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Mr. James R. Doty, Chairman  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Sent by email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: Rulemaking Docket Matter No. 034, Proposed Auditing Standards – *The Auditor’s Report on an Audit of the Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor’s Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor’s Report*; and Related Amendments to PCAOB Standards.**

Dear Mr. Doty,

ConocoPhillips appreciates the opportunity to comment on the Public Company Accounting Oversight Board (PCAOB) Proposed Auditing Standards - *The Auditor’s Report on an Audit of the Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor’s Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor’s Report*; and Related Amendments to PCAOB Standards (the Proposed Auditing Standards). ConocoPhillips is the world’s largest independent exploration and production company, based on proved reserves and production of liquids and natural gas. Headquartered in Houston, Texas, our global operations involve the exploration, production, transportation, and marketing of crude oil, bitumen, natural gas, liquefied natural gas, and natural gas liquids in 29 countries. As of September 30, 2013, ConocoPhillips had \$55 billion in annualized revenue, \$120 billion of total assets, and approximately 18,000 employees worldwide. Our success as a large accelerated filer fundamentally depends on the integrity, accuracy and timeliness of the information presented in our financial reports, as well as the working relationship among our management, board of directors and external audit firm. Accordingly, the Proposed Auditing Standards are of critical importance to the Company.

We commend the PCAOB’s efforts to make the auditor’s report more informative, thus promoting its relevance and usefulness to investors and other financial statement users. With respect to proposed enhancements to the auditor’s report regarding the auditor’s responsibilities for fraud and notes to the financial statements, as well as auditor independence and clarification of the *current* auditor responsibilities to read and consider other information – to the extent these matters advance this objective, we are supportive. However, we are troubled by the provisions in the Proposed Auditing Standards requiring additional disclosures concerning critical audit matters as determined by the auditor, disclosure of audit firm tenure, and enhancing the auditor’s responsibility with respect to other information outside the audited financial statements. We believe these provisions have the potential to improperly shift the responsibilities of management and the audit committee to the auditor; create substantial

confusion among investors and other users of the financial statements; and impose significant implementation and recurring costs which will considerably surpass any benefits.

Our key concerns are further elaborated below.

### **Shift of Responsibility from Management and the Audit Committee to the Auditor**

Financial reporting standards and Securities and Exchange Commission (SEC) rules provide a clear framework that preparation and reporting of financial statements are the responsibility of the company's management. A requirement for the communication of critical audit matters by the auditor would be entirely inconsistent with this framework. Management bears responsibility for and certifies to the completeness and accuracy of the financial statements. Existing authoritative literature, including the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) as well as SEC rules and interpretive guidance, requires management to discuss its critical accounting estimates and general accounting policies in pronounced detail. If any additional information regarding matters of significant judgment is deemed necessary for users of the financial statements, this additional information should be provided by management. Similarly, it should be addressed by new or enhanced enforcement of existing financial reporting standards and SEC rules, rather than new auditing standards.

#### **Responsibilities of Management**

The FASB guidelines in *ASC 235 – Notes to Financial Statements* require management to describe all significant accounting policies of the reporting entity. These policies identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles that materially affect the determination of financial position, cash flows or results of operations. In general, the disclosures encompass important judgments as to the appropriateness of principles, encompassing a selection from existing acceptable alternatives, principles and methods peculiar to the industry in which the reporting entity operates, and the application of generally accepted accounting principles to unusual or innovative situations.

The SEC's interpretive guidance (Release Nos. 33-8350; 34-48960; FR-72) regarding Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), which is required by Item 303 of Regulation S-K, requires management to disclose information concerning Critical Accounting Estimates. These are estimates and assumptions that are both a) material by nature due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and b) material based on their impact to a company's financial condition or operating performance.

As the SEC notes in its releases, such disclosures are made with the intent of presenting a company's analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time. Companies are required to address questions that arise once the critical accounting estimate has been identified by analyzing such factors as how they arrived at the estimate, how accurate the estimate has been in the past, how much the estimate has changed in the past, and whether the estimate is reasonably likely to change in the future. Further, companies are required to analyze specific sensitivity to change for critical accounting estimates, providing quantitative analysis and qualitative disclosure.

The SEC further notes that management's discussion of critical accounting estimates supplements the description of accounting policies required by the FASB. Accounting policy notes in the financial

statements describe the method used to apply an accounting principle, whereas the discussion in MD&A presents a company's analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time.

