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Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
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MFS Investment Management (MFS) and the MFS Funds Board Audit Committee appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or "the Board") Proposed Auditing Standards on *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* (the "Proposed Standards"). Our comments relate to the Proposed Standards' application to Securities & Exchange Commission (SEC) registered investment companies as issuers of financial statements.

#### Background on MFS and the Industry<sup>1</sup>

MFS is a global asset management firm providing investment management services to clients including 140 registered investment products which in total represent approximately \$170 billion in assets. MFS and its predecessor organizations have been registered as an investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act") since 1969. MFS is a majority owned subsidiary of Sun Life Canada (U.S.) Financial Services Holdings, Inc., which in turn is an indirect majority owned subsidiary of Sun Life Financial, Inc. (a diversified financial services organization). MFS has been a subsidiary of Sun Life since 1982. As of June 30, 2013, MFS managed approximately \$353 billion in assets.

From an industry perspective, U.S. investment companies are responsible for the investment of over \$13.6 trillion; mutual funds, which are owned by an estimated 92 million shareholders, represent the lion's share of those assets. There are roughly 7,600 mutual funds, 600 closed-end funds and 1,200 exchange-traded funds, each of which is subject to an annual audit requirement and oversight by the PCAOB and SEC. As is the case with the registered funds managed by MFS, investment companies typically have no employees of their own, and the operations are carried out by various affiliated entities (e.g., the investment advisor, the administrator and the distributor) and unaffiliated service providers (e.g., the custodian and the transfer agent) under the oversight of the manager and a Board of Trustees.

#### Overview of the Proposed Standards

The Proposed Standards are a follow-up to the PCAOB's 2011 Concept Release No. 2011-003 entitled *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements* (the "Concept Release") and the feedback received from related public roundtables. Based on the investor feedback received from those roundtables and on the Concept Release, the PCAOB's recommendations in the Proposed Standards seek to increase the relevance, usefulness and informational value of the auditor's report by (1) requiring the auditor to include more information in the form of "critical audit matters" on the most difficult, subjective or complex areas of the audit and (2) clarifying the auditor's responsibility with respect to fraud; independence; the notes to the financial statements; and other information outside the financial statements.

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<sup>1</sup> Industry statistics as of December 31, 2012 per the *2013 Investment Company Institute Industry Fact Book*.

As discussed below, MFS Investment Management (MFS) and the MFS Funds Board Audit Committee understand and support the PCAOB's intent to increase the value of the auditor's report, and support some - but not all - of the changes to the auditor's report outlined in the Proposed Standards. We are in favor of the PCAOB's proposed clarifications to the auditor's report with respect to independence, fraud and the notes to the financial statements. We, however, express strong reservations with regard to the inclusion of Critical Audit Matters and tenure in the auditor's report and we also believe that further clarification is needed on the scope and relative costs-benefits of expanding the auditor's responsibility for other information outside of the financial statements.

#### Independence, Fraud and the Financial Statement Notes

Under the Proposed Standards, the auditor's report would be modified to include a statement that the auditor is registered with the PCAOB and is required to be independent. The language in the auditor's report also would be enhanced to better articulate the auditor's responsibility for fraud and the notes to the financial statements. We believe that these enhancements to the auditor's report will clarify existing auditor requirements and responsibilities in these areas for investors and, as such, we fully support the PCAOB's proposed changes to the auditor's report related to clarification of auditor independence as well as the auditor's responsibility for fraud and the notes to the financial statements.

#### Critical Audit Matters (CAM)

CAM as defined by the Proposed Standards would be matters that were deemed by the auditor to be the most subjective, involved complex auditor judgments or were the most difficult areas on which to obtain audit evidence or form an opinion. Under the Proposed Standards, the auditor would be required to communicate in a separate section of the auditor's report any CAM that it identified during the audit of the current period's financial statements.

We do not support the PCAOB's proposal with respect to the inclusion of CAM in the auditor's report as we believe that CAM compromise the current "pass/fail" model of an audit and introduce subjectivity into what should be an objective process. Based on the subjective decisions made by different audit teams or firms, the CAM identified in the auditor's report may differ among very similar entities with the unintended consequence of negatively impacting the comparability of the entities. CAM may also impact the appeal of an entity to an investor relative to its peers based solely on how the auditor's report is drafted. Investors will be directed to focus on particular accounts within the financial statements which have been identified as CAM, instead of on the financial statements taken as a whole. Also, inclusion of CAM may compel the auditor to report information that is not otherwise publicly available and is not required to be disclosed by management, which we do not feel is appropriate. In these ways, the inclusion of CAM alters the defined role of the financial statement auditor in a manner that is not consistent with the audit function.

