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13 March 2012

International Accounting Standards Board
30 Cannon Street
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By email: commentletters@ifrs.org

Dear Sir or Madam,

Invitation to Comment – Exposure Draft ED/2011/6: Revenue from Contracts with Customers

We welcome the opportunity to comment on the IASB's Exposure Draft ED/2011/6: Revenue from Contracts with Customers. I am pleased to respond on behalf of BP p.l.c. to the invitation to comment.

We appreciate the efforts made by the Boards to address a number of the comments raised by constituents in respect of ED/2010/6 Revenue from contracts with customers (the "2010 ED"). However, we believe that there remain a number of issues as set out below. We address the specific questions asked in the ED in more detail in Appendix A to this letter, and provide some additional detailed comments in Appendix B.

Model for revenue recognition

As we said in our response to the 2010 ED, we do not believe that there are any fundamental flaws in the current IFRS standards for revenue recognition. The principles laid out in IAS 18 "Revenue" provide a practical approach to revenue recognition, and IAS 11 "Construction contracts" is consistent with IAS 18's principles in respect of the delivery of services. We see no particular need for new principles to have been developed for IFRS. We recognize that there are some gaps in IAS 18, for example in respect of multiple element arrangements and in respect of some of the implementation issues arising from IFRIC 15 "Agreements for the construction of real estate". However, we do not believe that it is necessary to have developed an entirely new model to deal with these gaps - a limited scope project to address them could have been more proportionate.

Our principal conceptual criticism of the ED is that it does not start by addressing the basic questions of the definition of revenue and how it is decision-useful. This discussion is necessary because the Boards have made a judgement in the ED that a revenue recognition principle based on the satisfaction of performance obligations is more useful than a principle which recognises revenue taking into account the entity's activity in the period. We believe that the Board needs to provide a definition of revenue, an explanation of the significance of revenue to the financial statements, and how it is decision-useful. In the absence of this, it is difficult to conclude on whether the proposed performance obligation approach is more useful than the activity-based approach to recognising revenue.

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Identification of separate performance obligations

We do not consider the ED is clear in distinguishing between a single performance obligation that is satisfied over a period of time, and a series of performance obligations, each of which is settled at a point in time. We believe that additional guidance is necessary to clarify whether, for example, a contract to supply oil or gas over a period of time is a single performance obligation satisfied over time, or a series of performance obligations, as described further on pages 8 and 9 of this letter.

Excessive disclosures

While we support the overall objective of the Board's proposed disclosure requirements, we question whether the proposed disclosure requirements will achieve this objective given the breadth, quantity and complexity of the proposed disclosures. We believe it will be a challenge to determine how best to present all the information required in such a way that provides useful, meaningful information for the users of the financial statements.

The proposed disclosure requirements for interim financial statements are also excessive. The segment revenue disclosures required by IAS 34 "Interim Financial Reporting" are usually adequate. In the oil and gas industry, revenue is not a metric that investors focus greatly upon – profit or margin and production data are more relevant measures. Mandating extensive disclosures in relation to numbers which due to their size it is difficult to argue are not material does not appear to be helpful to either preparer or user.

Presentation of bad debt expense

We believe that bad debt expense should not be required to be presented adjacent to revenue, particularly outside of financial institutions. We could see how the proposal could work in a bank (although we understand that loans from banks are not in the scope of the ED because they are in the scope of IFRS 9 / IAS 39 "Financial instruments"), but it does not seem appropriate in the oil and gas industry, or in the many other industries where credit risk is not a significant consideration when determining pricing.

IAS 1 "Presentation of Financial Statements" does not mandate any particular format or ordering of income statement line items so we find it curious that the geography of the bad debt expense line item should be subject to specific guidance whereas no other expenses are treated in this way. We believe that the charge for bad debts should be presented as an expense.

Onerous contracts

We do not agree with the proposal in the ED that performance obligations are the appropriate level at which to recognize onerous provisions, rather we believe they should be recognized at the contract level. We understand the argument that in certain cases recognition at the performance obligation level better reflects the economics of transactions, but find the resulting accounting counterintuitive and difficult to communicate. Further, we do not believe that a revenue standard is the appropriate place for guidance on provisions. We believe that all onerous contracts should be accounted for in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets".

