Statement regarding PCAOB proposed changes to the Audit Reporting Model
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Good afternoon. My name is John Corcoran and I am a Senior Vice President at MFS Investment Management. I also serve as the President of the MFS Funds, a group of 1940 Act mutual funds with over $170 billion in assets. I appreciate this opportunity to provide some thoughts on the PCAOB's proposed changes to the auditor's report. While several of these thoughts are relevant to any audited entity, I'll try to focus on how the proposal could impact registered investment companies.

U.S. investment companies are responsible for the investment of nearly $14 trillion; with the majority of the assets being in mutual funds, which are owned by an estimated 92 million shareholders. There are nearly 10,000 investment companies which are subject to an annual audit requirement and oversight by the PCAOB and the SEC.

Most of what I will cover today was highlighted in the joint comment letter that MFS Investment Management and the MFS Funds Board Audit Committee submitted to the PCAOB. As we said in that letter, we understand the PCAOB's overall objective to increase the value of the auditor's report and support some of the proposed changes; however, there are certain aspects of the proposed Standards where, as a preparer of investment company financial statements, we have concerns.

Let me first discuss those aspects of the Proposed Standards that we support.

Under the Proposal, 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 Proposal also recommends that the auditor's report more specifically articulate the auditor's responsibility with regard to fraud and the notes to the financial statements. We believe that these enhancements provide some clarity and could be helpful to shareholders without expanding the scope of the audit, so we support these aspects of the proposal.

Turning to the area of the Proposal that concerns us most, we do not support the proposed introduction of Critical Audit Matters (or CAM) to the auditor's report. Under the Proposed Standards, an auditor would be required to highlight as CAM matters that the auditor deemed to be the most subjective, involved complex auditor judgments or were the most difficult areas to obtain audit evidence.

Let me take a few minutes to explain our concerns.

We feel that the existence of CAM in the auditor's report will be incorrectly interpreted by our shareholders and potential investors as a "red flag" -- a sign that there is something wrong with the fund – when in fact judgments, estimates and assumptions are inherent in the financial statement process. For example, management is required to make certain judgments and give extensive financial statement disclosures regarding investment valuation. As such, we would expect valuation to be called out as a CAM. It's important to highlight that even though management makes these judgments, the auditor is still able to obtain sufficient audit evidence in order to reach an unqualified opinion. In these circumstances, calling out investment valuation as a CAM would raise a "red flag" to investors where no problem exists, significant disclosure is already made by management and the auditor's report on the financial statement as a whole is unqualified.

The PCAOB has expressed a view that they would not expect to see an auditor's report without a CAM. This could provide the auditor with an incentive to identify CAM in order to demonstrate the comprehensive nature of its audit and its compliance with the PCAOB's directive. If, as we believe, CAM are perceived as a "red flag" by investors, the inclusion of CAM will have unintended negative consequences in that investors are likely to use CAM as a subjective "yardstick" with which to evaluate a fund versus its peers.

This issue of auditor subjectivity can be illustrated in our industry where, for most large fund complexes, more than one audit firm is used. Under this two audit provider model, two substantially similar funds within a fund complex may be subject to audit by different audit firms - each with their own unique thoughts on what constitutes a CAM and how to document CAM in their auditor's report. Although the strategy, holdings, investment performance and disclosures of the two funds could be almost identical, the number of CAM identified and the description of those CAM will very likely differ. As a result, investors may form very different impressions on two substantially similar funds, putting one fund at a disadvantage simply because of the auditors' subjective identification and description of CAM in their auditor's reports. This concern is magnified when looked at in the context of the auditor's reports across industry's universe of competing funds - each of which is audited by different audit teams and audit firms.

Another concern we have with the inclusion of CAM in the auditor's report is that it may inappropriately put the auditor in the role of management. AU Section 110 states that the financial statements are the responsibility of management and that the auditor's responsibility is to express an opinion on whether those statements are fairly presented. When communicating their reasons for concluding something is a CAM, an auditor may be forced to include in the auditor's report information on an entity's operations or financial results that is not otherwise publicly available. For a fund, this could be information on immaterial, passed audit adjustments or immaterial differences in the judgments made in investment valuation. Any concept 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. If, in fact, management's financial statement presentation and disclosures are not sufficient, then the auditor should not be able to reach an unqualified opinion.