#### *Red Flag*

CAM may be incorrectly interpreted by investors as a "red flag", a sign that there is something wrong with the audited entity. Indeed, even the use of the word "critical" to describe the audit matters has negative connotations. Requiring the auditor to call out as CAM each area in which a significant judgment is made or on which audit evidence is most difficult to obtain, may cause investors to incorrectly conclude that there are problems with the audited entity, when in reality judgments, estimates and assumptions are inherent in the financial statement process, a fact that is clearly disclosed in the financial statements in accordance with Financial Accounting Standards Board Accounting Standard Codification ("ASC") 275-10-50-4.

In the investment company industry, the use of judgments, estimates and assumptions is generally most prevalent with respect to investment valuation, especially with securities that are classified as Level 3 under ASC 820's fair value hierarchy. As such, investment valuation would presumably be called out by the fund auditor as a CAM. Although management makes significant judgments, estimates and assumptions in the valuation of Level 3 securities and the auditor may have to engage the help of a valuation specialist to evaluate those valuations, the auditor is able to obtain sufficient audit evidence to

support those valuations in order to reach an unqualified opinion on the financial statements as a whole. Moreover, the financial statement disclosures with respect to investment valuation, especially with respect to the assumptions (i.e., methodologies and valuation inputs) used in valuing Level 3 securities, are very robust. In such circumstances, by calling out investment valuation as a CAM, the auditor is raising a "red flag" to investors where no problem exists and where significant disclosure is already available for the investor within the notes to the financial statements.

#### *Subjective Yardstick*

The PCAOB has expressed a view that they would not expect to see an auditor's report without a CAM. This may give the auditor an incentive to identify and disclose several items as CAM in order to demonstrate the comprehensive nature of its audit and its compliance with the PCAOB's directive. Given that CAM may be perceived as a "red flag" by investors, the requirement for auditors to disclose CAM may have further unintended negative consequences in that investors may use CAM as a "yardstick" with which to determine relative ratings on the investment worthiness of audited entities and even the quality of the related audits. The determination of CAM by an auditor is subjective and, as such, the number of CAM cited or the reason for citing a CAM in the auditor's report may differ among very similar entities based on subjective decisions made by the different audit teams or firms involved.

This issue of auditor subjectivity is particularly problematic for the investment company industry where, for most of the larger fund complexes, a portion of the funds in the complex are audited by one audit firm while the remainder are audited by a second firm (i.e., a "two audit provider model"). Under the two audit provider model, two substantially similar funds within the same fund complex could be subject to audit by two different audit firms - each with their own unique thoughts on what constitutes a CAM and the reasons why. Although the strategy, holdings and investment performance of those two funds may be almost identical, we believe that the fund that has more CAM (or more reasons for CAM) cited in its auditor's report may unjustly be at a relative disadvantage in the eyes of investors. This concern is magnified when looked at in the context of the auditor's reports for the industry's full universe of competing funds each of which is audited by different audit teams and firms.

#### *Auditor in the Role of Management*

In communicating their reasons for concluding something is a CAM, the auditor may be forced to include in the auditor's report information about the audited entity's operations or financial results that is not otherwise publicly available (e.g., control deficiencies or proposed auditor adjustments) and that is not required to be disclosed by management based on either management's judgment or the reporting requirements of the entity's regulators. Under such circumstances, the requirement to report CAM places the auditor in a position outside of the role of the auditor as defined by AU Section 110 *Responsibilities and Functions of the Independent Auditor* which states that "the financial statements are management's responsibility. The audited entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's responsibility for the financial statements he or she has audited is confined to the expression of his or her opinion on the fairness with which they present, in all material respects, financial position, results of operations and its cash flows in conformity with generally accepted accounting principles." The concept of CAM, which requires auditors to disclose information on the financial statements beyond what is required to be disclosed by management, is counter to the auditor's defined role and muddles the roles of management and the auditor. If the information that would be included in a CAM is considered truly important to an investor's investment decision making process, then management should be the party responsible for disclosing that information.

#### *Piecemeal Opinion*

The inclusion of CAM in the audit opinion will not only dramatically change the format and the length of the auditor's report, but also result in piecemeal CAM opinions which compromises the pass/fail model of the audit. Under AU Section 508 *Reports on Audited Financial Statements*, the auditor has a responsibility to express an opinion on the financial statements taken as a whole, or to state that an opinion cannot be expressed. Due to the prominence of presentation of the CAM, the auditor's conclusions on CAM audit areas may overshadow the auditor's opinion on the financial statements taken as a whole.