If you would like to discuss any of the comments in this letter, we would be happy to do so. Please do not hesitate to contact myself or Martin Perrie (martin.perrie@uk.bp.com).

Yours faithfully

Roger Harrington

APPENDIX A

Responses to the Invitation to Comment

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

Our response assumes that the Boards will proceed with a revenue recognition model based on the satisfaction of performance obligations, despite our reservations discussed in our cover letter.

Subject to our comments in the section “Single performance obligation satisfied over time or series of performance obligations each satisfied at a point in time” in Appendix B below, we do not believe that recognition of revenue over time is particularly relevant to our more material operations, where revenue recognition is normally straightforward. However, while the criteria set out in the ED do seem to be an improvement on those set out in IFRIC 15, we believe that additional guidance could be provided. We find Example 7 to be reasonably clear, but it would be helpful also to include an example with the alternative conclusion to help understand the distinction – for example by including both situations described in the November 2011 IFRIC discussion on IFRIC 15 (discussed by the Boards at their February 2012 meeting) and explaining clearly why one situation would result in the performance obligation being satisfied over time and the other would not.

Question 2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer’s credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer’s credit risk and why?

Commenting on accounting for the effects of credit risk is not straightforward while the Boards continue to debate the impairment model for financial assets, including how (and whether) trade receivables fall within its scope.

Having said that, we believe that bad debt expense should not be required to be presented adjacent to revenue, particularly outside of financial institutions. We could see how the proposal could work in a bank (although we understand that bank loans are not in the scope of the ED because they are in the scope of IFRS 9 / IAS 39), but it does not seem appropriate in the oil and gas industry, or in the many other industries where credit risk is not a significant consideration when determining pricing.

IAS 1 does not mandate any particular format or ordering of income statement line items so we find it curious that the specific geography of the bad debt expense should be subject to guidance whereas no other expenses are treated in this way.

We believe that the charge for impaired receivables should be presented as part of the appropriate expense line item and should only be shown separately on the face of the income statement if material, and otherwise disclosed in the notes.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We agree that some kind of limit on variable consideration is appropriate. The alternative, of recognizing revenue at fair value with no assurance of realization, would lead to a less meaningful revenue number. However, we are not sure that the introduction of a concept of "experience that is predictive" is helpful. One can never know whether experience will be predictive.

The concept of "predictive" is also used to determine whether an expected value (weighted average) or most likely amount should be used for recording variable consideration. We wondered why the phrasing used in paragraph 55 of the ED is instead "expects to better predict", which we consider to be better, and would support this wording being used in paragraph 81(b) as well.

We agree with the change from the 2010 ED that allows either an expected value or the most likely amount to be used, depending on which is expected to better predict the actual outcome. However, we believe that the guidance as drafted could be interpreted in various ways. For example, if there are 3 possible amounts receivable of 100, 400 and 500, with probabilities of 30%, 40% and 30%, respectively, would the company recognize the expected amount of 340 of revenue (when it is clearly not predictive as there is a 0% chance of actual revenue being exactly 340)? Or recognize 400 as the most likely outcome? Or is the company only reasonably assured of the minimum amount of 100, and so should only recognize any incremental amounts of 300 and 400 when and if they are received? We believe that this should be clarified.

While the list of examples in paragraph 82 of the ED of situations that are **not** expected to be predictive are helpful, examples of situations where experience **is** expected to be predictive would also be useful.

We do not welcome the exception introduced by paragraph 85 – we would expect that sales-based royalties are rarely "reasonably assured" as defined in the ED, other than possibly some kind of floor relating to a minimum volume of sales that will always be achieved based on the company's past experience. That being the case, the company should be able to follow the general principle and arrive at the same accounting without introducing an exception. If the Boards' intention was to arrive at lease-type accounting for licences of intellectual property, a neater solution might have been to include leases of intellectual property in the scope of the leases project.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

We understand the rationale that recognizing onerous performance obligations arguably better reflects the economics of certain transactions. However, on balance we believe that better, more understandable, and more easily explained accounting would be achieved by recognizing onerous contracts, i.e. at the contract level. We do not see the need for onerous contract guidance in a revenue standard and so would leave the onerous contract guidance in IAS 37. Further, we do not agree with a bright-line cut-off for contracts with a duration greater than one year. We believe that all material onerous contracts should be provided for, independent of their duration.

