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The Role of Controlling Shareholders and Auditor-Client Relationships in Related Party Transactions: Evidence from Malaysia

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ABSTRACT

This study investigates the relationship between controlling shareholders (CS), auditor-client relationships (ACRs), and related party transactions (RPTs) in Malaysia, a country characterized by concentrated ownership structures and family-controlled firms. The research aims to explore how specific levels of CS ownership (23% and 33%) influence RPT practices and disclosures, and to examine the moderating role of long-term ACRs in mitigating or exacerbating RPT risks. This study employs a pooled regression analysis using a sample of 580 companies listed on Bursa Malaysia from 2014 to 2017. Data were collected from annual reports and Datastream. The study also incorporates Social Network Theory to understand the dynamics of embedded relationships between auditors and clients. The findings reveal that CS with ownership levels of 23% and 33% are positively associated with RPTs, indicating that CS use their dominant positions to engage in RPTs for personal benefit. However, CS with higher ownership (33%) exhibit more cautious behavior, suggesting a nuanced relationship between ownership levels and RPTs. Long-term ACRs improve auditors' ability to detect and disclose RPTs, but they also mitigate the positive relationship between CS and RPTs, indicating that close ACRs may restrict CS's ability to exploit RPTs. Despite the use of data from 2014 to 2017, the findings remain highly relevant as Malaysia’s ownership structures and governance mechanisms have not undergone significant changes in recent years. The insights provided by this study continue to reflect the current state of RPT practices and their implications in Malaysia. The findings have important implications for policymakers and regulators. This paper suggests the need for stricter oversight of RPT disclosures, particularly in firms with concentrated ownership structures. Additionally, the study highlights the importance of maintaining auditor independence and skepticism in long-term ACRs to ensure transparency and fairness in RPT disclosures.

Keywords: Related Party Transactions (RPTs), Controlling Shareholders (CS), Auditor-Client Relationships (ACRs), Ownership Structure, Corporate Governance, Audit Quality.

INTRODUCTION

Related party transactions (RPTs) present a dual challenge in corporate governance. While they can serve as legitimate business activities to meet the economic needs of a group of related companies (Hwang, Chiou, and Wang, 2013; Rahmat et al., 2020), they are frequently exploited by controlling shareholders (CS) to expropriate company resources at the expense of minority shareholders (Liew et al., 2015; Waad et al., 2021). RPTs can be broadly categorized into two types: (1) transactions between related companies and the CS, and (2) transactions among related companies under the same CS. The first type is widely recognized as a conflict-of-interest transaction that primarily benefits the CS (Abigail & Dharmastuti, 2022; Lo & Wong, 2016; Wong & Kim, 2015), whereas the second type is often perceived as a genuine business transaction without any conflict of interest (Jian & Wong, 2010; Kohlbeck & Mayhew, 2010, 2017). This study posits that even the second type of RPTs can lead to conflicting interests with the potential to prioritize the benefits of CS. CS often leverage their strategic positions in key management roles (Bertrand et al., 2008; Chen and Wu, 2010; Juliarto et al., 2013; Munir et al., 2013) to design RPTs that serve their own interests (Defond & Zhang, 2014; Paligorova & Xu, 2012). However, there is limited evidence regarding the specific level of ownership at which such manipulation occurs. This study aims to address this gap by examining the relationship between CS ownership and RPTs.

The Malaysian context provides a unique setting for this study due to its concentrated ownership structure and the prevalence of family-controlled firms, where CS often dominate decision-making processes (Ali et al., 2021; Anafiah et al., 2017; Courteau et al., 2017; Zhang et al., 2014). Bursa Malaysia defines a CS as anyone holding more than 33% of shareholding. However, prior studies, including those conducted in Malaysia, suggest that ownership levels as low as 23-25% are sufficient to imply control (Claessens et al., 2002; Mohd Ghazali, 2010; Morck & Yeung, 2004). This study focuses on ownership thresholds of 23% and 33% to capture varying degrees of control and their impact on RPT practices and disclosures. These thresholds are particularly relevant in the Malaysian context, where CS often wield significant influence over corporate decisions, including auditor appointment and reappointment. Specifically, this study investigates whether CS with ownership levels of 23% and 33%—thresholds commonly associated with control in prior studies (Claessens et al., 2002; Mohd Ghazali, 2010; Morck et al., 1988)—engage in RPTs differently.

