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# Social Capital and Audit Fees : Evidence from Indonesia

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**Abstract**

A surge of problems is haunting the accountants to date, one of which is the absence of audit fees' standard. Although there have been many studies on the factors that influence audit fees, this issue still requires study. This study examines the effect of social capital on the amount of audit fees for go public companies in Indonesia in 2015-2019. A total of 610 observations representing 122 companies became the sample of this study. Hypothesis test is conducted on two groups of data based on the social capital index, namely the low and the high social capital index. Multiple regression analysis was used for data processing and analysis. This study indicate that the company's social capital has an influence on the audit fee. Firms domiciled in areas with a high social capital index pay lower audit fees and vice versa. Our study explains an understanding of how social capital works in accounting settings, especially in the field of auditing and provides recommendations.

**JEL Code :** M42, P16, O16,Z33
**Keywords :** Social Capital, Audit Fees, Indonesia

## I. Introduction

MANY STUDIES HAVE examined the factors that affect audit fees, for example the impact of industry specialization (Carson, 2009), role of audit firm size, impact of audit risk (Sonu, Heyjung, Ahn and Choi, 2017), dan client size (Kikhia, 2015). Although there have been many studies on the determinants of audit fees, this issue still a concern. A surge of problems is haunting the accountants to date, one of which is the absence of audit fees' standard (Sinaga, 2015). Considering the absence of audit fees' standard, various questions arise, whether audit fees are in accordance with the

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this is the first study in Southeast Asia directly examine the relationship between social capital and audit fees. This study also complements studies that investigate how variations in socio-economics factors, such as social capital, affect managerial decision making, especially in the field of auditing.

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# Social Capital and Audit Fees: Evidence from Indonesia

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# Social Capital and Audit Fees: Evidence from Indonesia

**ABSTRACT**

A surge of problems is haunting the accountants to date, one of which is the absence of audit fees' standard. Although there have been many studies on the factors that influence audit fees, this issue still requires study. This study examines the effect of social capital on the amount of audit fees for go public companies in Indonesia in 2015-2019. A total of 610 observations representing 122 companies became the sample of this study. Hypothesis test is conducted on two groups of data based on the social capital index, namely the low and the high social capital index. Multiple regression analysis was used for data processing and analysis. This study indicate that the company's social capital has an influence on the audit fee. Firms domiciled in areas with a high social capital index pay lower audit fees and vice versa. Our study explains an understanding of how social capital works in accounting settings, especially in the field of auditing and provides recommendations to public accountants to consider social capital factors in determining audit fees. This study contributes to both theoretically and practically by showing that the social environment can form a trust between auditors and clients, and have an impact on the audit fees.

**JEL Code:** M42, P16, O16, Z13
**Keywords:** Social Capital, Audit Fees, Indonesia

# Social Capital and Audit Fees: Evidence from Indonesia

## I. Introduction

Many studies have examined the factors that affect audit fees, for example the impact of industry specialization (Carson, 2009), role of audit firm size, impact of audit risk (Sonu et al. 2017), dan client size (Kikhia, 2015). Although there have been many studies on the determinants of audit fees, this issue still a concern. A surge of problems is haunting the accountants to date, one of which is the absence of audit fees' standard (Sinaga, 2015). Considering the absence of audit fees' standard, various questions arise, whether audit fees are in accordance with the challenges faced by auditors in auditing? Or vice versa, audit fees are not in accordance with their work as indicated by (Sinaga, 2015)? Empirical studies are needed to confirm this.

Simunic (1980) argues that the higher audit fees is the result from more audit work (auditor effort) and higher estimated losses /litigation risk. Causholli et al (2010) have analyzed various variables that have an impact on auditor effort/ litigation risk that may affect audit fees (e.g. elements of audit market and audit production). Furthermore, (Jha & Chen, 2015) investigates non-financial factors, namely the influence of social capital and client located on audit fees. A sense of mutual trust that is formed within the community (Jha & Chen, 2015) is called social capital which forms a cooperative attitude and forms collective action/behavior to achieve synergy between social and economic aspects that have an impact on behavior and contribute to audit fees (Liu, 2017).