Question 5: The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.¹ The disclosures that would be required (if material) are:

- **The disaggregation of revenue (paragraphs 114 and 115)**
- **A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)**
- **An analysis of the entity's remaining performance obligations (paragraphs 119–121)**
- **Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)**
- **A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).**

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

We do not agree with the proposed disclosures and consider them to be disproportionate.

We believe that the disaggregated revenue amounts by segment is usually sufficient in interim financial statements. In the oil and gas industry, revenue is influenced to such a large degree by volatile market prices of oil and gas that it is not normally a meaningful number. A measure of profit is much more meaningful to management and to users of the financial statements.

We cannot see any objective reason for requiring onerous performance obligation liabilities to be rolled-forward in interim financial statements when there is no corresponding requirement to roll-forward provision balances in the scope of IAS 37, which in many cases will be significantly more material.

As discussed in Appendix B below, we believe that a roll-forward of the contract assets lacks meaning in the absence of a roll-forward of the trade receivables balance.

¹ In the IASB exposure draft, see paragraph D19 in Appendix D.

Question 6: For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

Yes, we agree that the principles of the ED should be applied consistently to the disposal of non-financial assets that are not an output of an entity's ordinary activities.

APPENDIX B

Other comments

We set out below a number of other comments relating to the ED, on which the Board did not specifically seek input.

What is revenue and why is it important (paragraphs BC15-28)

Our principal conceptual criticism of the ED is that it does not start by addressing the basic questions of the definition of revenue and how it is decision-useful. This discussion is necessary because the Boards have made a judgement in the ED that a revenue recognition principle based on the satisfaction of performance obligations is more useful than a principle which recognises revenue taking into account the entity's activity in the period. We believe that the Board needs to provide an explanation of the significance of revenue to the financial statements, and how it is decision-useful. In the absence of this it is difficult to conclude on whether the proposed performance obligation approach is more useful than the activity-based approach to recognising revenue.

Even in the absence of a clear discussion of the importance of revenue to users of the financial statements we find the arguments against an activity-based approach set out in paragraph BC24 to be somewhat superficial. We do not believe that many proponents of an activity-based approach would support recognition of revenue as regular inventory (e.g. consumer goods) is manufactured. Activity-based revenue recognition would only be proposed for longer-term contracts currently in the scope of IAS 11. We are still to be convinced that the performance obligation approach provides better information to users of financial statements, particularly when a material disconnect arises between revenue and cash flows. Disclosure of cash inflows relating to as-yet unsatisfied performance obligations will help to bridge the gap, but we are not sure that this compensates for decision-useful information arguably being excluded from the income statement.

Scope (paragraphs 9-11)

The ED only deals with revenue arising from contracts with customers. The existing IAS 18 covers not only revenue from customer contracts, but also includes specific guidance for interest, royalties, dividends and amounts collected on behalf of third parties. We would encourage the Board to provide clarification on how such other types of revenue transactions should be accounted for.

Paragraph BC37 of the ED notes that the definition of a customer is a matter of judgement, and that in the oil and gas industry "collaborators" may or may not be customers depending on the facts and circumstances. We agree with this statement as we accept that there is usually a judgement to be made. However, we understand that even if the partner is not considered to be a customer we may still be able to recognize revenue, albeit not revenue from contracts with customers (i.e. it would be a different type of revenue outside the scope of the ED).

Identification of separate performance obligations (paragraphs 23-30)

Single performance obligation satisfied over time or series of performance obligations each satisfied at a point in time

We do not consider the ED to be completely clear so that preparers can distinguish between a single performance obligation that is satisfied over a period of time, and a series of performance obligations, each of which is settled at a point in time. For example, is a contract to supply oil or gas over a period of time a single performance obligation satisfied over time, or a series of performance obligations?

