



August 4, 2023

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

RE: PCAOB Rulemaking Docket Matter No. 051

Dear Madam Secretary:

Coterra Energy Inc. (“Coterra”) appreciates the opportunity to provide feedback on the Public Company Accounting Oversight Board’s (the “PCAOB” or the “Board”) Release No. 2023-003, *Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations, and Other Related Amendments* (the “Proposing Release” or the “Proposal”).¹ Coterra (NYSE: CTRA) is a premier exploration and production company that strives to be a leading energy producer in the United States.²

Coterra supports the PCAOB’s overall objective to adopt standards that meaningfully improve audit quality and protect investors. However, as a publicly traded company, we believe that the amendments described in the Proposing Release (the “Proposed Amendments”) would significantly expand the scope of financial statement and integrated audits and impose new and overly burdensome obligations on public companies. We anticipate the following aspects of the Proposed Amendments will result in the most substantial costs to companies under audit:

1. Replacing the term “illegal acts” with “noncompliance with laws and regulations”;
2. Requiring the auditor to identify laws and regulations with which noncompliance could reasonably have a material effect on the financial statements, assess and respond to the risk of material misstatement due to noncompliance with those laws and regulations and identify whether there is information indicating that noncompliance has or may have occurred;
3. Enhancing the auditor’s potential identification of noncompliance with laws and regulations through enhanced assessment of risks of material misstatement; and

¹ See PCAOB Release No. 2023-003, available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/pcaob-release-no.-2023-003---noclar.pdf?sfvrsn=fe43e8a_4.

² See Coterra Energy Inc. website, available at <https://www.coterra.com/who-we-are/>.

4. Implementing audit procedures regarding noncompliance for engagements involving other auditors and an auditor's specialist.

Each of the two Certified Public Accountants on the Board consider the Proposed Amendments to be a significant expansion of the auditors' responsibilities.³ We share this view and believe that the financial and non-financial compliance costs of the Proposed Amendments are likely to exceed the anticipated benefits. Consequently, Coterra strongly urges the PCAOB to withdraw the Proposal and substantially reconsider the anticipated costs and benefits of adoption.

I. The Proposed Amendments do not accomplish the PCAOB's mission of protecting investor interests.

Independent audits have long been required for registrants in support of the Securities and Exchange Commission's ("SEC") mission to protect investors, facilitate capital formation and maintain fair, orderly and efficient markets. The investor protection aspect of this mission was enhanced with the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and the creation of the PCAOB (under oversight of the SEC). The stated mission of the PCAOB is to:

*[O]versee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.*⁴

Coterra appreciates the vital role of independent audits in enhancing the confidence of investors and other market participants in a company's financial statements that underpins the PCAOB's investor protection mission. However, as we describe below, the Proposed Amendments would harm—rather than protect—investors by imposing new and burdensome obligations on auditors and the public companies that they audit and substantially increasing the costs of audits, including legal costs to ensure auditors are acting in compliance with the Proposed Amendments—costs that ultimately will be borne by stockholders. In addition, the expense and effort required to implement and continuously comply with the Proposed Amendments could further exacerbate the trend of companies avoiding the public markets for capital raising opportunities.

II. Investors do not expect auditors to play a larger role in identifying noncompliance.

The Proposing Release asserts—without providing specific support—that investors “expect auditors to play a larger role in identifying, evaluating and communicating noncompliance” and that “the [P]roposed [A]mendments would help reduce the expectations gap

³ See DesParte dissent (“I am unable to support today’s proposal as I believe it unreasonably and at great cost expands the scope of the audit to incorporate extensive new compliance attestation procedures and will require legal acumen and expertise well beyond the auditor’s core competency.”); see also Ho dissent (describing the Proposed Amendments as a “breathtaking expansion of the auditors’ responsibilities”).

⁴ See Section 101(a) of the Sarbanes-Oxley Act.

between investors and auditors.”⁵ We are not aware of any Coterra stockholders communicating such expectations or expressing a similar sentiment.