### *Significant Costs*

Although the level of audit evidence and audit work required to reach a qualified or unqualified opinion should not change, a significant increase in hours would be necessary for the auditor to draft the CAM language in the auditor's report and to document their conclusions in the audit work papers on why or why not something was deemed a CAM. The opinion, which would now include language outside of the audit firm's standard template language, will undoubtedly require additional levels of review by others outside of the audit engagement team including, but not limited to, the management of the audited entity; national consulting partners for the audit firm; and the legal counsel of both parties. The additional hours incurred would have significant associated costs given the senior level of the parties involved in the drafting and review of the opinion. These costs likely will be tacked onto existing audit fees which, in the case of most investment funds, will translate into higher fund expenses borne by investors. It should also be noted that these additional hours most likely would be incurred at the conclusion of the audit when filing deadlines are looming and the stress level is at its highest for all parties involved. While the associated costs would be significant, we do not see an appropriate corresponding benefit derived from CAM. We actually feel that inclusion of CAM weakens the audit report as it is likely to draw investor attention away from the auditor's opinion on the financial statements taken as a whole and re-direct investor focus to a few specific financial statement areas. Further, we would note that there is already significant, required financial statement disclosure on areas that may be identified in CAM.

For the reasons enumerated above, we do not support the inclusion of CAM in the auditor's report. Fundamentally, we believe that the overall goal of requiring auditors to disclose CAM is unclear. If the information that the PCAOB intended to be conveyed in CAM is information about the audited entity, we believe that many of the areas which would be identified as CAM already are subject to significant disclosure requirements in the notes to financial statements. If additional disclosure related to these areas is warranted, we believe that management should be required to provide this disclosure (in the notes to financial statements or elsewhere) rather than requiring the auditor to make the disclosure in its audit opinion. Also, in addition to the very tangible increase in audit cost that will result from the drafting, documentation and review of CAM, we believe that the number of CAM (along with the reasons cited for those CAM) will have a significant indirect cost to the audited entity in that CAM will inevitably become a "yardstick" against which entities are rated by investors. In our industry, where there are any number of comparable fund offerings from which an investor can choose, we believe that the relative attractiveness of a fund to an investor should be based on its comparative financial performance and should not be unjustly disadvantaged by a benchmark that is so subject to variability based on the audit team.

### Auditor Tenure

Under the Proposed Standards, the auditor's report would be modified to include a statement containing the years that the auditor has been serving consecutively as the entity's auditor. The requirement to disclose tenure in the auditor's report implies that tenure plays a role in the auditor rendering its opinion on the financial statements; however, despite extensive research on the subject, no conclusive link has been established between auditor tenure and the quality of the audit in terms of auditor independence, objectivity and professional skepticism. It should also be noted that in the context of an investment company complex in which new funds are often launched each year, the tenure disclosure may be confusing to investors as the auditor tenure dates may differ significantly fund to fund based on each fund's unique inception date. At MFS, for example, we have roughly 140 funds, substantially all of which have a different inception date and, therefore, a different auditor tenure date. We feel that there are other, more appropriate means of disclosing tenure, if information on tenure is indeed important to the investor. In fact, many public companies already disclose auditor tenure as part of their proxy statements.

### Other Information

Under the Proposed Standards, the auditor would be required to state in the auditor's report that they neither audited nor expressed an opinion on the other information<sup>2</sup>, but instead evaluated the information based on their audit work to conclude whether the other information contains a material inconsistency with the financial statements, a material misstatement of fact or both. Based on that evaluation, the auditor also would be required to make a statement whether they have or have not identified a material inconsistency and/or a material misstatement of fact in the other information that has not been appropriately revised by management.

Based on our review of the Proposed Standards, it appears that the scope in terms of the specific elements of other information and the expected level of auditor effort and documentation has not been sufficiently defined. Without further definition, we believe that the elements to be evaluated as well as the level of auditor effort and documentation are subject to interpretation and, therefore, may differ greatly among audit teams. As such, the PCAOB's objective of clarifying the auditor's responsibility for other information would not be met. Additionally, we believe that requiring the auditor to perform procedures over other information for which the auditor has little or no expertise would add significant regulatory and litigation risk for the auditor, while providing little, if any, value to the investor.

In order to ensure that the benefits to investors exceed the costs in terms of additional hours that will be incurred by the auditor and management in evaluating other information, we believe that the scope of this requirement to evaluate other information should be well-defined and limited to other information that is directly related to the financial statement audit. There is little value in requiring the auditor to evaluate other information (e.g., Code of Ethics) in which the auditor has neither training nor expertise as the very real increase in costs related to additional auditor hours incurred would have little, if any, corresponding benefit in terms increased assurance for the investor. Whatever the scope, this requirement will undoubtedly result in additional work by management and the auditor which will translate into increases in costs. Whether borne by management or passed along directly to shareholders, those cost increases will negatively impact the return to shareholders.

