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Sharman Inquiry
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Dear Sir,

Re: Sharman Inquiry Call for Evidence – Going concern and liquidity risks: Lessons for companies and auditors

We welcome the opportunity to provide input to the Sharman Inquiry on going concern and liquidity risks.

I am pleased to respond on behalf of BP p.l.c. to the call for evidence and our detailed responses to the individual questions posed are provided in the Appendix to this letter.

As you will no doubt be aware, in 2010 as a result of the Gulf of Mexico oil spill, BP faced significant costs relating to immediate response activities as well as significant uncertainty regarding the ultimate magnitude of its liabilities and timing of cash outflows. In addition to these direct consequences of the oil spill, the related indirect consequences posed a more immediate and perhaps even more significant risk to the group's liquidity at the height of the incident. The group's long-term credit rating was downgraded and we did not access some of the financing options that were available on more acceptable terms in the past.

This was the backdrop against which we prepared our half-year financial statements in 2010, with the oil spill ongoing and developments reported in the media on a daily basis. It was therefore necessary to rethink our previous approach to the assessment of going concern and to carry out additional procedures as part of the half-year 2010 assessment process and also for subsequent periods. We have reflected on this experience in preparing our responses to the individual questions in the Appendix.

We believe that the FRC guidance for directors in this area is sufficient and appropriate. The checklist of areas that should be considered is useful, but we do not think that the guidance on detailed procedures should be any more prescriptive. The guidance clearly puts the onus on the directors to use their judgement to determine the type and amount of work carried out to provide the necessary level of assurance about going concern. We believe this is entirely appropriate as the directors are best placed to make that judgement. Furthermore, in our view, well-run companies will most likely be carrying out the necessary forecasting, analysis and liquidity management processes that are appropriate to running the business and ensuring its continued existence. The directors should be able to draw upon these processes and the information they provide in order to make their assessment of going concern, rather than having to implement significant additional processes.

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We comment below on many of the specific issues on which evidence is requested. Our responses are concentrated mainly in the area of the company's assessment of going concern and liquidity risk as this is the most relevant to BP's experience.

Please do not hesitate to get in touch if we can be of further assistance.

Yours faithfully

Roger Harrington

APPENDIX

Responses to the Call for Evidence

Transparency of going concern and liquidity risk

1. *What combination of information about:*
    - *the robustness of a company's capital;*
    - *the adequacy of that capital to withstand potential losses arising from future risks; and*
    - *the company's ability to finance and develop its business model,*

   would best enable investors and other stakeholders to evaluate the going concern and liquidity risks that a company is exposed to? How effectively do current disclosures provide this information?

   We have no specific comments.

2. *What type of disclosures (if any) have been made into the market place outside annual and interim corporate reports about current stresses being experienced by the company and about the management of those stresses? How do these disclosures interact with the requirement to disclose principal risks and uncertainties in the Business Review and the required disclosure on going concern and liquidity risk in the annual and interim financial statements?*

   We have no specific comments.

3. *Are there any barriers within the current corporate reporting environment to companies providing full disclosure of the risks associated with going concern and liquidity both within and outside the company's annual and interim reporting? Are there any changes that might be made to encourage companies to give fuller and more transparent disclosures in this respect?*

   We do not believe that there are any significant barriers to providing the required disclosures. We believe that the extent and granularity of disclosure should reflect each company's circumstances, and should be determined in each case by the directors. Prescribing specific additional disclosures is, we believe, inappropriate and likely to add to the clutter within annual reports.

4. *Given the current measurement, recognition and disclosure requirements of International Financial Reporting Standards (IFRS), how effective are IFRS financial statements in enabling stakeholders to evaluate the robustness of a company's capital in the context of the going concern assessment? Are there any changes that could be made to these requirements that would better enable them to do so?*

   We believe that it is the disclosures made by companies that enable stakeholders to evaluate the robustness of a company's capital in the context of going concern, rather than recognition and measurement. The main relevant disclosures in the financial statements are those regarding management of capital required under IAS 1 (Note 31) and the IFRS 7 disclosures regarding liquidity risk (Note 27). These disclosure requirements can be effective, provided that companies are open and transparent in what they disclose.