Public companies have existing and comprehensive noncompliance detection systems outside of the external audit, such as whistleblower hotlines, management review, internal audit and other compliance and/or oversight functions. Moreover, enforcement of noncompliance with legal and regulatory frameworks is the responsibility of various federal and state regulatory bodies, including the SEC, which is understood within the investor community. The Proposing Release cites studies indicating that auditors currently play “an arguably relatively small role in identifying the noncompliance underlying those losses” as justification for increasing the auditor’s role in a way that detects additional instances of noncompliance at an earlier stage.⁶ To the contrary, we are of the view that auditors do not represent a large percentage of identified frauds because compliance programs at public companies are operating at a sophisticated level such that actual wrongdoings and/or potential wrongdoings are detected independent of the external auditor’s procedures.

III. The Proposing Release fails to adequately consider the significant financial and non-financial costs on public companies.

The Proposing Release describes the anticipated costs of the Proposed Amendments on auditors and audit firms.⁷ However, it devotes only a single paragraph to the impact of the Proposed Amendments on the companies being audited.^{8 9} In reality, public companies are likely to bear a significant portion of the anticipated increased costs, including the devotion of increased internal resources, the diversion of management attention and increased legal and auditor fees, arising from the Proposed Amendments.¹⁰ Smaller public companies with fewer resources may not be able to absorb the resulting increases in audit fees. The expanded use of lawyers and experts will be time-consuming and expensive for auditors and companies, and, ultimately, expensive for investors, who are supposed to be the intended beneficiary of the Proposed Amendments.

⁵ See Proposing Release at 70 (“Anecdotal evidence also indicates that stakeholders expect auditors to play a larger role in identifying, evaluating, and communicating noncompliance.”) (“Similarly, through outreach activities, the staff learned that many investors would prefer earlier and enhanced communication and reporting of noncompliance.”).

⁶ See Proposing Release at 73.

⁷ See Proposing Release at 63 (“In general, the staff’s review indicates that all [audit] firms would likely need to revise the relevant portions of their methodologies to a significant extent to implement the proposed amendments if adopted.”).

⁸ See Proposing Release at 78 (“In addition to auditors, companies being audited may also incur costs related to the proposed amendments, both directly and indirectly.”).

⁹ Although we have focused this letter on the anticipated consequences for publicly traded companies, we also share the concerns expressed by Board members Duane DesParte and Christina Ho in the PCAOB’s June 6, 2023 open meeting concerning the proper role of the auditor and its obligations to the public.

¹⁰ See Proposing Release at 78 (“To the extent that auditors incur higher costs to implement the proposed amendments and are able to pass on at least part of the increased costs through an increase in audit fees, companies could incur an indirect cost.”).

Coterra believes that the Proposed Amendments do not adequately consider the far-reaching negative effects on publicly traded companies, including the impacts described below.

A. The Proposed Amendments significantly expand the scope of the audit and may impair auditor independence by causing the auditor to act in the role of management.

The Proposed Amendments' elimination of the distinction of direct and indirect illegal acts (now "laws and regulations") are a significant scope expansion beyond the current requirements of a financial statement audit. In this regard, the Proposed Amendments would require that the auditor identify essentially all laws and regulations to which the company is subject, and then identify instances of non-compliance (without regard to materiality). Significant questions remain concerning whether auditors are responsible for the identification of any law or regulation that could tangentially impact the financial statements or only those laws and regulations that more closely affect a business's operations.

Similarly, the Proposed Amendments are vague in that they fail to provide much guidance to auditors on the question of which laws and regulations "reasonably could" have a material effect on the financial statements.¹¹ Although the Proposal states that these material laws and regulations "would not represent every law or regulation to which the company is subject," it fails to clarify what procedures will be expected of auditors to make this determination.

Coterra believes that management, with the engagement of in-house and external counsels, is in the best position to understand how a company's operations fit within the relevant legal and regulatory framework and how to promote compliance and detect, enforce and respond to noncompliance, including through the use of whistleblower hotlines, management review, internal audit and other compliance and/or oversight functions, as mentioned above. Historically, the auditor's role has been to review management's processes and representations. The Proposed Amendments go beyond this requirement¹² and create a requirement that auditors conduct independent investigations. In the case of new laws or regulations, it is possible that these investigations could occur before management has completed its own internal assessment.

It has never been within the auditor's role or core competency to identify the entire legal framework applicable to a company. This role has traditionally been reserved for management, in consultation with its in-house and external legal counsels, and the Proposed Amendments risk impairment of the auditor's independence by having the auditor act ahead of or instead of management.

