

## RESEARCH ARTICLE

# Stakeholder attitudes towards audit credibility in English local government: A post-Audit Commission analysis

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**Abstract**

In recent years, substantial changes have been implemented to the audit regimes for local authorities in several countries. Following the abolishment of the Audit Commission, a unique regime for the audit of local authorities has emerged in England, with external audit now fully conducted by private sector audit firms. Auditor appointments for the vast majority of local authorities are now managed by a new organisation, Public Sector Audit Appointments Limited (PSAA). Drawing on the determinants of audit credibility developed by Funnell, Wade and Jupe (2016), this paper examines how local authority stakeholders in the transformed landscape of local public audit in England perceive audit credibility, including the role of PSAA and other audit stakeholders. Findings show that the impact of current arrangements is positively perceived by stakeholders in relation to auditors' technical competence and independence, at least in the short term, however significant concern is found amongst stakeholders regarding the usefulness of local public audits. Compared to Funnell et al. (2016), we ascribe these differences to the different context of audit in English local government and suggest the relative weighting of determinants of audit credibility are contingent.

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**KEYWORDS**

Audit Commission, audit credibility, England, local government auditing, Public Sector Audit Appointments Ltd

## 1 | INTRODUCTION

A significant strand of research has emerged in accounting studies in recent years investigating perceptions of audits held by auditees based in the public sector. Perceptions are relevant to investigate since the credibility of audits is likely to influence the acceptance and use of audit information (Kells, 2011). The majority of studies of perceptions of audits concentrate on performance auditing by national-level audit institutes, mostly covering their audit activities in relation to national-level organisations such as central government departments, ministries and agencies (Pollitt & Summa, 1997; Skærbæk, 2009). Due to this focus on the national level, few studies investigate audit perceptions in local government, which is surprising given the significant size of local government as part of the total public sector but also the substantial institutional changes that have been implemented in the audit regimes for local government in several countries (e.g. for local public audit reforms in Finland, see Oulasvirta, 2015; and for Portugal, Marques & Pinto, 2019). In comparison to national-level focused audit studies, researching perceptions of audits in local government facilitates the analysis of a much wider array of stakeholder perspectives, such as private sector audit firms, governmental and non-governmental regulatory bodies and different types of local government auditees. Analysing perceptions of audits from multiple stakeholder viewpoints is critical as most audit research focuses exclusively on the audit client viewpoint. Audit research with regard to the private sector shows that important differences may exist in perceptions of audits from the viewpoint of auditees versus other stakeholders (Daugherty & Tervo, 2008; Hellman, 2006); however, we have little knowledge as to how audit perceptions may differ between stakeholders in the context of local public audit. Given the changes implemented in many local public audit systems, a focus on local government is also relevant as it provides a fruitful domain to identify how audit credibility may be impacted by institutional change. We define audit credibility as the perception of audits held by stakeholders, which includes but is not limited to auditees.

This paper investigates the credibility of audits for local authorities in England where local public audit has gone through significant institutional changes in recent years. Until 2015, the appointment of auditors to local authorities in England was the responsibility of the Audit Commission, which was a statutory agency setup by central government. The Conservative-led coalition government abolished the Audit Commission in 2015, and whilst English local authorities were empowered to appoint their own auditors, nearly all decided not to do so and instead opt-into a collective procurement scheme for their audit contracts, resulting in a national appointment of the auditor of 98% of English local authorities. Following a central tender process, Public Sector Audit Appointments Limited (PSAA) was named in the appointing person role, with the first audit contracts being awarded in 2017.

In this paper, we draw upon the determinants of audit credibility developed by Funnell, Wade, and Jupe (2016) in their study of performance auditing by the Australian National Audit Office to investigate how stakeholders in the transformed landscape of local public audit in England perceive audit credibility, encompassing the role of PSAA and other key stakeholders. According to this framework, audit credibility is dependent upon perceptions based on three criteria: the independence of the auditors, their technical competence and the usefulness of audit findings. Our findings demonstrate that the impact of the current institutional arrangements is perceived positively in relation to auditors' technical competence and independence; however, significant concern is traced amongst stakeholders regarding the usefulness of local public audits. Our paper also contributes to the literature by providing the first institutional review of the restructured English system for local public audit. The research for this paper draws on a variety of empirical sources, in particular semi-structured interviews and documentary analysis, combined with a survey.

The paper is structured as follows. We first review the relevant literature in the next section, which is followed by a discussion of the institutional characteristics of the system of local audit in England. Section four introduces the main participants in the study and discusses the interview process and survey methodology. We then analyse audit credibility, which is presented and discussed within Funnell et al. (2016) three-dimensional source credibility framework. The paper concludes with a summary of findings, theoretical and policy implications and suggestions for further research.

## 2 | THEORY

Research on perceptions of auditors and auditees regarding the credibility of audit work in the public sector has developed most extensively in relation to performance auditing, also known as value-for-money auditing. Most of these studies focus on national-level audit institutions (Pollitt & Summa, 1997; Skærbæk, 2009), such as the UK's National Audit Office (NAO) (Sharma, 2007). In contrast to the large array of national-level studies, few scholars cover perceptions of audit work in local government (but see Johnsen, Meklin, Oulasvirta, & Vakkuri, 2001; Lapsley & Pong, 2000). Available studies taking such an approach in relation to English local government were conducted in the 1990s, such as Pendlebury and Shreim (1990), who surveyed attitudes towards performance auditing amongst external auditors in English local government. However, given the large-scale changes implemented in the English audit landscape in recent years, which have substantially reduced performance auditing, the current relevance of their findings is uncertain.

According to Kells (2011), the credibility of audits in general depends upon perceptions and the experience during the process of audit of those who carry out the audit, those who are audited and those to whom the auditor reports. Credibility can be assessed by collecting views amongst auditees, auditors, and other stakeholders such as regulators. Schwarzkopf (2006) points out that the impact of auditors on auditees' decision-making will be critically affected by the perceived credibility of the source of information.

In this paper, we draw upon the determinants of audit credibility developed by Funnell et al. (2016) in their study of performance auditing by the Australian National Audit Office. Following Birnbaum and Stegner's (1979) assessment of information source credibility based on perceptions of a source's bias and expertise, Funnell et al. (2016) developed a framework for assessing audit credibility based on three determinants: auditor independence, technical competence and audit usefulness. Their approach was to define these concepts initially in broad theoretical terms and then discover how they were defined practically through the perceptions of different stakeholders.

Funnell et al. (2016) define auditor independence as 'the principle, long entrenched in audit discourse, that auditors must be, and be seen to be, willing and able to make objective, professional judgements, and to report them, free from the influence of those with a vested interest in the outcome' (p. 609); independence is essential if auditors are to hold auditees accountable to the public and other stakeholders. However, these two constituents of independence, objective judgements and reporting free from influence, whilst simple enough in theory can be harder to achieve in practice at least from the perception of auditees. Funnell et al. (2016) found differences among stakeholders as to the attributes they ascribe to auditor independence. Funnell et al. (2016) also note that in many countries 'auditor independence has never been achievable in any absolute sense' (p. 609) but only to the extent allowed by the relevant statutory framework.

In empirical literature in relation to the private sector, a tension has been observed between the interests of external stakeholders and auditees, which is reflected by auditors perceiving their role in different ways – either primarily as 'watchdogs' serving external stakeholders, or, alternatively, as clients' 'advocates' (Jenkins & Lowe, 1999; Öhman, Häckner, & Sörbom, 2012). Auditor independence has received significant attention in audit research in relation to the private sector. Several studies find that bigger audit firms tend to be more independent of auditees than medium-sized firms, with big audit firms, for example, more likely than small firms to issue going concern opinions (Mutchler, Hopwood, & McKeown, 1997), and large firms being named defendants in lawsuits proportionally less than small firms (Furman, 2000). This difference in independence is generally explained by the fact that auditors with a greater number of clients have 'more to lose' by failing to report a discovered breach in a particular client's records (DeAngelo,

1981; Mutchler et al., 1997). The difference in independence has contributed to a perception, at least observed with audit in the private sector, that large audit firms are able to provide higher audit quality compared to small firms.<sup>1</sup>

In relation to technical competence, Funnell et al. (2016) follow Birnbaum and Stegner (1979) in equating technical competence with expertise based on training, experience and ability such that what auditors say is accepted as an accurate reflection of the auditee's situation. They found in practice that whereas auditors emphasized the importance of following published technical standards, generic communication and people skills are also perceived as critical by both auditors and auditees. Several studies have found that technical competence is gained through experience and training and refers to the knowledge and expertise of the auditor. Technical competence increases audit quality and affects audit perceptions. Hammersley (2006) finds that expert knowledge increases the likelihood that auditors will detect errors in financial statements, whilst Pandit (1999) highlights how auditors' ability to understand the auditee's industrial sector conditions significantly affects perceptions of the audits performed. In many countries, the audit of public sector organisations is the exclusive domain of specialist auditors, often by emphasising the specific knowledge and expertise deemed important for auditors working in the public sector (Christiaens & Van Peteghem, 2007; Glöckner & Mühlenkamp, 2009). Drawing on a survey with Florida local government finance directors, a study by Lowensohn, Johnson, Elder, and Davies (2007) finds that specialisation is positively associated with perceived audit quality, leading the authors' to suggest that local governments might be well served by engaging with specialised, often smaller audit firms. In relation to the private sector, however, there is empirical evidence that instead of specialised, small audit firms, larger audit firms have auditors who have more expertise as large firms, partly due to their ability to generate economies of scale, have more resources at their disposal, which enables them to attract more skilled employees and invest in audit technology that enhances their sector expertise (Mutchler et al., 1997). In England, private firms have undertaken local public audits since 1972 (Ellwood & Garcia-Lacalle, 2015), and, despite the presence of small firms, the market has mostly been dominated by big audit firms. In this study, we follow Funnell et al. (2016) and report auditee and other stakeholder perceptions of what constitutes quality and whether it has been affected by changes to the audit landscape.

