Political Control and Audit Fees: An Empirical Analysis of Local SOEs in England

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IMPACT

We need to know more about the financial accountability of corporatized public services. In this article, we analyse the audit fees of a large sample of English local SOEs from 2009-2017, assessing the impact of board composition and ownership structure on those fees. We find that SOEs with more politicians on their boards of directors have higher audit costs and that this is especially so for majority-owned SOEs. Our findings highlight the need for policy-makers to evaluate the consistency of auditing arrangements for the hybrid arms-length organizations that are increasingly responsible for delivering public services.

ABSTRACT

This paper investigates relationship between political control and audit fees for local state-owned enterprises (SOEs) in England – hybrid public service organizations not subject to public sector audit. Panel regression techniques analyse secondary data on 405 SOEs for 2009-2017 where major local authorities held an interest. Statistical results suggest greater political representation on boards of directors of local SOEs is associated with higher audit fees and

positive relationship between political control and audit fees is stronger for majority public ownership.

Keywords: Corporatization, agency theory, audit fees, SOEs, local government

Public services in developed countries are undergoing significant changes to their governance and management that challenge the institution of public interest (Ferry & Ahrens, 2017), defined as "the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved" (International Federation of Accountants and Chartered Institute of Public Finance and Accountancy, 2014). In particular, there has been a movement away from primarily state-led public service provision towards hybrid arrangements involving a myriad of different types of organization in the service delivery process (Skelcher & Smith, 2017; Vakkuri & Johanson, 2018). This development has been especially striking at the local level, with the emergence of hybrid public service organizations that cut across the public, private and voluntary sectors, and on occasions enrol citizens (Sandford, 2016; Caperchione, Demirag & Grossi, 2017). As the local promotion of the public interest becomes attained through ever more complex service delivery processes, "accounting systems are increasingly required to support governments in managing, controlling, steering and monitoring the performance of contracts, partnerships, networks and other hybridized arrangements" (Steccolini, 2019, p.265).

One particularly significant issue within this context is the financial accountability of corporatized local public services, especially local state-owned enterprises (SOEs), which combine a business orientation with a social mission (Harrison, 2019). Local SOEs are enterprises (or companies), at least partly-owned by a local rather than a national or regional government (see Klausen & Winsvold, 2021; Papenfuß, Van Genugten, De Kruijf & Van Thiel, 2018), and can take the form of mixed enterprises/companies that are majority-owned by private or nonprofit organizations. In England, these hybrid entities are subject to private company law, and operate in an audit environment that is lower in publicness than that in which 'pure' public organizations function. A specific concern for the public interest within local SOEs is therefore the implications of the degree of political control that they require for the protection of core public values, especially financial accountability and control (Grossi & Thomasson, 2015;

Luke, 2010). Indeed, recent high-profile cases of the financial mismanagement of local SOEs in England have highlighted the challenge of managing such entities at arms-length (Murphy & Lacoma, 2021; Rudgewick, 2021).

In the UK, local SOEs are not subject to the public sector audit intended to ensure that local authorities provide value for money (Public Audit Forum, 2016), which places an increased burden on their parent organizations to design and implement governance structures that can provide assurance that financial accountability is upheld. Although research into the governance, accountability and performance of corporatized local public services has grown in recent years (Olsen, Solstad & Torsteinsen, 2017; Voorn, Van Genugten & Van Thiel, 2017), comparatively little attention has been paid to the auditing of local SOEs, which operate in "a twilight zone, being both private in one sense, acting according to the legislation of joint stock companies, and public in another sense, oriented towards fulfilling the needs of the municipal citizenry" (Collin, Tagesson, Andersson, Cato & Hansson, 2009, p.142). To better understand some of the dynamics of the financial accountability of corporatized public services, this paper draws upon arguments from agency theory and the auditing literature to investigate the relationship between political control and audit fees for local SOEs in England.

SOEs were originally employed by local authorities to socialize the management of natural resources and the provision of utilities, such as gas and electricity (Skelcher, 2017). Increasingly, however, public services traditionally provided in-house by local authorities, such as social housing, elderly care and waste management, are going through a process of corporatization after which they become subject to private company law (Ferry, Andrews, Skelcher & Wegorowksi, 2018). A key feature of this process of corporatization is the establishment of a board of directors responsible for overseeing the corporate governance of the new entities. The accountability challenges that are confronted by the local authorities responsible for managing SOEs are therefore focused on the ways in which the governing

boards exercise their responsibilities towards both the local authority owners and to local citizens as the ultimate beneficiaries of the services provided (Berge & Torsteinsen, forthcoming). In particular, local authorities may seek to hold SOEs accountable by ensuring that local politicians sit as non-executive directors on the board.