The voluntary nature of Related Party Transaction (RPT) disclosure further complicates this issue. As management is responsible for ensuring that all RPTs are fully disclosed in audited financial statements, auditors play a critical role in verifying the completeness and accuracy of these disclosures. However, management may intentionally conceal certain RPTs from auditors, particularly in cases where transactions are designed to benefit them (Gordon et al., 2007; Rahmat & Ali, 2016). A long auditor-client relationship (ACR) may exacerbate this issue, as prolonged familiarity could provide management with opportunities to hide their involvement in RPTs or disclose fewer transactions than occur (Fontaine & Pilotti, 2016; Karim & Zijl, 2013).

The ACR plays a pivotal role in shaping RPT disclosures. However, controlling shareholders (CS) may intentionally reappoint auditors to establish close ACRs, thereby gaining dominance over audit decisions. This can occur through informal networks or prior working relationships, where the CS selects auditors who are more likely to align with their interests (Rahmat & Ali, 2016). Human behavior plays a significant role in shaping long-term ACR tenures. Over time, emotional attachments and personal relationships between auditors and clients may develop, leading to a loss of objectivity and professional skepticism (Schmidt & Cross, 2014). Long ACR tenures may also foster trust between auditors and clients, which can either enhance auditors' ability to detect and disclose RPTs or compromise their independence depending on the level of skepticism maintained (Ghosh & Doocheol Moon, 2005; Ye et al., 2011).

A critical gap in the literature is the lack of understanding of how Social Network Theory influences the dynamics of ACRs and their impact on RPTs. According to Social Network Theory, actors develop networks to achieve their objectives, either through arm's-length relationships or embedded relationships (Gibson et al., 2014; Hoang & Antoncic, 2003; Uzzi, 1997). While arm's-length relationships are characterized by formal, transactional interactions with weak emotional ties, embedded relationships are built on prior interactions, shared beliefs, and shared values, fostering a high level of trust and cooperation (Morgan & Hunt, 1994; Robert Dwyer, 1987). In the context of auditing, auditors are often appointed through embedded relationships, particularly in family-controlled firms, where controlling shareholders prefer auditors who are familiar with their business operations and ownership structure (Beattie & Fearnley, 1998; Reheul et al., 2013). This study addresses this gap by examining how embedded relationships and the resulting trust between auditors and clients influence the detection and disclosure of RPTs, particularly in long-tenured ACRs.

This study examines whether a close (long-term) ACR tenure improves RPT disclosure by leveraging auditors' accumulated knowledge and expertise. Additionally, this study examines whether close (long-term) ACR moderates the relationship between CS and RPTs, and whether this moderating effect varies with ownership level. By incorporating human behavior into the ACR discussion, this study responds to the call by Gordon et al. (2007) for a more nuanced understanding of auditor-client dynamics.

This study prioritizes audit-firm tenure over audit-partner tenure for several reasons. Firstly, audit-firm tenure offers a broader perspective on Audit Client Relationships (ACR), reflecting the cumulative experience and institutional knowledge of the audit firm over time. Secondly, in the Malaysian context, audit firm rotation is more pertinent than partner rotation due to regulatory requirements and the structure of the audit market. Although audit-partner rotation is mandated in Malaysia, the institutional memory and continuity of the audit firm often play a more significant role in shaping audit quality and client relations (Gavana et al., 2024; Jadiyappa et al., 2021; Rahmat et al., 2018). By focusing on audit firm tenure, this study provides a more comprehensive understanding of how long-term ACRs influence Related Party Transactions (RPTs) and corporate governance outcomes.

The findings of this study indicate that both the 23% and 33% ownership levels are positively associated with RPTs, suggesting that Controlling Shareholders (CS) at these thresholds actively engage in RPTs. However, CS with higher ownership (33%) tend to manipulate RPTs more cautiously, indicating a nuanced relationship between ownership level and RPT. Furthermore, this study finds that extended ACR tenures are less effective in mitigating CS involvement in RPTs, highlighting the potential for reduced auditor skepticism in prolonged relationships.

These findings contribute to the literature in several ways. Firstly, new evidence is provided on how the CS ownership level influences RPT practices, addressing a critical gap in the literature. Secondly, the study underscores the limitation of extended ACR tenures in curbing RPT manipulation, offering fresh insights into the interplay between auditor-client dynamics and corporate governance. Thirdly, the importance of regulatory oversight in ensuring the transparency and fairness of RPTs, particularly in contexts with concentrated ownership structures, is emphasized.

The remainder of this paper is organized as follows. Section 2 provides the institutional background of ownership structure, ACR, and RPT in Malaysia. Section 3 presents a literature review and develops the hypotheses. Section 4 describes the research design, and Section 5 presents the empirical results. Finally, Section 6 discusses the findings and concludes the paper.