When the level of social capital in society is high, the auditor's efforts reflected in audit fees will be lower because social capital can reduce opportunistic behavior (Callois & Angeon 2004). Social capital can make people guilty if they do something unethical (Fukuyama 1997) and can reduce opportunistic behavior and have an impact on audit risk (Jha & Chen 2015; Sánchez-Ballesta & Yagüe 2021; Jha 2019). Companies that are headquartered in areas with high social capital tend to pay lower audit fees because they tend to manipulate financial information less (Yue 2010; Jha & Chen 2015; Chen et al. 2021; Sánchez-Ballesta & Yagüe 2021). In other words, the quality of financial reports is highly dependent on the quality of the social environment (McGuire et al. 2012).

Jha & Chen (2015) show that auditors actually consider the condition of a company's social capital in determining the amount of audit fees. The study (Jha & Chen, 2015) was conducted on companies headquartered in the US. However, it is not clear whether their findings can be generalized to other countries, especially developing countries such as Indonesia, where the quality of people's welfare (health, income, human capital) and the purchasing power are generally still below the international average (https://www.youtube.com/watch? blogs.worldbank.org/). In addition, management performance in Indonesia is generally assessed based on company profitability. Based on bonus plan hypothesis, the manager will choose a decision that can increase the bonus earned (Jaya et al. 2021). The question arises whether social capital in Indonesia can encourage managers to behave more honestly, or whether the phenomenon of financial pressure to achieve profit will triggers managers to manipulate financial reports and affect the amount of audit fees.

In Indonesia, studies on social capital issues are still very limited. By going through the topic of audit fees in Indonesia in the national accredited journals and the proceedings of the national accounting symposium in recent years, only three articles with the topic of audit fees were found, but none of them were associated with social capital variables. Therefore, this research aims to analyze whether social capital plays a role in economic decisions in Indonesia, by analyzing relationship between social capital and amount of audit fees in Go Public companies in Indonesia.

This study provides contribution on both theory and practice. Considering that there are still very few studies which study the social capital in literature of accounting, this research is a stepping stone for accounting researchers to understand how social capital works in accounting settings. The results of the study provide an explanation of the impact of social capital (social environment) on managerial decisions (determining the amount of audit fees), such as companies in an environment with high social capital has an impact on reduction in audit fees. This study also provides recommendations for public accountants to consider social capital in determining the amount of audit fees. This study also adds much needed references to the research litertature in the field of auditing, particularly the issues of social capital and audit fees in developing country.

## II. Theory & Hypothesis Development

### 2.3. Social Capital and Audit Fees

The audit fee depends on the auditor's efforts in planning and carrying out the audit work. Planning and implementation audit works requires management integrity, Management integrity is an important factor that auditors consider when deciding how much audit effort is required and how much in charging the clients (Beaulieu, 2001). Management integrity is closely associated to the quality of financial report and this is related to the social capital environment in where the client is located. Social capital affects the quality of financial report (McGuire et al, 2012); (Kang et al, 2010).

The auditor's efforts in planning the auditing (identifying things that are riskier and which require more resources) influenced by the social capital in which the company is located. Companies that are based in the areas with a high social capital are thought to have a high corporate culture as well. The psychology literature states that companies hire and retain employees who share their own values and employees prefer to work for companies that share their own values (McGuire et al. 2012). Social capital in the area where the company is based at is thought to have an impact on the auditor's trust in the companies' managers. Auditors feel less confident when companies are based in areas with a low social capital. Lack of trust will increase audit effort and worry about litigation, thereby increasing the client costs.

If there's a lack of trust of the auditor towards the management, then more substantive procedures will be carried out by the auditor to ensure that the financial statements are fairly presented (Beaulieu, 2001). When the company is in an area with high social capital, managers will tend to be more honest in presenting financial statements (Jha, 2019), and auditors will have more trust in clients and reduce auditor efforts.

In areas with higher social capital, it is easier for auditors to obtain evidence from customers, banks, suppliers, as well as stakeholders and they might be more precise. Therefore, it is easier for audit efforts to obtain sufficient and appropriate audit evidence which will result in lower audit fees. Auditors also perceive a lower lawsuit risk from companies located in areas with higher social capital (Simunic, 1980). Auditors' concerns about litigation risk can increase audit fees (Guiso et al, 2004).

