Paris-aligned accounting is vital to deliver climate promises - Investor Statement

18th June 2020

Last week, BP announced that it will lower the long-term oil and gas price assumptions used in its financial statements to $55 per barrel and $2.90 per million British thermal units, respectively, resulting in substantial estimated impairments of between $13 and $17.5 billion. This is equivalent to 13-17% of 2019 net assets.

This move by BP should be commended. It is hugely important, not just to BP shareholders who now have greater clarity over climate risks embedded in the business, but it has far-reaching implications for the world's ability to deliver on its commitment to the Paris Agreement.

Until we get Paris-aligned numbers at all companies, we cannot have confidence the companies will deliver their Paris promises. This is because the accounts tell executives what capital they have to deploy, and which investments will be most profitable. Where the numbers leave out material climate risks, both capital and performance will tend to be overstated, and this in turn will encourage company executives to over-allocate to harmful fossil fuels.

In short, Paris-aligned accounts give teeth to companies' Paris commitments.

BP's decision to bring down commodity price assumptions to reflect a decarbonising world follows an engagement by institutional investors. In a letter sent to BP's Audit Committee and the lead audit partner in November last year, which we are releasing today along with parallel letters sent to Royal Dutch Shell and Total, the investors made clear their expectations that BP would ensure its accounts were drawn up in a way that took account of the Paris Climate Agreement. Specifically, the investors asked for disclosure on:

- *How critical accounting judgments including, but not limited to, commodity prices, discount rates, and asset lives have been tested against credible economic scenarios that are consistent with achieving net zero carbon emissions by 2050 to 2070 and any adjustments made to these assumptions.*
- *The results of sensitivity and/or scenario analysis linked to variations in these judgements/ estimates, including one that is Paris-aligned if this is not used as the base case.*
- *Adjustments to distributable reserves to reflect energy transition risks to ensure dividends are not paid out of capital as per requirements under Part 23 of the Companies Act 2006; and threshold assumptions that would trigger cuts to dividends.*
- *Consistency between BP's disclosed climate-related risks set out under "Risk factors" and the assumptions that underpin the long-term viability statement and in the accounts.*
- *Consistency between the assumptions (notably long-term oil and gas prices and carbon taxes) used in the company's capital expenditure planning process and those used in the accounting process.*

The investors also asked for affirmation that the Audit Committee had taken steps to ensure material climate risks are properly considered by the external auditor. They pointed out at the time that BP's auditor, Deloitte, had mentioned climate change as a factor considered in impairment testing in the 2018 accounts, but it was unclear what impact this had and why the long-term price assumption was not changed.

BP's announcement last week begins to answer the investor group's call.

Shell and Total have also acted following parallel investor engagements, lowering their oil and gas price assumptions used in their 2019 audited accounts explicitly linked to accelerating decarbonisation. BP and Shell's auditors, Deloitte and EY deserve special mention for the detailed disclosures on climate risks included in this year's extended auditor report to shareholders. While there is further to go, we welcome these positive steps.

Other fossil fuel dependent companies need to sit up and take note. Based on our analysis of major European fossil fuel companies' 2019 financial statements (see summary table below), it is clear that almost none have aligned their critical accounting assumptions with the Paris Agreement. The level of BP's impairments demonstrates the potential materiality of this risk hidden in companies' balance sheets.

The question all company directors and their shareholders now need urgently answered is where else might company positions be overstated. And this question is not only pertinent to oil and gas companies, but any company that depends on fossil fuels to deliver future profits.

The investors below are part of a growing group calling on directors and auditors to act sooner rather than later to ensure Paris-aligned accounts that deliver a sustainable planet.

Signatories

Natasha Landell-Mills, Sarasin & Partners LLP

Cllr Doug McMurdo, Local Authority Pension Fund Forum

Craig Martin, Environment Agency Pension Fund

Faith Ward, Brunel Pension Partnership Ltd

Adam Matthews, Church of England Pensions Board

Harry Ashman, Church Commissioners of England

Valborg Lie, LGPS Central

Jeremy Punnett, M&G

Bruce Duguid, EOS at Federated Hermes, on behalf of its stewardship clients

Andrew Mortimer, Jupiter

Freddie Woolfe, Merian Global Investors

Eric Tracey, GO Investment Partners LLP

Peter Parry, UK Shareholders Association

Heike Cosse, Aegon Asset Manager

Louise Aagaard Jensen, PKA

Anna Maria Fibla Møller, P+

Eoin Fahy, KBI Global Investors

Faryda Lindeman, NN Investment Partners

Dr. Jan Amrit Poser, Bank J. Safra Sarasin Ltd

Wim Van Hyfte, Candriam

Tristan Delaunay, Indep'am

Tracey Rembert, CBIS

Rob Fohr, Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A

Table 1: Comparison of European oil and gas companies' commodity price assumptions used in financial statements

Company	Auditor (2019)	2017 LT prices	2018 LT prices	2019 LT prices
RD Shell	EY	Oil: $80/bbl (2020)	Oil: $70/bbl (2021) Gas: $3.5/mmBtu (2021)	Oil: $60/bbl (2022) Gas: $3/mmBtu
BP	Deloitte	Oil: $75/bbl Gas: $4/mmBtu	Oil: $75/bbl (2025) Gas: $4/mmBtu (2032)	Oil: $70/bbl [June 2020: $55] Gas: $4/mmBtu [June 2020: $2.90]
Total	KPMG EY	Oil: $80/bbl (2021) Gas: NBP $7/mmBtu (2020-24)	Oil: $80/bbl (2021) Gas: NBP $7/mmBtu (2020-24)	Oil: $70/bbl 2025-2030, falls to $50 in 2050 Gas: NBP $6/mmBtu HH $2.6/mmBtu
Repsol	PWC	Oil: $97.5/bbl (2026)	Oil: $106/bbl (2030) Gas: $5.9/mmBtu (2030)	Oil: $87/bbl (2035) then flat in money terms Gas: $5/mmBtu (2035)
Eni	PWC	Oil: $70/bbl (2022)	Oil: $70/bbl (2022)	Oil: $70/bbl (2022) Gas: $7.8/mmBtu
Equinor	KPMG	Oil: $84/bbl (2030)	Oil: $82/bbl (2030) Gas: $4.10/mmBtu (2030)	Oil: $80/bbl (2030) Gas: $3.60/mmBtu (2030)

Source: Sarasin & Partners analysis of company 2019 Annual Report and Accounts

Notes:

- Gas prices are Henry Hub (HH) unless otherwise indicated; Oil prices Brent
- Prices are given for different dates, so care is required in making comparisons. The quoted price relates to the date in brackets. Normally, the prices are in 2019 value terms.
- Generally, oil and gas prices are assumed to rise with inflation of 2% pa (and remain flat in real terms), unless otherwise indicated.