Institutional Background of Ownership Structure, Acr and Rpt

In Malaysia, corporate governance is heavily influenced by the presence of CS (CS), which often dominates decision-making processes through substantial shareholdings, key management positions, and intergenerational control(Courteau et al., 2017). More than 40% of board compositions in Malaysian listed companies comprise family members of CS, reflecting the prevalence of family controlled firms(Liew et al., 2015). These family members often come from wealthy backgrounds and hold a high social status, further consolidating their influence on corporate decisions(Kuek et al., 2021; Loy, 2010). The Malaysian cultural norm of accepting power distance and inequality makes it unlikely for minority shareholders to challenge the decision made by the CS(Satkunasingam & Shanmugam, 2006). As a result, CS has significant opportunities to engage in rent-seeking behaviors, particularly through RPT(Abdullah & Wan-Hussin, 2016; Kohlbeck et al., 2018; Liew et al., 2015; Rahmat et al., 2019).

RPTs are common features of corporate operations, particularly in family controlled firms. While they can serve legitimate business purposes, such as resource sharing and cost efficiency, they are often exploited by the CS to extract private benefits(Ali et al., 2021; S. Hwang & Kim, 2016; Kohlbeck & Mayhew, 2017; Wang et al., 2019). In Malaysia, the prevalence of RPTs is exacerbated by concentrated ownership structures and the dominance of CS over corporate decision making(Rahmat et al., 2020). Recent evidence suggests that RPTs are not only used for wealth expropriation, but also to consolidate control over affiliated companies, creating a network of interlocking interests that benefit the CS and their families(Habib et al., 2017; Peng & Jiang, 2010; Zhang et al., 2014). This practice is particularly concerning in Malaysia, where the regulatory enforcement of RPT disclosures is often inconsistent, leaving minority shareholders vulnerable to exploitation(Rahmat & Ali, 2016).

ACR plays a critical role in mitigating the risks associated with RPTs by ensuring transparency and accountability in financial reporting(Chien & Hsu, 2010; Wahab et al., 2011). However, auditors' effectiveness in detecting and disclosing RPTs is often influenced by ACR quality (Monin et al., 2007). While independent audit committees are responsible for appointing auditors, the CS, who often hold key management positions, may interfere in the selection process by appointing auditors who are more likely to align with their interests(Almer et al., 2014; Fiolleau et al., 2013). A long ACR procedure has a dual effect. On one hand, it may enhance the auditor's understanding of the client's operations, improving their ability to detect and disclose RPTs(Ghosh, 2011). On the other hand, prolonged relationships can lead to economic dependence and reduced skepticism, particularly when CS exerts influence over the auditor(Rahmat & Ali, 2016).

In Malaysia, mandatory audit rotation is forced to mitigate the risks associated with a long ACR tenure. The Malaysian Institute of Accountants (MIA) requires audit partners to rotate every seven years with a two-year cooling-off period. However, recent evidence suggests that mandatory rotation alone may not be sufficient to prevent the development of close ACRs, as auditors may still prioritize client relationships over audit quality(Daugherty et al., 2013). Furthermore, the rotation of audit partners does not address the institutional memory and continuity of the audit firm, which can lead to close relationships between the client and the audit firm(Wilson et al., 2018).

Auditor-client relationship from the Networking Perspective and RPTs

To understand the dynamics of the auditor-client relationship (ACR) and its impact on related party transactions (RPTs), we incorporate the Social Network Theory. This theory posits that actors develop networks to achieve their objectives, either through arm's - length relationships or embedded relationships. (Gibson et al., 2014; Hoang & Antoncic, 2003; Uzzi, 1997)

An arm's length relationships are characterized by formal, transactional interactions with weak emotional ties(Granovetter, 1973, 1983, 1992). These relationships are typically formed outside the actor's regular contacts and governed by contractual obligations rather than personal trust(Katz et al., 2004). By contrast, embedded relationships are built on prior interactions, shared beliefs, and shared values, fostering a high level of trust and cooperation(Morgan & Hunt, 1994; Robert Dwyer, 1987). Embedded relationships are often associated with stronger emotional ties and greater interdependence, making them more effective in achieving long-term objectives(Hoang & Antoncic, 2003; Uzzi, 1997).

In the context of auditing, while auditors are ideally appointed through arm's - length relationships to maintain independence, they are often selected from the client's network or based on prior working relationships(Beattie et al., 2001, 2004; Reheul et al., 2013). This practice is particularly prevalent in family controlled firms, where CS may prefer auditors who are familiar with business operations and ownership structures(Mohd Ghazali, 2010; Rahmat & Ali, 2016). Some past studies have shown that auditors appointed through embedded relationships are more likely to be reappointed if the client is satisfied with their prior work, leading to the development of close ACR over time(Ball et al., 2015; Bowlin et al., 2015; Reheul et al., 2013; Wilson et al., 2018).

