

July 27th, 2012

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

**RE: PCAOB Rulemaking Docket Matter No. 37
CONCEPT RELEASE ON AUDITOR INDEPENDENCE AND AUDIT FIRM ROTATION**

Dear Board Members:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's concept release regarding ways in which auditor independence, objectivity and professional scepticism could be enhanced.

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 \$140 billion.

While we value the ability granted to shareholders under the current process to provide regular input into auditor appointment through an annual vote, we believe that the reappointment process should be more transparent and a discussion of it should be included in companies' annual reports, enabling shareholders to have a stronger basis for their voting decisions. We also believe that currently auditors stay in place for too long, and would welcome markedly greater competition on the basis of audit quality and believe that this competition can only occur if there is a more active market for audit services. We consider that this more active market would be facilitated by a regular and transparent tender process. We do not believe that mandatory rotation will result in an effective solution to independence and other audit concerns.

We regularly find that auditors consider the company which they are auditing the client and refer to it in this way. From a practical perspective, the audited entity does appear to be the auditor's client: it hires the auditor and has the closest relationship with the audit team. However, we consider that the role of the auditor is not to work for the audited entity at all; its role is to carry out a function, mandated by law, for the shareholders. The shareholders should be respected and regarded as the client; yet the auditor has no contact with the shareholders and provides only the most perfunctory report on its work to those for whom the work is done. In the context of this general misapprehension as to who is the client for whom the auditor works, it is perhaps not surprising that the market for audit services does not function effectively and with appropriate competition. Most immediately in the context of this consultation,



the lack of an active market for quality audit services often leads to cosy relationships often compromising independence.

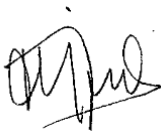
In general, the relationship of the auditor with the audited entity is mediated by the audit committee. This role is not universally well performed, and even where it is most audit committees will leave a good deal of the decision-making in the relationship to the finance staff. Given the leading role of the finance staff at the audited entity in the relationship – precisely those in relation to whom the auditor is supposed to be providing assurance – it is perhaps unsurprising that any competition that does occur will only rarely be with regard to audit quality. Our fear at the moment is that auditor reappointment is simply a rubber stamp on the incumbent auditor continuing for a further year. In this context it should be no surprise that investors are disengaged and we believe that to encourage engagement there will need to be communication of an active decision-making process.

We need to challenge audit committees to perform their role more fully and clearly on behalf of shareholders, and empower them to do so. A regime of mandatory rotation removes audit committee discretion, disempowering them; a system requiring regular auditor retendering would rather empower the audit committee and set higher expectations of them. We would welcome this, and the disclosure that would be necessary alongside it, as important drivers of audit quality.

In conclusion, we view regular tendering for the audit (at least perhaps every 10 years) as a means to promote enhanced accountability to shareholders. We do not believe that mandatory rotation would improve disclosures around audit committees' deliberations at the time of external auditor appointment/reappointment and how they satisfy themselves of the external auditors' independence. Instead, we consider that mandatory rotation would risk further promotion of process-based boilerplate rather than value-driven behavioural change to the benefit of the audited entities' shareholders.

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,

A handwritten signature in black ink, appearing to read 'M. Isaza', with a horizontal line underneath.

Manuel Isaza
Senior Associate