Finally, audit credibility is affected by the usefulness of audits as perceived by auditees. Funnell et al. (2016) found that an auditor was expected to add value to auditees as well as provide reliable monitoring information to external stakeholders. In terms of performance, auditing adding value was defined as the ability of audit reports to enhance the operating efficiency of auditees. Indeed generally the role of auditors of public sector organisations goes beyond reviewing the 'true and fair view' of the financial statements but also contributes to ensuring 'regularity, propriety and value for money' (Sharman, 2001; Stewart, 1984). The extent to which auditors could or should be involved in performance auditing has attracted much debate, both due to the difficulty of conducting those audits in practice and the more principal question whether this would engage auditors too heavily in the political process (Pendlebury & Shreim, 1990; Reichborn-Kjennerud, 2015). In the UK, performance auditing has a long history and is strongly embedded in the principles adopted by national audit institutions, such as the NAO. However as detailed further below, in English local government, since 2005 the scope of auditing has narrowed, with vastly reduced performance auditing, raising the possibility that perceptions of audit usefulness in the eyes of stakeholders may have changed.

Whilst all three credibility criteria carry relevance, the literature shows ample evidence of the complexities that exist for auditors when seeking to maintain credibility alongside all three criteria. Some of the criteria are strongly interlinked, such as auditors' independence, which can be seen as a precondition in order for auditors to be able to effectively apply their technical competence and for audit findings to be useful. The relevance of auditors' technical competence seems unquestionable, from any stakeholder perspective, in order for audits to be credible on the long term. However, a tension exists with respect to auditors' independence and the usefulness of audit work, which has been widely documented in the study of performance monitoring by national audit institutions (Bowerman, Humphrey, & Owen, 2003; Radcliffe, 1999). Sharma (2007), for example, emphasises the challenge the British NAO faces in

<sup>1</sup> Empirical evidence on this has remained controversial (cf. Jiang, Wang, & Wang, 2019) and also different accounting bodies, including the American Institute of Certified Public Accountants, have maintained that audit quality is independent of firm size.

balancing its roles as 'watchdog' and 'consultant', the former referring to financial statement auditing and the latter emphasising the NAO's broader role in adding value for auditees. The consultant role can be highly useful for auditees and other stakeholders, but the role involves a difficult balancing act, with auditors at risk of overstepping their mandate by involving themselves with policy effectiveness issues as opposed to administrative effectiveness (Funnell et al., 2016). Whilst the risks of performance monitoring have been well highlighted in studies on national audit institutes, the relevance of findings from national-level studies for understanding audit credibility dynamics at the local level is uncertain given the latter's distinctive institutional features.

A critical feature of the local level relates to the hierarchical relationships between local authorities and higher government levels, with higher level organisations often fulfilling a monitoring role over local finances. Depending on a country's constitutional setup, central-level organisations may possess significant intervention powers in local finances if they consider local authorities to not act with regularity and propriety, or – as is applicable in the UK – failing to achieve value-for-money. Central level monitoring organisations can be expected to emphasise auditors' ability to maintain independence, as this will be essential in order for the central level to perform its monitoring role effectively. Independence is likely to be similarly important for local stakeholders with a scrutiny role, such as council members; however, it may carry less weight for local actors carrying an executive role, as it is executive members who will primarily be held accountable for the auditors' findings. In parallel with what has been observed for the private sector (Beattie, Fearnley, & Brandt, 2001; McCracken, Salterio, & Gibbins, 2008), local government auditees may try to influence accounting choices by auditors, thereby impairing the auditor's independence.

More recent studies have emphasised the useful role auditors may perform during blame allocation processes. Drawing on the work of Latour (1987), Skærbæk and Christensen (2015, p. 527) demonstrate the role auditors play through 'purification', by which they refer to auditors enabling the transformation of previously contested ideas into 'facts with reason and without [-] or with minimum politics'. Guénin-Paracini and Gendron (2010) show the paradox of auditors being simultaneously respected and scapegoated, which indicates that auditors may not only be participants in blame allocation processes but are themselves potential candidates for being blamed. Whilst the role of auditors in blame games may be useful to some stakeholders, it is likely to go at the cost of auditors' independence credibility.

The importance allocated to the different auditor credibility attributes, as well as potential tensions between them, may be perceived differently depending on stakeholder. In the context of local public audit, limited knowledge exists as to how these perceptions operate in practice, and how they may be affected by the institutional context in which local stakeholders operate. The next section outlines the institutional features of local public audit in England.

### 3 | INSTITUTIONAL CONTEXT

In England, during the period leading up to 2014, the Audit Commission played a prominent role in the auditing field. The Audit Commission was established by the Local Government Finance Act 1982 (the 1982 Act). The remit of the Audit Commission was to appoint auditors to all local authorities in England (and until 2005 in Wales). The National Health Service and Community Care Act 1990 subsequently extended the remit of the Audit Commission to cover health service bodies. The Audit Commission fulfilled various roles, most significantly overseeing local public audit as regulator, commissioner and provider of local external audit services. In addition, it undertook inspections of local authorities, conducted value-for-money assessments and research studies and fulfilled functions for certifying claims and returns of government grants and assisted in the prevention and detection of fraud.

In discharging its responsibilities as regulator and commissioner of local audit, the Audit Commission was required to establish arrangements for ensuring the independence and technical competence of auditors and for defining the scope and usefulness of the audit work.

The independence of auditors from audited bodies was primarily ensured by auditors being appointed by the Audit Commission, until 2015. The auditors were a mix of around 70% being officers from the Audit Commission's in-house audit arm, and a segment of around 30% from private accountancy firms (Campbell-Smith, 2008).

The independence of the Audit Commission itself was enshrined in the 1982 Act (LFGA 1982 Sc3 P 1–3), whilst the technical competence of auditors was ensured by requiring auditors to be members of certain recognised professional accountancy bodies, and the establishment of internal arrangements by the Audit Commission to review the quality of work undertaken by auditors (Campbell-Smith, 2008). The 1982 Act had, following the recommendations of the Layfield Committee (1976), extended the scope of local audit beyond the audit of the accounts to include consideration of 'arrangements for securing economy, efficiency and effectiveness (the 3 'E's) in (the) use of resources'. The Audit Commission was also required to publish a Code of Audit Practice that interpreted the statutory audit requirements and provided a more detailed framework for undertaking audits. While the statutory provisions for the scope of the audit remained generally unchanged for most of the life of the Audit Commission, from 2005 onwards a re-interpretation of requirements resulted in a reduction in the scope of the audit, particularly in the context of the work required to discharge audit responsibilities for the 3 'E's (Audit Commission, 2005).

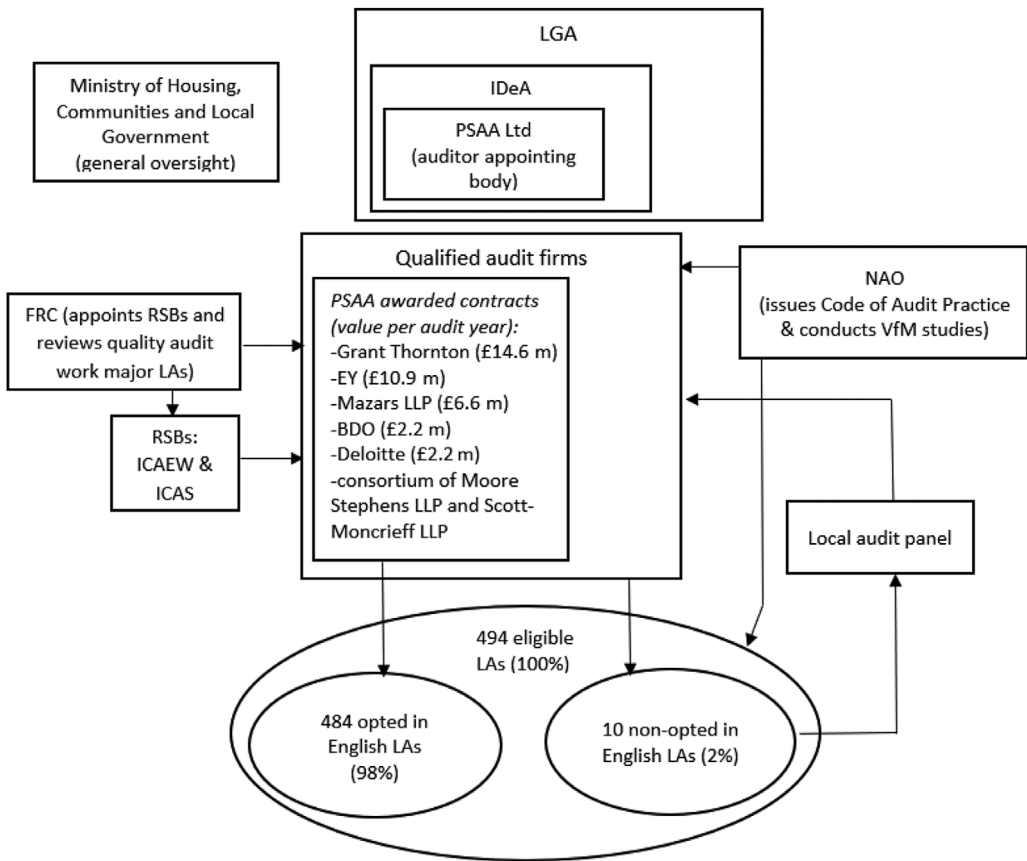
In 2010, radical changes were made to the arrangements for local government audit in England. These changes included significantly reducing the scope of local government audit, the termination of the Audit Commission's inspection activities, and, as determined in the Local Audit and Accountability Act 2014 (the 2014 Act), the abolition of the Audit Commission on 31 March 2015. Following the closure announcement, significant redundancies were made across the Audit Commission's central directorates, which continued earlier reductions in headcounts following the closure of the inspection and value-for-money teams. These changes, combined with savings generated from the decision to privatise the Audit Commission's in-house audit practice by the end of 2012, significantly contributed to the reduction in scale fees set by the Audit Commission for 2012/13 at a level of 40% lower than for the previous year.<sup>2</sup>

The 2014 Act allowed each authority to appoint its own auditors, albeit with some requirements regarding the independence of the appointment process. The government's motivations for reforming local public audit, as announced in the 2014 Act, can be found in the government's 2014 impact assessment. This assessment identified a lack of local accountability in the commissioning of audit services, which meant that local bodies had very little influence over who their auditor was or what they paid for that service. The paper further identified a lack of transparency and incentives to drive down costs of audit as a result of the Audit Commission charging for its own corporate costs and inspections. Further, local bodies were funding wider non-audit activities over which they had no control, duplication was identified across regulatory regimes; and, finally, the government believed there was no inherent justification for the public sector to be the main provider of local public audit (DCLG, 2014).

