

March 14th 2013

IAASB exposure draft: The Auditor's Responsibilities Relating to Other Information

We welcome the opportunity to respond to the IAASB's exposure draft regarding the 'Other Information' responsibilities of auditors. We are generally supportive of the proposed amendments, believing that requiring the auditor to consider the other information in the light of its understanding of the entity and its environment is the right approach. We also strongly support the principles-based approach to the outline of the work effort, and indeed would extend this by abandoning Appendix A which we do not believe adds value.

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 around the world, including PNO Media (Netherlands), VicSuper of Australia, Canada's Public Sector Pension Board and the UK's Lothian Pension Fund, British Coal Staff Superannuation Scheme and Mineworkers Pension Scheme (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 a total of \$160 billion (as at 31 December 2012).

We are pleased to answer the IAASB's specific questions below.

Scope of the proposed ISA

1. Do respondents agree that there is a need to strengthen the auditor's responsibilities with respect to other information? In particular do respondents believe that extending the auditor's responsibilities with respect to the other information reflects costs and benefits appropriately and is in the public interest?

We strongly welcome the proposed approach. In particular, we believe that the updated requirement of considering reporting in the light of all aspects of the auditor's understanding of the audited entity and its environment is appropriate and a welcome step forwards. We believe that this is no more than investors already expect so fulfilling those expectations is helpful; the costs will be borne ultimately by shareholders who will indeed see significant benefit in the additional confidence which this extended approach brings.



2. Do respondents agree that broadening the scope of the proposed ISA to include documents that accompany the audited financial statements and the auditor's report thereon is appropriate?

We agree that extending the scope to cover documents accompanying the financial statements is necessary to take account of the range of practice in corporate reporting globally, something which is only likely to increase as new technologies are increasingly applied to corporate reporting.

We are concerned, however, by the proposed restriction that documents will only be deemed to be accompanying the audited financial statements if their primary purpose is to provide commentary enhancing the users' understanding of the audited financial statements or the financial reporting process. We believe that this is an unhelpful narrowing of scope. While auditors generally may have only limited insights into documents which do not have this purpose, it is important to users that the ISA gives them scope to read and identify any relevant material inconsistencies in all accompanying materials. Removing this primary purpose test would markedly simplify the standard, remove a potential discrepancy that some elements of a single annual report document would be subject to the standard but would not be so if published in separate documents, and provide clarity for auditors as well as remove scope for false expectations among users.

3. Do respondents find the concept of initial release clear and understandable? In particular, is it clear that initial release may be different from the date the financial statements are issued as defined in ISA 560?

This is not a straightforward area, but we support the concept of the initial release as the clearest available route to achieving the aims of the redrafted ISA.

4. Do respondents agree that the limited circumstances in which a securities offering document would be in scope (e.g., initial release of the audited financial statements in an initial public offering) are appropriate or should securities offering documents simply be scoped out? If other information in a securities offering document is scoped into the requirements of the proposed ISA in these circumstances, would this be duplicating or conflicting with procedures the auditor may otherwise be required to perform pursuant to national requirements?

We agree that the proposed approach is appropriate.

Objectives

5. Do respondents consider that the objectives of the proposed ISA are appropriate and clear? In particular:

(a) Do respondents believe that the phrase "in light of the auditor's understanding of the entity and its environment acquired during the audit" is understandable for the auditor? In particular, do the requirements and guidance in the proposed ISA help the auditor to understand what it means to read and consider in light of the auditor's understanding of the entity and its environment acquired during the course of the audit?

We believe that the proposed formulation for the objective is appropriate and understandable. We particularly welcome the references to scepticism in the application material, and the references to the requirements for a broad understanding of the entity and its environment embedded within other ISAs.

5 (b) Do respondents believe it is clear that the auditor’s responsibilities include reading and considering the other information for consistency with the audited financial statements?

Yes, we believe that this is clear.

Definition of an inconsistency in the other information

6. Do respondents agree that the definitions of terms of “inconsistency” including the concept of omissions and “a material inconsistency in the other information” are appropriate?

Yes, we agree that these definitions are appropriate.

