CNOOC Limited

China, Oil & Gas

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<tr><td colspan="7">Summary view:
• Despite the significant carbon impact of CNOOC and the numerous transition and also physical climate risks that the company faces, the 20-F narrative reporting only very briefly considers climate. There is no apparent consideration given to climate issues in the assumptions and estimations used for the audited financial statements.
• The ESG Report – produced at approximately the same time as the 20-F and with limited assurance by the same audit firm – has more detailed discussion of climate risks and some disclosures on carbon emissions. However, CNOOC appears to be at an early stage in its thinking on climate change.</td></tr>
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Background

<u>The Business</u>

- CNOOC Ltd engages in exploration, production and trading of crude oil and natural gas and is the main producer of offshore crude oil and natural gas in China.[1] At end 2020, the company had 5.4bn barrels of oil equivalent in net proved reserves, with 58% located in China and 42% in overseas operations and interests. Average daily net production in 2020 was 1.4m barrels of oil equivalent. CNOOC Ltd aims to increase production with CAPEX set to grow from RMB77bn in 2020 to RMB94bn in 2021.
- CNOOC Ltd is a Hong Kong-incorporated and listed subsidiary of parent company CNOOC, incorporated in (Mainland) China. Through CNOOC, the Chinese government owns 65% of CNOOC Ltd with the remaining 35% as free float.
- CNOOC Ltd also has ADRs listed on the New York Stock Exchange, but trading has been suspended since March 2021 pending anticipated delisting. In November 2020 President Trump signed an Executive Order which prohibits US investment in companies identified by the US government's Office of Foreign Assets Control as being linked to China's military.
- According to its ESG Report, CNOOC Ltd's GHG emissions for 2020 totalled 9.3m tonnes of CO2 equivalent (9.1m tonnes Scope 1 and 0.2m tonnes Scope 2). These numbers do not include Scope 3 emissions, which will be much higher for a company operating in this sector.
- CNOOC Ltd faces substantial transition risks particularly as the Chinese government seeks to contain carbon emissions in the medium-term (peak emissions 2030) and achieve carbon neutrality by 2060. Government "policies and regulations" are noted as the first climate risk in the ESG Report with other risks including "market risk" as consumers seek lower-carbon energy sources, and reputational risk. The main physical risk identified is extreme weather, such as hurricanes and typhoons, and resulting damage to offshore assets.

<u>Approach to climate change</u>

- The 20-F narrative reporting highlights climate risk as one of the Risk Factors facing the company: "Rising climate change concerns could lead to additional regulatory measures that may result in higher costs … If we are unable to find economically viable and publicly acceptable solutions that could reduce our CO2 emissions from our new and existing projects, we may experience additional costs, and our reputation may be adversely affected." The

[1] China's 'Big Three' oil companies comprise: CNPC Group (parent company of Hong Kong-listed PetroChina), which is vertically integrated but historically specialised in onshore upstream exploration and production; Sinopec Group (parent company of Hong Kong-listed Sinopec), which is vertically integrated but historically specialised in refining and marketing; and CNOOC (parent company of Hong Kong-listed CNOOC Limited), historically specialised in offshore upstream exploration and production.

company also makes a high-level statement that “while pursuing production growth, we will actively respond to climate change and build a green and low-carbon enterprise”. However, beyond these statements, there is little consideration given to climate issues, even on subjects where there is a clear climate risk, such as forecasts for oil and gas prices and demand or impairment of oil and gas properties.

- The ESG Report covers climate issues in much greater detail and even states that “CNOOC supports the climate goals set in the Paris Agreement”. However, the ESG Report still gives the impression that CNOOC Ltd is at an early stage in its consideration of these issues and that the company is responding to the signals from the Chinese government. In March 2021, CNOOC Ltd committed to targets that almost exactly echo those of the Chinese government, with the company’s CO_2 emissions to peak before 2030 and carbon neutrality before 2060.
- CNOOC Ltd puts considerable emphasis on its expansion plans in natural gas as a contribution to “low-carbon transformation”. Presumably, the reasoning is that natural gas will replace much higher emitting coal consumption in China’s energy mix. By 2025, CNOOC Ltd targets 30% of total production to be natural gas.
- By 2025, 5% of CAPEX each year will be allocated to ‘new energy’. In 2020 CNOOC Ltd began operations at its first offshore wind project, with planned installed capacity of 300MW, while a second offshore wind project is now being developed.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- As a Hong Kong-incorporated company with a primary listing in the territory, CNOOC Ltd prepares its consolidated financial statements in accordance with both IFRSs issued by the IASB and HKFRSs issued by the Hong Kong Institute of Certified Public Accountants.
- There is no reference in the notes to the financial statements that accounting judgements have been impacted by climate-related considerations.
- In 2020 there were impairment losses of RMB6,697m (approx $1bn) on oil and gas properties across the world. The audited financials state that these impairment losses were taken primarily as a result of the decline in forecast oil price, but it is not disclosed to what extent, if any, these lower price forecasts were a result of climate change considerations.

Consistency with other reporting		Significant concerns

- The lack of any reference to climate considerations in the financials is at least consistent with the limited discussion of climate risks in the narrative reporting of the 20-F and Annual Report.
- However, there is an inconsistency with the ESG Report’s greater coverage of climate risks and the stated goals of peak carbon emissions before 2030 and carbon neutrality before 2060. The ESG Report was published in March 2021 – one month before the 20-F.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.
- In fact, the notes to the financial statements specifically state that CNOOC Ltd “believes that the preparation of sensitivity analysis for the impairment testing will be impracticable”.

Paris alignment		Significant concerns

- With no visibility, there can be no alignment with the goals of the Paris Agreement.

Audit: visibility in CAMs and consistency check

Audit firm: Deloitte Touche Tohmatsu	Responsible partner: Lam Kwok Yan
Audit standards: PCAOB[2]	

Visibility in Critical Audit Matters		Significant concerns

- There is no reference to climate change in the auditor's report.
- There are two related CAMs identified: (i) impairment and provision – depreciation, depletion and amortisation; and (ii) impairment and provision – determination of the recoverable amount of the oil and gas properties
- These two closely-related CAMs are both identified because they involve a number of significant judgements made by company management in assessing quantities of reserves and estimating recoverable amounts. The second of these two CAMs specifically refers to estimated future oil and gas prices as being a significant assumption made by management, but there is no apparent consideration of whether climate risk has impacted these future price estimates.

Consistency check		Some concerns

- PCAOB audit standards require the auditor to read other information that is presented together with financial statements and the auditor's report thereon. The auditor's report is silent on the outcome of the review, which implies that no material inconsistency was identified in the other information within the 10-K.
- The apparent absence of climate considerations in the audited financial statements is at least consistent, in a minimal sense, with the limited discussion of climate issues in the narrative reporting in the annual report.
- The same audit firm, Deloitte Touche Tohmatsu, provided a limited assurance engagement for the ESG Report in March 2021. However, the report on this limited assurance work specifically notes that it only covered "selected data and performance claims", while the procedures performed in a limited assurance engagement are less rigorous than for a reasonable assurance engagement and that "therefore a lower level of assurance is provided".

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.		**Key**
		Good practice
		Few concerns
		Some concerns
		Significant concerns

[2] The auditor's report states that the audits were conducted in accordance with the standards of the PCAOB. However, the PCAOB notes that it does not have access to conduct inspections and investigations of audit work of PCAOB-registered firms in China. (https://pcaobus.org/oversight/international/china-related-access-challenges) Although CNOOC Limited is incorporated in Hong Kong, the audit of the company's operations in China is not subject to inspection by the PCAOB.

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