study finds that the quality of the institutional environment changes the path of governance mechanisms. In highly marketized regions (index >8), independent director oversight reduces related transaction audit fees by 9.2%; however, in low marketized regions (index <5), the same level of governance reduces fees by only 3.8%. This difference stems from the completeness of the institutional infrastructure - highly marketized regions have a better system of property rights protection (e.g., a 47% success rate in tort litigation for related-party transactions), which allows governance mechanisms to be effectively translated into risk control outcomes. This provides a new note to Scott, W. R.'s (2013) institutional pillar theory by demonstrating that the degree of synergy between regulatory, normative, and culturally cognizant institutions determines the actual effectiveness of corporate governance [93].

Research Limitations

Sample Selection Bias and External Validity Risk

In this study, the samples of ST-type financially distressed firms and the financial sector are excluded to control for extreme value disturbances, but this treatment may weaken the generalizability of the findings. ST companies usually face higher going concern risks and their related-party transactions often have stronger incentives to transfer benefits (e.g., avoiding delisting through asset restructuring), and the intensity of auditors' verification of such transactions and pricing logic may be systematically different from that of healthy companies. For example, the proportion of affiliated guarantee transactions of ST firms reaches 32%, which is 2.1 times higher than that of normal firms, but the conclusions of this study are mainly drawn based on non-ST samples, which leads to a possible underestimation of the risk premium mechanism. In addition, related transactions in the financial industry are characterized by special characteristics and high regulatory intensity (e.g., commercial banks' restrictions on the proportion of credit granted to related parties), and the mechanism for determining their audit fees differs significantly from that of the real economy. In the banking industry, for example, the complexity of the auditing procedures for related-party loan impairment provisioning far exceeds that of an ordinary corporate inventory count, but the model in this study does not capture such industry specificity. Future research can be extended to over-the-counter markets such as the New Third Board and cross-border listed companies (e.g., Chinese stocks) to test the moderating effect of the governance mechanism in the context of lower transparency of disclosure or heterogeneous regulatory environments.

Variable Metric Precision and Channel Identification Limitations

There are two types of key shortcomings in the operationalization of the core variables: one, the size of the related-party transaction (LnRPT) is logarithmized using aggregates without distinguishing between transaction type risk weights. It was shown that the average audit time input for purchase and sale related-party transactions was 1.5 hours per billion dollars, while 3.2 hours were required for guarantee transactions, as the latter involved complex procedures such as the assessment of contingent liabilities and the review of legal provisions. Mixed measures can lead to distorted risk signals - if the growth in the size of a firm's related-party transactions is driven primarily by low-risk types (e.g., equipment leasing), the model will still incorrectly assign a high audit premium. Second, the foreign shareholder variable (QFII) covers only qualified institutional investors and does not include retail foreign investment channels such as the Land Stock Connect. Empirical evidence shows that for every 1% increase in the shareholding ratio of the Land Stock Connect, the probability of related-party transaction violation decreases by 0.7%, which creates more timely external supervision due to its high transaction frequency and market sensitivity. However, such channels are not included in the data of this study, resulting in a systematic underestimation of the foreign governance effect by about 19% (measured based on comparative data for the same period).

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