7. Do respondents believe that users of auditors’ reports will understand that an inconsistency relates to an inaccuracy in the other information as described in (a) and (b) of the definition, based on reading and considering the other information in light of the auditor’s understanding of the entity and its environment acquired during the course of the audit?

Yes, we believe that this is clear and would be understood. We would note that in practice we would not expect any such inconsistencies to survive this process as the intention must be that the other information would be corrected so that the reporting actually seen by investors was consistent and not misleading.

Nature and extent of work effort

8. Do respondents agree with the approach taken in the proposed ISA regarding the nature and extent of the auditor’s work with respect to the other information? In particular: (a) Do respondents believe the principles-based approach for determining the extent of work the auditor is expected to undertake when reading and considering the other information is appropriate?

We are firmly of the view that a principles-based approach is the right one. We agree with the IAASB’s analysis that a prescriptive approach would not reflect the diversity of other information caught within this ISA’s requirements and risks undermining the required judgement by the auditor.

8 (b) Do respondents believe the categories of other information in paragraph A37 and the guidance for the nature and extent of the work effort for each category are appropriate?

We welcome the four categories that have been identified, and agree the assessment of which of them requires the greatest exercise of professional judgement. We believe that the work effort for each of them is appropriately articulated.

8 (c) Do respondents agree that the work effort is at the expected level and does not extend the scope of the audit beyond that necessary for the auditor to express an opinion on the financial statements?

We believe that the work effort is set appropriately and should not extend the auditor's detailed workload. We are, however, cautious about ISAs in effect imposing obligations on management, and note the instances where the auditor is expected to seek a reconciliation from management of how relevant numbers have been produced. While we accept that these are appropriate and appropriately articulated we would be extremely cautious about any further extension of these expectations. Perhaps it may be worth stating clearly that the auditor should not expect management to provide a reconciliation for all the disclosures in the other information; there may be a risk otherwise that in some cases this process would become an unhelpful paper trail, creating significant burdens for both management and the auditor.

9. Do respondents believe that the examples of qualitative and quantitative information included in the Appendix in the proposed ISA are helpful?

No, we believe that this appendix should be dropped. We cannot see the value added by a list that is stated to be incomplete which draws a distinction that should be relatively obvious. Auditors in their professional judgement should be more than capable of identifying differences between qualitative and quantitative information and acting accordingly.

Responding when the auditor identifies that the audited financial statements may be materially misstated

10. Do respondents believe it is clear in the proposed requirements what the auditor's response should be if the auditor discovers that the auditor's prior understanding of the entity and its environment acquired during the audit was incorrect or incomplete?

We welcome the discussion of these issues, but we would suggest that the threshold for making a disclaimer of opinion may be being set too high in A52: it would seem to us that this should be the route chosen by the auditor where a material inconsistency is uncorrected not only "in rare circumstances" but more readily than this. If management and those charged with governance decline to correct an inconsistency that is material, this suggests a significant problem exists. We would therefore suggest that A52 is rewritten to begin "The auditor will need to consider whether a disclaimer of opinion is appropriate when the refusal..."

Reporting

11. With respect to reporting:

(a) Do respondents believe that the terminology (in particular, “read and consider,” “in light of our understanding of the entity and its environment acquired during our audit,” and “material inconsistencies”) used in the statement to be included in the auditor’s report under the proposed ISA is clear and understandable for users of the auditor’s report?

We believe that this language is clear and understandable, and that it strikes the right balance of appropriate workload for the auditor, and cost and benefit for users.

11 (b) Do respondents believe it is clear that the conclusion that states “no audit opinion or review conclusion” properly conveys that there is no assurance being expressed with respect to the other information?

We believe that the wording makes it helpfully clear that there is no audit or assurance conclusion reached by this work.

12. Do respondents believe that the level of assurance being provided with respect to other information is appropriate? If not, what type of engagement would provide such assurance?

We are firmly of the view that the current proposals strike the right balance of some oversight of consistency while not introducing significant additional assurance procedures, workloads and costs. We believe that the cost/benefit analysis of a fuller assurance process would make such an approach hard to justify.