We are also concerned that the inclusion of CAM in the auditor's report will create a piecemeal opinion which compromises the current pass/fail model of the audit. Under AU Section 508, 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 prominent presentation of CAM, the auditor's overall opinion on the financial statements will be overshadowed with the result that investors inappropriately focus on limited areas of statements that are designed to be looked at holistically.

One last concern we have regarding CAM – and it's the one that my staff and I would feel most acutely - is the additional cost and time it will take to issue auditor's reports. While the level of audit evidence and audit work required to reach a qualified or unqualified opinion in theory would not change, a significant increase in hours would be necessary for the auditor to draft CAM and to complete the associated documentation in the audit work papers. CAM would introduce non-standard language into the auditor's report which will require additional levels of review by the audit firm, the fund's management, and quite possibly the legal counsel of both parties. The significant costs associated with those additional hours likely will be tacked onto existing audit fees, resulting in higher fund expenses borne by investors. The additional hours would likely be incurred at the conclusion of the audit, putting additional pressures on already tight filing deadlines.

In summary, we do not support the inclusion of CAM in the auditor's report because we believe that CAM weaken the auditor's report by introducing subjectivity into an objective process and also produce a number of unintended, negative consequences.

Another aspect of the Proposed Standard that concerns us is the proposal to include auditor tenure to the auditor's report. This seems to suggest that tenure plays a role in the auditor rendering its opinion, when there is no link between tenure and audit quality. Additionally, there are logistical issues with reporting tenure in the context of a fund complex where new funds are launched each year such that tenure dates differ significantly fund to fund based on each fund's unique inception date. We believe that there are other, more appropriate places, such as proxy statements, to disclose tenure.

The last area of the Proposed Standards that I would like to comment on is the proposed clarification to the auditor's report with respect to the auditor's responsibility for other information. While we agree that it may be helpful to clarify which components of other information an auditor has evaluated, we do not believe the proposed standard, as written, is sufficiently detailed with respect to scope or the expected level of auditor effort and documentation. The scope should be more specifically defined to ensure consistency in execution by audit teams and should be limited to other information for which the auditor has sufficient expertise. There will be a real increase in costs for each additional element of other information that the auditor is required to evaluate, so there needs to be a corresponding level of benefit 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 a year that may include other information, at MFS we prepare over 35 filings annually which include the audited financial statements and the auditor's report for one or more of our 140 funds. Even if the scope of the auditor's evaluation were limited solely to other information that is financial in nature – such as portfolio holdings; valuation; fund expenses; expense ratios; and returns - the additional work required by the auditor would be significant. In addition, many of these filings are made at the trust level and, under the two audit provider model that I discussed earlier, not just one but perhaps two sets of auditors would be required to evaluate the other information in a trust's filing.

Given the significant level of additional hours that would be involved and the 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. Auditor field testing could then be performed to provide a better understanding of the level of effort and additional costs required. 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.

So in concluding I want to reiterate that we support the PCAOB's goals to improve the auditor's report, and specifically support the proposals to add language to the auditor's report clarifying auditor independence, and the auditor's responsibility with respect to fraud and the notes to the financial statements. However, we have significant concerns with other aspects of the Proposed Standards and would encourage the PCAOB to:

- Reconsider the inclusion of CAM in the auditor's report on the grounds that the inclusion of CAM would significantly increase the cost of an audit while reducing the quality of the report and creating several other notable, negative impacts.

- Consider using public documents other than the auditor's report for any required disclosure of audit firm tenure.

- Finally, gather more information through mechanisms like public roundtables and field testing in order to better evaluate the relative costs and benefits of increasing the auditor's responsibility for other information.

Thank you and I look forward to discussing these ideas with you.