December 11th, 2013

RE: PCAOB Rulemaking Docket 034: Proposed Auditing Standards on the Auditor’s Report and the Auditor’s Responsibilities Regarding Other Information and Related Amendments

Dear Board Members:

We welcome the opportunity to comment on the PCAOB’s proposals in relation to the auditor’s report.

By way of background, Hermes is a leading asset manager in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from across the world, all of which invest in companies whose audits are subject to PCAOB oversight. In all, EOS advises clients with regard to assets worth more than $195 billion.

We are supportive of the proposed disclosure enhancements and of the intent behind them, and believe that if auditors report in ways that aspire to communicate effectively, real value can be added for shareholders. We make these concrete suggestions to enhance the proposals. These are italicised to ease identification.

Requiring disclosure of matters that are critical to the audit process is a welcome addition to corporate disclosure as it provides greater clarity on the robustness of the audit process and in turn on the quality of the audit report. We are supportive of the inclusion in the audit report of information clarifying the auditor’s responsibility for the evaluation of other information which may influence their ultimate assessment of the company’s financial statements.

Currently the audit is entirely invisible to the shareholders who pay for it and for whose benefit it is carried out. This is simply not a sustainable situation and it is no wonder that confidence in the value of the audit continues to fall and questions continue to be asked about whether there might be different and alternative models that would better serve shareholder interests. Making the audit more visible to those who pay for it and for whose benefit it is carried out is a small but vital step forwards. As well as providing necessary visibility, we believe that good disclosures will potentially rebuild confidence in audit quality.

We agree with the PCAOB’s classification of “critical audit matters” and expect that by identifying these in the auditors report, users of financial statements will have a clearer indication of areas where further scrutiny is merited. As intended in the proposed reforms, it
will be of particular value to enhance disclosure around areas of the audit process where the
auditor has identified significant management judgements or where there is an indication of
significant uncertainty. In addition, this would promote greater accountability as it would
highlight areas in which the company has failed to provide sufficient information, or
information of sufficient quality, for the auditor to perform a thorough assessment. We hope
that, and will encourage, the audit firms to avoid this disclosure to descend into boilerplate. It
is important that both shareholders and regulators encourage audit firms to see competitive
advantage in good quality audits and the reporting of how they attempt to achieve them.

Another additional clear benefit of these proposals is that shareholders will have a
foundation of information on which to hold dialogue with the company (whether the executive
team or the audit committee) on matters related to the audit. We would also hope that over
time mechanisms can be found for these disclosures also to form the basis for contact
between shareholders and the auditor itself. Through these routes, both with the company
and with the auditor, greater confidence in audit quality, and also in the quality of the
company's reporting, can be built.

We believe that encouraging auditors to comment on matters that are unique to a company’s
audit process will be a welcome addition and a shift away from the largely boilerplate
language currently disclosed by most companies in their reports. This should be more
indicative of the quality of the disclosure that companies provide to auditors. We therefore
also welcome the proposal to require auditors not only to consider other information
disclosed by the company in preparation of its financial statements, but also to evaluate the
materiality of such additional information and the impact it may have in the quality of the
audit. To encourage further the development of helpful audit reports, we believe that the
auditors should identify any critical matters that had not been identified at the time of
commencement of the audit.

Overall, we view the proposed amendments as enhancements that should foster greater
transparency and accountability by companies and auditors alike. We need to challenge
audit committees to perform their role more fully and clearly on behalf of shareholders, and
the changes proposed by the PCAOB will further empower us to do so. However, to make
engagement on these issues more effective, we believe that the audit committee should
comment on what it believes the most important management judgments are in relation to
the matters covered by the external audit together with a description of the main elements of
its work programme during the year.

We appreciate the opportunity to provide input into the consultation. I would be glad to
discuss any of the points above with you further on +44 (0)20 7680 3758 or at
m.isaza@hermes.co.uk.

Yours sincerely,

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