According to the agency perspective on corporate governance, the presence of "outside" non-executives on the board of directors creates additional demand for independent and impartial oversight of managers' actions (Fama & Jensen, 1983). At the same time, the auditing literature highlights that auditors may supply additional work to provide assurance of financial control where there is greater political involvement in the corporate governance of SOEs (Habib, Ranasinghe, Muhammadi & Islam, 2018). From both these points of view, SOEs experiencing more political oversight of their executive decision-making are likely to have increased audit costs. To cast much-needed empirical light on this issue, our study draws upon a dataset of more than 400 local SOEs in England, to estimate the relationship between the percentage of local politicians on the board of each SOE and variations in the fee charged by the auditor of an SOE's annual accounts. The statistical results indicate that our measure of political control has a positive relationship with audit fees – a relationship that is stronger for majority-owned SOEs. The study therefore raises important theoretical and practical questions about the impact of political control for the accountability of hybrid public service organizations not subject to public sector audit.

Political control and external audit of local SOEs

As interest in the corporatization of local government has grown (Voorn, Van Genugten & Van Thiel, 2018), so too has the amount of research dedicated to investigating the distinctive dynamics around the governance and accountability of SOEs (e.g. Grossi & Thomasson, 2015; Klausen & Winsvold, 2021; Papenfuß & Schmidt, forthcoming). However, empirical evidence

on the implications of political control for the financial accountability of corporatized public services remains comparatively scarce. Local SOEs retain a fiduciary responsibility to uphold the public interest, but typically operate in a different audit environment from 'pure' public organizations because they are usually subject to private company law rather than public administrative law. As a result, corporatized services are often covered by private rather than public sector auditing standards, with weaker central/federal oversight of their accounting practices. In an audit environment of this type, the protection of the public interest may therefore be dependent upon local practice variations in accountability relationships and the quality of the services provided by private audit firms (Ferry & Eckersley, 2015).

In the UK, only those organizations designated 'public sector bodies', such as central government departments, NHS trusts and local authorities, fall under the rubric of public audit (Public Audit Forum, 2016). This means that many of the organizations now providing key public services, such as local SOEs, public-private partnerships and so on, are not subject to the same auditing standards as their parent organizations. The growing numbers of public services operating in audit environments that are lower in publicness raises questions about the role of political control of hybrid organizations for the financial accountability of those organizations. To better understand the financial accountability of local SOEs, this study analyses the audit fees paid by local SOEs, which represent an important indicator of the level of effort required to protect the public interest. Evidence on the relationship between political representation on the board of directors and audit costs can therefore illuminate accountability challenges for hybrid public service organizations operating in 'private' audit environments.

Agency theory asserts that the presence of outside non-executive directors on company boards is necessary to ensure that shareholders' interests are properly represented in corporate decisions (Fama, 1980; Fama & Jensen, 1983). In fulfilling their responsibility to provide independent control over managers' decision-making, non-executive directors have several

incentives for supporting and encouraging more rigorous external auditing of a company's accounts (O'Sullivan, 2000). Aside from the duty to prevent shareholder losses, the reputation of non-executive directors may suffer when firms misreport results and they can be held legally liable for failing to exercise reasonable care (Gilson, 1990). For all of these reasons, the presence of more non-executive directors on a company board may result in those boards being more willing to pay a premium for audit services (Carcello, Hermanson, Neal & Riley, 2002; Ghafran & O'Sullivan, 2017).

For SOEs, it seems likely that increased representation of politicians on their boards of directors will raise audit fees for the same reasons as those identified in the private sector literature dealing with non-executive directors. Politicians are directly accountable to voters for the quality of local public services, which means that those sitting on the board of a SOE have a wider democratic duty as well as a more narrow fiduciary duty to ensure that those organizations create public value (Olsen, Solstad & Torsteinsen, 2017). To publicly demonstrate the seriousness with which they treat their dual responsibilities, SOE boardrooms with more politicians may procure better quality external auditing, thereby generating increased audit fees.

In addition to the potential for political control to increased demand for audit effort, it is possible that auditors may be concerned about the financial accountability risks posed by political involvement in the management of hybrid organizations, which generate supply-side pressures for more intensive auditing. Prior accounting research suggests that political control of SOEs can threaten the independence of senior managers and directors responsible for corporate governance and strategic decisions regarding business operations (Caker & Siverbo, 2011; Garrone, Grilli & Rousseau, 2013). Because politicians are assumed to seek re-election, they may have less incentive to safeguard efficiency than the managers employed for that

purpose (Shleifer & Vishny, 1997), and auditors of SOEs with more politicians on their boards may therefore increase their efforts to protect themselves from future litigation.