The 2014 Act also determined that responsibility for the arrangements previously established by the Audit Commission to ensure independence, technical competence and audit usefulness, would in future be divided between a range of bodies, which are outlined in Figure 1. Despite the initial emphasis on local appointments, which also reflected the government's wider policy objectives (localism), the 2014 Act included a clause that enabled the Secretary of State for Communities and Local Government to specify one or more organisations to act as appointing persons who could develop a collective scheme for the appointment of local auditors. The clause was included following successful lobbying by the Local Government Association (LGA), who believed it was in the interest of local authorities to have in place an appointing person that could procure audit contracts collectively and, by doing so, generate economies of scale. The 2014 Act also gave the government the power to delegate statutory functions previously undertaken by the Audit Commission to a transitional body. The government awarded this transitional body status to the LGA in 2014, following the LGA's successful bid to take on the transitional body arrangements. PSAA was subsequently established by the LGA in August 2014, with transitional powers being delegated to PSAA by the Secretary of State to manage the audit contracts previously led by the Audit Commission.

The transitional arrangements were concluded in July 2016 when, again following a tender process, the Secretary of State specified PSAA as an appointing body for principal local authorities from 2018/19. Principal authorities include England's 354 local governments, 42 police bodies, 31 fire and rescue authorities, and smaller numbers of

<sup>2</sup> The scale fees specify the scale of fees for the audit of the accounts of opted-in authorities and represent the most accurate reflection available of the auditor's assessment of audit risk and complexity for each audited body (PSAA, 2017a).



**FIGURE 1** Local authority audit regime, England post-2015

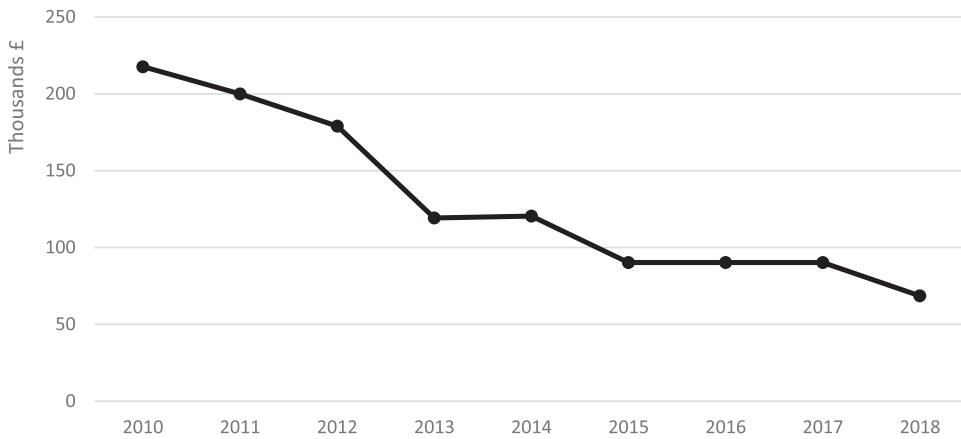
various other authorities such as transport authorities. Out of a total of 494 bodies eligible to join the PSAA scheme, 484 decided to opt-in.

Following a competitive tendering process, PSAA awarded contracts to six audit firms/consortia for a 5-year appointing period. In contrast to what was expected by PSAA, submitted bids enabled PSAA to reduce scale fees by 23% compared to the preceding year. As shown in Figure 2, this continued fee reductions realised by the Audit Commission of 40% in 2012 and 25% in 2015. The successful firms/consortia are specified in Figure 1 and include both Big-4 and mid-tier audit firms. The size of the lots was graduated in order to reward the better tenders with larger volumes of work, with lot sizes ranging from £14.6 m to £2.2 m (PSAA, 2017b).<sup>3</sup> Table 1 provides a timeline summary of the changes to the local government audit regime in England and shows that PSAA's auditor appointments have been effective from 2018/19 onwards.

Following the 2014 Act, the NAO has become responsible for defining, through its Code of Audit Practice, what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Act. The NAO's Code, issued in 2015, effectively continued the approach contained in the final Code produced by the Audit Commission in 2010, including specifying the requirement for conclusions on value-for-money arrangements.

A significant change introduced by the 2014 Act is the requirement for Recognised Supervisory Bodies (RSBs) – the Institute of Chartered Accountants of England and Wales (ICAEW) and the Institute of Chartered Accountants of

<sup>3</sup> The lot awarded to a consortium of the audit firms Moore Stephens and Scott-Moncrieff did not have a guaranteed value of work and was included to enable the appointment of an auditor at any bodies where all of the other successful firms could not accept the appointment for independence reasons (PSAA, 2017c).



**FIGURE 2** Average annual audit fee English local authorities, 2010–2018

Source: Own analysis based upon Audit Commission and PSAA scale fees for individual local authorities

**TABLE 1** Timeline of the main developments in English local public audit

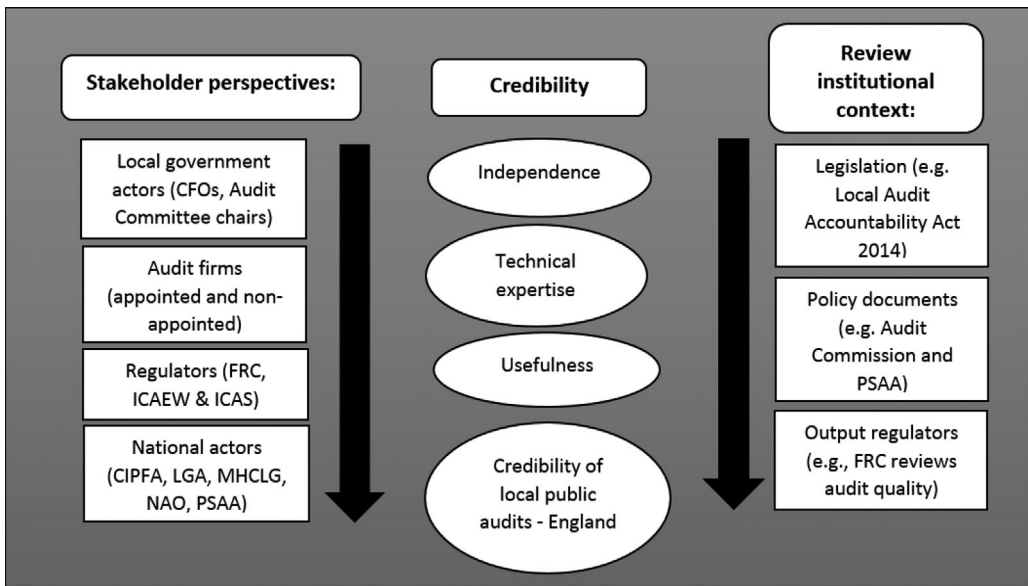
2010	End of the performance and inspection responsibilities of the Audit Commission Announcement of the abolition of the Audit Commission
2011	Decision to transfer all work previously undertaken by the Audit Commission's in-house Audit Practice into the private sector
2012	Audit Commission awards five-year contracts to four firms Audit Commission staff transferred to private sector audit employers
2013	Audit Commission repackaged and tendered the remaining 30% of audit work already carried out by private firms
2014	Local Audit and Accountability Act 2014 received Royal Assent Public Sector Audit Appointments Limited established by LGA and receives statutory functions on a transitional basis
2015	Closure of the Audit Commission on 31 March National Audit Office and Financial Reporting Council take on new responsibilities
2016	PSAA successful in tender process – Secretary of State for Communities and Local Government specifies PSAA as an “appointing person”
2017	Procurement exercise conducted by PSAA
2018	Start of new audit appointments regime for principal authorities

Source: Adjusted table based upon MHCLG/RAND Europe (2018).

Scotland (ICAS) – to approve and register audit firms to undertake local audit work, and to approve individuals as key audit partners within those firms that both meet the statutory qualification requirements and have the appropriate level of competence to carry out local audits (FRC, 2015). Following the closure of the Audit Commission, PSAA initially took over the role of monitoring the performance and quality of work of audit firms. With effect from the 2018/19 audit round, the Financial Reporting Council (FRC) is responsible for monitoring the quality of ‘major local audits’,<sup>4</sup> while the RSBs have responsibility for monitoring the quality of other local audits. PSAA will also continue to monitor

<sup>4</sup> Source: <https://www.frc.org.uk/auditors/professional-oversight/local-audit> (accessed 12 April 2019).





**FIGURE 3** Determinants of audit credibility, triangulated with institutional review

audit quality, in the context of managing its contracts with audit firms; this work will draw on the work undertaken by the FRC and RSBs, supplemented by specific contract monitoring metrics.

Thus post 2015 major changes in the English audit regime for local authorities have resulted in a fragmented approach with PSAA undertaking the limited role of audit appointments for opted-in local authorities, and the NAO, FRC and professional bodies all playing a role in standard setting. However, we lack knowledge as to the state of auditor and auditee perceptions under these arrangements. By relying upon a range of empirical sources, our paper identifies the requirements of local public audits, which auditees and other stakeholders believe must be present if those audits are to be regarded as credible (Funnell et al., 2016). The audit credibility criteria are analysed through a comprehensive review of the dimensions of credibility: competence, independence and usefulness. As is illustrated by Figure 3, our application of the credibility framework is not limited to stakeholder perceptions but we corroborate those views by analysing their relationship with the evolution of the institutional arrangements for local public audit in England.

