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Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 29; PCAOB Release No. 2011-007: Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2

Dear Board Members:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's proposals to Improving the Transparency of Audits by amending PCAOB Auditing Standards and Form 2, dated October 11 2011.

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, including *(only those clients which have expressly given their support to this response are listed here)*. In all, EOS advises clients with regard to assets worth more than $140 billion.

We firmly welcome the PCAOB's attention to this important area, and are generally supportive of the proposals. In particular we welcome the proposal with regard to the disclosure of other firms involved in the audit. We believe that this is an important innovation, and it is one which we will seek to promote internationally. It is of especial importance in the context of accounting scandals where subsidiary auditors apparently resigned over concerns about some elements of the audit, something which only came to light for investors after the wider accounting issue was revealed. Having disclosure of the auditors of subsidiaries (and by implication, disclosure of when these auditors change) might prove a potential window on such emerging issues.

We answer the PCAOB's specific questions below.

Yours faithfully

Paul Lee
Director

Disclosure of the Engagement Partner

A. The Proposed Audit Report Disclosure

1. Would disclosure of the engagement partner's name in the audit report enhance investor protection? If so, how? If not, why not?

We believe that this proposed disclosure would be a significant positive step. It would enhance transparency and accountability of the key individual involved in the audit, leading over time to more attentive audit behaviours and higher quality audits as a result. We believe that it would therefore enhance investor protection.

2. Would disclosing the name of the engagement partner in the audit report increase the engagement partner's sense of accountability? If not, would requiring the signature by the engagement partner increase the sense of accountability?

As noted above, we believe that there would be an enhanced degree of accountability from a disclosure of the engagement partner's name. We are of the view that requiring a signature would increase that degree of accountability still further, by making the individual partner reflect directly at the end of the audit about physically agreeing to the publication of the accounts.

3. Does the proposed approach reflect the appropriate balance between the engagement partner's role in the audit and the firm's responsibility for the audit? Are there other approaches that the Board should consider?

We would favour requiring the audit partner to sign the accounts. As indicated about, we believe that requiring a signature would drive a higher degree of accountability than just requiring the individual to be named. We do not believe that either route would in any way undermine the clear responsibility of the firm as a whole for the audit, and so do not believe that this need be a concern to the PCAOB in this respect.

4. Would the proposed disclosure clearly describe the engagement partner's responsibilities regarding the most recent reporting period's audit? If not, how could it be improved?
5. Would the proposed disclosure clearly describe the engagement partner's responsibilities when the audit report is dual-dated? If not, how could it be improved?

We believe that the proposed disclosures adequately and clearly describe the responsibilities, and address the concerns highlighted in the discussion. We have no suggested improvements.

6. Would the proposed amendments to the auditing standards create particular security risks that warrant treating auditors differently from others involved in the financial reporting process?

We do not believe that there are specific circumstances in relation to the auditors which warrant treating them differently from others involved in the process. However, we are conscious of the particular circumstances which led to the exception allowing non-disclosure in the UK and EU, and were supportive of this exception being available in such rare and extreme circumstances.

7. Would the proposed amendments to the auditing standards lead to an increase in private liability of the engagement partner?
8. What are the implications of the proposed disclosure rule for private liability under Section 10(b)?
10. Would the disclosure of the engagement partner's identity have any other liability consequences (such as under state or foreign laws) that the Board should consider?
11. Would a different formulation of the disclosure of the engagement partner ameliorate any effect on liability?

We are inevitably not fully informed as to the details of US law and litigation practices – and it is for this reason that we do not attempt a response to question 9, which seems to depend on a

detailed reading of the legislation on which we believe we can add little value. On the broader questions and the policy approach, we are clearly of the view that naming the engagement partner, or requiring his or her signature to the audit report, should not affect the personal liability situation. The individual responsible for the audit report should be liable for fraudulent statements or omissions from it, whether or not his or her name or signature is appended to it. In our experience, litigation against the audit firm usually sees the names of the individual senior auditors attached as parties to the litigation. We believe that a naming or signing requirement would not alter this, nor increase the likelihood of action against individuals.