In the environment with a low level of trust, litigation risk will be higher and finally require greater effort in carrying out audit work. Therefore, for companies located in areas with a low social capital, auditors are likely to apply more effort and demand higher audit fees and instead, if companies are located in areas with high social capital, auditors are likely to apply less effort and demand lower audit fees.

The probability of litigation involving auditors is also higher in the areas with low social capital (Simunic, 1980). Auditors also identify a higher risk of lawsuits from companies that are in the areas of low social capital. Companies tend to behave poorly and third parties may have an unfavorable opinion of the management. Fear/worry about litigation risk can increase audit fees because litigation costs are relative to audit fees, so auditors tend to consider the trustworthiness of their clients. In an environment of low trust, the auditor's effort and litigation risk will be higher. Therefore, auditors are likely to exert more effort and demand higher audit fees on companies which are located in areas with low social capital. On the other hand, auditors will exert less effort and demand lower audit fees if the companies are based in an area with a high social capital.

Managers may be more honest in areas with high social capital and norms. Managers are encouraged to behave more honestly in the areas with high social capital. Classical literature holds that social norms affect individual decisions (Cialdini et al, 1991). When someone deviates from social norms, guilt will arise. In the context of managerial reporting behavior, stakeholders (institutional investors, bankers, managers) are more likely to interact which leads to greater information exchange, more effective supervision, and leads to more honest behavior (Wu 2008).

### 2.4. Research Gap

Simunic (1980) argues that the higher audit fees is the result from more audit work (auditor effort) and higher estimated losses /litigation risk. Guiso et al (2008) & Grullon et al (2010) argues that in determining audit fees, auditor consider the social capital where the company is headquartered. Social capital affects the quality of financial report (McGuire et al, 2012); (Kang et al, 2010). Jha (2013) found that companies are headquartered in areas of low social capital , the quality of financial reports is also low. So, it can be said that one of the things can affect audit fess is social capital

Jha & Chen (2015) show that auditors actually consider the condition of a company's social capital in determining the amount of audit fees. The study (Jha & Chen, 2015) was conducted on companies headquartered in the US. However, it is not clear whether their findings can be generalized to other countries, especially developing countries such as Indonesia, where the quality of people's welfare (health, income, human capital) and the purchasing power are generally still below the international average

(https://www.youtube.com/watch? blogs.worldbank.org/). In addition, management performance in Indonesia is generally assessed based on company profitability. Based on bonus plan hypothesis, the manager will choose a decision that can increase the bonus earned (Jaya et al. 2021). The question arises whether social capital in Indonesia can encourage managers to behave more honestly, or whether the phenomenon of financial pressure to achieve profit will triggers managers to manipulate financial reports and affect the amount of audit fees.

### 2.5. Hypothesis Development

Previous studies have shown that the level of auditor skepticism was varied based on where the client is located. Auditors are more skeptical and considering the low quality of reporting expected from clients who live in areas with low social capital. Managers may be more transparent and honest in areas with high norms and social capital. Companies located in areas that have high social capital will encourage their managers to behave more honestly. Classical literature thinks that social norms in society have an effect on the individual decision making (Cialdini et al, 1991). When a person deviates from social norms, guilt will arise. In the context of managerial reporting behavior, stakeholders interact more frequently which leads to greater information exchange, more effective supervision, and leads to a more honest behavior (Wu, 2008).

Grullon et al (2010) also state that auditors consider the social capital in where the companies are located, in determining the amount of audit fees. A strong evidence that auditors in determining audit fees, will consider the social capital where the company is located (Jha & Chen, 2015). The effect of social capital is stronger when the office is located closer to the client. The results show that when auditors are located in the social capital area as the clients, the effect of social capital on audit fees is three times higher if compared to when they are located further away (located in different cities). (Jha & Chen, 2015) also show that social capital has become stronger in 2004 (after the Sarbanes-Oxley Act), when audit practices become more auditing works (more complex) due to the implementation of the Sarbanes-Oxley Act (SOX).

Trust between companies, stakeholders, and investors is built through social capital (Lins et al. 2017). Jha & Chen (2015) also prove that auditors take and need more time and judgment to sign audit reports of clients who are in a low social capital environment. Auditor trust will decrease in companies which are located in areas with lower social capital, because they tend to have lower quality financial reports and tend to manipulate financial reports / financial statements (Jha, 2019). Due to the reduced auditor trust in companies located in areas with low social capital, so audit fees will increase. Conversely, high social capital encourages managers to behave more honestly which will lead to a decrease in audit risk and audit fees (Yue 2010; Jha 2019). High social capital is expected to reduce earnings manipulation due to feeling of guilt, monitoring, and punishment (Sánchez-Ballesta & Yagüe 2021).

