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5 September 2018

Dear [redacted]

Subject: Audit of EnQuest PLC – climate change-related trends and risks

We are writing to you in your capacity as the senior statutory auditor responsible for Ernst & Young LLP's (**EY**) audit of EnQuest PLC's (**EnQuest**) 2017 Annual Report and Accounts (**Annual Report**).

On 7 September 2018, we intend to submit a complaint to the Financial Reporting Council (**FRC**) in relation to EnQuest's Annual Report (**Complaint**). In the Complaint (draft included with this letter), we submit that by failing to refer to climate change or the low carbon transition in relevant sections of its Annual Report, EnQuest has failed to provide an adequate description of:

- the principal risks and uncertainties facing its business;[1]
- the main trends and factors likely to affect the future development, performance and position of its business;[2] and
- the long term viability and prospects of the company in light of these risks and trends.[3]

As an international oil and gas production and development business, EnQuest's business is materially exposed to the trends and risks associated with climate change and the low carbon transition. As detailed in the Complaint, such trends and risks have now been widely recognised by investors, governments, regulators and a majority of EnQuest's peers.

However, other than the mandatory disclosure of greenhouse gas emissions for which the company is responsible, EnQuest's Annual Report makes no reference at all to any risks or trends associated with climate change or the low carbon transition. Accordingly, as detailed in the Complaint, it is our view that EnQuest's Annual Report has not been prepared in

[1] Companies Act, s 414C(2)(b); DTR 4.1.8 R.
[2] Companies Act, s 414C(7)(a).
[3] LR 9.8.6, Corporate Governance Code [C 2.2].

accordance with the applicable legal requirements and contains material misstatements by virtue of its omission of this information.

EY's audit

In EY's report to EnQuest's members contained in the Annual Report (**Audit Report**), EY states that:

- *'[i]n our opinion, based on the work undertaken in the course of the audit: … [t]he Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements'*; and
- *'[i]n the light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report'*[4]

In our view, in carrying out the work necessary to provide these opinions in compliance with the relevant audit standards (**ISAs**), the matters raised in our Complaint should have been picked up by EY and discussed with EnQuest's management and/or its audit committee.

In this regard, we note that EY has publicly signed up as a supporter of the Task Force on Climate-related Financial Disclosures (**TCFD**) and has published extensively on the topic of climate change-related risks and their financial implications. Many of EY's other audit clients also include significant discussions of climate change-related trends and risks in their own annual reports.

In light of recent changes to the Companies Act, statutory auditors now have a critical role to play in providing investors with assurance (to the standard set by relevant ISAs) that information disclosed by companies about trends and risks facing their business is prepared in accordance with the relevant legal requirements, is free from material misstatements, and is otherwise fair, balanced and understandable.

In our view, this should necessarily entail a consideration of material climate change-related trends and risks facing a company, including whether such trends and risks might have implications for assumptions and estimates used in preparing financial accounts themselves.

Whilst we are rightly not aware of the discussions which took place between EY and EnQuest as part of the audit process, in our view, EnQuest's failure to provide a substantive discussion of climate change-related trends or risks in its Annual Report indicates that these matters may not have been robustly addressed in the audit.

In order to bring these matters to your attention we have set out in an appendix to this letter what we consider to be the most relevant requirements under the applicable ISAs. We have also set out below a number of questions related to these requirements, which we would appreciate your response to.

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[4] EnQuest PLC Annual Report and Accounts 2017, p 103. We note that EY is required to provide these opinions under s 496 of the Companies Act and ISA (UK) 720.

Questions for EY

1. What processes and procedures does EY have in place to ensure that its extensive institutional knowledge about climate change-related trends and risks and their financial implications are made available to audit teams and are included in standard audit programmes?
2. Does EY agree that the trends and risks associated with climate change and the low carbon transition are relevant to obtaining an understanding of an entity and its environment, where that entity carries on business in the oil and gas sector?
3. Does EY consider that it is required as an auditor to assess the reasonableness of directors' judgments in relation to the information included in the strategic report and directors' report in order to determine whether the relevant legal requirements have been complied with?
4. What processes and procedures does EY perform to identify material inconsistencies between information about trends and principal risks included in the strategic report and directors' report and EY's knowledge about an entity's objectives and business risks obtained in the audit?
5. What processes and procedures does EY perform to identify whether information about trends and principal risks included in the strategic report and directors' report is materially misstated?

We would be grateful for any response you can make in relation to these questions by 21 September 2018. Please note, we intend to make a copy of this letter public on our website and provide a copy to the FRC, along with our Complaint in relation to EnQuest.