Although private sector research has identified a positive relationship between board independence and audit quality (e.g. Beasley& Petroni, 2001; Carcello, Hermanson, Neal & Riley, 2002; O'Sullivan, 2000), there are few studies of the impact of political representation on boards of directors on external auditing. Evidence from emerging economies suggests that auditors charge an additional premium for firms with stronger links with political actors (Habib, Ranasinghe, Muhammadi & Islam, 2018), but relies on an assumption of auditor independence that may be too strong in such economies (Wang, Wong & Xia, 2008). For this study, however, it seems reasonable to assume an acceptable level of auditor independence given the robust corporate governance regulations and well-established competitive audit market in the UK. Hence, any connection between political representation and audit fees is likely to be the result of accountability pressures rather than collusion. Hence, based on the arguments of agency theory that have just been set out, this study tests:

Hypothesis 1: Political control will be positively associated with audit fees.

The demand and supply-side factors associated with the positive relationship between political control and audit fees may become even more salient in majority public-owned organizations. The involvement of politicians in SOEs with a closer connection to their parent organizations may require additional efforts to strengthen organizational and democratic legitimacy (Aars & Ringkjøb, 2011), which, in turn, might make a focus on audit quality more likely. At the same time, the potential for financial mismanagement and goal displacement to occur in SOEs under the influence of politicians would seem likely to be greater in those that are owned by public

sector organizations, and that therefore have fewer countervailing competitive and economic forces with which to constrain political rent-seeking (D'Souza & Nash, 2017).

All of the above implies that political control could have particularly strong effects on audit pricing in the presence of majority public ownership for two main reasons. Firstly, because auditors will need to work harder to satisfy clients' heightened demand for exemplary financial accountability and good corporate governance. And, secondly, because auditors will have to take great care in order to address any negative consequences for sound financial management in situations that are more favourable for the exercise of political opportunism, including having the financial and reputational resources needed to absorb any potential losses. Hence, given the potential interactive effects of political control and public ownership on audit pricing, this study proposes:

> *Hypothesis 2*: The positive political control-audit fees relationship will be stronger for majority public-owned than minority public-owned organizations.

Research design

The study sample includes all the enterprises (or companies), at least partly-owned by the full population of 150 single and upper-tier local authorities in England for the period 2009-17. Single and upper-tier local authorities provide local public services in the areas of: education (e.g. primary and secondary schooling), social care (e.g. services for older people), environmental services (e.g. waste management), highways, economic development, and leisure and culture services (e.g. sports centres, libraries). With the exception of county councils, they are also responsible for aspects of social housing (e.g. sheltered accommodation and rent subsidies). Single and upper-tier local authorities manage about a quarter of the total UK public sector budget (HM Treasury, 2018).

To identify SOEs in which local authorities had an interest, the annual statements of account for each local authority were scrutinized in detail – a process facilitated by their adherence to the International Financial Reporting Standards (IFRS) requiring them to: present consolidated financial statements for all the entities they control (IFRS10); report on the existence of joint arrangements (IFRS11); and disclose their interests in other entities (IFRS12. To construct a local SOE dataset for the purposes of the study, the registered company number for each entity in which each local authority had an interest was imported into the FAME database from Bureau Van Dijk to extract SOE-level accounting data. This process revealed that some of the SOEs identified in the local authority accounts lacked full accounting data either because they were dormant or because they were small entities exempt from producing full company accounts.[1] As a result, the final sample of SOEs included in the analysis was 405. Of this sample, 234 SOEs are *private companies limited by shares* (58%) and 138 are *private companies limited by guarantee* (34%), of which 38 are registered charities; with twenty-five SOEs being limited liability partnerships (6%), and eight being registered charities or trusts that are not companies limited by guarantee (2%).

Dependent variable

The dependent variable is the *audit fee* reported in the annual accounts for each SOE included in the sample. Because their financial statements are likely to be consolidated within the group accounts of local authorities, local SOEs are influenced by public sector accounting standards, especially those that are majority-owned. Nevertheless, local SOEs in England are not specifically covered by the Code of Audit Practice, which regulates the auditing of local authorities. Instead, they are subject to the auditing requirements of UK company law, which only requires them to have their annual accounts independently audited (unless they qualify for

a small size exemption, see footnote 1). Hence, the hybrid nature of local SOEs is reflected in the auditing arrangements to which they are subject.

The evolution of audit pricing for local SOEs during the study period is illustrated in Table 1, which shows the mean and the standard deviation for the SOE audit fees paid each year from 2009 to 2017, along with correlations between the mean audit fee for each year. The table illustrates the growing number of SOEs reporting audit information, and the increase in price year-on-year. It is also apparent from the standard deviation figures that the variation in audit fees between local SOEs grew considerably between 2009 and 2017, but that, as the correlations highlight, there is not a great deal of variation year on year within SOEs.

[Table 1 about here]

Independent variables

The degree of *political control* over each SOE in the sample was measured by calculating the proportion of local elected politicians on a SOE's board of directors. The presence of these politicians on a SOE board signals the interest of the parent organizations in extending democratic control over the SOE. A measure of the *public ownership* of each SOE was constructed by calculating the percentage of the shares held by public organizations in each SOE. Following prior studies, a dichotomous variable coding majority public-owned SOEs one and all other SOEs zero was then created (Andrews, Boyne & Walker, 2011).