Social capital in the area where the company is located, is suspected to have effect on the auditor's trust in managers. There is a lack of trust from Auditors when the company is located in an area with low social capital. Lack of trust will increase audit effort and concerns of litigation is suspected to increase client fees. Based on this argument, this study presumes that

**H:** Companies located in areas with a high social capital index will pay lower audit fees, or vice versa.

## III. Research Method

### 3.1 Variable Measurement

***Audit Fees***

Audit fees are rewards in the form of money (economic rewards) given to auditors who perform audit services, which are often called agency fees according to certain standards or criteria, including the consideration of risk compensation and profit requests (Liu, 2017). Data on audit fees are taken from companies which disclose the amount of audit fees, and are listed on the Indonesia Stock Exchange (IDX) in the period 2015–2019. The natural logarithm of audit fees is used to measure audit fees.

***Social Capital***

Social capital is defined as a mutual trust in society and is a norm that facilitates collective action (Woolcock, 2001). Social capital is measured using the regional/provincial social capital index developed by the Statistics Indonesia in 2014 (https://www.bps.go.id/) (https://www.bps.go.id/). This social capital index is the last issued by Statistics Indonesia which is still in use today. This social capital index remains relevant to be used to analyze its effect on audit fees for five years (2015-2019). This assumption is based on (Anheier, Gerhards, & Romo, 1995) who state that unlike human and physical capital indexes, social capital indexes are “sticky”. The idea is also confirmed by (Jha & Chen, 2015) who found the correlation between the social capital index in the United States for a period of almost a decade, 2000-2009, which was 0.91.

The 2014 Social Capital Statistics publication provides information that describes the condition of

social capital in Indonesia is described in three groups of indicators, which are collective action, membership in local associations and networks, trust and tolerance. This publication provides input for policy makers in designing, implementing, and evaluating development programs both at the regional and central levels.

The measurement of social capital that exists in the Indonesian society has been conducted in 2010 using 2009 National Socio-Economics Survey. In 2014, 10 scale of data and the method of exploratory factor analysis were used for the index calculation to identify the structure of the relationship between variables and dimensions of social capital with Principal Component Analysis (PCA) as the extraction method. The result of social capital index is made up of seven factors, namely: trust, religion tolerance, ethnic tolerance, reciprocity, participation in collective action, participation in group, and network. Those seven factors are included into three social capital indicators approach, namely: (1) trust, (2) collective action, and (3) group and network.

The 2014 national social capital index was 49.45 on a scale of 0-100. The magnitude of this social capital index varies between provinces with the difference between the highest and lowest index being 17.62. The highest index is in Province of Central Java at 55.62, while the lowest index is in the Riau Islands with 38.00. This study divides the social capital index into two categories, namely low and high by dividing the two parts of the difference between the highest and the lowest index. If the social capital index is in between 38.00 - 46.81, then it is regarded as low and if it is in between 46.82 - 55.62, it is categorized as high.

***Control Variable***

The control variable is a variable that is controlled or made constant so that the effect of the independent variable on the dependent is not affedcted by external factors that are not examined (Sugiyono, 2016). This study uses 15 (fifteen) control variables at the firm-level, which are Size, Leverage, Inherent Risk, Profitability, Type of auditor, Auditor Business, Public exchange, Audit Tenure, Audit issues (Audit Opinion and Going Concern); Regional characteristics (cost of living; population density; population density growth); and Audit Quality.