## 4 | METHODS

Following Funnell et al. (2016), a realist approach was taken whereby initial broad theoretical concepts of independence, technical competence and usefulness were applied to perceptual data gathered by interviews, documentary analysis and a survey. The three-stage process used by Strauss and Corbin (1998) was then used to analyse data and refine the three concepts to reflect actual perceptions of English LG audit stakeholders. In 2018, we conducted 43 semi-structured interviews with local authority chief financial officers (CFOs), audit firms and other key stakeholders including local authority representative bodies, local authorities' treasurers associations, professional accountancy bodies and other organisations including PSAA, the NAO and the Ministry of Housing, Communities and Local Government (MHCLG). CFOs interviewed included CFOs from opted-in bodies (10) and non-opted-in bodies (2) and from different types and sizes of local authorities (including districts, county councils, unitary authorities, London boroughs and police and fire authorities). A majority of the interviewees had direct experience with the previous system of public audit run by the Audit Commission, whilst most interviewed stakeholders with policy-level responsibility had been

**TABLE 2** Overview interviews

Position	Number of interviewees
Audit committee chairs	4
Chief Financial Officers	14 (including CFOs of 2 LAs . non-opted in with PSAA)
Audit firms (appointed and non-appointed firms)	9
Regulators (FRC, ICAEW, ICAS)	3
Other stakeholders (e.g. CIPFA, local authority treasury societies, LGA, MHCLG, NAO, PSAA)	12
<i>Total</i>	42

Workshops	Number of participants
CFOs of opted-in bodies	9
PSAA staff	5
Representatives of other key stakeholders including audit firms, regulatory bodies, and the NAO	9

involved in discussions about the post 2010 reform of the system of English local public audit. Table 2 provides an overview of the conducted interviews. Interviews were in-depth and semi-structured, providing some flexibility and spontaneity and allowing the interviewees freedom to pursue their particular interests. The interviews lasted between 40–90 minutes and were digitally recorded and then professionally transcribed.

For the analysis of the data, a three-stage process developed by Strauss and Corbin (1998) was followed: open, axial and selective coding. Open coding was used for identifying, breaking down, conceptualizing and categorizing the data. Examples of concepts and categories identified are public audit experience (e.g. as used in PSAA's procurement process), the perceived increased use of trainee public auditors and CFO preferences and expectations in relation to how external auditors interact with local authority stakeholders. Subsequently, axial coding was used in order to relate categories to their subcategories. A key phenomenon emerging at this stage were stakeholder concerns about auditors being insufficiently trained and experienced, contributing to the perception that audits are increasingly a 'box ticking exercise'. Finally, selective coding was used to integrate and refine major categories in order to create a larger theoretical scheme (Strauss & Corbin, 1998, p. 143). This process demonstrated, for example, that CFO concerns about a more rigid audit approach reflected a broader distinction made by stakeholders between auditors' technical competence in a narrow versus broad sense; the former referring to auditors narrow technical skills such that they conduct an accurate audit, whilst the latter refers to auditors broader professional and personal skills such that their audit is also accepted as an accurate reflection of the situation. A similar three-stage analysis was conducted to identify key concepts related to auditor independence and usefulness.

We also conducted an online survey amongst all 484 CFOs of opted-in bodies, which was designed based upon analysis of a first tranche of our semi-structured interviews and identification of main themes. The purpose of the survey was to ascertain perceptions of various aspects of the appointing person process and identify perceptions of audit fees and quality at a more generalizable level. In addition to providing some general analysis, responses also assisted framing of subsequent interview and workshop questions. Likert-type scales were used, each covering a specific facet of the respondent's perceptions of the PSAA scheme, together with encouragement to provide additional comments. Two reminders were sent and, after 3 weeks, we had received 116 responses corresponding to a response rate of 24% (8% margin of error at 95% confidence level), which is similar to other survey-based research in public accounting (cf. Schoute & Budding, 2017). Surveys were completed by CFOs from a representative cross section of authorities of different sizes and types and in different geographical regions. These were transferred

**TABLE 3** Detailed findings of survey amongst CFOs of opted-in bodies

	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Can't say/ don't know
I was pleased to see the reduction in audit costs.	21.1% (23)	58.7% (64)	17.4% (19)	1.8% (2)	0.9% (1)	0%
I would like to see further reductions in audit fees in future.	3.5% (4)	21.1% (24)	36.8% (42)	34.2% (39)	2.6% (3)	1.8% (2)
I am concerned that audit costs may now be too low to enable a good quality service.	12.3% (14)	33.3% (38)	25.4% (29)	23.7% (27)	3.5% (4)	1.8% (2)
I am concerned about the effect of the reduction in audit fees on the long-term sustainability of the audit market.	7.9% (9)	30.7% (35)	26.3% (30)	27.2% (31)	5.3% (6)	2.6% (3)
At the moment I have no significant concerns about audit quality.	13.8% (15)	63.3% (69)	6.4% (7)	11.9% (13)	4.6% (5)	0%
I am concerned that the auditor may look for opportunities to propose variations that are not justified.	13.4% (15)	33% (37)	26.8% (30)	18.8% (21)	3.6% (4)	4.5% (5)
I am expecting audit quality to improve under the new contract.	0.9% (1)	8.8% (10)	56.6% (64)	32.7% (37)	0.9% (1)	0%
I am confident that PSAA will work hard to ensure that audit quality does not deteriorate.	8.8% (10)	68.4% (78)	15.8% (18)	2.6% (3)	0%	4.4% (5)

to raw data and % category response tables for descriptive analysis at the whole data level, with results shown in Table 3.

We also subjected additional comments made by CFOs in the survey to textual analysis to highlight common themes. Using these datasets, we conducted qualitative analysis which identified CFO concerns about fee levels and quality. Following the analysis of survey results, a final tranche of semi-structured interviews was completed and then finally a set of three workshops. The workshops invited samples of local government CFOs (again representing different types and sizes of local authorities) and other stakeholders including PSAA, audit firms and regulators, to explore the main themes in the context of the inter-active workshop environment. Similar to the interviews, all workshops were digitally recorded, professionally transcribed and subsequently analysed using the above-outlined coding strategy.

For the purpose of the present paper, we re-examined our 'raw' data and coding through the analytical framework of audit credibility (Funnell et al., 2016). This resulted in a thematic review of the data focused on the credibility of audits from different stakeholder perspectives. The review included extensive discussion in the research team in which we assessed for how far the data supported that perceptions of audit credibility were based on *technical competence*, *independence* or *usefulness* and what further understanding the data provided of the ingredients of each. This review demonstrated that the survey had generated important information on audit credibility at a more generalizable level; however, the largest amount of data relevant to our thematic ordering derived from the interviews and workshops, and it is this information on which we draw in most of the subsequent analysis.

## 5 | SOURCES OF CREDIBILITY

### 5.1 | Independence

The two constituents of independence – objective judgements and reporting free from influence – were noted above and the difficulty of achieving these in practice in the public sector, particularly from the perception of auditees (Funnell et al., 2016), as was the link between independence and the size of the audit firms (DeAngelo, 1981; Jamal & Sunder, 2011; Mutchler et al., 1997). In applying these factors to the new situation in England, we firstly outline the policy and organisational framework governing audit independence in England before reviewing data on firm size followed by auditee perceptions. Finally, we examine the issue of PSAA's own governance and statutory position on independence.

#### 5.1.1 | Ethical and organisational framework for ensuring auditor independence

The independence of the auditor from the entity being audited is considered to be one of the key principles underpinning professional standards for public sector audit work. At a global level, the International Organisation of Supreme Audit Institutions' (INTOSAI) Lima Declaration of Guidelines on Auditing Precepts emphasises that public auditors 'can accomplish their tasks objectively and effectively only if they are independent of the audited entity' (INTOSAI, 1998, p. 6). At the United Kingdom national level, the Public Audit Forum, a representative body of all the UK's public audit institutions, identifies the 'independence of public sector auditors from the organisations being audited' as a key principle of public audit, further adding that 'auditors must be independent, to avoid improper influence and allow work to be carried out freely'.<sup>5</sup>

As with the Audit Commission regime, the independence of auditors is now ensured through a hierarchy comprising firstly compliance with Ethical Standards defined by the FRC (FRC, 2019) for all private and public sector audit, secondly, compliance with the Code of Audit Practice for local public audit issued by the NAO and, thirdly, through the method of appointing auditors. So, whereas under the Commission regime, the Commission regulated all aspects of independence, responsibilities are now divided between the FRC, NAO and PSAA (with FRC and NAO requirements applying more widely than just to local authorities). The NAO's Code of Audit Practice for local audit requires auditors to 'carry out their work with integrity, objectivity and independence' and 'be seen to be impartial and independent' (NAO, 2015, p. 8) and in accordance with the ethical framework applicable to auditors, including the Ethical Standard 1 for auditors set by the FRC. This requires auditors to ensure that they are free from conditions and relationships that could compromise or appear to compromise their independence from an audited body. The requirements effectively replicate those included in the Audit Commission's Code of Practice.

For the vast majority (98%) of local authorities, independent appointment of auditors is ensured through PSAA, which is independent of any one individual local authority and responsible for procuring audit contracts, and allocating auditors to individual authorities. Further to ensure independence, auditors are required to identify in tenders any local bodies 'at which the tenderer has an independence issue and so is unable to provide audit services' (PSAA, 2017b, p. 4).

#### 5.1.2 | Ensuring independence – auditor objectivity and audit firm size

The International Ethics Standards Board for Accountants defines independence of mind as 'the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment,

<sup>5</sup> Source: <https://www.public-audit-forum.org.uk/our-principle> (accessed 12 April 2019).