B. The Proposed Amendment to Form 2

12. If the Board adopts the proposed requirement that audit reports disclose the name of the engagement partner, should the Board also require firms to identify the engagement partner with respect to each engagement that the firms are otherwise required to disclose in Form 2?
13. If the Board does not adopt the proposed requirement that audit reports disclose the name of the engagement partner, should the Board nonetheless require firms to identify the engagement partner with respect to each engagement that the firms are otherwise required to disclose in Form 2?

We believe that this disclosure requirement would be useful whether or not the proposal to require the disclosure of the engagement partner in audit reports is taken forward, and so we would support the proposed change to Form 2 whatever the broader conclusion of the PCAOB is.

14. Disclosure in the audit report and on Form 2 would provide notice of a change in engagement partner only after the most recent period's audit is completed. Would more timely information about auditor changes be more useful? Should the Board require the firm to file a special report on Form 3 whenever there is a change in engagement partners?
15. A change in engagement partner prior to the end of the rotation period could be information that investors may want to consider before the most recent period's audit is completed. Should the Board require the firm to file a special report on Form 3 when it replaces an engagement partner for reasons other than mandatory rotation to provide an explanation of the reasons for the change?

One of the challenges with requiring reporting is to identify those disclosures which should be of concern from those which occur merely as a matter of course. We are concerned that a requirement to file a special report whenever the engagement partner changes risks falling on the wrong side of this balance, and generating a burden of irrelevant disclosures. We believe rather that the proposal to require a special report when an engagement partner is changed for reasons other than mandatory rotation strikes a happier balance, of potentially flagging an issue which may need to be of concern while avoiding needless reporting. While the level of filing will still be high, at least the burden under this proposal would be reduced.

Disclosure of Other Participants in the Audit and Referred-to Accounting Firms
A. Disclosure When Assuming Responsibility or Supervising

16. Is it sufficiently clear who the disclosure would apply to? If not, how could this be made clear?

We believe that the proposals are sufficiently clear.

17. Is it appropriate not to require disclosure of the individual who performed the EQR? If not, should disclosure of the engagement quality reviewer be required when the EQR is performed by an individual outside the accounting firm issuing the audit report or should the disclosure be required in all cases?

We believe that it is essential that the identity of the individual performing the EQR should remain private, and so firmly agree that it is appropriate for this individual not to be disclosed. To do otherwise might risk the independence and effectiveness of the review process.

18. Is it appropriate not to require disclosure of the person that performed the Appendix K review?

For similar reasons, we agree that it is appropriate not to require such disclosure.

19. Is it appropriate not to require disclosure of persons with specialized skill or knowledge in a particular field other than accounting and auditing not employed by the auditor or persons employed or engaged by the company who provided direct assistance to the auditor?

We agree with the proposal not to require such disclosure.

20. Would disclosure of off-shoring arrangements (as defined in the release) or any other types of arrangements to perform audit procedures provide useful information to investors and other users of the audit report? If yes, what information about such arrangements should be disclosed?

We do not believe that there is useful information for investors from any disclosure of off-shoring arrangements as such. We have become concerned about targets which certain audit firms have set for off-shoring, which we do not believe is appropriate in audits which are seeking audit quality as their aim rather than just cost-effectiveness. We would expect audit committees and audit regulatory authorities to ensure that there is no diminution in quality arising from any such off-shoring activities, and would welcome disclosure of the process by which these parties carry out this responsibility – in the case of the audit committee, in the annual proxy statement – but we do not believe that disclosure in the way that the PCAOB is currently considering is required in this respect.

2. Details of the Disclosure Requirements

21. Would disclosure in the audit report of other participants in the audit provide useful information to investors and other users of the audit report? Why or why not?

We believe that this would provide investors with highly useful information, by giving an insight into the scope and process of the audit overall, and the relationships between the different audit firms cooperating to fulfil the audit. Given that some recent accounting scandals have seen subsidiary auditors apparently resign in relation to issues which only subsequently came to light, having disclosure of the auditors of subsidiaries (and by implication, disclosure of when these auditors change) would be a potential window on emerging issues.

22. Are the proposed requirements sufficiently clear and appropriate with respect to identifying other participants in the audit? If not, how should the proposed requirements be revised?
23. Are the proposed requirements sufficiently clear as to when the name of a public accounting firm or a person would be required to be named in the audit report? Is it appropriate that the name of the firm or person that is disclosed is based on whom the auditor has the contractual relationship?