Considering management's standing requirements to discuss accounting policies and critical accounting estimates in comprehensive detail, we believe financial statement users will not benefit from additional discussion of complex accounting and auditing matters by the auditor. Management has deeper knowledge, closer involvement with the business, and more complete information about the company than the auditor. The responsibility of management to prepare and disclose information regarding critical matters should be maintained. We do not believe an auditor's discussion of critical audit matters would add value to the discussion provided by management regarding critical accounting estimates and accounting policies. We are disappointed PCAOB Release 2013-005 (PCAOB Release) on Proposed Auditing Standards fails to provide a meaningful analysis regarding the manner in which an auditor's discussion of critical audit matters would supplement existing FASB and SEC requirements.

#### Responsibilities of the Auditor

While the financial statements are explicitly the responsibility of management, the responsibility of the auditor is to attest and verify the information prepared and presented by management. The provisions of the Proposed Auditing Standards will inappropriately expand the role of the auditor into financial reporting related to a company's accounting policies and estimates in addition to attesting on the company's financial statements. This is inconsistent with the expectation the auditor should not be the original source of disclosures about an entity.

#### Responsibility of the Audit Committee

The audit committee plays a significant role in the oversight of a company's internal controls, the integrity of its financial reporting processes, and the approval and independence of the external auditor. SEC rules require management to annually disclose whether its board of directors has at least one audit committee financial expert who is independent of management. The expert must have a thorough understanding of the audit committee's oversight role, expertise in accounting matters, understanding of financial statements, and the ability to ask the right questions to determine whether the company's financial statements are complete and accurate. This requirement places notable importance on the governance role provided by the audit committee.

Auditors communicate significant audit risks to a company's audit committee. These may include critical accounting policies and practices and critical accounting estimates, among other items which may be considered critical auditing matters. Requiring the auditor to further clarify and provide public discussion regarding these matters autonomously in its audit report unavoidably reduces the importance of the governance role performed by the audit committee, as greater oversight responsibility is undertaken by the auditor instead. We believe the information included in the auditor's working papers regarding significant judgments involved in the audit should appropriately be communicated to the members of the audit committee, who have the opportunity for robust dialogue with the auditor. The audit committee can then analyze this information in the appropriate context and ensure the company's financial statement disclosures appropriately present these matters in a manner that is not confusing to investors. This is another area we do not believe a requirement for an auditor to discuss critical audit matters adds value beyond the existing regulatory framework.

### *Relationship of Management, the Audit Committee and the Auditor*

In the current regulatory environment, the relationship between management, the audit committee, and the auditor typically has a healthy level of tension, which leads to disclosure of constructive financial information that benefits financial statement users. The appropriate level of tension in these relationships has a very delicate balance which should be maintained. We have serious concerns the expansion of the auditor's role will place a significant strain on these relationships. Placing a requirement on the auditor to disclose critical accounting and auditing matters independently of management and the audit committee raises concerns about confidentiality. It also may discourage certain management teams and audit committees from discussing various matters with the auditor due to apprehension about additional public disclosure. This may lead to an unproductive level of confrontation, as each party disputes the types of critical matters which should or should not be included in the auditor's report and the language with which these should be conveyed. We do not believe there is a need for dissemination of complex, judgmental audit information to extend beyond the audit committee and management.

### **Potential Confusion among Financial Statement Users**

We are concerned that additional disclosures made by the auditor regarding critical audit matters will likely create confusion among financial statement users. The result will be overlapping, conflicting, inconsistent and onerous information added by both management and the auditor. Many financial statement users do not have the appropriate context to properly interpret the matters requiring the most complex auditor judgments that the audit committee has. This context includes live interaction with the auditor and deep background knowledge of the company's financial reporting processes integral to the audit committee's oversight role.

