

Hermes's Response to the Auditing Practices Board Exposure Draft on the Auditor's Report on Financial Statements

Introduction

Hermes is one of the largest pension fund managers in the City of London and is wholly owned by the BT Pension Scheme. We also respond to consultations such as this one on behalf of many other clients, including Ireland's National Pension Reserve Fund, Pensioenfonds PNO Media of the Netherlands, Canada's Public Sector Pension Investment Board, the UK's BBC Pension Fund and the Lothian Pension Fund (only those clients which have expressly given their support to this response are listed here). We have around £60 billion assets under advice as at 31st July 2008.

Hermes takes a close interest in matters of company law and regulation because they set the context for the exercise of our clients' rights as part-owners of the companies in which they invest. We seek to safeguard our clients' current rights and also to enhance the transparency and accountability of companies and their directors to their long-term owners.

By enhancing accountability, we hope to improve efficiency by addressing what economists call the agency problem. It is our fundamental belief that companies with concerned and involved shareholders are more likely to achieve superior long-term returns than those without. By helping make company directors accountable to company owners for the decisions they make and the actions that they take, we believe that over time we will encourage better decision-making and greater value-creation. We believe that this will benefit our clients, which need long-term real growth to meet their obligations to pension beneficiaries, and it will also make companies and economies as a whole more efficient.

In pursuit of these aims Hermes supports a flexible regime which will:

- encourage company accountability;
- encourage responsible ownership by shareholders and fiduciaries;
- ensure independence of those who audit and monitor company performance; and
- ensure the measures used in reporting performance are relevant for owners.

Summary

We believe that the example concise report provides a substantial improvement on the current format of audit reports, both by eliminating disclosures which are unnecessary and to increase the useful disclosures.

We also very much welcome the APB's intention to use its influence internationally, including within the IAASB and the EU, to assist the development of auditors' reports. We believe that this is of great importance to companies and investors globally.

Our major disappointment with the example concise report is that it does not refer to emphases of matter. We continue to believe that reporting that there are no emphases of matter within the audit report is a useful disclosure to all relevant audit reports. We believe that it will both add perceived value to the audit by making an explicit statement which will be welcomed by both boards and investors.

Even more importantly, we believe that where there is an emphasis of matter, the auditor's report should contain a reference to the emphasis of matter and that statement should contain a cross reference to the notes to the accounts that discusses the matter. This will enable better navigation through annual reports to the disclosures that really matter.

We believe that the concise auditor's report should also include a statement relating to the auditor's responsibilities in relation to other information. For the same reason as described above we believe that inclusion of such a statement would improve the quality of reporting – and therefore add value to shareholders.

Whilst the exposure draft does not mandate changes to the audit report, we believe that the example concise report could contain these suggestions which would further improve its content. By adding these changes to the example concise report the APB would encourage such disclosure.

Question 1 - The APB invites comments on:

- (a) the proposed ISA (UK and Ireland) 700 (Revised) on pages 15 to 31;**
- (b) the proposed "Statement on the scope of an audit and the auditor's responsibilities in respect of a publicly traded company incorporated in the United Kingdom, on pages 33 to 39, which it is intended would be posted to the APB's web site; and**
- (c) permitting cross referencing to information held on the APB's web site.**

- (a) We have no additional comments on the exposure draft other than those made in the summary above.
- (b) We have no comments on the scope statement.
- (c) We welcome the ability to cross reference information held on the APB's web site.

Question 2 – Do commentators support APB's proposal of describing the auditor's responsibilities and the work an auditor typically performs by either:

- (a) cross referring to standard paragraphs maintained by the APB on its web site; or**
- (b) including a description in the auditor's report itself?**

We are satisfied that cross referring to the APB's website enables readers of annual reports to access the relevant standards with sufficient ease whilst improving the clarity of the auditor's report and therefore support option (a).

Question 3 – On pages 41 and 42 the APB sets out a schedule of the range of example statements that it presently intends to post to its web site. Are there any other examples that you believe it is imperative that the APB should post to its web site?

As an investor in publicly traded companies we have no comment to make on entities outside of the private sector. Within the private sector, we are solely interested in publicly quoted companies and some private companies. We therefore find it difficult to comment.

Question 4 – In addition to the need for the APB to develop and maintain current examples relating to a number of different types of entity what other practical difficulties do you think might arise from the APB’s proposed approach?

We have no comment to make on this approach – we do not perceive that there are any serious practical difficulties.

Question 5 – Is the wording of paragraph 18 in the Exposure Draft of the proposed ISA (UK and Ireland) 700 (revised) sufficiently generic to apply to all entities that are required to be audited? (In this regard more detail concerning the legal framework applicable to a particular type of entity will be provided in the applicable example “Statement of the scope of an audit and the auditor’s responsibilities”). If not please describe any concerns?

We believe that the paragraph is satisfactory.

Question 6 – Do you agree that it is logical for the reference to the “true and fair view” to be the final element in the auditor’s opinion on the financial statements? If you disagree what would be your preference for ordering the elements.

The “true and fair view” is the logical conclusion of the work that the auditor conducts to state its opinion. We therefore believe that it is appropriate to come at the end of the opinion.

Question 7 – Please provide any comments that you may have on the steps set out concerning the APB’s proposed course of action and the proposed timing of those steps (see pages 5 and 6)? Are there any other actions that you believe the APB should be taking?

We believe that the steps seem appropriate. As previously discussed, we welcome the APB’s intention to improve auditors’ reports internationally which will be of benefit to companies and their owners.