Reappointment of auditors in close ACR fosters trust between the auditor and the client, which can have dual effects. Trust facilitates smoother communication and cooperation, enabling auditors to gain a deeper understanding of the client's business operations and potential risks, including RPTs(Fontaine & Pilote, 2012; Saiewitz & Kida, 2018). However, excessive trust may compromise the auditor's independence and skepticism, as emotional attachments and economic dependence reduce the auditor's willingness to challenge the client's decisions(Ater et al., 2019; Garcia-blandon & Ma Argiles, 2015; González-díaz et al., 2015; Jenkins & Vermeer, 2013). Some evidence suggests that close ACRs may lead auditors to become more lenient in their assessments, particularly when the client exerts a significant influence over the audit process(Aghazadeh & Hoang, 2020; Mwintome et al., 2024).

Literature Review and Hypotheses Development

CS exerts significant influence on corporate decision-making through substantial shareholdings and strategic positioning in key management roles(Ronald J & Jeffrey N., 2003). This dual control enables CS to plan and manipulate RPTs to serve their own interests, often at the expense of minority shareholders(Zhang et al., 2014). Even when professional managers are appointed, they may collude with the CS to conceal RPTs as their loyalty often aligns with the CS(DeAngelo & DeAngelo, 2000). Furthermore, the intergenerational transfer of control, where large shareholdings and top management positions are inherited by the CS's descendants, ensures the perpetuation of expropriation activities in concentrated companies(Bertrand et al., 2008b). This dynamic makes it nearly impossible to eliminate expropriation in firms dominated by CS.

Empirical evidence strongly supports a relationship between CS and RPTs. Studies show that RPTs are often used as tools for wealth expropriation, particularly in firms with concentrated ownership structures(Juliarto et al., 2013b; Kang et al., 2014). While RPTs may serve legitimate business purposes, such as sustaining operations or providing financial assistance, they are frequently executed only when CS stands to benefit(Hwang et al., 2013). For instance,Aharony et al. (2010), found that CS provides financial aid to subsidiaries during times of distress, but later extracts loans from the same subsidiaries without repayment once the subsidiaries regain stability. SimilarlyFriedman et al. (2003), demonstrated that CS selectively offers personal financial assistance only when the subsidiary is capable of repaying the loan. These findings underscore the opportunistic nature of RPTs, which are often designed to secure future benefits for CS.

Hwang and Kim (2016) highlight the strategic use of RPTs to consolidate control and perpetuate family dominance across generations. Bae et al. (2002) documented that M&A s are executed primarily to benefit the CS, while Hwang and Kim (2016) showed that excessive RPTs are used to provide financial assistance to related-party companies, ensuring their survival and continued control by the CS. These practices not only reinforce the dominance of the CS, but also create long-term risks for minority shareholders, who are often excluded from the decision-making process.

The relationship between CS and RPTs is grounded in agency theory, which highlights conflicts of interest between CS (principals) and minority shareholders (agents). The theory posits that CS, as principals, may exploit their power to engage in self-serving RPTs, particularly when monitoring mechanisms are weak (Jensen and Meckling, 1976).

Based on cumulative evidence and theoretical foundations, it is evident that CS utilizes their dominant power to engage in RPTs that serve their own interests, often at the expense of minority shareholders. Consistent with prior studies, we predicted that CS would be positively associated with RPTs. Therefore, we propose the following hypotheses:

H1: CS are positively associated with RPTs.

According to Social Network Theory, professional services should ideally be conducted at arm's length to avoid emotional attachments that could compromise objectivity (Granovetter, 1983). However, emotional attachments may still develop over time, regardless of whether the relationship is initially formed through an embedded or arm's length contract. In the context of auditing, past studies have shown that auditors are often appointed through embedded contacts where prior relationships or personal networks influence the selection process (Beattie and Fearnley, 1998; Guan et al., 2015). Furthermore, auditors are more likely to be reappointed if there is a strong rapport or "chemistry" between the auditor and client (Jenkins and Vermeer, 2013; Reheul et al., 2013).

