Brendan Nelson
Audit Committee Chair
BP plc
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United Kingdom
(c/o ben.mathew@bp.com)

26 November 2019

Dear Mr. Nelson,

Assurance that BP is accounting for material climate risks

We are writing as a group of long-term investors to seek assurance that BP plc is incorporating material climate-related risks in its financial statements and associated notes[1]. As you will be aware, there has been considerable interest in improving company reporting of material climate risks in companies' narrative reporting in line with the Financial Stability Board's Task Force for Climate-related Financial Disclosures (TCFD). We are writing to ask that, alongside improving narrative disclosure, the Audit Committee ensures BP's financial reporting meets company law requirements to provide a "true and fair" view of the underlying economic health of the entity.

To provide us with sufficient comfort that BP's accounts are reflecting material climate risks, we would welcome the following disclosures:

- 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[2].
- 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.

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[1] The focus of this letter is on decarbonisation, but we are also concerned that the accounts reflect material physical impacts from climate change wherever possible.
[2] The IPCC Special Report "Global warming of 1.5C" sets out the emission reduction trajectories – and net zero requirement by 2050-2070 – consistent with achieving the well below 2C and 1.5C targets agreed in the Paris Climate Agreement.

- 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 (for instance, the accounts assume oil and gas prices of $75/bbl and $4/mmBtu for Henry Hub from 2024 in 2015 prices, rising with inflation every subsequent year).
- Steps taken by the Audit Committee to ensure material climate risks are properly considered by the external auditor, and the impact that this has had. We note that Deloitte mentioned climate change as a factor considered in impairment testing in the 2018 accounts, but we are uncertain what impact this had and why the long-term price assumption was not changed.

Our requests are in line with calls by the new Chief Executive of the Financial Reporting Council in his annual letter to Audit Committee Chairs and Finance Directors, in which he states (our emphasis added)[3]:

> "*… consistent with the UK Corporate Governance Code's focus on emerging risks, and after considering the likely consequences, companies should, where relevant, report on the effects of climate change on their business (both direct and indirect). Such reporting should cover how the Board has taken account of the resilience of the company's business model and its risks, uncertainties and viability in the immediate and longer term in light of climate change. <u>It should also consider the impact on the financial statements, in particular in relation to asset valuation and impairment testing assumptions</u>.*"
>
> … "*We will continue to have a key focus on the adequacy of disclosures supporting transparent reporting of estimation uncertainties. An <u>understanding of their sensitivity to changing assumptions is of critical value to investors, giving them clearer insight into the possible future changes in balance sheet values</u> and which can inform their investment decisions.*"

In the event you are unable to give assurance that climate risks are being incorporated into the accounting and audit process, we would welcome an explanation.

Context

Under the Paris Agreement, Article 2.1(c) signatories have committed to "*Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*". Based on the latest climate science, the Intergovernmental Panel on Climate Change believes that a well below 2°C pathway will need to get us to net zero carbon emissions between 2050 and 2070.

[3] https://www.frc.org.uk/getattachment/71345784-8f60-438b-a474-fc7c79ace9e3/Year-end-letter-(003).pdf

Accounting numbers are critical in directing finance flows, both by determining the capital available for investment as well as a key driver of executive performance-related pay and thus incentives. This point is emphasised by the TCFD. In the Spring, IIGCC published a briefing paper (attached) setting out the responsibilities for Audit Committees and auditors to consider material climate risks as part of their existing obligations to ensure that a company's financial statements deliver a true and fair view of the underlying economics of the business.

As you will know, in the UK the capital maintenance regime further requires that accounts are drawn up prudently to prevent illegal distributions (i.e. distributions out of capital)[4]. Foreseeable losses or liabilities need to be accounted for, while unrealised gains should not be treated as distributable. These requirements underpin trust in financial markets as they reassure providers of both debt and equity that their capital is protected.

Finally, it is important that key judgments, assumptions, sensitivities and uncertainties are disclosed to shareholders, and that the narrative disclosures in the Annual Report and Accounts (such as the Strategic Report, including the Viability Statement) are consistent with the numbers presented in the accounts. These disclosures are also part of meeting requirements for company Report and Accounts to be "fair, balanced and understandable".