Size is measured with the natural logarithm of total assets (LnTA); Measuring leverage \ by calculating Total Liabilities divided by Total Assets; Inherent risk is calculated by adding up (Receivable + Inventory)/Asset; Profitability is measured by ROA and a dummy variable to show the losses experienced by the company (score 1, if the company suffers losses in that year and/or otherwise, score 0); The type of auditor is divided into Public Accounting Firm (PAF) non-Big 4 and Big 4 by using a dummy variable, namely if the PAFs are considered as Big 4, then it will be given a score of 1 and if it is non-Big 4, it will be given a score of 0; Auditor effort is measured using the lag between the date of the auditor's signature and the date of the end of the fiscal year (day to sign), the audit fee is estimated to be higher if the lag between the signing date of the audit report and a greater date of the end of the fiscal year. This indicates that there was a delay in the publication of financial statements due to problems that arose during the audit period; Public exchange is proxied with a dummy variable, namely a score of 1 if the company's shares are exchanged on the main board, while a value of 0 if the company's shares are exchanged on the development board. Companies whose shares are listed on the main board are companies that have large sizes and track records, for example, have an unqualified opinion for the last 2 years, posted operating profit in the last 1 financial year, have net tangible assets of > IDR 100 billion and the number of shareholders of > 1000 parties. Companies with good track records will make it easier for auditors to conduct the audit process, so that it has an effect on the audit fees. Audit tenure is proxied by auditor exchange. One of the reasons why clients change auditors is to obtain lower audit fees. Audit problems are proxied by issuing an audit opinion using a dummy variable (score 1, if an unqualified opinion is issued and a score of 0, if a non-qualified opinion is issued). If the resulting opinion is not an unqualified opinion, it is assumed that there are problems that can increase the risk of higher audit fees. Audit problems are also proxied by the issuance of going concern reports by using a dummy variable, namely a score 1, if the auditor issues a going concern audit report or otherwise, score 0. Regional characteristics are measured by the cost of living in the area, population density, per capita income, and population growth (Jha & Chen, 2015). The larger the population and the greater the per capita income in an area, the higher the audit fee will be. Audit Quality, proxied by big4 PAFs. When a company is audited by one of Big4 PAFs that has quality in conducting a good audit process, the audit fees will be greater than if the company uses a non-Big 4 PAFs.

### 3.2 Population and Sample

All go public companies in Indonesia for the 2015-2019 period are the population of this study. The five-year period is considered because it is the latest data that can be obtained and is deemed to be able to obtain sufficient and adequate results to explain the factors that affect audit fees. Purposive sampling method

was used to select samples, namely the method of selecting samples based on certain criteria to obtain a representative sample. The sample criteria are go public companies that are listed on the Indonesia Stock Exchange in 2015-2019 and have been listed on the IDX by December 31, 2011 at the latest; not delisting during the observation period; Companies that provide annual reports along with financial statements that have been audited by independent auditors and companies that disclose the amount of audit fees in the annual report. A total of 610 observations representing 122 companies became the sample of this study.

### 3.3 Empirical Model

Multiple regression analysis is used for hypotheses testing. The regression equation is as follows:

$$AUFEE = \beta_0 + \beta_1 SOCIALCAPITAL + \beta_2 SIZE + \beta_3 DEBT + \beta_4 ROA + \beta_5 BIG4 + \beta_6 LOSS + \beta_7 DAYS\ TO\ SIGN + \beta_8 PUBLIC\ EXCHANGE + \beta_9 UNQUALIFIED\ OPINION + \beta_{10} GOING\ CONCERN + \beta_{11} INHERENT\ RISK + \beta_{12} AUDITOR\ CHANGE + \beta_{13} COST\ OF\ LIVING + \beta_{14} RURAL + \beta_{15} LN\ POP + \beta_{16} POPG + \varepsilon$$

**Notes:**

AUFEE: Audit Fee; SOCIAL CAPITAL: Social Capital; SIZE: Size; DEBT: Leverage; ROA: Return on Aset; BIG4: Big4 or non-Big4 Public Accounting Firm; LOSS: Loss; DAYS TO SIGN: Lag between the signing date of the audit report and the end of the fiscal year; PUBLIC EXCHANGE: Main or Development Stocks; UNQUALIFIED OPINION: Unqualified Opinion; GOING CONCERN: going concern modification report; INHERENT RISK: Inherent Risk; AUDITOR CHANGE: Auditor Change; COST LIVING: regional minimum wage; RURAL: Population density is less than the media; POPULATION: Population density at a certain area; POP G: Population density growth.