¹¹ See Proposed AS 2405.03.

¹² See Proposing Release at 29 (explaining that although "the auditor would be able to benefit from management's process to identify [relevant] laws and regulations," that identification "would not be limited to those laws and regulations identified by management").

B. Management has limited time, attention and resources to devote to the audit of immaterial issues of noncompliance with laws and regulations.

Coterra believes that the requirement for the auditor to design procedures to identify any illegal act that “could reasonably have a material effect on the financial statements” would increase the cost of an audit above its benefit. Many large public companies in highly regulated industries employ robust teams of in-house legal counsels, plus external legal counsels, to monitor, identify, and respond to regulatory requests, subpoenas, and where necessary, investigate potential violations of laws and regulations. These companies require lawyers and experts in a wide variety of subject matter areas, depending on the nature of the potential noncompliance and the nature of the underlying business.

The Proposal would require that the external auditor engage in similar and duplicative processes to a company’s internal procedures and processes and other management functions. Moreover, the Proposal would require auditors to make substantive judgments on legal and regulatory matters, areas that require knowledge and expertise well beyond their professional competencies and training and increase risk to the attorney-client privilege by significantly expanding the sharing of information that may represent attorney advice. This would, as a result, require auditors to engage legal specialists, environmental, and human resource experts, among others, on virtually every audit, leading to significant costs and audit fee increases for public companies. Further, expanding the auditor’s use of such experts could cause auditors to over-engage these experts to avoid potential professional liability under the highly rigorous requirements of the Proposed Amendments.¹³

Expanding the role of the auditor to require legal and other skills, knowledge and expertise would also result in significant non-financial costs to companies. For example, the Proposed Amendments would require auditors to pose questions to company personnel well beyond those which are material. Management would devote a significant portion of its limited time and energy to addressing auditor inquiries or educating the auditor on the applicability—or inapplicability—of particular laws and regulations. As a result, the enhanced auditor responsibility may have an unintended consequence of reducing focus on the actual financial statements. Moreover, because companies may be subject to hundreds of new laws and regulations each year and given the ever increasing pace of rulemaking in the United States and abroad, we do not believe that the Proposed Amendments would achieve significant cost efficiencies over time, as the Proposing Release suggests.

¹³ The Proposed Amendments expressly state that “[a]uditors have a fundamental obligation to protect investors” and “that obligation governs this standard to identify and evaluate information indicating that noncompliance with laws and regulations, including fraud, has or may have occurred.” *See* Proposed Amendments to AS 2405.01. However, PCAOB rules and standards only govern (*i.e.*, control and direct) the auditor’s work, and such overarching statements risk being interpreted as creating legal or fiduciary duties for auditors to an unknown group of investors or the public generally.

C. The Proposed Amendments would significantly expand internal controls over financial reporting.

While an auditor's understanding the process and controls surrounding legal and compliance matters may be a reasonable expectation, auditing and drawing conclusions on that process for all laws and regulations (beyond those that are material to the financial statements) would require a skill and expertise beyond that of the typical external audit team. The Proposed Amendments raise concerns regarding the impact on a company's internal controls over financial reporting due to increased burdens on both in-house and external legal counsels in identifying all laws and regulations to which a company is subject and instances of noncompliance, regardless of materiality. By eliminating this materiality standard, the Proposed Amendments effectively require that companies develop new internal controls over *non-financial* reporting that will require the design and implementation of controls having limited relationship to the risks of material misstatements in the financial statements. The resulting integrated audit would take on characteristics of an operational compliance audit.

D. The Proposed Amendments will significantly increase the time required to complete the annual financial statement audit.

The increased audit procedures described above will create unnecessary additional pressure on the ability of companies to complete the annual financial statement audit in the required time frames. For large accelerated filers, the SEC requires the filing of the Annual Report on Form 10-K within 60 days after year-end.¹⁴ The auditor's expanded use of lawyers and experts will be time-consuming and stress the resources of companies and audit firms during this critical period. Ironically, the Proposed Amendments are likely to be considered regulations that could lead to noncompliance with SEC rules such as the SEC's filing requirements and would need to be considered by auditors under the Proposal.

