Petrobras

Brazil, Oil and Gas

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<tr><td colspan="7">Summary view:
• There is a disconnect between the relatively extensive coverage of climate-related issues in the narrative reporting and the lack of any reference to these considerations in the audited financial statements (although Petrobras does disclose the oil price assumption used for impairment testing).
• The narrative reporting covers not only targets / commitments on carbon emissions, but also discussion of carbon risks to Petrobras and description of different long-term oil price assumptions. However, it is not clear how these risks and scenarios feed through to accounting judgements, for example, on asset life, impairments and decommissioning costs.</td></tr>
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Background

The Business

- Petrobras is the publicly listed, 36% state-owned national oil company of Brazil. They are one of the largest producers of oil and gas in the world, primarily engaged in exploration and production, refining and trading. The ultra-deepwater "pre-salt" oil fields off the south eastern Brazilian coast are expected to continue to remain the main source of future growth of proved reserves of oil and gas. Having sold down their stake, Petrobras is now a minority shareholder in BR Distribuidora, the largest diesel and petroleum retailer in Brazil.
- Petrobras is significantly exposed to climate-related issues both through their scope 1 and 2 emissions (ranging from the carbon emissions of exploration and production through refining and distribution) and the scope 3 emissions from the use and further processing of their products.

Approach to climate change

- Petrobras has cited climate change as a significant risk both in the narrative reporting of their annual report and other disclosures, including a Climate Change Supplement. More specific reference is made not only to the possibility of increased operating expenses and reduced demand for their products but also, notably, to the possibility of reduced access to capital due to "public image issues with investors." The stated strategy of the company is to be resilient in a scenario of lower oil prices and higher carbon prices by being one of the lowest cost producers of oil and gas with comparatively lower carbon emissions.
- The company has made 10 sustainability commitments, the majority of which relate to carbon emissions, including: a 25% absolute reduction in operational emissions by 2030; a 32% reduction in carbon intensity in upstream operations by 2025; and a 16% reduction in carbon intensity in refining by 2025, and 30% reduction by 2030. These commitments relate primarily to reductions in scope 1 emissions, rather than scope 3 emissions from their products – despite 87% of Petrobras' total value chain emissions being from Scope 3 emissions, while only 13% are from Scope 1 (Scope 2 emissions are negligible).
- Metrics related to carbon intensity in upstream and refining operations are a "main indicator" influencing variable remuneration for all employees.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- With ADRs listed in New York, Petrobras reports under IFRS and publishes a 20-F Annual Report.
- While the narrative reporting suggests that climate-related considerations do impact long-term oil price assumptions, which in turn, should impact certain judgements by the company (e.g. asset life), there is no reference in the notes to the audited financial statements to accounting judgements having been impacted by climate-related considerations. In fact, the explanatory notes in the financials explain that the downward revision to oil price assumptions in 1Q20 was driven by the collapse in oil prices with the on-set of the pandemic and over-supply from OPEC.

Consistency with other reporting		Significant concerns

- In addition to an annual report, Petrobras publishes both a Sustainability Report (following GRI standards) and, starting in 2019, a Climate Change Supplement. However, these additional reports are not issued at the same time as the annual report. At the time of writing, Petrobras had not yet issued a Sustainability Report nor the Climate Change Supplement for 2020.
- There is a disconnect between the relatively extensive discussion of climate issues in the narrative reporting – both in the annual report and elsewhere – and the lack of any clear reference to climate considerations in the audited financial statements. The narrative reporting suggests that the energy transition is a consideration in long-term oil price assumptions, which should feed through to various underlying accounting judgements, but this link is not clearly evidenced or articulated.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Some concerns

- There is some limited disclosure of climate-related assumptions in the financials. Petrobras discloses oil prices used for impairment testing with prices ranging $45-$50 for the next five years (2021-25) and a "long-term average" of $50. The explanatory notes in the financials explain that this downward revision to these prices in their strategic plan in 1Q20 was driven by the collapse in oil prices with the on-set of the pandemic. (The narrative reporting, in contrast, makes a general remark that climate has impacted long-term forecasts but the timing suggests that the primary driver was the impact on oil demand due the pandemic and economic downturn.)
- The narrative reporting, but not the audited financial statements, disclose some sensitivity analysis around various scenarios from the International Energy Agency including the Sustainable Development Scenario (which would result in a 10% decrease in net present value) and a Stated Policies Scenario (which would result in a 40% increase in net present value).

Paris alignment		Significant concerns

- Although the narrative reporting – but not the financials – state that the revised long-term price assumptions are "compatible with scenarios aligned with the Paris agreement", this is little more than an assertion with the price assumptions used appearing to have little relation to Paris-aligned scenarios.

Audit: visibility in CAMs and consistency check

Audit firm: KPMG	Responsible partner: Marcelo Gavioli[1]

[1] Audit partner for 2020 20-F Annual Report is not stated, but Marcelo Gavioli was the KPMG Engagement Partner for Petrobras in 2020.

Audit standards: PCAOB

Visibility in Critical Audit Matters		Significant concerns

- There is no reference to climate change in the auditor’s report.
- There are 4 CAMs identified: (i) measurement of the defined benefit obligations for pension and health plans; (ii) impairment testing of exploration and production assets; (iii) provisions and disclosures for certain labour, civil and tax lawsuits; (iv) provision for decommissioning costs.
- Both the second (impairment testing) and fourth (decommissioning costs) CAMs would be expected to depend in part on climate-related considerations. However, there is no mention of whether climate issues are an aspect of these CAMs, even though the narrative reporting suggests that climate issues are a factor considered in estimating long-term oil and gas pricing, which, in turn, could impact impairments and decommissioning.
- The Annual Report of the Audit Committee does not reference any climate-related considerations.

Consistency check		Significant concerns

- The scope of the auditor’s work appears to only cover audit of the Consolidated Financial Statements as the audit report does not refer to any assurance or review of other information from the company, such as the narrative reporting in the 20-F or last year’s separate Climate Change Supplement.
- KPMG also provided limited assurance on the Sustainability Report 2019.

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

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