Measures of SOE size, age, leverage, charitable status and service area are added to the models to capture relevant client-based attributes[2], with auditor tenure and a big 4 auditor variable included to adjust for auditor attributes.[3] SOE size is measured as the log of total assets, which is assumed to have a positive relationship with audit fees (Hay, Knechel & Wong, 2006). SOE age is measured as the number of years since the financial year in which the enterprise was incorporated. Audit fee studies offer inconclusive theory and evidence regarding the effects

of age (e.g. Mohammed, Mohd-Saleh & Ahmed, 2018). Financial leverage is measured as the ratio of long-term liabilities to total assets, which is expected to raise the price of audit (Simunic, 1980). Charitable status is measured using a dichotomous variable indicating whether or not an enterprise is registered as a charity with the Charity Commission of England and Wales. Forty-six of the SOEs studied here are registered charities, the great majority of which are also companies limited by guarantee (38). SOEs with charitable status are anticipated to have higher audit fees due to the greater complexity of regulations affecting the voluntary sector (Beattie, Goodacre, Pratt & Stevenson, 2001), including the statutory requirement for them to have their public benefit statement audited.[4] A set of dichotomous variables coded for the main public service provided by each SOE is added to the models: administrative support; cultural services; economic development; educational support; environmental services; leisure services; social care; social housing; and, transportation. Administrative support services is the reference category. It is anticipated that audit fees will be higher for more complex services (e.g. transport infrastructure) and those subject to greater government regulation (e.g. social care).

Auditor tenure is measured as the number of years since the financial year in which an audit firm was appointed. The audit fees literature suggests auditor tenure is likely to be associated with higher fees (Hay, Knechel & Wong, 2006). To capture the potentially positive effects of a reputation for high audit quality on audit fees, a dichotomous variable coded one if an SOE's accounts are audited by one of the Big 4 accounting firms (Deloitte, Ernst & Young, KPMG, Price Waterhouse Coopers) and zero otherwise, is included in the model. The large auditor premium is well-established in the empirical literature (Campa, 2013). During the study period about fifteen per cent of the SOEs appointed the same auditor as their parent organization. To explore whether having the same auditor as the parent authority influences the audit fees of an SOE through cost-sharing and/or redistribution, a measure capturing the use of

the same auditor by a SOE and its main local authority shareholder was added to the model, but it made no difference to the results (available on request).

To account for potential geographic variations in audit fees, dichotomous variables capturing the region in England in which each organization operates are included in the models.[5] Controlling for regional variations captures the full extent of the territories served by local SOEs, and that they are sometimes owned and/or controlled by multiple local authorities within the same region. Importantly, prior research suggests that there are regional variations in auditing practices across the UK (e.g. Brinn, Peel & Roberts, 1994; Clatworthy, Mellett & Peel, 2002).

Descriptive statistics for the variables used in the analysis are presented in Table 2. The table highlights that the mean audit fee for the local SOEs included in the study for the period 2009-17 is £17,160. The mean proportion of politicians' on SOEs boards of directors is around 11.6%, and about two-thirds (66%) of the SOEs studied are majority public-owned. On average, the studied SOEs hold almost £30 million (£27,894,000) in assets, are highly leveraged (72%), and about eleven years old. They appoint the same auditors for around six years at a time, and just over one-thirds (36%) of them appointed a big 4 accountancy firm. Less than a fifth of the SOEs are registered charities during the study period, and, overall, local SOEs tend to provide economic development (34%), social housing (16%) or administrative support services (10%).

[Table 2 about here]

The median figures shown in Table 2 diverge considerably from the mean figures for several of the measures, especially audit fees, political control, and assets and leverage, pointing to wide variations between SOEs. The standard deviations for each of these measures, and for organizational age and auditor tenure, are large, confirming that the attributes of local SOEs

tend to vary greatly. The skewness statistics reported in Table 1 indicate that audit fees, assets and leverage are not normally distributed (skew values of well over 2), so logged versions of these variables are included in the regression models. To mitigate the potential impact of outliers on the regression models, log(assets) is winsorized at the 1st and 99th percentiles of the distribution, while political control, organizational age and auditor tenure are winsorized at the 99th percentile of their distribution (see Ettredge, Scholz & Li, 2007). Correlations between all of the variables included in the statistical models are shown in Table 3 below.

[Table 3 about here]

Results

Table 4 presents Hausman-Taylor (HT) (1981) estimates for the regression models. The HT estimator is employed because it accommodates time-invariant independent variables (e.g. public ownership and type of service provided) and allows time-varying variables to be correlated with the individual effect. As a result, potentially endogenous time-varying variables can be instrumented by the deviations from their own means, which, in this case, controls for any potential endogeneity in the Big 4 auditor choice-audit fees relationship. Sargan-Hansen tests point to the robustness of the HT estimator. Multicollinearity does not seem to be a serious concern for the analysis since the individual Variance Inflation Factor is below 4 (average = 1.84) for all explanatory variables (Belsley, Kuh & Welsch, 1980).