A long tenure in the auditor-client relationship (ACR) can have dual effects. On one hand, it may foster a close ACR that facilitates smoother communication (Fontaine & Pilote, 2012; Saiewitz & Kida, 2018) and more efficient negotiation during the audit process (Meyer et al., 2007; Ball et al., 2015). On the other hand, prolonged relationships may compromise the auditor's skepticism, as emotional attachments and economic dependence can reduce the auditor's willingness to challenge the client's decision(Jenkins & Vermeer, 2013; Kyriakou & Dimitras, 2018). Some past studies have highlighted that long ACR tenures can enhance auditors' skills and industry-specific knowledge, enabling them to better understand clients' business operations, ownership structure, and potential risks, including RPTs(Azizkhani et al., 2018; Ball et al., 2015; Hapsoro & Santoso, 2018; Siregar et al., 2012). This improved understanding may increase auditors' ability to detect and ensure the appropriate disclosure of RPTs. However, the effectiveness of long-term ACR tenures in mitigating RPT risks depends on the auditor's ability to maintain professional skepticism and independence.

Audit firms and regulators have implemented precautionary measures to address the risks associated with long-term ACR tenures. For instance, audit firms often match the client's personality with that of the audit partner to minimize conflicts and ensure productive discussions on accounting issues(Gibbins et al., 2010; McCracken et al., 2008). Additionally, mandatory rotation policies such as those practiced in Malaysia aim to prevent auditors from becoming too familiar with their clients, thereby maintaining their skepticism and independence(Bowlin et al., 2015). Despite these measures, the reappointment of auditors over long tenures may still allow them to develop specialized skills, including the ability to detect and disclose RPTs more effectively.

Given the dual effects of long-term ACR tenures, we predict that close (long-term) ACRs are positively associated with RPT disclosure. While long tenures may enhance auditors' ability to detect and disclose RPTs, they may also create opportunities for CS to influence the audit process. Therefore, we propose the following hypotheses:

H2: Close (long-term)) ACR is positively associated with RPT disclosure.

By holding key management positions, CS has a significant influence on the appointment and reappointment of auditors(Almer et al., 2014; Fiolleau et al., 2013). This influence often leads to the development of a close ACR, characterized by trust and emotional attachment between the auditor and the client(Reheul et al., 2013). Although a close ACR may facilitate smoother communication and cooperation during the audit process(Fontaine & Pilote, 2012; Saiewitz & Kida, 2018), it also poses risks to auditor independence and skepticism. Auditors are required to maintain independence, and failure to manage the level of trust in a close ACR may compromise their ability to challenge the client's decisions, particularly in cases involving RPTs(Glover & Prawitt, 2014).

Studies have shown that clients often dominate close ACRs, particularly in later years of engagement. In the early years, clients may have been more cooperative, but as the relationship matured, they tended to become more contentious and aggressive in pushing for their preferred accounting treatments(Messier Jr et al., 2015; Schmidt & Cross, 2014). This dominance can lead auditors to become more reckless and less likely to challenge clients' decisions, increasing the risk of undetected or undisclosed RPTs(Baker & Al-thuneibat, 2011; Kerler III & Brandon, 2010). Recent evidence suggests that auditors in close ACRs may identify the existence of related parties but still conceal RPTs to maintain this relationship(González-díaz et al., 2015; Louwers et al., 2008). This behavior underscores the challenges auditors face in balancing trust and skepticism in close ACRs.

The quality of close ACR is ultimately determined by the auditor's ability to maintain independence and professional skepticism throughout the audit process(Fontaine, 2011). At sufficient levels of skepticism, auditors can effectively limit CS engagement in RPTs by challenging questionable transactions and ensuring appropriate disclosures. However, when auditors fail to maintain skepticism, the client may dominate the ACR, leading to increased RPTs, as the client perceives less resistance from the auditor. A close ACRs can either mitigate or exacerbate RPT risks depending on the auditor's ability to withstand client pressure and maintain independence. When auditors maintain sufficient skepticism, close ACRs can mitigate CS engagement in RPTs by ensuring appropriate disclosures and challenging questionable transactions. However, when auditors fail to maintain skepticism, close ACRs may exacerbate RPT risks as the client dominates the relationship and perceives less resistance from the auditor. Therefore, we propose the following hypotheses:

H3: Close (long-term) ACR mitigates the positive relationship between CS and RPTs.

RESEARCH DESGIN

This study employs content analysis to analyze research questions. This study used pooled regression model.

Sample and Data Collection

This study utilizes companies listed on Bursa Malaysia from 2014 to 2017 as the sample. Financial institutions and instances of missing data were excluded from the sample. Some of the data employed in this study were obtained through DataStream and manually collected from annual reports. The sample comprised 580 companies listed on Bursa Malaysia, resulting in 2,900 observations. There have been no changes in corporate governance practices in Malaysia since 2017.

