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22 May 2013

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Submitted via email: commentletters@efrag.org

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Dear Sir or Madam,

Emissions Trading Schemes – Draft Comment Paper

We welcome the opportunity to comment on EFRAG's Draft Comment Paper on Emissions Trading Schemes. I am pleased to respond on behalf of BP p.l.c. to the invitation to comment.

We agree that accounting for emissions trading schemes is complex within the current IFRS accounting framework, and so welcome the French ANC and EFRAG's projects to consider this issue. We set out below our responses to certain of the questions raised in the draft comment paper.

Are emissions allowances intangible assets?

Emissions allowances share, in our view, many of the characteristics of intangible assets, although we agree with the analysis set out in the draft comment paper that the requirement to surrender the allowances at the end of a compliance period is a specific feature of emissions allowances. We agree that the requirement to surrender the allowances should result in some form of linkage between the accounting for the assets and the related liabilities.

Business model as a basis for accounting for emissions allowances

The comment paper distinguishes correctly, in our view, between emissions allowances which are to be used by a company to satisfy its own obligations under an emissions trading scheme and those which are held by a company for trading purposes. We agree that a cost-based model is appropriate for allowances held by an entity to satisfy its own obligations, and we also agree that a fair value model is appropriate in a trading context.

In an environment where emissions allowances are granted to companies in certain industries free of charge we question the assertion in the paper that showing the cost of complying with the conditions of the scheme and the value of the allowances received at fair value better reflects the economics of the situation. Where a certain level of emissions can be made free of charge we believe that the accounting which best reflects the economics is that the lower actual expense is reflected in the income statement. We particularly believe that this is the case where the government issuing the allowances and requiring the surrender of the allowances is the same entity.

Own use accounting

We agree that emissions allowances to be used in a company's production processes should be measured at cost. Where a forward purchase of emissions allowances for its own use at a later time qualifies for the "own use" exemption in IAS 39 we agree that it should not be accounted for as a derivative. It is not clear to us under what circumstances own use accounting could not be applied if the forward purchase was for emissions allowances that will be used to settle a company's own obligations under an emissions trading scheme.

Consequently, where a company enters into a forward contract to purchase emission allowances, we believe that if the forward contract meets the definition of a derivative under IAS 39 it should be accounted for as such, and we do not support the further extension of the own use exemption described in paragraph 45 of the draft comment paper. Hedge accounting may be applied by companies where derivative accounting is required, and we believe that this could largely achieve the same accounting result as extending the availability of "own use" accounting to additional forward contracts.

Accounting for free allowances on initial recognition

We disagree with the statement in paragraph 47 of the draft comment paper that free allowances should be initially recognized at fair value. For the reasons set out above, we believe that the economics of receiving allowances for free are better reflected by the allowances being recorded initially at their cost of nil.

A consequence of requiring free allowances to be initially recognized at fair value is that there is an unsatisfactory answer as to where the corresponding credit is recorded. As the allowances are received at the start of the compliance period and are available to be sold freely, it does not appear that the credit should be recorded as "deferred income" as it does not meet any reasonable definition of a liability. We find the solution of recognizing the credit in other comprehensive income to be an unsatisfactory solution to a problem that could be avoided entirely by initially recognizing the free allowances at their cost of zero.

Measurement of the liability

We agree that the event which generates the liability is the act of emitting the regulated gases. We further agree that the emissions allowance asset and the liability to surrender allowances are discrete assets and liabilities which should not be offset. The asset and corresponding liability should each be derecognized when the allowances are surrendered.

We believe that an appropriate means of providing the linkage between the asset and the liability is to require the liability to be measured at the value of any related assets, plus any difference recognized at fair value at the balance sheet date. Where emissions allowances have been received free of charge this will result in part of the liability being measured at zero, which faithfully depicts the economics of those liabilities having zero cost to the company.

Cost-based accounting model should allow for sales

The draft comment paper appears to start with the default position that emissions allowances should be recognized at fair value unless a company can demonstrate that it will use the emissions allowances in a "compliance model". Consequently, the draft comment paper would prohibit cost-based accounting where a company has sold its allowances rather than holds them until surrender.

In our view, the default position should be that emissions allowances are accounted for at cost, but where the company (or part of the company) is clearly purchasing and selling emissions allowances for trading purposes, fair value accounting should be required for that specific business model. We disagree with the proposed "tainting" rules and believe that some level of sales and purchases should be allowed within a cost-based model.

Accounting for similar schemes

Emissions trading schemes and schemes which require the blending of a minimum quantity of biofuels into petroleum products (biofuel quota schemes) share many of the same accounting questions. We believe that accounting for biofuel quota schemes should also be addressed by any future standard on accounting for emissions trading schemes.

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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 me or Martin Perrie (martin.perrie@uk.bp.com).

Yours faithfully

p.p. Martin Perrie.

Roger Harrington