Company assessment of going concern and liquidity risk

5. *What processes are undertaken by directors in making their assessment of whether the company is a going concern when preparing annual and half-yearly financial statements?*

Prior to the Gulf of Mexico oil spill, the assessment undertaken by the directors in preparing the financial statements was very straightforward. The FRC guidance was followed, and the checklist was used to ensure that all the necessary areas had been considered and that the company's routine processes and procedures were sufficient to highlight any issues. This review was documented and summarised in papers prepared for the Audit Committee. Given the company's circumstances at that time this level of review was considered appropriate and there were typically no indications that any further detailed work was warranted.

A significant amount of additional work was undertaken for the going concern assessment carried out as part of the preparation of the first set of financial statements subsequent to the Gulf of Mexico oil spill. Much, if not all, of the additional work was being carried out for the purposes of cash management of the company, rather than specifically for the purposes of the going concern assessment. The main additional activities were:

- Cash flow forecasts for the very short term i.e. for the following month, on a weekly basis were frequently updated. Given the circumstances at the time there was a need to identify variations in cash flows on a more detailed and immediate basis than normal, including any critical points between month ends and in the very short term (the next week).
- Enhanced cash flow forecasts and liquidity analyses – the previous routine forecasting process was enhanced to provide more detail over the period to the end of the following financial year (to cover almost 18 months in total), and by flexing the forecast for specific scenarios. These scenarios included estimates of differing adverse impacts of the oil spill itself, both direct and indirect, as well the possible compounding impacts of adverse changes in the economic environment e.g. lower oil price scenarios.
- Additional independent review and challenge processes were instigated to test the robustness of the forecasts.

- *Which records and information are referred to in making this assessment?*

  The following information is referred to as part of the assessment:
  - The annual group business plan.
  - Cash flow plans and forecasts.
  - Most recent actual financial information e.g. cash and debt balances at the end of the most recent reporting period.
  - Debt maturity profiles.
  - Borrowing facilities and recent experience in raising finance.
  - Models developed to calculate the impact of different scenarios such as lower oil prices and a different credit rating.

- *the assumptions that have been made when making this assessment?*

  As described below, the company starts with forecasts of accessible cash balances (using base case assumptions, and also upside and downside cases), and then overlays scenarios to stress-test the assumptions over 30-day and 90-day periods to test shorter-term liquidity. These scenarios assume that an unplanned event occurs, incurring costs, and leading to a credit rating downgrade, and the resulting cash flow consequences are modelled (including collateral calls by counterparties and an inability to rollover debt on maturity).

- *What types of risks are included in the going concern assessment: financial, strategic, operational, other? How are these presented in the assessment?*

  The going concern assessment includes operational risk by modelling the estimated impacts of an unplanned operational event as part of the stress-test scenarios. Financial risks included in the stress-test scenarios include a credit rating downgrade and an inability to rollover debt on maturity. In addition, cash flow forecasts are flexed for upside and downside oil price environments.

- *What is the role of the audit committee and risk management committee (where one exists) in this process and what inputs do they receive in order to carry out this role?*

  The audit committee receives and reviews a summary paper prepared by the Finance function outlining the principles of the going concern assessment, the company's approach to the assessment, and proposed disclosures. The paper includes a description of the company's procedures and processes, along with relevant facts and information, for each of the areas in which the FRC guidance provides suggested procedures (e.g. forecasts and budgets, borrowing facilities etc.). It also includes an overview of the most recent liquidity analysis – see below.

  The group financial risk committee (GFRC) reviews in detail the liquidity analyses which are prepared on a regular basis. The GFRC is chaired by the Group CFO, who also attends the audit committee. The information they receive consists of the latest forecasts of accessible cash balances for the period up to the end of the next year, using base case planning assumptions (oil prices), and also flexed for higher and lower oil prices. The results are compared against a minimum target of accessible cash balances. Secondly, shorter-term liquidity is considered by running 30-day and 90-day stress tests which assess the extent to which the company would be impacted under certain adverse scenarios.

- *What impact has undertaking the going concern assessment had on the planning and management of the company?*

  The undertaking of the going concern assessment has not had any direct impact on the planning and management of the company per se. Rather, the company increased and enhanced the amount and frequency of analysis it carries out regularly in assessing liquidity, in response to specific issues that the company has been facing. Significant uncertainty about cost and liabilities due to the Gulf of Mexico oil spill necessitated greater focus on cash flows and liquidity as part of the ongoing planning and management of the company. The same analysis has been used to support the assessment of going concern.