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Regression model and Variable Measurements

Pooled regression was used to examine the hypotheses. The regression models were as follows:

$$\begin{aligned} RPT_{i,t} = {} & \beta_0 + \beta_1 CSType_{i,t} + \beta_2 AudTen_{i,t} + \beta_3 CSType_{i,t} * AudTen_{i,t} + \beta_4 AudQ_{i,t} \\ & + \beta_5 SIZE_{i,t} + \beta_6 LEV_{i,t} + \beta_7 GROWTH_{i,t} + \beta_8 ROA_{i,t} + \beta_9 BDSIZE_{i,t} \\ & + \beta_{10} BDIND_{i,t} + \beta_{11} ACIND_{i,t} + \beta_{13} \Sigma 3_{i,j} Year_{i,t} + \beta_{14} \Sigma 4_{i,j} Ind_{i,t} + \varepsilon_{i,t} \quad \text{Eq. 1} \end{aligned}$$

Where:

RPT represents the natural logarithm of RPT. RPT is defined as RPT among RP companies, where CS controls both companies. CS $Type_{i,t}$ denotes a binary variable that is controlled by the CS share being either 23 percent of share (CS23) or 33 percent of share (CS33); the value is equal to “1” if a company is controlled by CS at a classified level of ownership or “0” otherwise. $AudTen_{i,t}$ denotes the auditor’s tenure, and is measured by the years of reappointment. $AudQ_{i,t}$ is a binary variable representing audit quality and has a value equal to “1” if a firm is audited by the Big 4 or “0” otherwise. $SIZE_{i,t}$ is the natural logarithm of the company’s total assets. $LEV_{i,t}$ represents a company’s leverage scaled by the ratio of total debt to total assets. $GROWTH_{i,t}$ represents a company’s market value at the end of year t, divided by the book value of total assets. $ROA_{i,t}$ is the ROA ratio of return on assets. $BDSIZE_{i,t}$ represents board size based on the number of directors. $BDIND_{i,t}$ represents the proportion of independent non-executive directors to the total board members. $ACIND_{i,t}$ represents the proportion of independent non-executive members to the total number of members on an audit committee. $Year_{i,t}$ represents a vector of year indicator variables for 2013, 2014, 2015, 2016, and 2017 and finally, $Ind_{i,t}$ represents a vector of industry indicator variables based on the Bursa Malaysia industry classification. where $\varepsilon_{i,t}$ is an error term.

RESULTS

Table I Descriptive Statistics

Panel A: Continuous variables								
	RPT	CS	AUDTEN	SIZE	LEV	ROA	BDSIZE	ACIND
Mean	5.909	50.434	4.600	5.713	0.181	0.056	7.307	0.892
Median	6.900	53.345	5.000	5.670	0.160	0.060	7.000	1.000
Maximum	9.400	98.010	8.000	8.160	0.760	1.050	13.000	1.000
Minimum	0.000	0.000	0.000	1.410	0.000	-0.940	4.000	0.600
Std. Dev.	2.715	17.771	2.345	0.646	0.155	0.111	1.809	0.148
Panel B: Dummy variables								
Panel B1: Controlling shareholder (CS)								
		Frequency	Percentage					
CS>23		2 728	94.069					
CS<23		172	5.931					
		2 900	100.000					
CS>33		2 499	86.172					
CS<33		401	13.828					
		2 900	100.000					
Panel B2: AUDQ								
Big-4		1,462	50.414					
Non-big-4		1,438	49.586					
		2 900	100.00					

Notes: CS23> is a controlling shareholder with more than 23 percent shareholding and CS<23 is a controlling shareholder with less than 23 percent of shareholding, CS33> is a controlling shareholder with more than 33 percent shareholding and CS<33 is a controlling shareholder with less than 33 percent of shareholding. Big-4 refers to Big-4 companies which are Ernst&Young, PwC, KPMG, Deloitte, while non-Big-4 refers to others.