**TABLE 4** Top 10 UK accounting firms – firms in bold were awarded a local public audit contract by the Audit Commission (in 2012) and/or PSAA (in 2017)

Firm name	UK revenue 2017 (£M)	Local auditor under Audit Commission contract 2012	Local auditor under PSAA contract 2017
PwC	3,598	N	N
<b>Deloitte</b>	<b>3,380</b>	<b>N</b>	<b>Y</b>
<b>EY</b>	<b>2,150</b>	<b>Y</b>	<b>Y</b>
<b>KPMG</b>	<b>2,068</b>	<b>Y</b>	<b>N</b>
<b>Grant Thornton</b>	<b>533.8</b>	<b>Y</b>	<b>Y</b>
<b>BDO</b>	<b>456</b>	<b>Y</b>	<b>Y</b>
RSM	319	N	N
Smith & Williamson	242	N	N
<b>Moore Stephens</b>	<b>181.38</b>	<b>N</b>	<b>Y</b>
<b>Mazars</b>	<b>160</b>	<b>Y</b>	<b>Y</b>

Source: Own composition, firm size revenue data from ICAS (2017).

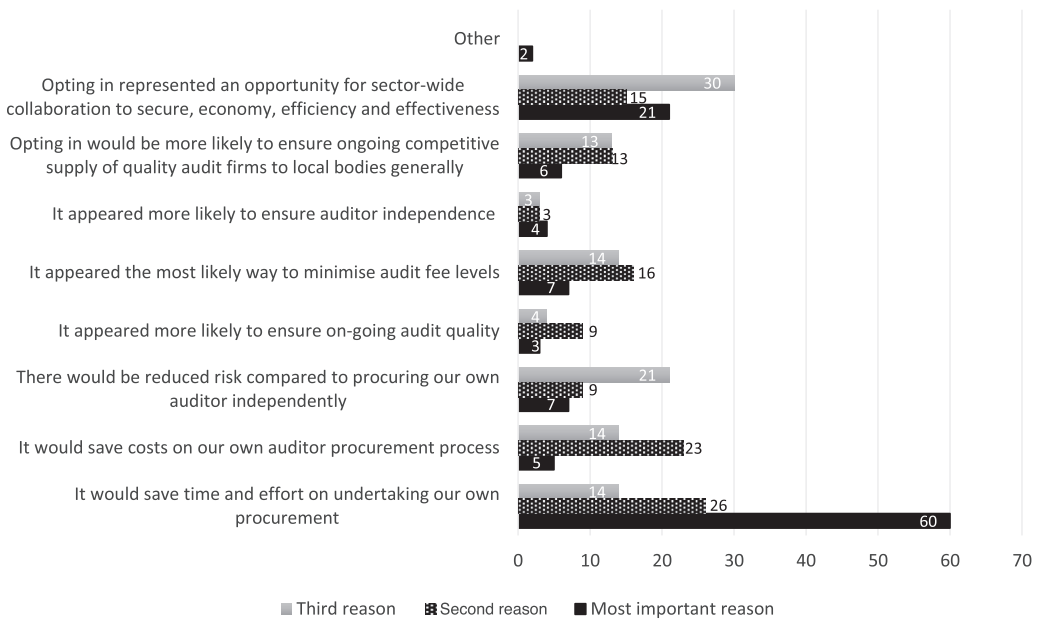
thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism' (IESBA Code 290.6(a)). In the context of local audits, in addition to the independent appointment of auditors as discussed above, for the audits of financial statements these fundamental principles are met through compliance with International Standards on Auditing (ISAs) (FRC, 2009). The NAO's Code of Audit Practice requires auditors undertaking local audits to comply with these standards. The Code, supported by Auditor Guidance Notes, also contains requirements regarding how auditors should undertake their work on value-for-money arrangements.

From 2014/15 to 2017/18, PSAA monitored compliance with the Code (and ISA) requirements under the transitional arrangements put in place by the Secretary of State. These arrangements consisted of three elements. First, PSAA commissioned the FRC's Audit Quality Review Team to undertake a programme of inspecting auditors' work on financial statements and value-for-money arrangements; second, they reviewed a sample of each firm's audit Quality Monitoring Reviews; and third, PSAA reviewed the FRC's reports on the results of its inspection of the firms' audits in the private sector. These reviews concluded that with regard to audit work on the accounts, whilst there was scope for improvement, overall the audits had been performed to an acceptable standard and that the evidence on audit files was sufficient to support auditors' value-for-money arrangements conclusions. From 2018/19 onwards, the new quality arrangements outlined previously apply in respect of contracts let by PSAA.

In relation to audit firm size, PSAA has awarded contracts to audit firms which are all part of the top 10 of the UK's largest accountancy firms. As is shown by Table 4, the distribution of work by PSAA in terms of the size of the firms has remained very similar compared to the distribution of audit work under the last contract let by the Audit Commission. Insofar as larger firms may be a proxy for greater independence, the development of a supply market consisting entirely of private sector firms under PSAA did not see an increase in smaller firms and hence a potential reduction in auditor independence.

### 5.1.3 | Stakeholders' perception of audit independence

Our survey of CFOs sought to identify the extent to which the management of independence issues by PSAA was significant in authorities' decisions to participate in the PSAA scheme. The vast majority of responding CFOs reported they considered the management of the independence of auditors by PSAA to be attractive (56% of respondents) or very attractive (41% of respondents) aspects of the PSAA Appointing Person scheme. However, as is shown in Figure 4,



**FIGURE 4** Survey results CFOs

when asked to identify the reasons for ultimately opting-in to the PSAA scheme, out of 116 CFO responses, only four CFOs identified ensuring auditor independence as being the most important reason; three identified this factor as the second most important reason; with three identifying it as the third most important reason. One CFO submitted a narrative comment that he had no wish to appoint his own auditors stating, 'it is better for public scrutiny and governance that the appointment of the auditor is undertaken independently.'

This view was echoed by an interviewed PSAA officer. He expressed the view that the need to appoint auditors who are independent of the audited body was considered to be of the highest importance and that 'all other factors pale ... into insignificance compared to independence. Auditors have to be independent'. This consideration was given as one of the main factors that formed PSAA's decision to tender for lots to cover the whole of England, as such an approach would make it easier to allocate auditors to each of the 484 opted-in authorities, even where one or more auditors could be conflicted. As shown by Figure 4 however, by far the most important reason indicated for opting-in into the PSAA scheme was the opportunity to save time and effort on undertaking the audit procurement.

The number of auditees and stakeholders that raised independence during the interviews and workshop sessions was also limited. The issues that were raised related to the independence of the process of procuring and appointing auditors, the status of PSAA and the role of auditors in the context of the 'wider audit' regime in the public sector. Auditees and other stakeholders who raised the issue of independence were generally supportive of auditors being appointed by a body that was independent of the bodies being audited. Due to the many resemblances with the auditor appointment regime ran by the Audit Commission, PSAA's appointment of auditors 'felt like a very natural transition' for local authorities, as put by one CFO.

One CFO noted the benefits of PSAA appointing auditors as allowing authorities to be at 'arm's length' from procuring and appointing auditors. In his opinion, by opting-in to the PSAA scheme, 'no one can ever accuse our members of influencing the outcome of the external audit process' and that 'politics can get in the way' of the independence and neutrality of external auditors. One representative of a professional body disagreed with authorities appointing their own auditors on the grounds that it places too much pressure on the auditors to not speak out. To support this view, he cited the low numbers of incidences of public interest reports issued by auditors of NHS Foundation Trusts, where

individual entities have been appointing their own auditors since 2004, due to concerns that making such reports might result in them losing the audits.

The public interest aspect of independent appointment of auditors was noted, with one particular stakeholder referencing the possible defensiveness and conflict of interest in bodies that have previously been subject to criticism by an auditor:

Having an independent appointment process is really important for the public because then the auditor could say things that were difficult without fear or favour.

CFOs further expressed the view that the scope of the audit should be widened to include more extensive coverage of financial resilience and value-for-money assessments. A wider scope of audit is consistent with the principles adopted by the UK Public Audit Forum; that public audit involves more than an opinion on accounts, but that it also covers issues such as regularity, propriety and value-for-money. It was however questioned whether auditors could or should undertake such work without compromising their independence and fettering their independence. One PSAA interviewee commented:

having expressed a view on an authority's financial plans, if these turned out to be undeliverable, would the auditor be able to then review and comment objectively on the plans?

The necessity for statutory provision to legitimise such work was also highlighted by another stakeholder, an auditor, who pointed to the current regulatory climate which emphasises the need for audit independence, and that 'it is a very difficult line to tread in keeping your independence and also trying to assess resilience'.

### 5.1.4 | Auditor independence and PSAA's organisational position

PSAA is a wholly owned subsidiary of the Improvement and Development Agency (IDeA), which in turn is a subsidiary of the LGA. The LGA describes itself as 'the national voice of local government'<sup>6</sup> and, as a membership organisation, includes 415 authorities amongst which are 349 English Councils. In light of this ownership, some interviewees questioned the extent to which PSAA can be considered to be genuinely independent of audited bodies. One CFO questioned whether PSAA is 'actually as independent as it needs to be', suggesting that the NAO would be better placed to appoint auditors on the basis that this would 'feel like a more neutral place'. Another interviewee, a representative of a professional body, noted that 'it's fine for local government through the LGA to arrange a procurement exercise', but that 'in the longer term we would like to see the establishment of a public body managing the audit market'.

