



MFS Investment Management
500 Boylston Street, Boston, MA 02116-3741
617.954.5000 mfs.com

December 13, 2011

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

File Reference: PCAOB Rulemaking Docket Matter No. 37, *Concept Release on Auditor Independence and Audit Firm Rotation*

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") *Concept Release on Auditor Independence and Audit Firm Rotation* (the Concept Release). Our comments relate to the Concept Release's application to Securities & Exchange Commission (SEC) registered investment companies as issuers of financial statements.

Background on MFS and the Industry¹

MFS is a global asset management firm providing investment management services to clients including more than 130 registered investment products which in total represent approximately \$105 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 of 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 September 30, 2011, MFS managed approximately \$208 billion in assets.

From an industry perspective, U.S. investment companies are responsible for the investment of over \$13.1 trillion with mutual funds representing the lion's share of those assets. There are roughly 9,700 mutual funds, 800 closed-end funds and 900 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.

Concept Release Overview

The Sarbanes-Oxley Act contained a number of provisions designed to address auditor independence, including charging the audit committee (and not management) with hiring the auditor and overseeing the audit; prohibiting auditors from providing certain non-audit services; and imposing audit partner rotation. However, PCAOB inspections continue to identify deficiencies in important, high-risk audit areas bringing auditor independence, objectivity and professional skepticism into question. The Concept Release solicits public comment on ways that auditor independence, objectivity and professional skepticism could be enhanced and explores mandatory audit firm rotation as one possible approach.

¹ Industry statistics as of December 31, 2010 per the 2011 *Investment Company Institute Industry Fact Book*.

As discussed below, MFS Investment Management (MFS) and the MFS Funds Board Audit Committee support the desire to improve audit quality; however, we do not believe that mandatory audit firm rotation is the solution. We believe that the audit committee should determine if and when audit firm rotation is necessary and that, counter to its intended objective, mandatory audit firm rotation would result in more costly, lower quality audits.

Importance of Institutional Knowledge

Anyone who has been a member of the public accounting profession at one time in their career will appreciate the complexities involved with auditing a new client and the challenge of overcoming the learning curve of understanding client operations and key risk areas. When possessed of institutional knowledge of an audited entity, the auditor can conduct a better planned, more effective audit that focuses on the areas of greatest risk. The importance of institutional knowledge on audit effectiveness should not be understated. Mandating audit firm rotation will result in the loss of institutional knowledge for the entire audit team, not just a rotating partner. A lack of institutional knowledge will impact not only the incoming auditors but also their client, especially the client's financial accounting and reporting personnel who must take time out from their existing responsibilities to educate their new auditors on processes and controls. The end result will likely be a more costly and lower quality audit.

Like all other endeavors, auditing has a component of continuous improvement. During the initial years of the audit rotation period, the auditor's achievement of efficiency and effectiveness may be hindered by the team – staff through partner – having to get up to speed on not only the client's general ledger accounts but also its operations, its information technology systems, its customer base/clients, its service providers, the client's internal controls and the internal controls at its service providers among other things. The learning curve issue is even more pronounced in the investment company industry where for most major fund complexes, fund year-ends and audits take place throughout the year in order to realize operational efficiencies. In certain other industries, a new auditor may have almost a year to plan for an annual audit. With a large fund complex like ours where funds are under audit nearly every month of the year, a new auditor does not have the luxury of substantial lead time to get up to speed on operations and controls prior to the audit.

In the initial years of the audit, substantial effort goes into documenting internal controls, performing comprehensive risk analyses and related engagement planning. The benefits of the investment in this effort are not fully realized until the later years of the audit. Audit firm rotation has the impact of limiting the time in which these efficiencies can be realized, and therefore the annual audit will inevitably be more costly. If rotating audit firms are forced to keep audit fees artificially low, then public accounting firms will likely have to change their mix of audit staff, giving more time to less experienced, less costly audit staff in order to meet aggressive budgets. The end result, we believe, will be sub-standard audits which will likely result in more, not fewer, negative findings in PCAOB inspections.

Human Capital Impacts

Mandatory audit firm rotation may also have a number of other unwanted side effects that could negatively impact audit quality. The market share and industry expertise of public accounting firms differ across the U.S. such that certain firms have a bigger presence in specific industries and in certain cities. Mandatory audit firm rotation would require public accounting firms to change client bases frequently. Accordingly, audit firms may be forced to relocate manager and partner-level resources amongst their offices in order to serve new clients. In addition, the firms may need to retrain lower level audit staff in new industries. With mandatory audit firm rotation limiting the number of years over which the firms could recover those additional costs, firms may be forced to limit their retraining efforts which would negatively impact audit quality. The quality of the audit may also suffer if, as a result of the pressures associated with frequent relocations, public accounting firms' cannot retain their best, most experienced people.

Periodic changes in client bases within audit firm offices will also create the need for firms to change their mix of audit staff by hiring staff from other firms that have the requisite expertise. Practically speaking, this creates the real risk that some staff, managers and partners, who lose a significant audit client as a result of mandatory audit firm rotation, may decide to resign from their current firm in order to join their client's incoming audit firm. This outcome would undermine the objectives of mandatory audit firm rotation.

Another human capital issue that deserves consideration relates to the fact that retired public accounting firm partners make up a significant portion of the talent pool from which audit committees select new members, including their financial experts. A retired partner's retirement compensation is often funded, but is not guaranteed, in large part by the current operations of the public accounting firm, so for independence reasons the audit committees on which retired partners serve are often precluded from selecting as auditors the firm(s) from which those partners retired. Mandatory audit firm rotation would compound this independent auditor selection issue, forcing audit committees to either select from an ever shrinking subset of audit firms - some of which may not have the depth or industry expertise to appropriately conduct the audit - or call for talented and experienced committee members to step down to satisfy auditor independence requirements.