- *How has the assessment of going concern and liquidity risks been incorporated into other aspects of company stewardship and reporting?*

  The company provided a summarised description of its mid-2010 liquidity review in the 2010 half-year report. This accompanied a description of the factors having an adverse impact on liquidity and the mitigating actions being taken by management. The liquidity position of the company as at the reporting date, including undrawn committed borrowing facilities, was also described in detail.

  This disclosure was considered appropriate in the light of the company's circumstances at that time. Previously there had been no specific separate section on liquidity included in the group's interim reports; instead liquidity was discussed under relevant sections.

- *How effective is this assessment in addressing the robustness and adequacy of a company's capital and its ability to continue financing and developing its business model? What, if any, improvements could be made?*

  As noted above, the work that has been used to support the assessment of going concern for financial reporting purposes would be carried out in any case for the purposes of the cash management of the company. For BP, this work therefore includes the analysis that we believe is necessary to provide the required level of assurance that the company can continue in business and pursue its business strategy.

  We believe that companies need to be flexible and update and amend their approach as necessary to respond to changes in their circumstances.

6. *What is different about the review of going concern when raising capital compared to the annual going concern assessment undertaken for accounting purposes? Could some of the different procedures be used in the annual accounting or audit assessments?*

   We believe that the processes for assessing going concern in support of raising capital should be similar to those which are applied for an annual going concern assessment for accounting purposes. It may be interesting for The Inquiry to consider whether from a bank's perspective, the information provided in a company's annual report is appropriate.

7. *Does the company assess future cash flows and liquidity on a regular basis throughout the year? If so, how regularly is this done and is the information used any different to that used in the annual and half-yearly assessment for the purpose of preparing financial statements?*

   Future cash flows and liquidity are assessed on a monthly basis by the GFRC as described above. The annual and half-yearly assessments of going concern in turn make use of this liquidity analysis.

   The treasury operational processes are, however, run on a daily basis, including looking at cash and liquidity for a 12-week period. In addition, the supply and trading function also reviews its positions on a daily basis.

8. *To what extent and how do directors assess the viability of a company over the course of its natural business cycle?*

   We have no specific comments.

9. *The current model of disclosure identifies three categories of company[1]. What sort of behaviours does this model drive? Is there a different model that might be useful? Would more guidance on the application of the current model be helpful?*

[1] The disclosures in the financial statements which follow from the directors' conclusion on whether the company is a going concern identify three categories of company:

1. *Those where the use of the going concern basis of accounting is appropriate and there are no material uncertainties related to events or conditions that may cast significant doubt about the ability of the company to continue as a going concern;*
2. *Those where the use of the going concern basis of accounting is appropriate but there are material uncertainties related to events or conditions that may cast significant doubt about the ability of the company to continue as a going concern; and*
3. *Those where the going concern basis is not appropriate.*

We have no specific comments

10. *In your experience, what issues have resulted in a heightened focus on the assessment of going concern? What was the nature of the risks that gave rise to these circumstances? Had these risks been identified in advance, and if so, how?*

As noted above, in 2010 BP's focus on the assessment of going concern was heightened as a result of the impacts of the Gulf of Mexico oil spill. The risks associated with the loss of containment of hydrocarbons due to technical integrity failure and other risks including those associated with drilling and production, crisis management and liquidity, financial capacity and financial exposure were all previously identified within the "Risk factors" section of the Annual Report and Accounts.

The auditor's approach to going concern and liquidity risk

11. *How does the auditor approach the assessment of going concern and liquidity risk? To what extent does this involve the testing of the company's processes and what other work is carried out? Is there any specific reporting on the work done by the auditor on going concern and liquidity risk to Audit Committees? Does the assessment of going concern involve different processes in certain industry sectors? Are there different processes used where there is overseas reporting in addition to UK reporting?*

We have no specific comments.

Feedback on the Guidance for Directors of UK Companies in respect of going concern and liquidity risk

12. *Do you believe that amendments to the Guidance for Directors of UK Companies in respect of going concern and liquidity risk would be helpful? For example:*
    - *Guidance for directors on disclosures does not specify the language to be used, whereas auditors use more standardised wording. Is this helpful?*
    - *Is there a need for a clear boundary between the three types of company?*

We do not have suggestions for any specific amendments to the guidance. Furthermore, we do not believe that standardised wording should be mandated, or that bright line boundaries are required between the three types of company identified. As with many other aspects of financial reporting, the directors should be responsible for making judgements in these areas.

13. *Are there any other views that you would like the Panel of Inquiry to take into account?*

We have no further comments.