Although PSAA is a wholly owned subsidiary of the IDeA, which in turn is a subsidiary of the LGA, it operates independently of both. PSAA's Corporate Governance Framework stresses that the Board's responsibility includes 'ensuring that PSAA is properly managed, and remains independent from the leadership of the LGA (PSAA, 2018, p. 4), and that 'IDeA acknowledges the independence of the company and the responsibility for running the company as that of PSAA and its Board' (PSAA, 2018, p. 6). PSAA's independence is recognised in the LGA's accounts which state that PSAA's accounts are not consolidated into the LGA's accounts 'because the LGA does not exercise or have the ability to exercise control over PSAA' (LGA, 2018). Nevertheless, a senior PSAA officer recognised that the Audit Commission as a statutory body and a public corporation could be seen as having 'a whole lot more independence than (PSAA has)', even though the Audit Commission was not itself a completely independent body as some key decisions required sign off by ministers. Conversely, some interviewees queried whether it was really necessary for PSAA to be completely independent of the LGA. One local government representative noted:

<sup>6</sup> Source: <https://www.local.gov.uk/about/who-we-are-and-what-we-do> (accessed 10 May 2019).

I have always felt there are some people who play up the independence issue, and [that PSAA] has to be independent of the LGA, and whether in reality that is important. Having said that, does it make a difference? In reality I don't think it is a big issue.

## 5.2 | Technical competence

Technical competence is reflected in auditors' possessing a skillset such that what they say is accepted as an accurate reflection of the auditee's situation (Funnell et al., 2016). This skillset refers to both the narrow technical and broader professional and personal skills of auditors. The former refers to auditors' ability to conduct an audit that complies with the requirements put on auditors by the regulatory framework and encompasses both the competence of auditing the accounts (in accordance with the NAO Code of Audit Practice and the ISAs) and conduct value-for-money assessments (in accordance with the NAO Code and Guidance). Technical competence also refers to auditors' broader professional skills in the process of conducting the audit and communicating its findings to auditees. We found mixed views amongst stakeholders regarding auditors' technical competence, and whether audit quality had been impacted by the recent institutional changes.

### 5.2.1 | Auditee perspectives

In the survey, 78% of CFOs indicated that they had currently 'no significant concerns about audit quality', and 79% of respondents said that they were pleased to see the reduction in audit costs (see also Table 3). Simultaneously, however, 46% indicated concern about audit costs being now too low to enable a good quality service in future, whilst 39% opposed further reductions in audit fees (25% supported further reductions, and 37% indicated neither agreement nor disagreement). Concerns about audit fee reductions were reflected in our interviews, with one CFO commenting, in what we found being representative for the majority of interviewees: 'the continual squeeze on fees must... go beyond just efficiencies'. Although auditors were generally perceived as strong in a narrow technical sense, a majority of CFOs highlighted concerns regarding auditors' technical competence in a broader sense. Auditors were perceived as showing increasing difficulties in contextualising an authority's finances and appeared more often than in the past out of their comfort zone when analysing more strategic or governance issues. Several interviewed CFOs suspected this was due to an increased use of computerised analysis leading to a more rigid and standardised audit approach. Two CFOs referred to this as a 'tick the box audit' which they perceived as problematic since, in their view, acquiring strategic insight into the performance of their authority from their auditors was as important a part of the audit as receiving external assurance on the technical soundness of the accounts. Most CFOs interviewed reflected critically upon the limited work conducted as part of the value-for-money analysis and drew negative comparisons with the Audit Commission style comparative studies, which, in their view, reflected deep knowledge of the sector and greater depth of audit.

There was also a sense that audits were conducted in increasingly tight timeframes and that auditors' understanding of the specifics of the public sector has been deteriorating due to reduced investments by audit firms in public sector audit, demonstrated by higher staff rotation and changes in the scale mix of audit teams, especially by greater use of junior staff. One CFO observed:

We have a very small team here and what we've noticed is, our team of staff in the finance department, over the last few years, have actually spent more time explaining simple, straightforward accounting things to the audit team. Yes, I am getting a bit of saving on the audit fee but, actually, now I am losing that in the time of my staff doing silly things.



CFOs referred to junior audit staffers as not demonstrating the same level of 'empathy' (CFO county council) with how their local authority operates, or not bringing 'that texture, that richness to the audit that they may otherwise have done' (CFO London borough). We found evidence that in some cases the perceived inexperience of auditors with local public audit affected CFO's acceptance of the auditor's findings, with one CFO of a major county council commenting:

If you are greeted with somebody who has very little knowledge or experience and they have to start off by asking you a lot of very basic questions you think, 'Hang on a minute, if you are having to ask me these very basic questions, how can you then perhaps tell me how I should be doing things in a different way?' Does that make sense? The psychology of it is such that you tend to be slightly more dismissive if they are critical of you or they suggest doing things in a different way.

Despite CFOs critical comments on what was described as a more rigid audit approach, the majority of interviewed CFOs perceived auditors to be strong with regard to their knowledge of accounting and auditing procedures. Reflecting research findings for the private sector (e.g. Shockley & Holt, 1983), most interviewed CFOs articulated a preference for their audits to be conducted by auditors from large audit firms, which they perceived to be more experienced and qualified, often by making references to these firms (historically) larger involvement in local public audit. In this respect, most interviewed CFOs articulated concern that under PSAA's most recent procurement two large audit firms – KPMG and PwC – who had been involved in local government audit in the past, had not received a contract from PSAA.

As part of reviewing auditors' performance and audit quality, arrangements are in place to review auditors' competence. PSAA has developed audit quality arrangements, based on International Audit and Assurance Standards Board's Framework for Audit Quality, which has been 'distilled' into three tests to consider the quality of audits under PSAA contracts – focusing upon auditors' adherence to professional standards and guidance, contract compliance and relationship management. When asked about the quality assurance arrangements in the survey, 77% of responding CFOs were confident that PSAA will work hard to ensure that audit quality does not deteriorate in future. However, whilst further explored in the interviews CFOs but also interviewed audit committee chairs generally demonstrated limited awareness of the monitoring arrangements being developed, whilst some of those who did questioned their likely effectiveness, either because they saw a risk of duplication in the new structures ('regulatory overkill'), or doubted PSAA's ability to help maintain standards. One CFO commented:

I don't want to look on the Audit Commission with rose tinted glasses, [-] but it did have the scale to be able to hold firms to account if their audit was of a poor quality. It is difficult to see PSAA, in the event of a new significant complaint being raised or general unease in the sector, being able to exercise any kind of real policy quality role. To an extent, it is just inherent in the model; it is just such a low-cost model that you just move several steps back on the overall regulation of the firms by the audit standards boards.

### 5.2.2 | Auditors' perspectives

The ability of auditors to conduct technically competent audits was also discussed during our interviews with audit firms. The majority of interviewees indicated that it has become more challenging for audit firms to make investment in systems that improve the quality of the audit, investments interviewees deemed critical to ensure auditors' skills are future proof and reflect changing needs and features of clients. PSAA's procurement structure was widely seen as critical in influencing firms' investment decisions, in particular PSAA's decision regarding the number and size of lots to use. With only six lots used in PSAA's procurement in 2017, there are only six appointed firms active in 98% of the English local government audit market, at least for a period of 5 years (with a possible 2 years extension). Several audit

firm interviewees pointed out that if a firm is out of the market for 5 years or more it will be extremely challenging to retain capability given the costs involved, although undertaking advisory work in the sector may help to retain a knowledge base. One audit firm suggested using a staggered procurement instead, that would result in a lot becoming available every year or two. This procurement approach would be more similar to the corporate sector where opportunities for winning a contract are more frequently available.

Audit firms emphasised that the reductions in audit fees, which had started during the Audit Commission era (see Figure 2), have made the market less attractive commercially. All interviewees at audit firms commented that due to PSAA's weighting of evaluation tenders, which applied a 50:50 ratio for quality and price, the evaluation had effectively come down to price as it had been difficult if not impossible for higher quality to offset higher prices, partly due to PSAA's relatively narrow evaluation of quality during the tender process. Firms said that based on their experience of other sectors, they would expect the quality element of the evaluation to be at least 70%. One auditor stated that his firm would not normally tender for contracts where price constitutes more than 25% of the evaluation criteria, and said that if 'it's just a pure price game in the future [its] not a market we want to play in'. Several audit firms, but also other stakeholders, highlighted that if price carries an equal weight to quality it would be unattractive for firms to make investments that were deemed critical to ensure the availability of high-level local public audit expertise. PSAA's quality: price assessment, however, is higher compared to the 40:60 quality: price ratio used by the Audit Commission during its procurement exercises.

From the perspective of building expertise, some aspects of PSAA's procurement approach however were reflected upon positively by audit firms. Firms emphasised the importance of having lots of a minimum size in order to have the scale to justify a suitable partner and maintain a specialised public audit team (one audit firm interviewee indicated lot sizes of at least £1–2 m). Whilst PSAA's lot sizes were seen as helpful for supporting a specialised infrastructure, the inability to bid for regional lots was seen as unhelpful for maintaining such an infrastructure. It was argued by one firm that the mix of audits they received was broadly as expected, however, another successful tenderer that we interviewed said that their audits were 'not as geographically close ... as we would have hoped'.

The majority of interviewed audit firms argued strongly for better geographical indication of audits, which, as they argued, would enable them to facilitate management of their audits as they could structure their tenders around their public sector centres of excellence. All audit firm interviewees emphasised the fragility of the local government audit market, with one interviewee pointing out that even firms with large lots might not want to stay in the market if they do not make enough money 'whilst probably being raked over the coals by the regulator'. Firms also noted aspects unrelated to PSAA's procurement process as having made auditors' work technically more challenging. Most frequently mentioned was the legislative change that, from 2017/18, brought forward the statutory accounts publication deadline by 2 months to 31 July, which has halved the auditor's timeframe, and was perceived as reducing the ability of audit firms to maintain field sector expertise (cf. Russell, 2018).<sup>7</sup>

### 5.2.3 | National stakeholder perspectives

Aspects related to auditors' competences were also investigated from the perspective of various national stakeholders. In relation to PSAA's tender evaluation process, we found that PSAA included an additional requirement for tenderers focused on having prior experience of local government audit. We found unease amongst the RSBs – ICAEW and ICAS – regarding this public audit experience requirement as interviewees from the RSBs indicated they considered local government audit 'no more specialised than any other industrial sector'. However, interviews with local authority stakeholders confirm PSAA's decision to include this additional criterion reflected auditee preferences.