### *Confusing, Lengthy Information within the Audit Report*

The Proposed Standards define critical auditing matters as those matters that involved the most difficult, subjective, or complex auditor judgments; posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; and posed the most difficulty to the auditor in forming an opinion on the financial statements. Users who read an unqualified audit opinion followed by detailed discussion of critical auditing matters may misinterpret the language as demonstrating the auditor had reservations about the opinion provided, and consequently undermine the audit opinion. Far worse, they may incorrectly conclude they should not place reliance upon financial information in these areas. Even if the audit report is extended multiple pages, it is characteristically impossible for an auditor of a global company to accurately convey the audit effort related to all complex audit areas without leading to misconceptions by financial statement users who lack the perspective of the audit committee and also lack the opportunity for active dialogue with the auditor. We also believe auditors may include tedious legal disclaimers to avoid liability that could be associated with their expanded reports. We question whether this addition of lengthy and possibly confusing materials to the audit report adds value to investors who are already encumbered with voluminous financial disclosures.

We are also concerned that requiring the auditor to read and evaluate other information outside the audited financial statements, rather than read and consider this information as currently required under AU Section 550, will create further confusion about who is accountable for the financial statements and related information. Specifically, users may conclude that the auditor, rather than management, has responsibility for this other information, which includes forward looking statements, operating statistics, discussion of business performance, and analysis of the business outlook and environment "through the

eyes of management” as required by SEC rules. Moreover, we question how an auditor could evaluate certain other information, such as material incorporated by reference from the Proxy Statement, when that content is not yet available at the time the audit report is issued.

Auditors currently read financial information in the MD&A, earnings releases, and other sources for inconsistencies with the audited financial statements. We understand investors may not fully realize these additional procedures currently being performed by the auditor. To the extent investors require additional clarification over the auditor’s current responsibilities regarding other information outside the audited financial statements; we support the inclusion of a statement in the auditor’s report clarifying this role.

#### *Disclosure of Duplicative, Conflicting and Confidential Information*

The expansion of the auditor’s responsibilities also poses a significant risk for disclosure of duplicative, conflicting and confidential or competitively sensitive information. The matters currently included in the MD&A disclosures will almost certainly be judged as critical audit matters that are communicated to the audit committee. In addition, auditors may have numerous other matters included in the engagement completion documents or reviewed by the engagement quality reviewer that warrant consideration for disclosure as critical audit matters as defined in the Proposed Auditing Standards. Information underlying these complex auditing matters and conclusions reached should be clearly documented in the auditor’s supporting working papers, which are currently subject to both PCAOB investigations and peer review. We are concerned that auditors, who anticipate inspection and peer review findings, may disclose more of these matters, as well as more information on the matters currently discussed by management, than investors would find useful. Accordingly, in addition to duplication, there may also be significant discrepancies between the critical auditing matters disclosed in the audit report and the critical accounting estimates and accounting policies disclosed by management. This could raise the level of confusion and lead to potential issues regarding confidentiality.

#### **Significant Costs Overshadowing Negligible Benefits**

When new regulations are considered, a thorough cost/benefit analysis should be performed to ensure financial statement users receive benefits which outweigh the costs of implementation and compliance. As the PCAOB notes in Appendix 5 V.F.1. of the PCAOB Release, companies and their audit committees will incur additional recurring costs due to audit fee increases, additional time for review of critical audit matters and discussion with the auditor, and time spent comparing the critical audit matters identified by auditors of industry peers.

We believe these costs will be significant and can easily be underestimated. Based on preliminary discussions, it appears likely our audit fees will increase by no less than 5% due to time spent on critical auditing matters and procedures performed evaluating other information outside the audited financial statements. While this percentage may not appear substantial, when it is applied to a consolidated audit fee of \$14.4 million, as disclosed in our 2013 Proxy Statement, the dollar amount is not trivial. Further, we believe the extended length of the financial reports, the additional time incurred and resources involved reviewing and discussing critical audit matters, as well as the costs associated with disclosure risk of confidential information and investor confusion, warrant seriously challenging the appropriateness of the suggested changes.

The Chair of the SEC, Mary Jo White, in her October 2013 speech to the National Association of Corporate Directors, questioned whether investors are well-served by the existing burdensome

disclosure, described as “information overload,” in financial filings. In addition, the FASB has taken up a formal project to improve the effectiveness of disclosures by clearly communicating the information that is most important to users of each entity’s financial statements. The implementation of auditing standards that further duplicate disclosures and add new disclosures will be burdensome to financial statement users. This fundamentally violates the principles underlying the SEC and FASB objectives for more resourceful and streamlined financial information.