[Table 4 about here]

The coefficient for the percentage of politicians on the board of directors is positive and statistically significant implying that there is support for hypothesis 1 regarding the connection between political control and audit costs. In fact, the regression estimates suggest that,

conditional on the model and data, a one standard deviation increase (15%) in the proportion of politicians on the board of SOEs is associated (on average) with an increase in the price of audit of about 4.5%. Such an increase would therefore signal that more than a quarter of the board members were politicians (i.e. 11.62 + 15.23).

Evidence for hypothesis 2 can be evaluated by inspecting the coefficient for the interaction between political control and public ownership in the second column of Table 4. That coefficient is positive and statistically significant, suggesting that political control and public ownership may have a combined positive effect on audit pricing, with audit being more expensive for majority-owned SOEs with greater political representation on the board of directors. To explore this finding in more detail, the interaction can be depicted graphically by comparing the slope around the intercept value for the audit fees for majority and minority-owned SOEs that have political control one standard deviation above and below the mean level (see Dawson, 2014).

The interaction plotted in figure 1 indicates that the audit fees for SOEs that are majority public-owned are similar to those that are minority-owned, when there are low levels of political control, but that majority-owned SOEs with high levels of political control have higher audit fees than their minority-owned counterparts. A one standard deviation increase above the mean proportion of politicians on the board is associated with audit fees that are 9% higher in majority than minority-owned SOEs. This finding provides support for hypothesis 2, and for the arguments about the connection between political control, public ownership and external auditing advanced above.

[Figure 1 about here]

To explore our findings in more depth we interviewed knowledgeable practitioners about the dynamics of political control, public ownership and financial accountability in local SOEs. One important theme to emerge from those interviews was how the distinctive audit environment may explain why audit fees are higher in local SOEs with more political representation on the board of directors. A local politician experienced in overseeing local SOEs emphasised how the typical way of working for elected members "almost by definition will be inappropriate for a new company", especially in terms of "basic stuff like accounts, I mean, the whole way in which auditing and accounts are different." Critically, a finance specialist indicated that local politicians who serve on SOE boards can potentially be sued if they are "making a political decision based upon what's happening in your board or your party and that's to the detriment of the company". They also highlighted how politicians on SOE boards may lack commercial know-how or familiarity with managing conflicts of interest, which, in turn, provides further reason for their seeking a more intensive audit of an SOEs finances. Indeed, a local authority director of finance and commercial services stressed how for large wholly-owned SOEs it is essential that "you get assurance from the external auditors."

. In addition to the above points which support the demand-side arguments suggested by agency theory, it is possible that where there is majority ownership it may be easier for a local authority's audit committee to require the group auditor to place more reliance on the work of the auditors of SOEs. Further statistical analysis suggests that level of political representation and public ownership makes no difference to the audit fee for SOEs with the same auditor as their main parent (results available on request). Nonetheless, cost-sharing decisions could occur even where the auditors of the parent and a SOE are different. At the same time, it is conceivable that the supply-side factors identified in the auditing literature , such as auditors' pricing the risk of political interference higher in majority-owned organizations, may be important.

A former partner in a Big 4 audit firm involved in local audit indicated that where SOEs exist "with Board Member Councillors", conflicts of interest are more likely, and for that reason "the risk of external challenge is greater and so there is a risk premium attached to the audit fee" Indeed, the costs of auditing such conflicts of interest are usually "commented upon explicitly within the Audit Findings Report given to Audit Committees at the time the financial statements are signed". Importantly, the interviewee stressed that the impetus for greater assurance "doesn't necessarily always come from the local politicians on the [SOE] Board, but Executive Management, auditors, other Councillors, other Board Members etc". Supporting these points, a local authority audit committee member emphasised how majority-owned SOEs, in particular, "take up a substantial amount of time for members (and officers). They're often subject to more discussion than might seem ostensibly necessary: they tend to be politically sensitive".

Turning to the results for the control variables shown in Table 4, it appears that contrary to prior research (Axen *et al*. 2019), public ownership is unrelated to the audit fees for local SOEs. To investigate the issue of public ownership further, we first substituted a measure capturing the percentage ownership of the SOE for our measure of majority public ownership, and then substituted that measure with one capturing whether a SOE was wholly-owned by a local authority. Neither measure of public ownership had a statistically significant relationship with SOE audit fees (results available on request), so we are unable to conclude whether having a controlling interest in a SOE leads to higher or lower audit costs.

