



August 11, 2016

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

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MFS Investment Management (MFS) and the Audit Committee of the MFS Funds Board appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Proposed Auditing Standard entitled *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards* (the "Proposed Standard"). Our comments relate to the Proposed Standard's application to U.S. Securities & Exchange Commission (SEC) registered investment companies as issuers of financial statements and are consistent with our comments on PCAOB Release No. 2013-005<sup>1</sup> (the "2013 Comment Letter").

#### Background on MFS and the Industry<sup>2</sup>

MFS is a global asset management firm registered under the Investment Advisers Act of 1940, as amended, that provides investment management services to clients. MFS provides investment advisory and administrative services to 135 investment companies (the "MFS Funds") registered under the Investment Company Act of 1940, as amended (the "1940 Act"), and supervised by the MFS Funds Board, which in total represent approximately \$207 billion in assets. 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, 2016, MFS managed approximately \$425 billion in assets.

From an industry perspective, U.S. investment companies are responsible for the investment of over \$18.1 trillion; open-end investment companies ("mutual funds"), which are owned by an estimated 93 million shareholders, represent approximately 90% of those assets. There are roughly 9,500 mutual funds, 600 closed-end funds and 1,600 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 most registered investment companies, the MFS Funds have no employees of their own and their operations are carried out by various affiliated entities (e.g., the investment advisor, the administrator, the transfer agent and the distributor) and unaffiliated service providers (e.g., the custodian and the fund accounting agent) under the oversight of the MFS Funds' Board of Trustees.

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<sup>1</sup> MFS and the Audit Committee of the MFS Funds Board filed a joint comment letter dated December 10, 2013 on the PCAOB Release No. 2013-005, *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*.

<sup>2</sup> Industry statistics as of December 31, 2015 per the 2016 *Investment Company Institute Industry Fact Book*.

### Overview of the Proposed Standard

A follow-up to PCAOB Release No. 2013-005 (the "2013 Proposal"), the Proposed Standard seeks to increase the relevance, usefulness and informational value of the auditor's report by:

- Standardizing the format and required elements of the auditor's report, including the reporting of audit firm tenure;
- Clarifying the auditor's responsibility with respect to fraud, independence, and the notes to the financial statements; and
- Requiring the auditor to include more information in the form of "critical audit matters" (CAM) on areas of the audit that were especially challenging, subjective or complex.

As discussed below, MFS and the MFS Funds Board Audit Committee understand and support the PCAOB's intent to increase the value of the auditor's report. We applaud the PCAOB's decision to exempt registered investment companies<sup>3</sup> (other than business development companies) from the requirement to report CAM and, with the notable exception of audit firm tenure reporting, we strongly support the proposed clarifications and changes to the auditor's report outlined in the Proposed Standard. Although we continue to express strong reservations with regard to the reporting of audit firm tenure in the auditor's report, we are encouraged by the PCAOB's willingness to consider other alternatives, such as disclosing tenure on PCAOB Form AP<sup>4</sup>, if tenure reporting is ultimately required.

### Format of the Auditor's Report

The Proposed Standard establishes a standard format for the auditor's report in an effort to more effectively communicate key messages and enhance comparability between entities. Under that standard format, the opinion paragraph would be the first paragraph of the report and standard headers would be required for each of the report's various sections. The Proposed Standard also would require the use of standard addressees, in that the auditor's report must be addressed to the entity's investors and its board of directors or equivalent body in addition to any additional, optional addressees. We believe that investors would benefit from these changes and we fully support these efforts to standardize the format of the auditor's report.

### Independence, Fraud and the Financial Statement Notes

Under the Proposed Standard, 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 clarifications.

### Critical Audit Matters (CAM)

CAM as defined by the Proposed Standard would be any matter arising from an audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. Under the Proposed Standard, 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.

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<sup>3</sup> Investment companies registered under the 1940 Act.

<sup>4</sup> PCAOB Form AP, *Auditor Reporting of Certain Audit Participants*.

Based on the feedback received on the 2013 Proposal, the Proposed Standard would exempt certain industries, including registered investment companies (other than business development companies) from the requirement to report CAM in their auditor's report. We strongly support the proposed exemption of registered investment companies and, in response to question #37 of the Proposed Standard, we believe that this exemption is entirely appropriate. As discussed in the Proposed Standard and expanded upon below, there are a number of factors unique to registered investment companies in terms of their structure, their purpose, and their regulatory reporting requirements that render the concept of CAM disclosure unnecessary for the industry.