We believe the proposals are sufficiently clear and appropriate.

24. Would disclosure in the audit report of other participants in the audit have an impact on the ability of independent public accounting firms to compete in the marketplace? If so, how would the proposed requirement impact a firm's ability to compete in the marketplace?

We believe that this proposal could have two helpful effects in terms of enhancing competition, both in effect removing some of the mystique which surrounds the Big 4 firms. First, by revealing the level of large-scale and high quality audit work already carried out by firms other than the Big 4, it would reduce the perception that only Big 4 firms are capable of carrying forward sizeable audits. And second, the disclosure of a list of different affiliated firms which are part of the Big 4 networks would emphasise that these entities are not single firms but networks with different

levels of quality and effectiveness. Again, this would make clear the degree of management required of multiple firm contributions to an audit even where that audit is carried out solely within a Big 4 network, and would thereby reduce the impression that only the Big 4 networks are capable of carrying forward large audits. By reducing the mystique around the Big 4 this proposal should over time lead to a greater willingness to use rival firms and so to enhanced competition.

25. Are there any challenges in implementing a requirement regarding the disclosure of other participants in the audit? If so, what are the challenges and how can the Board address them in the requirements?

The one substantive challenge that we would identify is the need to include some materiality requirement, such that a firm responsible for carrying out less than say 1% of the audit work (probably by hours, not by fees to avoid differential pay levels in different jurisdictions affecting the materiality calculation) would not need to be disclosed. This is discussed further below.

3. Disclosure of Percentage of the Total Hours in the Most Recent Period's Audit, Excluding EQR and Appendix K review

26. Is the percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review, a reasonable measure of the extent of other participants' participation in the audit? If not, what other alternatives would provide meaningful information about the extent of participation in the audit of other participants?
27. What challenges, if any, would requiring the percentage of audit hours as the measure of the other participants' participation present?

As indicated above, we believe that the percentage of the total hours in the audit is the best measure of a firm's contribution to the audit, as the only measure which is roughly comparable across borders. We do not believe that it would present major challenges; as the PCAOB indicates, this is information which is gathered routinely.

28. Should the Board require discussion of the nature of the work performed by other participants in the audit in addition to the extent of participation as part of the disclosure? If so, what should be the scope of such additional disclosures?

We would favour not setting any such requirements at the moment, and allowing firms to develop practice as they feel appropriate to aid user understanding of the information that they disclose.

29. Would the proposed disclosure of the percentage of hours attributable to the work performed subsequent to the original report date in situations in which an audit report is dual-dated be useful to users of the audit report?

We support the proposals in this regard.

30. Is the example disclosure in the proposed amendments helpful? Would additional examples be helpful? If so, what kind?

We believe that the example is helpful and that no other examples are needed.

4. Thresholds

31. Should disclosure of the names of all other participants in the audit be required, or should the Board only require disclosing the names of those whose participation is 3% or greater? Would another threshold be more appropriate?

We agree that a materiality threshold is required. As we have indicated in our response to Question 25, we believe that a threshold of 1% would be more appropriate, providing fuller information but still not overburdening the reports with excessive information. A threshold of 3% could enable much of the work in an audit not to be included in the relevant disclosures.

32. Is the proposed manner in which other participants in the audit whose individual extent of participation is less than 3% of total hours would be aggregated appropriate?

We believe that the proposed approach to those participants which are aggregated is appropriate, with the caveat that we believe the threshold should be 1% rather than 3%.

B. Disclosure When Dividing Responsibility

33. Are the requirements to disclose the name and country of headquarters' office location of the referred-to firm sufficiently clear and appropriate?

We believe that the proposals are sufficiently clear and appropriate.

34. Are there any challenges associated with removing the requirement to obtain express permission of the referred-to firm for disclosing its name in the audit report? If so, what are the challenges and how could they be overcome?

We are not aware of substantive challenges associated with this proposal.

35. In situations in which the audit report discloses both the referred-to firm and other participants in the audit, would using different disclosure metrics (e.g., revenue for the referred-to firm and percentage of the total hours in the most recent period's audit for the other firms and persons) create confusion? If so, what should the disclosure requirements be in such situations?

We believe that disclosures in different forms would not create significant confusion, and we have confidence that investors would be able to navigate the proposed information effectively, even if there is more than one disclosure metric.