Sinopec

China, Oil & Gas

Accounting		Climate Assumptions		Audit		Date of analysis: May 3 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2021 Report date: April 20 2021 AGM: May 25 2021
						CA 100+ company, so seen by investors as key to driving global net zero emissions
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Some concerns	

Summary view:

- Despite the significant carbon impact of Sinopec 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 Sustainability 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, Sinopec appears to be at an early stage in its thinking on climate change and does not yet have a climate strategy.

Background

<u>The Business</u>

- China Petroleum & Chemical Corporation, commonly known as Sinopec, is one of the world's largest oil and gas companies by revenues. It is vertically integrated with significant operations across four main segments: exploration and production; refining; marketing and distribution; and chemicals. Sinopec's business mix is proportionately biggest in downstream refining and retail operations, with the company operating the largest retail petrol station network in China. Marketing and distribution accounted for 52% of 2020 total external sales. Sinopec is also the largest chemicals player in China, with this segment accounting for a further 15% of 2020 external sales. E&P only contributed 5% of external sales in 2020 as most production is refined internally, but this segment accounts for 38% of CAPEX, including investments in crude oil production, shale gas and LNG.[1]
- Sinopec is incorporated in China with A shares listed in Shanghai and H shares listed on the Hong Kong Stock Exchange. ADRs, representing H shares, are listed on the NYSE. Sinopec is 69% owned by the Chinese government through parent company Sinopec Group Company.
- According to its Sustainability Report, 2020 GHG emissions totalled 171m tonnes of CO_2 equivalent (129m tonnes Scope 1 and 42m tonnes Scope 2). Refining and Chemicals accounted for the bulk of these emissions at 144m tonnes. However, these numbers do not include Scope 3 emissions, which will be much higher for a company operating in this sector.
- Sinopec 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. Among the measures anticipated are a quota system for carbon emissions and restrictions on certain carbon-intensive processes. Sinopec also notes "market risk" from potential reduced consumer demand for high carbon intensity energy, and reputational risk. The company also faces physical risks, which it splits into acute risk, such as increased frequency of extreme weather events, and chronic risk, such as changes in rainfall and weather patterns including average temperatures.

<u>Approach to climate change</u>

- The 20-F narrative reporting highlights climate as one of the company's key Risk Factors: "The Paris Agreement on climate change adopted in December 2015 has placed binding

[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.

commitments on nations that have ratified it since November 2016, which may lead to more stringent national and regional measures in the near future. Compliance with these measures could result in substantial impact on capital expenditure, profit and strategic growth opportunities." However, beyond this statement, there is practically no consideration given to climate issues, even on subjects where there is a clear climate risk, such as environmental matters or impairment of long-lived assets.

- The Sustainability Report covers climate issues in much greater detail but still gives the impression that Sinopec is at an early stage in its consideration of these issues, saying that Sinopec: "conducts researches on the strategic path of having carbon emissions peaking and achieve carbon neutrality".
- In September 2020, the Chinese government announced the goal "to peak carbon emissions by 2030 and achieve carbon neutrality by 2060". For its part, in March 2021, Sinopec set a goal of achieving "net zero by 2050" and peak emissions before the national peak target in 2030 (although, based on the disclosed emissions, this would exclude Scope 3). It is possible that Sinopec is preparing a more concrete climate strategy, with the Sustainability Report stating that "In the future, Sinopec Corporation will formulate its carbon peaking and carbon neutral strategy, targets, road map, as well as a detailed action plan".

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- With overseas listings in Hong Kong and New York, Sinopec reports under IFRS as issued by the IASB.
- There appears to be no reference in the notes to the financial statements that accounting judgements have been impacted by climate-related 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 reference to climate risks in the narrative reporting of the 20-F and Annual Report.
- Sinopec also produces a Sustainability Report, which was published in March 2021 – one month before the 20-F. This Sustainability Report (which states that it was prepared with reference to GRI Standards and the TCFD recommendations) has greater coverage of climate risk, both in terms of disclosures of carbon emissions and in terms of general commitments, including targets to reach net zero by 2050.
- Although the company's other reporting is, so far, lacking in a clear climate strategy, there is an inconsistency between the articulation of risks – transition and physical – in the Sustainability Report and the lack of consideration of these risks in the Annual Report and 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.
- The notes to the financial statements outline some sensitivity analysis on impairments, including the impact of a 5% decrease in oil price. Out of the RMB14,560m impairment losses taken in 2020, the majority (RMB8,495m) were from the Exploration and Production segment, where the Notes state that "the primary factors in the segment impairment loss for the year end December 31, 2020 were low oil price outlook and downward revision of oil and gas reserve in certain fields". However, the impact, if any, of climate change considerations on this oil price outlook is not stated.

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: PricewaterhouseCoopers Zhong Tian	Responsible partner: Jianrong Zhao
Audit standards: PCAOB[2]	

Visibility in Critical Audit Matters		Significant concerns

- There is no reference to climate change in the auditor's report.
- There is one CAM identified: recoverability of the carrying amount of property, plant and equipment relating to oil and gas producing activities.
- This CAM specifically mentions that key estimations and assumptions included future crude oil prices, but there is no apparent consideration given to the fact that these prices could be impacted by climate transition risks.

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, PricewaterhouseCoopers Zhong Tian, did provide a limited assurance engagement for the Sustainability Report in March 2021 but this was only for selected 2020 key data, including GHG Emissions and CO2 Capture. The report on this limited assurance work specifically notes that the procedures performed in a limited assurance engagement are less rigorous than for a "reasonable assurance engagement" and that the firm did not cover other elements of the 2020 Sustainability Report beyond this key data.

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)

Stripes image credit: Prof. Ed Hawkins www.showyourstripes.info