Our concerns

We have concerns that, at present, BP's accounts may be over-looking material climate considerations, and consequently potentially overstating both performance and capital. The most obvious risk is that decarbonisation will reduce long-term demand for fossil fuels likely leading to structurally lower oil and gas prices and thus potentially margins and profitability. Risks of impairments, reduced asset lives and higher asset retirement obligations are potentially material.

Research by Carbon Tracker, using Rystad data, suggests that decarbonisation in line with the Paris goals would result in a structural long-term price closer to $40 per barrel than the $75 per barrel BP is using[5]. Aurora Energy Research, a market intelligence firm, produces similar price projections where decarbonisation is delivered in line with the Paris goals. Moreover, BP's own announced goal in its 2018 Annual Report to shareholders is to achieve break-even for the overall business at $35 to 40 per barrel by 2021, suggesting this may be a more sensible view of what the company needs to plan for. While it is impossible to know the future, the Board of directors should both adopt a prudent mindset in drawing up its accounts and ensure consistency between the front and back halves of the Annual Report and Accounts.

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4 Part 23 2006 Companies Act s830 sets out that for distributions (e.g. dividends) to be legal, they can only be made out of "profits available for the purpose". This means accumulated realised profits not needed to cover foreseeable losses. In addition, companies must comply with the "net asset restriction" (s831), which prohibits distributions that result in net assets falling below the aggregate called up share capital and undistributable reserves. Similar legal requirements exist in the European Union.

5 https://www.carbontracker.org/reports/breaking-the-habit/

As shareholders, we would also like to understand the sensitivity of BP's key assets, liabilities and reported equity to lower commodity prices, including a price aligned with achieving net zero carbon emissions by 2050. Further, we would like to understand how these balance sheet impacts flow through to the Profit and Loss account as well as dividend paying capacity.

Uncertainty around the decarbonisation trajectory is not a reason to delay accounting and reporting adjustments. Indeed, it is precisely because of the high level of uncertainty around the transition pathway that BP has a greater responsibility to provide enhanced disclosure around critical judgments and sensitivities to different decarbonisation scenarios, including one aligned with the Paris goals.

Meeting request

We would be grateful if you would share this letter with other members of the Audit Committee and the Lead Independent Director. We would welcome a dialogue with you on the points we raise.

We are also copying in the lead audit partner, Douglas King at Deloitte, to ensure he is clear about shareholder concerns and can reflect this as he acts on our behalf in performing the audit. We have further raised our concerns with the Financial Reporting Council. Finally, it is worth saying that we will be taking your and Deloitte's response to these enquiries into account as we formulate our voting decisions at the next Annual General Meeting.

We would be grateful if you could contact Natasha Landell-Mills (natasha.landell-mills@sarasin.co.uk) to arrange a meeting.

Yours sincerely,

Natasha Landell-Mills, Partner
Sarasin & Partners LLP

Cllr Doug McMurdo, Chair
Local Authority Pension Fund Forum

Valborg Lie, Stewardship Manager
LGPS Central

Faith Ward, Chief Responsible Investment Officer
Brunel Pension Partnership Ltd

Edward Mason, Head of Responsible Investment
Church Commissioners for England

Ashish Ray, Head of Governance and Sustainability
Jupiter Asset Management

Peter Parry, Policy Director
UK Shareholders Association

Dewi Dylander, Head of ESG
Danish Labour Market Pension Fund (PKA Ltd.)

Kirstine Lund Christiansen, Head of ESG
P+(DIP/JOEP)

Charlotte Sølling, ESG Manager
MP Pension

Eoin Fahy, Head of Responsible Investing
KBI Global Investors

Wim Van Hyfte, Global Head of ESG Investments & Research
Candriam

Rob Fohr, Director of Faith-Based Investing and Corporate Engagement
Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A

Nicholas Abel, Sustainable Investment Services
Wespath Benefits and Investments

Tracey Rembert, Director, Catholic Responsible Investments
Christian Brothers Investment Services, Inc.

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Helge Lund, Chair
Paula Reynolds, Director, Audit Committee
Pamela Daley, Director, Audit Committee
Dame Alison Carnwath, Director, Audit Committee
Ian Davis, Senior Independent Director
Douglas King, Lead Audit Partner, Deloitte
Bruce Duguid, CA100+ Lead investor (EOS at Federated Hermes, on behalf of its stewardship clients)