E. The Proposed Amendments will exacerbate challenges associated with retention of qualified accountants to address audit requirements.

Attracting and retaining high quality talent has always been an important priority for public company accounting departments. But the challenges of doing so have been greater recently. Over 300,000 United States accountants and auditors left their jobs in the past two years, which represents a 17% decline in employed accountants and auditors from a 2019 peak.¹⁵ Public companies already struggle to retain qualified accountants to address the current audit requirements.¹⁶ Enhanced audit requirements are likely to result in increased hours and pressure for company accounting personnel. As a result, the Proposal may exacerbate these challenges by undermining the attractiveness of working for public companies.

¹⁴ See SEC Form 10-K, available at <https://www.sec.gov/files/form10-k.pdf>.

¹⁵ See *The CPA Shortage*, Society for Human Resource Management, available at <https://www.shrm.org/hr-today/news/all-things-work/pages/the-cpa-shortage.aspx> (May 6, 2023).

¹⁶ See *The Accountant Shortage is Showing Up in Financial Statements*, Wall Street Journal, available at <https://www.wsj.com/articles/the-accountant-shortage-is-showing-up-in-financial-statements-b14a6b94> (July 11, 2023).

The Proposed Amendments have the potential to significantly affect non-accounting personnel as well. Scoping the universe of applicable laws and regulations is not the only management and investigative function the proposal seeks to impose on auditors. For example, the Proposal also requires auditors to read all publicly available information about the company disclosed by the company's executive officers, including information disseminated through a continuum of mediums such as websites, social media accounts, and media and analyst reports. This onerous requirement extends the compliance burden to groups that typically reside outside the scope of a traditional audit, such as a company's investor relations department. Coterra expects that the Proposed Amendments would add new, sweeping obligations and responsibilities to nearly every business function within a public company.

IV. The Economic Analysis compares hypothetical or uncertain benefits against the tangible and substantial costs of the Proposed Amendments.

The Proposing Release states that the Board "expect[s] that the benefits of the proposed amendments would justify the costs."¹⁷ However, this conclusion is not supported by the accompanying discussion in the Economic Analysis. In fact, the Economic Analysis juxtaposes the *hypothetical or uncertain benefits* with the *tangible and substantial costs* of the Proposed Amendments.

In its twenty-one year history, the PCAOB has rarely adopted amendments with such high compliance costs.¹⁸ The Board repeatedly acknowledges the magnitude of these costs in the Economic Analysis, using adjectives such as "significant," "substantial" and "considerable." In contrast, the benefits of the Proposed Amendments appear to be hypothetical or uncertain, with the Board relying on qualifiers such as "may" or "could."

While the benefits of the Proposed Amendments are uncertain, the costs are not. We recommend that the Board attempt to quantify the anticipated benefits of the Proposed Amendments, including consideration of the likelihood that those benefits will be realized. Ultimately, the Economic Analysis fails to justify the consequences of the Proposed Amendments.

V. Conclusion

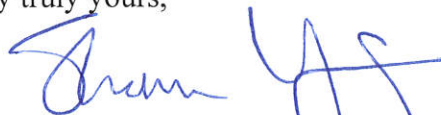
In conclusion, while Coterra supports the PCAOB's goals to update its auditing standards and protect investors, we have deep concerns about the Proposed Amendments and their impacts on public companies. The high costs of the Proposed Amendments are likely to outweigh the purported benefits. We strongly urge the PCAOB to withdraw the Proposal or consider more efficient policy-making approaches.

¹⁷ See Proposing Release at 72.

¹⁸ Section III describes important consequences for public companies that require robust economic analysis and full consideration by the Board. Such analyses and considerations are largely absent from the Proposal.

We appreciate the opportunity to express our view and concerns regarding the Proposed Amendments and look forward to the PCAOB's response to these concerns.

Very truly yours,



Shannon E. Young III
Executive Vice President and Chief Financial
Officer
Coterra Energy Inc.

cc:

PCAOB

Erica Y. Williams, Chair
Duane M. DesParte, Board Member
Christina Ho, Board member
Kara M. Stein, Board Member
Anthony C. Thompson, Board Member
Barbara Vanich, Chief Auditor