Whilst discussing auditor's technical competence, one PSAA interviewee emphasised the audit quality arrangements put in place, whilst another stated that auditors' technical competence had in fact been increased in the past

<sup>7</sup> This change was implemented by MHCLG in the Accounts and Audit Regulations 2015 - Regulation 10(1).

two decades due to a tightening of regulatory standards. In response, however, to the news that for the statement of accounts for 2018/19, audit opinions of 40% of local authorities opted-in with PSAA were not completed by the target date of 31 July – up from 13% in the preceding year – PSAA's Chief Executive emphasised 'the need for improvement' and stated that 'auditors must have sufficient appropriately trained and skilled staff' (PSAA, 2019).

Concerns on audit quality were also reflected by CIPFA's Chief Executive, who, in his evidence to the House of Commons' Public Accounts Committee, highlighted the 'need to ensure that there is not a race to the bottom in terms of the quality of external audit' (Whiteman, 2018). Similarly, the NAO's Comptroller and Auditor General noted that

if there are firms that are no longer finding local audit work sufficiently attractive, or if there are fewer suppliers, there is a risk that there will be less incentive to develop the audit approach or to invest in the skills needed to deliver the quality that we should expect of local public audit'. (Morse, 2018, p. 7)

Reports by the FRC indicate that the quality standards of some major audit firms have fallen, albeit not specifically in the context of local government audits. FRC reports on audit performance by the Big-4 in the corporate sector include numerous references to 'insufficient procedures performed' and 'insufficient evidence obtained', which implies that the extent of audit work performed has reduced, either due to cost pressures, a reduction in technical expertise, or a combination of both (FRC, 2018a). In case of mid-tier audit firms, which under PSAA's current contracts conduct 64% of their audits, audit performance in the corporate sector has been reviewed differently depending upon firm (e.g. whilst the FRC identified multiple areas of significant improvement being required for Grant Thornton, it identified none such areas for BDO (FRC, 2018b, 2018c)).

### 5.3 | Audit usefulness

Funnell et al. (2016) third determinant of perceived audit credibility is audit usefulness. They highlight that auditors are expected to add value to auditees as well as provide reliable monitoring information to external stakeholders. In terms of performance auditing, adding value was defined as enhancing the operating efficiency of auditees. This indeed reflects the tradition that for public sector organisations auditors are expected to do more than reviewing the truth and fairness of financial statements but to also contribute to 'regularity, propriety and value for money' (Sharman, 2001; Stewart, 1984). Funnell et al. (2016) found a tension in practice between adding value for auditees and meeting external stakeholder requirements. As summarised above, in England, the performance auditing scope of local government audits had been reducing successively since 2005. In this context, the critical question addressed in this section is: In the changed environment in England how do stakeholders including auditees perceive that audit usefulness, or added value, has changed?

#### 5.3.1 | Auditee perceptions

In the survey, 46% of CFOs had expressed concerns that audit fee levels may have become too low to enable a good quality audit service in future. Subsequent interviews and workshops therefore included a focus on the issue of quality. Analysis of the data deriving from the interviews and workshops identified that a large component of CFO concerns about audit quality were in fact concerns about audit usefulness. Typically, CFOs saw that audits had become narrower, now focusing on assuring the accuracy of accounts and as a result losing activities such as auditor assessments of value-for-money and financial planning which CFOs perceived to have been core audit activities under the Audit Commission. Despite the fact that the narrowing of audit scope resulted from successive changes to the Code of Audit Practice, which had been ongoing since 2005, CFOs did instinctively attribute this narrowing largely to reductions in fee levels. One CFO commented:

I don't know whether it's the quality so much, as the focus. Because they've had their fees squashed, they concentrate so much on the accounts!

In fact, CFOs saw usefulness as primarily defined by whether audits helped them tackle the key challenges they faced. Following severe budget reductions in central government funding for English local government, which have cumulated to 49.1% between 2010/11 and 2017/18 (NAO, 2018), many local authorities have faced increased challenges in balancing their budgets. In this context, many CFOs felt audits were not useful as they did not contribute to the process of effective budget reduction due to the audit scope being largely limited to a financial audit which reported on the accuracy of the backwards looking accounts. One interviewed CFO observed:

You can have an audit that meets relevant regulatory standards but isn't telling you a great deal about some of the numbers that matter.

The majority of CFOs said that too much audit time was spent on aspects that added no value to the financial management of the authority. Asset valuation was frequently given as an example: local authorities often have large assets but their value does not impact on the actions of the local authority nor its financial abilities as most assets are not sold nor leveraged, and in case they are there is a strict process to ensure an appropriate value is obtained. Whilst in line with duties put on auditors by the Code of Audit Practice, the majority of interviewed CFOs questioned the considerable proportion of the audit resource dedicated to verifying the valuations. One CFO commented:

We've had long and tedious debates with our auditors about the exact value of our assets. The numbers might move a bit, but none of the numbers actually matter to our financial position or to anybody.

Most CFOs stated they would value audits that better helped them to ensure that their authorities were able to cope with the financial challenges they actually face – robust financial planning and ensuring value-for-money. These perceptions raise the question: Why do CFOs value audit opinions on such topics as it seems unlikely CFOs may believe their own figures to be inaccurate? However, there were several references to the usefulness of auditors in getting messages through to stakeholders including the body's own elected politicians. Some referred to past experience where auditors had helped them convey difficult messages to elected councillors, reinforcing the message and making it more likely action would be taken. One CFO commented:

One avenue would have been to have a fairly frank conversation with the auditors, and the auditors to put stuff in their reports that would have supported the Section 151 officer [i.e. the CFO], that the members can be cross with the auditor but what can they do? In the old days, they couldn't even change the auditor.

Auditors are thus seen as having the potential to assist in a blame deflection strategy (Hood, 2002) as local politicians can shift blame for the authority's financial performance to the CFO, who carries clear legal responsibility for ensuring that the authority's finances are sound (under Section 151 of the 1972 Local Government Act). CFOs could seek to share or shift the responsibility to/with auditors if the audit terms of reference are suitably wide to encompass CFO responsibilities. Equally the above given CFO comment supports Skærbæk and Christensen's (2015) notion of a 'purifying' role for the auditor in strengthening the believability of financial information politicians might otherwise have preferred to downplay. However, with the successive narrowing of audit scope since 2005, audit may be less useful in this respect than it once was. Most CFOs indeed reflected that audit had changed significantly in the past decade: whilst the ending of complex and data demanding performance audits conducted by the Audit Commission was mostly welcomed, the large reduction in value-for-money and financial standing audit activity was seen as a loss as they had generally been perceived as being 'very helpful to raise standards'.

The Audit Commission was also seen as having been a powerful voice for the local government sector, using the outcomes of audit work and its own national research to identify key issues facing the sector and make the case for change. Under the current regulatory regime, PSAA has a narrow remit, being simply to undertake audit appointments and manage the resulting contracts. Although the NAO's more recently extended work on local government finances was positively reflected upon by our interviewees, it was seen that, when compared to the Audit Commission, the NAO's limited capacity put severe strains on the scope and frequency of its analyses. Reflecting the concerns of some CFOs that audit focus had become too narrow, several interviewed CFOs suggested that PSAA could consider filling the gap in part left by the removal of the Audit Commission, for example, contributing to reviews of the Code of Audit Practice. Several interviewed CFOs indicated they would support higher fees for an audit that was more useful, with one CFO observing:

I think the price of the service would rise, but the value I get from it would rise, and I would then be able to drive out some efficiency savings from the services reviewed.

If many CFOs did not feel that audits were useful to them, they also felt they were not useful to the public either, partly because the contents of audit reports were not easy for the public to understand.

### 5.3.2 | Non-auditee-stakeholders – local politicians

The concerns of CFOs about audit usefulness, in terms of its scope, were not however universally shared by other key stakeholders included in the study. Of the five local politicians that were interviewed (four audit committee chairs and one council leader), none repeated the specific concerns of the CFOs about audit usefulness based on scope, but two of them reflected perceptions that external audit added little value generally to their authorities, with one interviewee referring to external auditors as 'a chore through which we have to go'. Although these comments cannot necessarily be taken as representative of local politicians as a whole, they do reinforce the suggestion by many CFOs that current audits have limited usefulness and that this is reinforced by the lack of understandability of audit reporting to non-financial readers. For some within the audit and accountancy professions though such views rather suggest that audit committees based on elected politicians are not up to the job, reflected by ICAEW's (2018, p. 20) suggestion that to ensure necessary skills audit committees should have a majority of independent members.

### 5.3.3 | National stakeholder perspectives

None of the representatives of national governmental organisations (MHCLG, NAO, FRC) raised concerns in our interviews either about audit usefulness generally or about the narrow scope and approach to reporting. CFO concerns were however reflected by representatives of some non-governmental national organisations with the interviewed chief executive of one accounting body stating: 'it appears that fees are too low, and that audit quality is basic'. The tension between calls for increased usefulness and the requirement for independence, and consistency with international audit standards, was also identified by ICAEW as 'possibly the widest expectation gap for CFOs' (ICAEW, 2018, p. 17), further stating:

The auditor can only provide an opinion on what has already been done. It is not possible, under current international audit, assurance and ethical standards, for auditors to provide an opinion or comment on management's thinking process (ICAEW, 2018, p. 17).

In line with this, national stakeholders rebutted the criticisms of audit usefulness, pointing out that they resulted from a confusion about the auditor's role compared to the CFOs' role, and the standard which auditors are now expected to achieve and the importance of maintaining auditor independence. A PSAA interviewee pointed out:

Auditing standards have really changed in nature over the last 15 or 20 years. There's now much more kind of precision about what the auditors have to do [-]. If you don't think that your medium-term plan has got realistic planned savings in it then it is your job to speak truth to power [-]. I'm not sure that the auditor is necessarily the logical person to do it. They're fettering their discretion.