Auditor evaluation and reporting on information outside of the audited financial statements will increase the scope of the auditor’s assurance responsibilities, adding further procedures and increasing the amount of time spent in an already time-consuming process for both the auditor and management. We are concerned with the amount of time needed to complete these additional procedures within existing reporting deadlines. We are also apprehensive that increasing the scope of the auditor’s assurance responsibilities will result in the development of still more auditing standards and additional regulatory efforts in an industry that is already burdened with abundant rules.

We are further perplexed by the PCAOB’s intent to require disclosure of audit firm tenure in audit reports. As the PCAOB admits in the Release, “the Board has not reached a conclusion regarding the relationship between audit quality and audit firm tenure.” The limited number of empirical studies, of which we are aware, addressing the relationship between audit firm tenure and audit quality indicate audit quality is positively correlated with audit firm tenure. The PCAOB states that financial statement users have indicated a strong interest in this information, yet the Release provides only narrow discussion regarding one shareholder activist group. We would expect the PCAOB to provide more comprehensive dialogue in this area, including results of its own empirical studies and cost/benefit analysis, rather than focusing the debate on a limited group of activists. After more vigorous due process, if the final conclusion is audit firm tenure should be disclosed, we strongly believe this additional information should be provided by management. Likewise, management should have the opportunity to provide related narrative so financial statement users do not reach an inappropriate conclusion regarding the correlation between audit quality and audit firm tenure.

Given the substantial and definitive costs of compliance with the Proposed Auditing Standards, the PCAOB Release, comprising nearly 300 pages of material, explained the potential benefits of these standards in merely a few short paragraphs. The discussion of benefits is largely conditional, using language such as “a more informative auditor’s report could benefit investors,” and the discussion wholly lacks any form of specificity. We do not believe additional disclosure of critical auditing matters by the auditor provides value to financial statement users as a whole, and we doubt whether a requirement for auditor evaluation of other information adds any value beyond that already provided by the requirements of AU Section 550. It certainly suggests the proposed standard would be challenged to withstand a rigorous cost/benefit analysis.

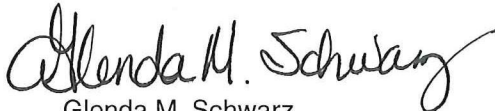
We respectfully disagree with the PCAOB’s conclusions investors would benefit from further insights obtained by the auditor during the audit of the financial statements. We question whether purported benefits in terms of increased confidence in corporate reporting outweigh the costs. An extended audit report and the expanded role of the auditor into a preparer of financial information provides no perceived enhancement to corporate governance, no reduction of investor risk and no additional comparability of reports. We see no provisions to ensure consistency of application across audit reports, and this lack of comparability will cause further confusion. We question the unsubstantiated presumption that users of financial statements will find this greater volume of disclosure from the auditor helpful, in addition to the existing detailed disclosures from management already required by the present authoritative literature. The Proposed Auditing Standards appear to be a solution in search of a problem, and we request a much more comprehensive analysis of the specific benefits.

## Summary and Conclusion

We commend the PCAOB's efforts to make the auditor's report more informative, thus promoting its relevance and usefulness to investors and other financial statement users. With respect to proposed enhancements to the auditor's report regarding the auditor's responsibilities for fraud and notes to the financial statements, as well as auditor independence and clarification of the *current* auditor responsibilities to read and consider other information – to the extent that these matters promote this objective, we are supportive. We believe the PCAOB needs to more strongly consider the negative impacts caused by the provisions in the Proposed Auditing Standards requiring additional disclosures concerning critical audit matters as determined by the auditor, disclosure of audit firm tenure, and enhancing the auditor's responsibility with respect to other information outside the audited financial statements. The negative consequences of shifting the responsibilities of management and the audit committee to the auditor; creating confusion among users of the financial statements; and imposing implementation and ongoing costs which significantly overshadow negligible benefits warrant heavier consideration. Considerable effort must be made to identify more specific benefits which outweigh these substantial, definitive costs. We strongly believe any additional information deemed necessary for users of the financial statements should be provided by management, and it should be addressed by financial reporting standards and SEC rules rather than new auditing standards.

We thank you for the opportunity to offer our comments on the Proposed Auditing Standards, and we hope that you find our comments helpful. Please contact Ken Seaman, Assistant Controller, by telephone at (281) 293-5628 or by e-mail at [Ken.W.Seaman@conocophillips.com](mailto:Ken.W.Seaman@conocophillips.com) if you have any questions or wish to discuss our comments further.

Sincerely,



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