As found in the auditing literature, assets, leverage and auditor tenure are all positively related to audit fees. Importantly, there is no evidence of a Big 4 auditor premium, which given the use of the HT estimator suggests that auditor self-selection is highly unlikely to be an issue. Unlike previous research finding higher audit fees among public-benefit SOEs in New Zealand (Redmayne, Bradbury & Cahan, 2011), charitable status appears to be unrelated to the audit

fees paid by local SOEs in England. Nevertheless, audit fees appear to be higher for the SOEs that provide mainly social care, social housing or transportation services, and lower for those providing economic development services. At the same time, the coefficients for the regional variables suggest there are statistically significant geographical variations in audit pricing. In particular, audit fees for local SOEs appear to be higher in London (the reference category), when controlling for client and auditor attributes, than in all the other regions of England except for the East and the South West.

Conclusion

Consistent with the arguments about demand and supply-side factors that are advanced in this paper, our analysis suggests that greater direct political control of SOEs is associated with higher audit fees, and that the positive political control-audit fee relationship appears to be stronger in majority-owned SOEs. Like many other hybrid public services, local SOEs are not subject to public sector auditing standards, so the results suggesting a connection between political control and audit pricing represent a useful vantage-point for understanding the governance of corporatized public services.

The protection of public values is especially challenging to evaluate and assess in the case of local SOEs, because these entities operate at 'arms-length' from their parent organizations, have intermittent contact with them, and are often tasked with business goals as well as a social purpose (Klausen & Winsvold, 2021). The findings from this study imply that in audit environments lower in publicness, increased political control of SOEs may be associated with a greater demand for, and supply of, financial assurance. It is possible that this is a response to the lighter-touch audit regime for local authorities associated with the replacement of the Audit Commission as the principal local audit appointing person by Public Sector Audit Appointments (PSAA). However, further statistical analysis suggests that the audit price for

local SOEs has neither increased nor decreased since the abolition of the Audit Commission (available on request). Allied to the concerns about financial disclosure pertaining to local SOEs raised by the Redmond Review (2020, p.49), the results of our study imply that greater central oversight of the auditing of local SOEs by Supreme Audit Institutions, such as the NAO, and other regulatory bodies, such as the Financial Reporting Advisory Board or the new Audit, Reporting and Governance Authority, may be necessary to ensure that the financial accountability of local public services is consistent across different delivery models.

In England, local SOEs are private entities covered by company law, and are not subject to the same financial accountability demands that apply to their parent public organizations, which makes it particularly important to understand the corporate governance practices most likely to ensure that the public interest is being upheld. Stakeholder organizations should therefore consider: i) whether the auditing requirements embedded in company law are likely to be sufficient to promote the public interest in hybridized public services; ii) whether new guidelines and standards might be required to address the implications of different corporate governance practices; and, iii) if some form of government intervention in, and management of, the audit market for hybrid public services may be required.

Despite its strengths, the limitations of this study include, firstly, that the results are based solely on SOEs in England. The legal form, political control and purpose of SOEs is often different in other countries (Torsteinsen, 2019). Evidence from cross-country comparative research that could capture variations in the publicness of audit environments would therefore highlight the extent to which the findings presented here might be generalizeable. Secondly, the focus in this study is exclusively on the relationship between political control and audit fees. There are other auditing measures connected with the public interest that may potentially be influenced by variations in political control. Research that addressed the impact of political control on audit quality, audit committee composition and financial control within hybrid public

service organizations would provide extremely informative insights into the dynamics of accountability in these increasingly prevalent organizational forms.

Notes

[1] UK government guidance indicates that companies can qualify for an audit exemption, provided that their articles of association or shareholders do not demand one, when they have at least two of: i) an annual turnover of no more than £10.2 million; ii) assets worth no more than £5.1 million; iii) 50 or fewer employees on average. https://www.gov.uk/audit-exemptions-for-private-limited-companies

[2] Measures of SOE profitability (Return on Assets and Return on Capital) were unrelated to audit fees. Due to the large number of missing observations for those measures, they were excluded from the regression models.

[3] Engagement attributes (Hay, Knechel & Wong, 2006) were not tested as the audit opinions were unqualified for over 99% of the SOE-year observations included in the study sample, and, unfortunately, non-audit fees were reported for less than half of those observations.

[4] Registered charities are responsible for preparing a trustees' report that incorporates a public benefit statement: 'A statement confirming whether the charity trustees have complied with their duty to have due regard to the guidance on public benefit published by the Commission in exercising their powers or duties' (https://www.gov.uk/government/publications/charity-reporting-and-accounting-the-essentials-cc15b/charity-reporting-and-accounting-the-essentials)

[5]There are nine regions in England, which correspond to the NUTS(1) statistical regions of Europe: East of England; East Midlands; London; North East; North West; South East; South West; Yorkshire and Humber; West Midlands. Dichotomous variables coded one for each of

the regions and zero otherwise were included in the statistical models, apart from London which was considered the reference category.