All continuous variables were winsorized to a 1% level to reduce the skewness problem. The mean (median) value for RPT was 5.909 (6.900) with a standard deviation of 2.715, indicating moderate variability in RPT disclosures across the sample. The median value of 6.900 suggests that most firms engage in RPTs at a significant level. For Related Party Transactions (RPT), the mean value of 5.909 and median of 6.900 indicate that most firms engage in a substantial volume of RPTs, with the higher median suggesting a slight right skew in the distribution. The standard deviation of 2.715 reflects moderate variability across firms, with RPT values ranging from 0.000 (indicating no disclosed transactions) to 9.400 (reflecting high RPT activity). Meanwhile, the mean controlling shareholder (CS) ownership of 50.434%—with a median of 53.345%—confirms the prevalence of concentrated ownership structures in Malaysia, where dominant shareholders typically hold majority stakes. These patterns align with the study's institutional context and underscore the relevance of examining CS influence on RPT practices.This study used CS as a binary variable, and the breakdown of CS is presented in panel B. Meanwhile, for AUDTEN, the mean, maximum, and minimum values were 4.600, 8.000, and 0.000, respectively. This figure indicates that companies in Malaysia, on average, keep the same auditor for 4.6 years (~ five years). However, some companies do not reappoint the same auditor, whereas others reappoint the same auditor for eight years in a row. Hence, on average, companies in Malaysia are perceived as having close ACR to their auditors. The means for SIZE, LEV, and ROA are 5.713, 0.1818, and 0.056, respectively. On average, BDSIZE has a board of directors of 7.307 (~7).

Panel B in Table II depicts the frequency of the dummy variables used in this study, which refer to the CS and AudQ. The results in Panel B1 show the frequency details of CS at 23% and 33% shareholding. More than 94.069% of CS held shares at more than 23% of shareholding, and only 86.172% held shares at more than 33%. This trend shows that the CS has lessened their shares at higher shareholding, that is, at 33 percent of shareholding. Meanwhile, in Panel B2, 50.414% of the sample was audited by the Big 4, and 49.586% by the non-Big 4. There were no multicollinearity issues among the variables used in this study (Table II).

Table II Correlation Analysis

	CS	AUDTEN	AQ	SIZE	LEV	ROA	BSIZE	ACIND
CS	1.000	0.063	0.149	0.092	0.018	0.064	0.121	-0.033
AUDTEN	-	1.000	0.231	0.152	0.017	0.061	0.042	-0.003
AQ	-	-	1.000	0.268	0.101	0.047	0.143	-0.128
SIZE	-	-	-	1.000	0.367	0.181	0.266	-0.092
LEV	-	-	-	-	1.000	0.098	0.142	0.014
ROA	-	-	-	-	-	1.000	0.060	-0.009
BSIZE	-	-	-	-	-	-	1.000	0.034
ACIND	-	-	-	-	-	-	-	1.000

In Model 1, the positive coefficient of CS23 is 0.726 (t-statistic = 2.832, $p < 0.05$), indicating that controlling shareholders (CS) with more than 23% ownership are positively associated with RPTs. This finding supports H1, confirming that CS use their dominant positions to engage in RPTs for personal benefit, which is consistent with prior studies (Cheung et al., 2006; Juliarto et al., 2013). In Model 2, the coefficient for CS33 is 0.569 (t-statistic = 9.069, $p < 0.01$), which is also positively related to RPTs, but weaker than the 23% threshold. This suggests that CS with higher ownership levels (above 33%) may exhibit more cautious behavior, possibly to avoid regulatory scrutiny or reputational damage. These findings highlight the dual role of CS ownership in influencing RPTs. While CS with moderate ownership (23%) are more likely to engage in RPTs for personal gain, those with higher ownership (33%) may prioritize long-term sustainability and reputation over short-term benefits.

Table III Multiple Regression Result

	Model 1		Model 2	
	Coefficient	t-Statistic	Coefficient	t-Statistic
C	3.107	4.528***	3.438	5.328***
CS23	0.726	2.832**		
CS33			0.569	9.069***
AudTen	0.119	3.404***	0.094	7.656***
CS23*AudTen	-0.096	-2.071**		
CS33*AudTen			-0.075	-3.623***
AudQ	-0.162	-0.733	-0.150	-0.685
SIZE	0.349	3.388***	0.350	3.402***
LEV	0.498	1.266	0.520	1.351
ROA	0.927	2.577*	0.925	2.575***
BSIZE	-0.026	-1.029	-0.03	-1.259
ACIND	-0.028	-0.104	0.006	0.0219
Year	Included		Included	
Industry	Included		Included	
n	2,900		2,900	
Adjusted R2	82.27%		82.28%	
Durbin-Watson stat	1.718		1.723	
F-Statistic	23.888		23.889	
Prob (F-statistic)	0.000		0.000	

Notes: Refer to Table II for variable definition and measurement.