If you would like to discuss the contents of this letter, please contact Daniel Wiseman (dwiseman@clientearth.org) or Alice Garton (agarton@clientearth.org).

Yours sincerely,

ClientEarth

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Annex - Relevant audit standards and questions for EY

It is our understanding that in carrying out the work necessary to provide its opinions in relation to the information contained in EnQuest's directors' report and strategic report, EY is required to comply with relevant legal and professional requirements, including ISAs.[5]

We acknowledge that the standard of assurance required to provide these opinions does not amount to the level of 'reasonable assurance' applicable to the audit opinion provided in relation to the financial statements.[6] Nonetheless, we understand that the relevant audit standards must still be followed in providing these additional opinions. In this respect, we consider the following requirements to be most relevant:

- the requirement to exercise professional scepticism and professional judgement in planning and performing the audit (ISA (UK) 200 [15], [16]);
- the requirement to obtain an understanding of EnQuest's objectives and strategies, and those related business risks that may result in risks of material misstatement (ISA (UK) 315 [11], [15], [16]);
- the requirement to obtain an understanding of the legal and regulatory requirements applicable to EnQuest's strategic report and directors' report and how EnQuest is complying with those legal and regulatory requirements (ISA (UK) 720 [12-1]); and
- the requirement to perform procedures necessary to identify: any material inconsistencies between EnQuest's strategic report and directors' report and EY's knowledge obtained in the audit; and whether the strategic report and directors' report appear to be materially misstated in the context of EY's understanding of the legal and regulatory requirements applicable to that information (ISA (UK) 720 [14-2], [15]).

Further details in relation to each of these requirements are set out below, along with questions to EY in relation to the application of these requirements in the conduct of its audit.

Professional scepticism and professional judgement – ISA (UK) 200

ISA (UK) 200 sets out the overall objectives of the independent auditor and how the audit is to be conducted in order to comply with the ISAs in general. Under paragraphs 15 and 16 of ISA (UK) 200, EY is required to plan and perform its audit with 'professional scepticism' and to exercise 'professional judgment'. Accordingly, EY's audit staff are required to adopt 'a questioning mind' and to apply 'relevant training, knowledge and experience' to the conduct of their audit.[7]

In this context, we note that EY has demonstrated extensive institutional knowledge about climate change-related trends and risks and their financial implications. EY has publicly signed up as a supporter of the Task Force on Climate-related Financial Disclosures (**TCFD**). EY has also published extensively on the topic. To provide just one example, in a 2017 report entitled, *'Are your climate disclosures revealing the true risks of your business?'*, EY states that:

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[5] See, The Statutory Auditors and Third Country Auditors Regulations 2016, regs 4(1)-(2) (SATCAR).
[6] See ISA (UK) 200 [11]-[12].
[7] See ISA (UK) 200, [13(l)].

'Climate risks are more complex and longer-term in nature than most traditional businesses risks, and this has contributed to a lack of understanding and measurement on their potential impacts. Climate risks are further categorized as transition risks and physical risks, both of which have the potential to impact financial statements …. Where an organization does not have a clear understanding of the range and magnitude of potential financial impacts from climate change, this may be increasingly detrimental to its financial performance.'

The adoption of the Recommendations will potentially require changes to existing financial risk processes and disclosures. For example, CFOs may need to be better informed regarding the climate risks that the company may be exposed to, and the time period over which their impacts are anticipated. Due to the forward looking nature of this analysis, risk assessments should be updated regularly to assess technology, regulation, consumer and physical changes that may impact the materiality of the risk… Depending on the materiality and the timeframe, climate risks should be considered in terms of future revenue and cost expectations, provisioning and liability, and asset depreciation.

In light of this example, EY appears to hold itself out as having 'relevant training, knowledge and experience' to consider and address climate change-related trends and risks in the conduct of its audit. In our view, in applying professional scepticism and professional judgment in accordance with paragraphs 15 and 16 of ISA (UK) 200, this expertise must be put into practice.

Question 1: What processes and procedures does EY have in place to ensure that its extensive institutional knowledge about climate change-related trends and risks and their financial implications are made available to audit teams and are included in standard audit programmes?

Objectives, strategies and business risks – ISA (UK) 315

ISA (UK) 315 deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control. Under paragraph 11 of ISA (UK) 315, EY is required to obtain an understanding EnQuest's 'industry, regulatory, and other external factors' and EnQuest's 'objectives and strategies, and those related business risks that may result in risks of material misstatement.' Under paragraphs 15 and 16 of ISA (UK) 315, EY is also required to understand and assess EnQuest's risk management and internal control processes.