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Table 1. Audit fees: year-on-year analysis

	Audit fee (£000s)	N of obs	Mean	SD	1	2	3	4	5	6	7	8
1	2009	188	14.82	16.88								
2	2010	208	14.28	16.88	.95							
3	2011	228	14.85	19.09	.88	.90						
4	2012	237	16.20	26.93	.92	.95	.91					
5	2013	248	18.09	40.96	.85	.88	.87	.97				
6	2014	273	16.82	41.47	.86	.85	.85	.93	.98			
7	2015	283	17.72	41.16	.86	.87	.91	.92	.97	.99		
8	2016	300	19.58	49.74	.81	.83	.87	.92	.97	.98	.99	
9	2017	281	19.89	51.06	.72	.74	.81	.87	.97	.97	.97	.95
	2009-17	2246	17.16	37.78								

Supplemental file

Table S1. Political control and audit fees – same auditor as parent analysis

Political control (PC)	.003*	.003*	.003*
	(.001)	(.001)	(.001)
Majority public ownership (PO)	.089	.086	.104
	(.088)	(.088)	(.090)
Same auditor as parent (SA)	.017	.066	.123
	(.050)	(.069)	(.129)
SA x PC		-.003	
		(.003)	
SA x PO			-.138
			(.137)
Size (log)	.146**	.146**	.146**
	(.025)	(.025)	(.025)
Leverage (log)	.038**	.038**	.038**
	(.014)	(.014)	(.014)
Organizational age	-.001	-.001	-.001
	(.009)	(.009)	(.009)
Auditor tenure	.015**	.015**	.014**
	(.005)	(.005)	(.005)
Big 4 auditor	.082	.081	.089
	(.071)	(.072)	(.072)
Charitable status	.069	.066	.079
	(.144)	(.144)	(.145)
Culture	-.073	-.075	-.079
	(.251)	(.251)	(.252)
Economic Development	-.254	-.251	-.260+
	(.159)	(.159)	(.160)
Education	-.120	-.117	-.122
	(.183)	(.183)	(.183)

Environment	-.117	-.115	-.122
	(.205)	(.205)	(.204)
Leisure	.021	.024	.014
	(.186)	(.186)	(.187)
Social care	.392*	.390*	.388*
	(.193)	(.190)	(.193)
Social housing	.298+	.302+	.294+
	(.164)	(.164)	(.165)
Transportation	.519*	.523*	.516*
	(.239)	(.239)	(.238)
Observations	2241	2241	2241
Wald Chi	5879.71**	5923.32**	5867.85**
Sargan-Hansen	10.49	10.78	10.49

Notes: +p<.10; *p < .05; **p < .01. Robust standard errors in parentheses. Year and regional effects not shown. log(Size) is winsorized at the 1st and 99th percentiles of the distribution. Political control, organizational age and auditor tenure are winsorized at the 99th percentiles of their distribution.

Table S2. Political control and audit fees – alternative public ownership measures

	β	Robust s.e.	β	Robust s.e.
Political control	.003*	.001	.003*	.001
Percentage public ownership	.001	.001		
Wholly-owned			.117	.092
Size (log)	.146**	.025	.146**	.025
Leverage (log)	.038**	.014	.038**	.014
Organizational age	-.002	.009	-.002	.009
Auditor tenure	.014**	.005	.014**	.005
Big 4 auditor	.083	.071	.082	.071
Charitable status	.085	.146	.085	.144
Culture	-.087	.250	-.065	.249
Economic Development	-.260+	.157	-.252	.157
Education	-.131	.181	-.123	.183
Environment	-.136	.202	-.140	.202
Leisure	.008	.184	.004	.182
Social care	.365*	.191	.365*	.191
Social housing	.266+	.162	.267+	.162
Transportation	.510*	.239	.547*	.239
Observations	2241		2241	
Wald Chi	5899.53**		5897.54**	
Sargan-Hansen	10.99		11.57	

Notes: +p<.10; *p < .05; **p < .01. Year and regional effects not shown. log(Size) is winsorized at the 1st and 99th percentiles of the distribution. Political control, organizational age and auditor tenure are winsorized at the 99th percentiles of their distribution.

Table S3. Political control and audit fees (controlling for the post-Audit Commission period)

	β	Robust s.e.
Post-Audit Commission	.040	.075
Political control (PC)	.003*	.001
Majority public ownership (PO)	.093	.088
Size (log)	.146**	.025
Leverage (log)	.038**	.014
Organizational age	-.002	.009
Auditor tenure	.014**	.005
Big 4 auditor	.083	.071
Charitable status	.074	.144
Culture	-.090	.250
Economic Development	-.271+	.157
Education	-.139	.181
Environment	-.133	.203
Leisure	.001	.184
Social care	.378*	.192
Social housing	.278+	.162
Transportation	.506*	.237
Observations	2241	
Wald Chi	5901.26**	
Sargan-Hansen	10.48	

Notes: +p<.10; *p < .05; **p < .01. Year and regional effects not shown. log(Size) is winsorized at the 1st and 99th percentiles of the distribution. Political control, organizational age and auditor tenure are winsorized at the 99th percentiles of their distribution.