Applying the guidance in paragraph 27 of the ED, the answer to this question will depend on whether each monthly delivery is distinct or not, which in accordance with paragraph 28 depends on whether the company regularly sells the oil or gas separately (i.e. not under long term contracts), or whether the customer can benefit from the monthly delivery of oil or gas. However, paragraph 29 introduces a restriction that a bundle of promised goods is not distinct if the goods are highly interrelated and the company provides an integration service, and if the goods are modified or customised to fulfil the contract.

One might conclude, for example, that a three year contract to supply oil once a month to a customer at the point of production is a series of 36 monthly performance obligations, as the customer can use the oil and there is no significant interrelation or integration required. In contrast, a ten year contract to supply a fixed amount of regasified liquefied natural gas on a monthly basis might be viewed as being a single performance obligation, even when the customer can benefit from the gas as it is delivered, as one could interpret there to be interrelationships between the deliveries – the construction of the liquefaction and regasification plants depended on the existence of the long term contract – and the liquefaction and regasification are modifications/customizations of the underlying gas required to fulfil the contract.

Additional guidance would be helpful to clarify the distinction between these two types of situations, or indeed whether there is a distinction to be made. In our view, in both situations described, revenue should be recognized in respect of each delivery of oil or gas.

Bundling of performance obligations

Further, in relation to these paragraphs, the ED appears to be written implying that there is only one way of bundling performance obligations. There could be situations where there are multiple ways of combining individual goods and services into performance obligations – e.g. a company sells products A and B and also accessories X and Y. Products A and B each need to be used with an accessory, and both X and Y are compatible with both A and B. If the company sells one each of A, B, X and Y, the possible bundles are: A and X, and B and Y; or A and Y, and B and X. It would be helpful if the drafting of the final standard acknowledged this.

Other clarifications

We also thought that paragraph 28 of the ED could be clarified in two respects:

- (a) What the Boards intended by “the entity regularly sells the good or service separately” – does this mean “more than occasionally”, say 5-10% of sales of the particular product, or does it imply a higher threshold?
- (b) In the case of, say, mobile phones sold which are blocked to only work on one network, do the “other resources readily available to the customer” include grey-market “unblocking” services which would allow the device to be used on other networks?

Performance obligations satisfied at a point in time (paragraph 37)

We believe that the sentence included in paragraph 37(b) of the ED, “Hence, the transfer of legal title of an asset indicates that the customer has obtained control of the asset” could be open to abuse and seems to be somewhat more definitive than is appropriate. We agree that legal title is **an** indicator of control, but it should be made clear that it should be considered together with other indicators in the light of the particular facts and circumstances.

Principal versus agent considerations (paragraph 50 and B16-B19)

The application guidance on principal versus agent included in paragraphs B16-B19 of the ED is similar to that currently included in paragraph IE21 of IAS 18. While the existing guidance in IAS 18 is helpful in distinguishing between when a company is acting as a principal or as an agent in many situations, the indicators are often inconclusive when analysing whether taxes are in substance taxes on sales or production and whether a gross or net presentation of them is appropriate. Additional guidance to help distinguish sales taxes from other types of taxes would be helpful.

Time value of money (paragraphs 58-62)

We do not agree with a bright line of one year for permitting non-discounting of amounts to be received in the future. Rather, we believe that the general concept of materiality should be applied. There is an implicit requirement to discount the fair value of consideration in IAS 18 and application of the materiality concept based on country-specific facts and circumstances has not caused any significant problems. The effect of discounting an 11 month receivable in a country with high interest rates could be significantly more than discounting a three year receivable in a country where interest rates are very low.

Incremental costs of obtaining a contract (paragraphs 94-97 and 128)

We believe that the wording used in paragraphs 94 and 95 is somewhat confusing, particularly when taken together with paragraph 128. There is a difference between costs to obtain a contract (i.e. costs relating to a contract that will be obtained in the future) and costs having obtained a contract (i.e. costs incurred subsequent to obtaining the contract as a result of having obtained it), but the terms seem to be used interchangeably. We read paragraph 96 as implying that only costs incurred having obtained a contract (e.g. commission payable as a result of the contract being agreed) can be capitalized, and that costs incurred as part of bidding for or negotiating a contract cannot be capitalized. Costs incurred as part of bidding for or negotiating a contract are incurred irrespective of whether the bid or negotiation are successful, so we find it curious that pre-contract and set-up costs are specifically mentioned in paragraph 128. If we have understood correctly, we would suggest using the wording "incremental costs having obtained a contract".