***significant level $p<0.01$, **significant level $p<0.05$, *significant level $p<0.10$.

In both Models 1 and 2, AudTen was positively and significantly related to RPTs, with coefficients of 0.119 (t-statistic = 3.404, $p < 0.001$) and 0.094 (t-statistic = 7.656, $p < 0.001$), respectively. This supports H2, indicating that long-term auditor-client relationships (ACRs) enhance auditors' ability to detect and ensure the disclosure of RPTs. The findings suggest that auditors with longer tenures acquire relevant skills and knowledge, enabling them to better understand clients' business operations and identify RPTs. The interaction between CS and AudTen provides further insight into the dynamics of closely related ACRs. In Model 1, the interaction term CS23 * AudTen was negatively related to RPTs, with a coefficient of -0.096 (t-statistic = -2.071, $p < 0.05$). Similarly, in Model 2, the interaction term CS33 * AudTen is negatively related to RPTs, with a coefficient of -0.075 (t-statistic = -3.623, $p < 0.01$). These findings support H3, which indicates that close (long-term) ACRs mitigate the positive relationship between CS and RPTs. The negative interaction terms suggest that close (long-term) ACRs could limit CS involvement in RPTs as auditors become more effective in detecting and challenging questionable transactions. While long-term ACRs foster trust between auditors and clients, it can also create a sense of accountability. A CS may be less likely to engage in abusive RPTs if they know that their actions will be closely scrutinized by a trusted auditor. This dynamic creates a balance between trust and professionalism, whereby auditors use their relationships with clients to ensure transparency and fairness in RPTs (Fontaine and Pilote, 2012; Saiewitz and Kida, 2018).

CONCLUSION

This study investigates the relationship between controlling shareholders (CS), auditor-client relationships (ACRs), and related party transactions (RPTs) in Malaysia. The findings indicate that CS is positively associated with RPTs, suggesting that CS leverage their dominant positions to engage in RPTs for personal gain. This finding aligns with prior studies e.g. (Cheung et al., 2006; Juliarto et al., 2013), which have consistently shown that CS with significant ownership stakes tend to use RPTs as a tool for expropriation of minority shareholder's wealth. However, this study extends the literature by demonstrating that the relationship between CS ownership and RPT is nuances, with CS at higher ownership level (33%) exhibiting more cautious behavior compared to those at lower ownership levels (23%). This suggests that while CS with moderate ownership are more likely to engage in RPTs for personal gain, those with higher ownership may prioritize long-term sustainability and reputation over short term benefit.

The study also examines the role of close (long-term) ACRs in moderating the relationship between CS and RPTs. The results demonstrate that long-term ACRs enhance auditors' ability to detect and disclose RPTs, as auditors acquire a deeper understanding of the client's business over time. This finding is consistent with prior research (e.g., Azizkhani et al., 2018; Ball et al., 2015), which suggests that longer auditor tenure improves audit quality through accumulated knowledge and expertise. However, this study contributes new insights by showing that close (long-term) ACRs may constrain the ability of CS to engage in RPTs. The interaction between CS and close ACRs revealed a negative relationship with RPTs, indicating that close ACRs reduce the information asymmetry between auditors and clients, making it more difficult for CS to conceal or manipulate RPTs. This finding underscores the importance of maintaining auditor independence and skepticism in long-term relationships, as auditors with longer tenures are better equipped to challenge questionable transactions and ensure transparency in RPT disclosures.

Given the lack of significant changes in corporate governance in Malaysia, the findings remain relevant despite the older data. This study has several limitations. First, the assumption that all committed RPTs are fully disclosed in annual reports may not always hold true due to the complex nature of these transactions. Second, the focus on Malaysian listed companies may limit the generalizability of the findings to other countries. Future research could investigate the frequency of concealed RPTs and compare findings across different countries to understand the impact of regulatory and cultural differences.

These findings contribute to theoretical implications in several ways. First, this study supports the Social Network Theory that embedded relationships (such as long-term ACR) can foster trust and cooperation, enabling auditors to detect and disclose RPTs more effectively. Second, this study provides new insights into the dynamics of RPTs in Malaysia, particularly the nuanced relationship between CS ownership levels and RPT practices. The findings underscore the importance of regulatory oversight and auditor independence in ensuring transparency and fairness in RPTs. Policymakers should consider revising auditor reappointment policies to ensure auditors maintain their independence and skepticism in long-term relationships. Additionally, regulators should strengthen oversight mechanisms to ensure transparency and fairness in RPT disclosures, particularly in firms with concentrated ownership structures. Audit committees should play a more active role in monitoring RPTs and ensuring that auditors maintain a high level of professional skepticism, particularly in firms with concentrated ownership structures.

In conclusion, this study underscores the dual role of long-term ACRs in enhancing audit quality and restricting abusive RPTs, emphasizing the importance of maintaining auditor independence and skepticism in long-term relationships.

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