## IV. Result and Discussion

### 4.1 Descriptive Statistic Test

The following are the results of descriptive statistical test from 610 observations obtained from 122 companies listed on the Indonesia Stock Exchange (IDX) in 2015-2019. Table 1 shows descriptive statistical tests. The mean value for Social Capital is 43.9442, meaning that the average social capital index in Indonesia is in the low category and the values of Quartile1, Quartile3 for Social Capital are the same, namely 42,5800 which indicate that 75% of companies in Indonesia are in the category of low Social Capital index. The LN audit fees variable has a mean value of 20.0463. Some control variables have the same $Q_1$, $Q_2$ and $Q_3$ values, namely the Loss variable which is at 0.000 meaning that 75% of companies in Indonesia do not have a negative Return on Assets value, while the unqualified opinion variable has the same $Q_1$, $Q_2$ and $Q_3$ values, which is equal to 1, meaning that 75% of the financial statements of companies in Indonesia have an unqualified opinion while the going concern variable has a value of 0.000 for $Q_1$, $Q_2$ and $Q_3$, meaning that 75% of companies in Indonesia have auditors who provide a modified going concern report, while the auditor variable exchange has a value of 0.000 for $Q_1$, $Q_2$ and $Q_3$, meaning that 75% of companies in Indonesia do not change auditors and the Rural variable has a value of 1,000 for $Q_1$, $Q_2$ and $Q_3$ , meaning that 75% of companies in Indonesia are in areas with a population density smaller than the median.

### 4.2 Hypotheses Test

The following are the results of descriptive statistical test from 610 observations obtained from 122 companies listed on the Indonesia Stock Exchange (IDX) in 2015-2019 Hypothesis test is conducted on two groups of data based on the social capital index, namely the low social capital index and the high social capital index. Companies that are included in areas with a low social capital index (38.00-46.81) are companies located in the provinces of DKI Jakarta and Riau, with a total of 95 companies and 475 observations. Companies that are in the areas with a high social capital index (46.82-55.62) are companies located in the provinces of West Java, North Sumatra, Banten, South Sumatra, Central Kalimantan, East Java, and Central Java, with a total of 27 companies and 135 observations.

This study conducts hypothesis testing twice with significant level 5%, which are hypothesis testing for companies in low social capital areas and hypothesis testing for companies in high social capital areas.

Table 2 shows that social capital has a positive effect on audit fees (coefficient 0.006; p-value < 0.000). These results indicate that both the direction and strength of the coefficient for the relationship between audit fees and social capital support the hypothesis. Companies located in areas with a low social capital index pay higher audit fees. This means that companies located in areas with a low social capital index will be charged a higher audit fee. These results support (Jha & Chen, 2015) and the statement of (Jha, 2019) namely that auditors' trust will decrease in companies located in areas with low social capital. Companies located in areas with low social capital tend to manipulate financial statements and auditors would take more time to sign the clients' audit reports, and therefore auditors will increase the audit fees. Table 2 also shows several control variables that have a positive and significant effect on audit fees, namely the Big Four category

(coefficient 4.285; p-value < 0.000), Going Concern Assumption (coefficient 5.527; p-value < 0.000). If one company is audited by one of the Big4 PAFs which are qualified in conducting a good audit process, the amount of audit fees will be greater than if the company uses a Non-Big4 PAFs. Table 3 shows the results of multiple regression in companies located in areas with high social capital index. The findings show that social capital has a negative effect on audit fees (coefficient -1.864; p-value 0.044). These results indicate that both the direction and strength of the coefficient for the relationship between audit fees and social capital of companies located in areas of high social capital index support the hypothesis. Companies located in areas with high social capital index pay lower audit fees. These results support Jha, 2013; Jha & Chen, 2015; Yue, 2010; Chen et al. 2021; Sánchez-Ballesta & Yagüe, 2021 who state that managers of companies located in high social capital areas tend to be more honest in financial statements and auditors will have more trust in clients and would eventually make decisions to reduce auditor efforts. In addition to the quality of financial statements, the ease of obtaining objective evidence from stakeholders is also believed to occur in companies that are in the area of a higher social capital. Therefore, the required audit effort is less and audit fees are lower. In addition to Social Capital, other factors that negatively affect audit fees for companies located in areas of high social capital index are Size (Coef -10.550; P-value <0.000) and Debt (Coef -2.878; P-value 0.005).