Accordingly, this will require EY to consider industry conditions and technological developments; market demand and pricing for EnQuest's products; energy supply and costs; the relevant regulatory environment, including legal and political developments; government policies, including financial incentives and tariffs or trade restrictions; and environmental requirements.[8]

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[8] ISA (UK) 315, [A24-A29].

Section 3 of the Complaint sets out evidence as to why climate change-related trends and risks represent significant risks for EnQuest's business. As noted in the Complaint, these risks are recognised by many of EnQuest's peers, some of which are also audited by EY.

For example, the 2017 annual report for Royal Dutch Shell plc, includes extensive discussion of climate change and the low carbon transition. These issues feature prominently in both the chair's message and the CEO's review. The Strategic Report includes five dedicated pages specifically discussing trends and factors related to climate change and the low carbon transition, the risks that this is creating for Shell's business and how it is managing them. It also includes an extended discussion about climate change in its section on principal risks and mentions climate change and the energy transition in its viability statement.

In light of this evidence, in our view, EY should have considered the risks and trends associated with climate change and the low carbon transition when obtaining an understanding of EnQuest and its environment in accordance with ISA (UK) 315.

Question 2: Does EY agree that the trends and risks associated with climate change and the low carbon transition are relevant to obtaining an understanding of an entity and its environment, where that entity carries on business in the oil and gas sector?

Legal and regulatory requirements for 'other information' – ISA (UK) 720

ISA (UK) 720 deals with the auditor's responsibilities relating to 'other information' included in the Annual Report, including a company's strategic report and directors' report. Under paragraph 12-1 of ISA (UK) 720, EY is required obtain an understanding of the legal and regulatory requirements applicable to the 'other information' and how EnQuest is complying with those requirements.

Section 4 of the Complaint sets out our submissions as to why EnQuest's strategic report and directors' report do not comply with the relevant legal and regulatory requirements applicable to that information.

In summary, in our view, a reasonable director in the position of EnQuest's directors would have considered that the risks and trends associated with climate change and the low carbon transition would be material to a shareholder's understanding of the development, performance, position or future prospects of EnQuest's business – and would have disclosed this information in its annual report accordingly.[9]

Accordingly, in our view, in order to determine whether or not the strategic report and directors' report have been prepared in accordance with the relevant legal requirements as required by ISA (UK) 720, EY would need to consider and assess the reasonableness of directors' judgments in relation to that information.

[9] See relevant guidance contained in: FRC, Guidance on he Strategic Report 2014, [7.24]-[7.25] (as in force at the relevant ime).

Question 3. Does EY consider that it is required as an auditor to assess the reasonableness of directors' judgments in relation to the information included in the strategic report and directors' report in order to determine whether the relevant legal requirements have been complied with?

Misstatements in the 'other information' – ISA (UK) 720

Under paragraph 14-2 of ISA (UK) 720, EY is required to perform such procedures as are necessary in EY's professional judgment to identify: any material inconsistencies between the 'other information' and EY's knowledge obtained in the audit; and whether the 'other information' appears to be materially misstated in the context of EY's understanding of the legal and regulatory requirements applicable to that information. Under paragraph 15 of ISA (UK) 720, EY is also required to remain alert for indications that the 'other information' appears to be materially misstated.

Relevantly, ISA (UK) 720 states that *'[a] misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information)'.*[10]

Section 4 of the Complaint sets out our views as to why EnQuest's failure to refer to climate change or the low carbon transition in its Annual Report is a breach of its legal duties. In light of the submissions set out in our Complaint, it is our view that the strategic report and directors' report included in EnQuest's Annual Report have not been prepared in accordance with the applicable legal requirements and contain material misstatements by way of omission.

Accordingly, in our view, in order to comply with the requirements of ISA (UK) 720, EY is required to have appropriate processes and procedures in place to identify material inconsistencies between information about trends and principal risks included in the strategic report and directors' report and EY's knowledge about an entity's objectives and business risks obtained in the audit, and also to identify material misstatements in light of this knowledge.

Question 4. What processes and procedures does EY perform to identify material inconsistencies between information about trends and principal risks included in the strategic report and directors' report and EY's knowledge about an entity's objectives and business risks obtained in the audit?

Question 5. What processes and procedures does EY perform to identify whether information about trends and principal risks included in the strategic report and directors' report is materially misstated?

[10] ISA (UK) 720 [12(b)].