#### *Structure and Purpose*

Pursuant to Section 3(a)(1) of the 1940 Act, an investment company refers, in pertinent part, to any issue that "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities". Given that an investment company's primary business is investing, investment valuation would presumably meet the definition of a CAM in that it is an audit area for which the results are generally communicated to the audit committee and the related amounts are both material to the financial statements and likely to be subject to auditor judgment. Generally a registered investment company's investments represent almost 100% of its net assets, so in most circumstances it is likely that investment valuation would be the only CAM identified in a registered investment company audit. Given that a registered investment company's investment objective - and the types and the relative mix of investments held by the fund - generally would not change significantly from one reporting period to another, it is unlikely that the details of an investment valuation CAM would change much from audit to audit. As such, information conveyed in the valuation CAM would become boilerplate over time with the result that any investment decision-making relevance it might have to investors would be greatly diminished.

Additionally, we believe that by calling out investment valuation as a CAM, the auditor would be signaling to investors that there is a valuation issue with the fund, when in fact no problem exists and where significant disclosure is already available for the investor within the notes to the financial statements. Although an auditor in certain circumstances may need to engage the help of a valuation specialist, an auditor who is rendering an unqualified opinion is able to obtain sufficient audit evidence to support management's investment valuations. Furthermore, over the past decade the Financial Accounting Standards Board (FASB) has been very focused on standard setting around fair valuation, with the result that financial statement disclosures for registered investment companies with respect to investment valuation, especially with regard to the assumptions (i.e., valuation approaches, techniques and inputs) used in valuing Level 3 securities<sup>5</sup>, are very robust<sup>6</sup>. In an industry where such robust disclosures already exist, we believe that the concept of a CAM is uninformative and unnecessary.

#### *Regulatory Reporting Requirements*

Conceptually, a CAM is intended to provide more information about the audit, thus making the auditor's report more informative and relevant to investors, presumably with the end result of those investors being able to make better-informed investment decisions. However, as noted by several commenters on the 2013 Proposal, an investor's decision on whether or not to invest in a registered investment company is likely based primarily on a fund's investment objectives, its principal investment strategies and risks, its past performance and its fees and expenses - none of which would normally meet the definition of a

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<sup>5</sup> One of three levels under the fair value hierarchy prescribed by the Topic 820 *Fair Value Measurement* of the Financial Accounting Standards Board's Accounting Standards Codification.

<sup>6</sup> In 2006 the FASB issued Statement on Financial Accounting Standard No. 157 (FAS 157), *Fair Value Measurement*, which defined "fair value", established a framework for measuring fair value, and required the disclosure of information related to fair value determinations. A number of related FASB Staff Positions (FSP) were also issued to provide clarifications on FAS 157. Subsequently, the FASB issued Accounting Standards Update (ASU) 2010-06, *Fair Value Measurements and Disclosures (Topic 820)* provides more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2, and 3. The FASB also issued ASU 2011-04, *Fair Value Measurement (Topic 820)* in which the FASB provided common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRS. Most recently, the FASB has issued Proposed ASU 2015-350, *Fair Value Measurement (Topic 820) - Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* which would clarify and improve existing fair value disclosure requirements.

CAM. Those data elements which are key to a fund investor's investment decision-making process are all required to be disclosed by a registered investment company in its prospectus, which is updated at least annually. In fact, the SEC advises an investor to request and read a fund's prospectus before investing in a fund<sup>7</sup> and requires funds to provide investors with a prospectus either prior to or upon their purchase of shares. As such, we believe that it is the information in a fund's prospectus, and not CAM, that is integral to a registered investment company investor's decision-making process.

In addition to the requirement of a prospectus that is updated annually, there are a number of other industry-specific regulations – existing and proposed - intended to provide investment company investors with the information necessary to make more informed investment decisions and to reduce the risks of investing in investment companies. The 1940 Act sets forth requirements with respect to an investment company's portfolio diversification, liquidity, leverage and custody of securities with the intent of reducing an investor's risk. We note that registered investment companies are required to file with the SEC their quarterly portfolio holdings. In addition, the SEC's Proposed Rule on *Investment Company Reporting Modernization* would enhance portfolio holding reporting and would require investment companies to report additional information, such as information about their use of securities lending and more information about their investments in derivatives and debt securities. The SEC has also issued another proposed rule to promote effective liquidity risk management and enhance fund liquidity disclosures for open-end registered investment companies<sup>8</sup>. In an industry where a wealth of information is already required to be reported under existing regulations with more inevitably to come from proposed rules, we believe the concept of a CAM is unnecessary for an investment company investor.

#### *Subjectivity and Costs*

In addition to the arguments expressed above, there are two other reasons why we support the PCAOB's proposal to exempt investment companies from the requirement to report CAM in their auditor's report; those reasons being subjectivity and costs.

As discussed more fully in our 2013 Comment Letter, we believe that the CAM identified in the auditor's report may differ among very similar entities based on the subjective decisions made by different audit teams or firms, with the unintended consequence of negatively impacting the comparability of the entities. 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"). Because each audit firm under the two audit provider model may have different interpretations as to what constitutes CAM, two funds with substantially similar investment objectives and investment strategies, portfolio holdings and investment performance may have differing disclosures regarding CAM. For example, one fund may report more CAM or more reasons for CAM. We believe that such a result may confuse investors in the funds. This concern is magnified when looked at in the context of the auditor's reports for the industry's full universe of competing funds, many of which are audited by different audit teams and firms.