Table 2. Descriptive statistics

	Mean	Median	Standard Deviation	Skewness	Kurtosis
Audit fee (£000s)	17.16	10	37.78	11.08	155.72
Political control	11.62	6.25	15.23	1.58	2.52
Majority public ownership	.66	1	.47	-.67	-1.55
Assets (£000s)	27,894.75	4857.98	178839.33	16.96	307.99
Leverage	.72	.32	2.75	36.22	1548.65
Organizational age	11.10	8	9.57	1.29	1.07
Auditor tenure	6.27	5	5.37	1.59	2.62
Big 4 auditor	.36	0	.48	.57	-1.68
Charitable status	.15	0	.35	2.01	2.03
Administrative Support	.10	0	.30	2.72	5.43
Culture	.05	0	.22	3.99	13.96
Economic Development	.34	0	.47	.69	-1.52
Education	.09	0	.29	2.77	5.67
Environment	.08	0	.27	3.16	8.01
Leisure	.07	0	.26	3.31	8.97
Social care	.04	0	.21	4.45	17.78
Social housing	.16	0	.36	1.89	1.59
Transportation	.07	0	.25	3.42	9.68

Number of observations = 2,246.

Table 3. Correlations for all variables

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1	Audit fee (£000s)																	
2	Majority public ownership	.09																
3	Political control	.02	.13															
4	Size (£000s)	.55	-.04	-.01														
5	Leverage|	.29	.17	.01	.26													
6	Organizational age	.04	-.11	.24	.07	-.06												
7	Auditor tenure	.03	.03	.17	.07	-.04	.62											
8	Big 4 auditor	.14	-.04	-.13	.27	-.02	-.04	.05										
9	Charitable status	-.07	-.28	.10	-.11	-.17	.34	.23	-.25									
10	Administrative Support	.01	.05	-.11	.01	-.09	-.07	-.07	-.02	-.14								
11	Culture	-.03	-.06	.12	-.06	-.14	.32	.18	-.09	.45	-.08							
12	Economic development	-.22	-.10	-.10	-.09	-.10	-.07	-.05	.08	-.15	-.23	-.17						
13	Education	-.04	-.08	-.07	-.02	.02	-.07	.00	-.11	.11	-.11	-.08	-.23					
14	Environment	-.05	.02	.01	-.06	-.04	.03	.10	.09	-.03	-.10	-.07	-.21	-.09				
15	Leisure	-.03	-.24	-.03	-.02	-.04	.02	-.01	-.14	.34	-.09	-.07	-.20	-.09	-.08			
16	Social care	.06	.09	-.05	-.07	-.02	-.14	-.13	-.01	-.05	-.07	-.05	-.15	-.07	-.06	-.06		
17	Social housing	.20	.25	.04	.08	.31	-.12	-.04	-.02	-.18	-.14	-.10	-.31	-.14	-.13	-.12	-.09	
18	Transportation	.23	.07	.14	.25	.05	.25	.06	.17	-.11	-.09	-.06	-.19	-.09	-.08	-.08	-.06	-.12

Number of observations = 2,246. The correlation matrix has been computed with the transformed variables as they enter the regression models.

Table 4. Political control and audit fees

	β	Robust s.e.	β	Robust s.e.
Political control (PC)	.003*	.001	-.002	.003
Majority public ownership (PO)	.093	.088	.033	.092
PC*PO			.006+	.004
Size	.146**	.025	.147**	.025
Leverage|	.038**	.014	.037**	.014
Organizational age	-.002	.009	-.003	.009
Auditor tenure	.014**	.005	.014**	.005
Big 4 auditor	.083	.071	.082	.072
Charitable status	.074	.144	.088	.145
Culture	-.089	.250	-.086	.252
Economic Development	-.271+	.157	-.268+	.159
Education	-.139	.181	-.152	.183
Environment	-.133	.203	-.114	.202
Leisure	.001	.184	-.002	.183
Social care	.378*	.192	.377*	.193
Social housing	.278+	.162	.286+	.163
Transportation	.506*	.237	.518*	.236
East Midlands	-.546**	.170	-.543**	.171
East of England	.041	.173	.045	.175
North East	-.550**	.139	-.543**	.140
North West	-.250*	.123	-.244*	.124
South East	-.444**	.166	-.422**	.166
South West	-.199	.145	-.187	.145
West Midlands	-.312*	.159	-.296+	.157
Yorks&Humber	-.363**	.136	-.346**	.137
Observations	2246		2246	
Wald Chi	5901.26**		6003.52**	
Sargan-Hansen	10.48		10.58	

Notes: +p<.10; *p < .05; **p < .01. Year effects not shown. log(Size) is winsorized at the 1st and 99th percentiles of the distribution. Political control, organizational age and auditor tenure are winsorized at the 99th percentile of their distribution.

Figure 1. Political control x public ownership and audit fees