On a related note, by increasing the number of firms that audit a company over time, mandatory audit firm rotation will limit the independent candidates from which that company's audit committee can select new members. As a result the quality of audit committee oversight may suffer.

Understanding the Root Cause

We believe that the call for mandatory audit firm rotation will not address deficiencies found in PCAOB inspections given that no conclusive link has been made between the number of PCAOB inspection findings and the perceived lack of auditor independence, objectivity and professional skepticism. As pointed out in the Concept Release, the root cause for the greater than expected number of inspection findings is as yet unknown and may in fact be caused by other factors. The two other contributing factors explored in the Concept Release are (1) the selection bias in the PCAOB's inspection process (i.e., its propensity to focus inspection efforts on the highest risk, most complex, most judgmental areas of the audit) and (2) a lack of technical competence or experience exhibited by audit firm staff on the inspected engagements. Neither factor - one of which is inherent in the inspection process and the other of which may be characteristic of any public accounting firm - would be addressed by mandatory audit firm rotation. What's worse, the lack of technical competence and the experience factor would likely be exacerbated by rotation for the reasons cited above. We cannot ignore the fact that two major historical studies cited in the Concept Release have considered but ultimately rejected mandatory audit firm rotation.

Audit Committee Oversight

The proponents of mandatory audit firm rotation believe that it will increase auditor independence, objectivity and professional skepticism. We question the need for mandatory audit firm rotation on the grounds that we do not perceive auditor independence, objectivity and professional skepticism to be lacking and we believe that there are mechanisms already in place to effectively oversee auditor qualifications and performance in these areas.

In response to the Sarbanes-Oxley Act's call for a heightened level of audit committee oversight, a number of processes were put in place to monitor independence and to keep auditor objectivity and professional skepticism in check. The audit committee is now responsible for the appointment of the auditor; pre-approval of audit and permitted non-audit services; an annual review of audit firm independence including the audit firm's response to any infractions; and a review of the PCAOB's annual inspection findings with respect to the audit firm.

Within a large mutual fund complex such as ours, this oversight function is even more rigorous as fund year-ends occur by necessity practically every month of the year and fund audit committees

meet frequently as a result. With the auditors presenting at many of those meetings, the audit committee members have frequent exposure to audit partners and managers. Frequent exposure coupled with the audit committee's use of an auditor executive session fosters open dialogue on issues between the two parties without management influence. Through its frequent contact with the auditors and its review of audit results from the numerous fund year-ends throughout the year, the audit committee gets real-time feedback on auditor performance such that the audit committee is the party best suited to make the annual auditor reappointment decision. Although annual reappointment is the norm, there is no guarantee of reappointment in perpetuity in this environment.

Although we believe that the audit committee oversight model described above is very effective, we acknowledge that not all audit committees are created equal and that there is always room for improvement. As such, we would support measures to enhance audit committee oversight of both the audit firm and the audit process. For example, we suggest that the PCAOB may want to consider mandating that audit committees have at least one "audit expert" with an in-depth knowledge of the audit process, who could provide the audit committee with additional perspective on the audit process and audit quality. Additionally, we would support a requirement for the audit committee (and not management) to perform the initial review of the partner candidates when, under existing rules, partner rotation is required. Finally, while we strongly oppose the concept of mandatory audit firm rotation based on tenure, we would support a measure that would require audit committees to periodically assess whether audit firm rotation might be appropriate based on a combination of factors.

Two-Provider Model Alternative for Investment Companies

If ultimately the PCAOB determines that some enhancements to current practices are needed to improve independence, objectivity, and professional skepticism, we ask that consideration be given to industries where alternative methods already in place may be more effective and less disruptive than mandatory audit firm rotation. For instance, within the investment company industry a model that has traditionally worked well for most major fund complexes such as ours is the so called "two provider model" where certain funds in the complex are audited by one audit firm with the remainder audited by a second firm.

This model addresses all of the concerns outlined in the Concept Release without the disruption of a required rotation. The two audit firms and their client derive the benefits of audit personnel who are knowledgeable with regard to the client and the client's industry. With respect to objectivity, common issues amongst the funds are subjected to the scrutiny and objective views of two audit firms. Competition between the two firms to provide the highest quality, most efficient audit ensures professional skepticism and keeps audit costs in check which benefits shareholders. Additionally, by spreading the audit work over two firms, the risk of developing cozy relationships and of management exerting inappropriate influence is mitigated. Finally, when the two provider model is in place, there are still other firms (including at least two of the Big 4 public accounting firms) from which to select for any non-audit service needs.

Conclusion

While we understand that the greater than expected number of inspection findings is a source of great concern for the PCAOB, we do not believe that a perceived lack of independence, objectivity and professional skepticism is to blame or that mandatory audit firm rotation would improve audits. Mandatory audit firm rotation is an unproven solution that will undoubtedly increase audit costs (a tangible negative impact to shareholders) and may decrease audit quality and is a concept we cannot support. We disagree wholeheartedly with the concept that the tenure of an audit firm should be subject to an arbitrary cutoff date, such as 10 years. The responsibility for the selection and retention of an audit firm should continue to reside with those best qualified to make the decision – the Audit Committee - as was originally contemplated by the Sarbanes-Oxley Act.

MFS and the MFS Funds Board Audit Committee appreciate the opportunity to offer comments on the Concept Release. If you have any questions about our comments please feel free to call Bob Uek or John Corcoran at 617-954-5637.

Sincerely,



John Corcoran
Senior Vice President
MFS Investment Management

Robert W. Uek
Chairman
MFS Funds Board Audit Committee