In addition to the increase in audit cost that would inevitably result from the drafting, documentation and review of CAM, the Proposed Standard mentions that investment companies might bear additional costs of applying the CAM requirements as compared to other types of companies. Consistent with other investment company complexes (ICC)<sup>9</sup>, the shareholder reports and financial statements for certain MFS Funds (e.g., the MFS target date funds-of-funds) are compiled in one document that contains a single auditor's report covering the audits for that group of MFS Funds. If investment companies were not exempted from the requirement to report CAM, our auditors would have to prepare separate auditor's reports for each of the MFS Funds, thus increasing the typesetting and printing costs borne by the funds' shareholders.

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<sup>7</sup> *Mutual Funds, A Guide for Investors* which can be found at [www.sec.gov](http://www.sec.gov).

<sup>8</sup> The SEC's proposed rule on *Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release*

<sup>9</sup> SEC Rule 2-01(f)(14)(i) of Regulation S-X defines an investment company complex.

### Audit Firm Tenure

Under the Proposed Standard, the auditor's report would be modified to include a statement containing the year that the audit firm began serving consecutively as the entity's auditor. The Proposed Standard clarifies that tenure, with respect to an investment company within an ICC, would be the year that the auditor began serving consecutively as the auditor of any investment company in the ICC. While we appreciate this clarification, we continue to adamantly oppose the requirement to disclose audit firm tenure in the auditor's report.

We believe that disclosing tenure in the auditor's report implies that tenure plays a role in the auditor rendering its opinion on the financial statements. However, as discussed in the Proposed Standard, despite extensive research, no conclusive link has been established between auditor tenure and the quality of the audit in terms of auditor independence, objectivity and professional skepticism. More alarming is the suggestion made in the Proposed Standard that some investors may draw incorrect conclusions about tenure, resulting in negative impacts to a fund in terms of its cost of capital and the time spent by management and the audit committee to dispel these investor misperceptions. Our opposition to the PCAOB's required disclosure of tenure is bolstered by the fact that neither the International Auditing and Assurance Standards Board (IAASB) or the UK's Financial Reporting Council (FRC) has been concerned with establishing a link between audit firm tenure and auditor independence and that neither standard setter requires tenure to be disclosed in the auditor's report.

In the Proposed Standard, the PCAOB asks a number of questions around audit firm tenure including whether it would be more appropriate to disclose auditor tenure in Form AP than in the auditor's report<sup>10</sup>. The PCAOB's recently adopted Form AP is intended to provide investors and financial statement users with information about the partners serving on the audit engagement and about the other accounting firms, if any, involved in the audit. If the PCAOB believes that audit firm tenure must be consistently disclosed for all companies in one publicly-available document, then we would submit that tenure disclosure in Form AP would meet that objective.

### Conclusion

MFS and the Audit Committee of the MFS Funds Board appreciate the opportunity to provide comments on the Proposed Standard. We support the PCAOB's overall objectives and its efforts to standardize the format of the auditor's report as well as its proposed clarifications with regard to auditor independence, fraud and the notes to the financial statements. As detailed above, the bulk of our comments are focused on (1) the proposed exemption of registered investment companies (other than business development companies) from the requirement to report CAM in the auditor's report and (2) the proposed requirement to disclose audit firm tenure in the auditor's report. In closing we would like to reiterate that:

- We strongly support the PCAOB's proposed exemption of registered investment companies from the requirement to report CAM in the auditor's report. In addition to our concerns around auditor subjectivity and industry-specific costs, we believe that there are a number of factors unique to registered investment companies in terms of their structure, their purpose, and their regulatory reporting requirements that render the concept of CAM uninformative and unnecessary for the industry.
- We adamantly oppose the PCAOB's proposed requirement to disclose audit firm tenure in the auditor's report and we encourage the PCAOB to consider using public documents (e.g., Form AP) other than the auditor's report for any required disclosure of audit firm tenure, as there is no evidence that tenure has a bearing on the auditor's ability to render an opinion.

Should you have any questions about our comments regarding the Proposed Standard, please feel free to call Bob Uek or Dave DiLorenzo at 617-954-5000.

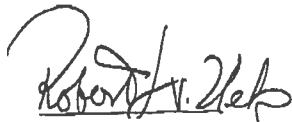
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<sup>10</sup> Question 18 of the Proposed Standard

Sincerely,



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Fund Treasurer  
Senior Vice President  
MFS Investment Management



Robert W. Uek  
Chairman  
MFS Funds Board Audit Committee