### 4.3 Analysis of Covariance (ANCOVA)

The analysis of covariance (ANCOVA) is another technique that is occasionally used for improving the precision of an experiment. Suppose that in an experiment with a response variable Y there is another variable, say X, and that Y is linearly related to X. Furthermore, conclusion that x cannot be controlled by the experimenter but can be observed along with Y. The analysis of covariance is a method of adjusting for the effects of an uncontrollable nuisance variable and the procedure is a combination of analysis of variance and regression analysis (Montgomery, 2013). The finding shows in Table 4, from the output, it can be seen that the significance figures for the control variables Size, Debt, Big 4, ROA, Going Concern, & Auditor exchange are below the Sig value of 5%, and because the Sig value is <0.05, then H0 is rejected. This means that at the 95% confidence level it can be said that there is a linear relationship between Size, Debt, Big 4, ROA, Going Concern, & Auditor exchange with audit fees. This statement indicates that the ANCOVA assumption has been met.

## V. Conclusion and Implication

This study motivated by the existing literature, which show that managerial decision and business practices are driven by the social environment. This study analyzes whether the social environment can affect the audit fees. The social environment reflects the company's culture and influences the behavior of managers. Therefore, the social environment will form a trust between the auditor and the managers, and provide an overview to the auditor about the auditor's effort in conducting the audit and the magnitude of audit risk, which leads to the determination of audit fees.

The finding show that social capital has a positive effect on audit fees in companies located in area with low social capital index (coefficient 0.006; p-value < 0.000) that means companies located in areas with a low social capital index pay higher audit fees. And the second findings show that social capital has a negative effect on audit fees in companies located in areas with high social capital index (coefficient -1.864; p-value 0.044) that means companies located in areas with high social capital index pay lower audit fees

Result of this study consistent with the hypothesis and prove that the company's social capital has an effect on audit fees. For companies located in areas with a high social capital index tend to pay lower audit fees (accountants charge a cheaper audit fee) and vice versa, companies in areas with a low social capital index pay higher audit fees. Companies located in areas with a low social capital index pay higher audit fees. This means that companies located in areas with a low social capital index will be charged a higher audit fee. These results support (Jha & Chen, 2015) and the statement of (Jha, 2019) namely that auditors' trust will decrease in companies located in areas with low social capital. Companies located in areas with low social capital tend to manipulate financial statements and auditors would take more time to sign the clients' audit reports, and therefore auditors will increase the audit fees. Companies located in areas with high social capital index pay lower audit fees. These results support Jha, 2013; Jha & Chen, 2015; Yue, 2010; Chen et al. 2021; Sánchez-Ballesta & Yagüe, 2021 who state that managers of companies located in high social capital areas tend to be more honest in financial statements and auditors will have more trust in clients and would eventually make decisions to reduce auditor efforts

This study has several limitations, such as: first, this study assumes that the social capital index is relatively stable every year so that the 2014 index published by the Statistics Indonesia is used to analyze its effect on audit fees for 5 years (2015-2019). Although this assumption is supported by (Anheier, Gerhards, &

Romo, 1995) and (Jha & Chen, 2015), this assumption might be inaccurate and might affect the results. Future studies are advised to re-test if a new social capital index has been published or conduct an independent calculation to obtain the social capital index. To gain another perspective on social capital, future research may also measure social capital by reflecting on factors of social deviance, such as crime rates (robbery, divorce, and other cases). Second, the short period of observation (5 years) and the proportion of samples that are not balanced between companies located in areas with high and low social capital, namely 22% (N = 135) and 78% (N = 475) which might reduce the power of statistical tests. Therefore, future studies may extend the years of observation. Future studies can analyze other non-financial variables that can affect audit fees, for example local culture and also analyze the impact of social capital on dysfunctional behavior in accounting, such profits management and budget gaming. Future studies are also suggested to control for known client-specific, auditor-specific, audit-specific and country-specific assignments.

This study contributes to both theoretically and practically by showing that the social environment can form a trust between auditors and clients, and have an impact on the determination of audit fees. To our knowledge, this is the first study in Southeast Asia directly examine the relationship between social capital and audit fees. This study also complements studies that investigate how variations in socio-economics factors, such as social capital, affect managerial decision making, especially in the field of auditing.