The need for a scope clarification is especially important in the context of an investment company complex due to the number and year-round nature of the filings involved. In contrast to a corporate entity where there is generally one filing annually that would constitute other information, we prepare roughly 35 filings annually which include the audited financial statements and the auditor's report for one or more of our 140 funds. That number would be slightly larger for years in which fund mergers or other events occur. Even if the scope of the auditor's evaluation were limited solely to other information that is financial in nature (e.g., portfolio holdings; valuation, derivative and purchase and sales disclosures; fund expenses, expense ratios and returns), the additional work required by the auditor to complete their evaluation would be significant. The auditor's evaluation would be further complicated by the fact that filings deadlines are very tight and that these filings are made at the trust level (i.e., a trust generally includes multiple funds). Under the two audit provider model discussed above, a portion of the funds in a trust may be audited by one audit firm with the remainder audited by a second firm, with the result that not just one but two sets of auditors would be required to evaluate the other information in a trust's filing. With our fund year-ends staggered throughout the year for operational efficiency, our auditors' evaluation of other information would be practically non-stop.

Given the significant level of additional hours that would be involved and the perceived lack of clarity with respect to the scope of the auditor's responsibility for evaluating other information, we suggest that the PCAOB consider gathering more information before proceeding with this requirement. Public roundtables may help to determine the specific elements of other information that are most important to investors. Armed with that investor feedback, the PCAOB would then be able to determine which areas that auditors have the necessary expertise to evaluate. Once the types of other information have been sufficiently narrowed down, then auditor field testing of clients could provide a better understanding of the level of

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<sup>2</sup> Other information in the Proposed Standards refers to information in an entity's annual report filed with the SEC under the Securities Exchange Act of 1934 that also contains the entity's audited financial statements and the related auditor's report.

effort required and the additional costs to be incurred. The overall objective of this fact gathering should be to define a scope for which the perceived benefit to investors exceeds the very real costs associated with the increase in auditor and management efforts.

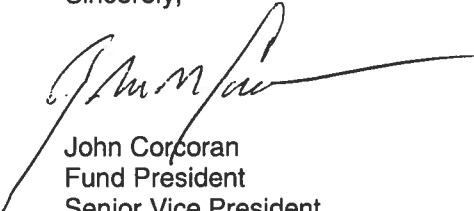
Conclusion

MFS and the MFS Funds Board Audit Committee appreciate the opportunity to provide comments on the PCAOB's proposed changes to the auditor's report. We support the PCAOB's goals, and specifically support the proposed changes to the auditor's report related to clarification of auditor independence as well as the auditor's responsibility for fraud and the notes to the financial statements. We do, however, have significant concerns on certain other items outlined in the Proposed Standards. In response to those concerns, we encourage the PCAOB to:

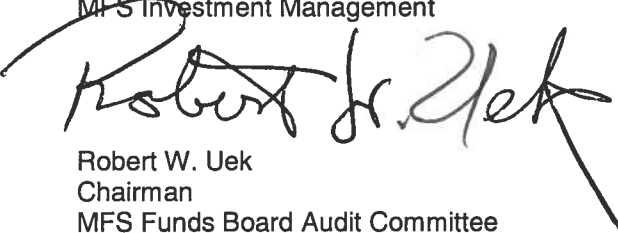
- Reconsider the inclusion of CAM in the auditor's report because CAM would (i) introduce subjectivity into what should be an objective process; (ii) cause an investor to concentrate on piecemeal information and conclusions rather than the financial statements taken as a whole; (iii) considerably change the role of the auditor as defined in AU Section 110; and (iv) significantly increase audit cost with no corresponding benefit, only the potential downside of negatively impacting the comparability and investor appeal of a fund relative to its peers based on different audit teams' unique thoughts on what constitutes a CAM and the reasons why.
- Consider using public documents more appropriate than the auditor's report on financial statements for any required disclosure of audit firm tenure (e.g., proxy statements), as there is no evidence that tenure has a bearing on the auditor's ability to render an opinion.
- Gather information through mechanisms like public roundtables and field testing to understand (i) the types of other information on which investors are most interested in obtaining additional auditor assurance and which types of information that an auditor has the necessary expertise to evaluate as well as (ii) the relative costs-benefits of increasing the auditor's responsibility for each specific type of other information. With this level of detail, the proposed scope of the auditor's responsibility for other information then can be defined in a manner that provides an appropriate benefit in consideration of the additional costs that inevitably would be incurred by management and the auditor.

Should you have any questions about our comments regarding the Proposed Standards, please feel free to call Bob Uek or John Corcoran at 617-954-5637.

Sincerely,



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MFS Investment Management



Robert W. Uek  
Chairman  
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