Distinction between a contract asset and a receivable (paragraph 106)

The ED includes in its scope all contracts with customers except, among others, those within the scope of IFRS 9. IFRS 9 states that its scope is the same as IAS 39's, and IAS 39 sets out its scope as all financial instruments except for nine different types, some of which relate to contracts with customers and some of which do not. It is then necessary to refer to IAS 32, which defines financial instruments and financial assets. We find this confusing and wondered whether it would be possible to set out the scope of the standard in a positive manner stating what **is** in its scope.

The ED defines a contract asset as an entity's right to consideration from a customer in exchange for goods or services transferred to the customer. However, when the entity has an unconditional right to consideration, a receivable is recognised. A right to consideration is unconditional when nothing other than the passage of time is required before payment of that consideration is due.

As currently drafted, the ED definition of a contract asset is in line with the definition of a financial asset in IAS 32. And in accordance with IAS 32, a receivable would fall within the definition of a financial asset, being defined as "a contractual right to receive cash or

another financial asset from another entity ...". However, the ED brings into play a different definition for a receivable, defining these as an "unconditional right to consideration".

For example, we consider that consideration receivable for oil physically delivered in December 2012, which is priced using the January 2013 oil future, is unconditional but that its amount is variable. Paragraph 106 appears to be saying that the consideration is conditional due to the pricing being dependent on a future oil price.

Further, it is not clear whether contract assets are financial assets which would fall within the disclosure requirements of IFRS 7 – whether the conditionality of the cash flows introduced by the contract asset definition somehow excludes them. It does seem clear, in contrast, that contract liabilities are not financial liabilities as the obligation is to deliver goods or services and not cash or another financial asset.

We also thought that it would be useful to provide guidance regarding the transition from contract asset to trade receivable as, depending on the results of the Boards' final conclusions on impairment of trade receivables, the measurement bases may be different. In particular, it would be helpful to provide clarity if there is a difference in the measurement of the contract asset (not at fair value) and subsequent trade receivable (at fair value) related to the time value of money and customer credit risk. It is our understanding that the guidance relating to time value of money and collectability in the ED apply only to revenue and contract assets, and not to trade receivables.

Disclosures (paragraphs 109-1,056)

While we support the objective of the Board's proposed disclosure requirements, we question whether the proposed disclosure requirements will achieve this objective, given the breadth, quantity and complexity of the proposed disclosures. It will be a challenge to determine how best to present all the information required in such a way that provides useful, meaningful information for the users of the financial statements. As there is significant emphasis placed on the entity to determine the level of information to be disclosed, this will inevitably make comparability across entities more difficult for the user.

From a cost-benefit perspective, we believe that the costs and efforts of providing the additional disclosures would seem to outweigh the benefits of providing such information. We are concerned that the proposed requirement to disaggregate revenue into categories will duplicate disclosures already required by IFRS 8, and so request that the Board clarify how the requirements interact with those in IFRS 8.

We have a number of specific concerns:

- no materiality threshold is applied – paragraphs 109 and 113 of the ED requires the disclosures "for all of the following", apparently irrespective of their materiality. We note that this contradicts the statement in paragraph BC342 that companies are not "required to disclose information that is not material".
- the requirement in paragraph 124 to disclose significant judgements is redundant in the light of the overarching requirements of IAS 1 to disclose significant accounting judgements.
- a roll-forward of the contract assets is somewhat meaningless in the absence of a roll-forward of the trade receivables balance as the cash collected will be only a subset of the total cash collected from customers.

Transition (paragraphs C2-C5)

We note that the “date of initial application” is defined as the “start of the reporting period in which an entity first applies this [draft] IFRS. It is not clear to us whether this is intended to mean the “start of the earliest comparative period presented in the year when the IFRS is first applied” or “start of the current reporting period in the year when the IFRS is first applied”. We infer from the wording of paragraph C3(d) that the Boards intended it to mean “start of the current reporting period in the year when the IFRS is first applied” but would appreciate it if the wording were clarified.