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## APPENDIX

**Table 2. Hypothesis Test Results - Low Social Capital Index**

| Dependent Variable: Audit Fees<br>Low Social Capital Index (DKI Jakarta and Riau) | | |
|---|---|---|
| **Variables** | **Coefficient** | **P-value** |
| SOCIAL CAPITAL | 0.006 | <0.000** |
| SIZE | -8.433 | <0.000** |
| DEBT | -1.117 | 0.265 |
| ROA | -0.600 | 0.549 |
| BIG 4 | 4.285 | <0.000** |
| LOSS | 0.817 | 0.415 |
| DAYS TO SIGN | -0.344 | 0.731 |
| PUBLIC EXCHANGE | -0.309 | 0.758 |
| UNQUALIFIED OPINION | -0.761 | 0.447 |
| GOING CONCERN | 5.527 | <0.000** |
| INHERENT RISK | -1.176 | 0.240 |
| AUDITOR EXCHANGE | -2.554 | 0.011* |
| COST OF LIVING | 0.163 | 0.871 |
| LN POP | -0.003 | 0.998 |
| POP G | 0.274 | 0.784 |

Source: Output Multiple Regression Analysis (**p-value<1%, *p-value<5%)

**Table 3. Hypothesis Test Results - High Social Capital Index**

| Dependent Variable: Audit Fees<br>High Social Capital Index (West Java, North Sumatra, Banten, South Sumatra, Central Kalimantan, East Java, Central Java) | | |
|---|---|---|
| **Variables** | **Coefficient** | **P Value** |
| SOCIAL CAPITAL | -1.874 | 0.044* |
| SIZE | -10.550 | <0.000** |
| DEBT | -2.878 | 0.005** |
| ROA | 4.012 | <0.000** |
| BIG 4 | 0.580 | 0.564 |
| LOSS | 2.564 | 0.012* |
| DAYS TO SIGN | 0.320 | 0.750 |
| PUBLIC EXCHANGE | 2.815 | 0.006** |
| GOING CONCERN | 5.107 | <0.000** |
| INHERENT RISK | -1.836 | 0.070 |
| AUDITOR EXCHANGE | 1.616 | 0.110 |
| COST OF LIVING | -1.328 | 0.188 |
| RURAL | 0.343 | 0.732 |
| LN POP | -1.674 | 0.098 |
| POP G | -0.724 | 0.471 |

Source: Output Multiple Regression Analysis (**p-value<1%, *p-value<5%)

**Table 3. Hypothesis Test Results - High Social Capital Index**

| Dependent Variable: Audit Fees<br>High Social Capital Index (West Java, North Sumatra, Banten, South Sumatra, Central Kalimantan, East Java, Central Java) | | |
|---|---|---|
| **Variables** | **Coefficient** | **P Value** |
| SOCIAL CAPITAL | -1.874 | 0.044* |
| SIZE | -10.550 | <0.000** |
| DEBT | -2.878 | 0.005** |
| ROA | 4.012 | <0.000** |
| BIG 4 | 0.580 | 0.564 |
| LOSS | 2.564 | 0.012* |
| DAYS TO SIGN | 0.320 | 0.750 |
| PUBLIC EXCHANGE | 2.815 | 0.006** |
| GOING CONCERN | 5.107 | <0.000** |
| INHERENT RISK | -1.836 | 0.070 |
| AUDITOR EXCHANGE | 1.616 | 0.110 |
| COST OF LIVING | -1.328 | 0.188 |
| RURAL | 0.343 | 0.732 |
| LN POP | -1.674 | 0.098 |
| POP G | -0.724 | 0.471 |

Source: Output Multiple Regression Analysis (**p-value<1%, *p-value<5%)

**Table 4. Analysis of Covariance Result**

| **Variables** | **Sig** |
|---|---|
| SIZE | 0.000 |
| DEBT | 0.000 |
| ROA | 0.678 |
| BIG 4 | 0.000 |
| LOSS | 0.513 |
| DAYS TO SIGN | 0.437 |
| PUBLIC EXCHANGE | 0.083 |
| GOING CONCERN | 0.000 |
| UNQUALIFIED OPINION | 0.642 |
| INHERENT RISK | 0.414 |
| AUDITOR EXCHANGE | 0.009 |
| COST OF LIVING | 0.497 |
| LN POP | 0.702 |
| POP G | 0.718 |

Source: Output ANCOVA