### 5.3.4 | Auditors' perspectives

The requirements and constraints of regulatory codes and professional standards were also identified by auditors themselves as determining their usefulness or otherwise to stakeholders. Auditors were also concerned at both the possible conflict between independence and giving an opinion on the suitability of forward financial plans, and on the limited capacity of locally elected politicians. One auditor workshop participant commented:

It is a very difficult line to tread in keeping your independence and also trying to do what you're indicating, which is to help bang the table with the members who are not sophisticated.

This comment both captures the potential role of auditor and auditing in the financial 'purification' process discussed by Skærbæk and Christensen (2015) and equally encapsulates the tension between independence and usefulness – with 'banging the table' suggesting an auditor could find themselves becoming a partisan participant in government (Radcliffe, 1997). Equally it reinforces one of the key rationales for the collective procurement process – assurance of independence – advocated by the LGA in lobbying for the appointing person role and of PSAA itself in presenting its benefits. By the time this study concluded the 'expectations gap' was sufficient however to provide a sufficiently strong case for change. Following sector consultation in 2019, the NAO's revised Code of Audit Practice introduced in 2020 includes a more detailed focus on value-for-money and clearer expectations on meaningful and effective auditor reporting (NAO, 2020), which is expected to increase the usefulness of audits for different stakeholders.

## 6 | SUMMARY AND CONCLUSIONS

In this paper, we assess the credibility of local public audits in England against Funnell et al. (2016) criteria of auditor independence, technical competence and audit usefulness, based on the perceptions of key stakeholders.

The post-Audit Commission arrangements in England are perceived by auditees as being effective in terms of managing the independence of auditors. However, independence did not feature as one of the key factors that influenced authorities to join the PSAA scheme and few interviewed CFOs raised independence either as a concern or a significant benefit of the PSAA scheme. PSAA representatives did underline the importance of ensuring and demonstrating the independence from the audited bodies and that this was reflected in the arrangements that they established to procure and appoint auditors. More widely auditors' independence continues to be ensured through the requirement for auditors to comply with the NAO's Code of Audit Practice, international and FRC auditing standards and PSAA's annual review of audit quality. That the firms undertaking local audit tend to be larger firms further supports perceptions of audit independence.

The main reservations regarding PSAA's management of auditor independence among stakeholders related to the extent to which PSAA could be itself independent, being an (indirect) subsidiary of the LGA, and also whether auditors could retain their independence from audited bodies if the scope of the audit regime were to be widened. However,

the relatively low number of comments made by auditees and stakeholders indicate that independence is not an area of significant concern, and at least in terms of perceptions the post-Audit Commission arrangements for independence are credible.

In relation to technical competence, auditors' credibility was generally perceived as positive in a narrow technical sense, which is perhaps unsurprising given the fact that auditors must deliver a standards and Code compliant audit. Nonetheless, in the context of continuing reductions in audit fees, it was felt that it was increasingly challenging for audit firms to mobilise the resources to ensure the long-term availability of high-level local public audit expertise. Reflecting audit credibility studies in relation to the corporate sector (Pandit, 1999), we find that the ability of auditors of local governments to demonstrate understanding of the specific conditions of the local sector importantly impacts upon auditee perceptions of the quality of the audits performed. Several local government interviewees suspected that due to the impact of continuing audit fee reductions auditors' broader technical competence had been negatively affected, as they felt audit firms were increasingly employing staff with limited experience operating in the specific context of local public audit. These concerns were reflected by our survey results, which indicated that more CFOs oppose rather than endorse further audit fee reductions. The role of PSAA's procurement process and tender structure were perceived as having mixed impact, with some hampering maintaining high technical audit expertise, including the geographical spread of auditor appointments and the risk of audit firms to lose out during the tender process, making it difficult to retain knowledge and subsequently re-enter the market.

Stakeholders in local government defined usefulness of audits primarily by whether audits helped them tackle the key challenges they faced. From this perspective, the contribution of audits was critically reflected upon by the majority of CFOs, as the audit's focus was perceived as being of little relevance for addressing wider financial resilience or value-for-money questions. This highlights that the issue of audit usefulness is in fact an issue of audience: useful to whom? Many CFOs had reservations about the usefulness of current audits as they did not see them as helping them practically to do their job nor in their discussions with local politicians. But it is questionable if this management control function is the primary purpose of public audit, and the literature indeed emphasises many other functions and values of statutory audits (Hay & Cordery, 2018). The key stakeholders to determine audit usefulness may not be CFOs but rather elected politicians responsible ultimately for the finances of the organisation, members of the public and national government which in the UK has responsibility for local government effectiveness and conduct. Local public audit cannot be compared to that of a commercial company where audit is primarily to assure shareholders; the stakeholder relationship is more complex with locally elected politicians sitting on audit committees or councils arguably being agents for local electors. In this respect, the questions raised by CFOs about the understandability of audit reports for the public may be seen as the most serious issue concerning audit usefulness. The credibility of local public audits may be best facilitated by making them more understandable for a wider audience.

Following our analysis of the three components of audit credibility, it can be concluded that the new arrangements in England have made a positive contribution to maintaining auditor independence, even though this appeared to be taken for granted by many (local) stakeholders due to the resemblance of the current regime, in this regard, with the previous English system of local public audit. With respect to technical competence and audit usefulness a more mixed picture emerges, and, at least from the perspective of some stakeholders, these credibility criteria have exhibited signs of impairment in recent years. The influence of PSAA compared to other institutions (such as the NAO) on these criteria is inconclusive at this stage. The reduction in the usability of audits is not due to PSAA's influence, as its roots can be traced back to the Audit Commission days when the scope of audits and value-for-money activities had been significantly reduced. Similarly, audit fee reductions, whilst continuing under PSAA, were already implemented under the Audit Commission and had made the area less attractive from a commercial perspective, reducing firms' incentives to invest in local public audit.

Following Funnell et al. (2016), Skærbæk (2009) considered how performance audits differed from financial audits, the former being contentious, and expected to be valuable to users, and the latter 'more traditional and far less contentious' (Funnell et al. 2016, p. 605). Our findings however suggest that, far from being uncontentious, 'traditional' financial auditing also displays a duality with a demand for greater usefulness by local stakeholders being recognised

by regulators whilst also defending the need for the traditional financial audit role to provide assurance to external stakeholders including government and regulators. In this context, enhancing the financial resilience of local authorities is seen by users as the potential usefulness of financial auditing equivalent to the usefulness sought by auditees in performance auditing (Funnell et al., 2016). Similar to the discussion on performance auditing, this duality raises the question of the paramount aim of financial auditing, whether to external stakeholders or to the auditee, and the potential for role conflict between public accountability and improvement objectives, it being suggested the aspirations for the latter exist in financial auditing as much as performance auditing. In the post-Audit Commission era and in the context of the severe financial pressures on English local authorities, there is the suggestion in comments from CFOs that greater priority should be given to usefulness even if the audit's paramount aim remains external accountability.

The NAO's updated Code of Audit Practice (2020) puts more emphasis on enhancing the impact of auditors' work, which might alleviate some concerns traced in our study. However, some observers have questioned the scope to fundamentally improve audit credibility within the current regime with one important government-commissioned review stating that arrangements for local audit 'need to be fundamentally rethought' (Kingman, 2018, p. 15). Reviews have also been underway to address audit credibility in the private sector which may have an impact on local audit approaches (Brydon, 2019; CMA, 2019).

In terms of theoretical implications, our study demonstrates that needs and expectations in relation to local public audit diverge significantly across stakeholders. Identifying the position and interests of different stakeholders is essential to understand differences in the acceptability of audit findings and perceived scope and need for making changes to local public audit. Local public audits are faced with a wider range of stakeholders compared to audits conducted in central government. For local public audits to be credible a larger number of interests need to be considered, which makes arriving at a shared view of its content and implementation more challenging. Within the context of the fragmentation of local public audit responsibilities over multiple regulatory agencies, as occurred in England, an enhanced risk exists of audit credibility perceptions remaining under-articulated from a local stakeholder perspective.

We further add to Funnell et al. (2016) by finding that different stakeholders place different weight on credibility criteria which can lead to different credibility perceptions overall. In the case of post-Audit Commission England, auditees did not weigh independence highly (whereas PSAA and national stakeholders did) but did attach weight to usefulness. During the time of our study we found that institutional stakeholders such as the NAO were reacting to this by attaching more weight to usefulness themselves in their revisions of the audit code of practice. We suggest that these stakeholder weightings vary according to context: in local public audit in post-Audit Commission England the independence of auditors was not questioned due to the continuing robustness of independence arrangements but given financial resilience pressures and a reduction in the extent of the broader performance auditing over recent years, auditees did place great weight on usefulness. This contrast with the performance audits of the Australian National Audit Office studied by Funnell et al. (2016) where auditees demonstrated more equal concerns about all three perceptual criteria. This reflected the context whereby performance audits had a clearer duality of purpose and key stakeholders (satisfying the need for assurance by Parliament on the one hand and adding value to auditees on the other) leading to challenges in demonstrating independence and technical competence as well as usefulness.

To ascertain the long-term impact of the recent audit reforms in England, future research would benefit from collecting insights into audit quality in addition to perceptions amongst stakeholders investigated in this paper. Examples of audit quality indicators constitute the incidence of public interest reports, the meeting of statutory deadlines for audits over multiple years, and the quality of local public audits performed as analysed by the regulatory bodies. Given the divergence in the systems of local public audit across the UK, but also internationally, country comparative research promises to provide further vital insights into how audit credibility is influenced by different institutional arrangements, including but not limited to auditors' appointment, auditors' remuneration, and audit scope.



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## DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available from the corresponding author upon reasonable request. The data are not publicly available due to privacy or ethical restrictions.

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