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Dear Sir or Madam,

Consultation paper: Considerations of materiality in financial reporting

We welcome the opportunity to comment on ESMA's Consultation paper: Considerations of materiality in financial reporting. I am pleased to respond on behalf of BP p.l.c. to the invitation to comment and our detailed comments to certain of the individual questions posed in the exposure draft are provided in the Appendix to this letter.

We welcome the efforts of ESMA to promote discussion of materiality, particularly in the context of disclosures in financial statements. We do not believe that current practice is fully aligned with the objective of providing all relevant, and only relevant, information necessary for investors to make decisions. We believe that ESMA, other regulators and the IASB have an important role to play in promoting cultural change and in facilitating a better understanding of how materiality should be applied in the context of disclosure. It is an important debate, and there have already been some interesting ideas raised on this subject from the UK Financial Reporting Council on "Cutting Clutter" and the Scottish and New Zealand institutes of chartered accountants on "Losing the Excess Baggage". However, there is only so much that a single body can do to influence materiality decisions as behavioural and cultural factors are embedded firmly in the mindsets of preparers, auditors and regulators.

We would support guidance from ESMA to aid the consistency of understanding and application of the concept of materiality within Europe. We believe that management is ultimately responsible for materiality decisions, and so while the view of regulators is an important factor which will be used while forming a view on materiality, any guidance should not be mandatory.

However, as a company whose shares are listed in both London and New York, we believe that it is important that ESMA involves the US Securities and Exchange Commission (SEC) in the development of any guidance with the objective of ensuring that there will be consistent interpretation and enforcement in both the EU and US markets. While we recognise that there is currently a lack of guidance in Europe, it would be counter-productive for dual-listed companies if new guidance were issued that is inconsistent with the SEC guidance.



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If you wish 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

Responses to the Invitation to Comment

Q1: Do you think that the concept of materiality is clearly and consistently understood and applied in practice by preparers, auditors, users and accounting enforcers or do you feel more clarification is required?

We believe that the concept of materiality is relatively clearly understood in terms of recognition and measurement and correction of quantified errors.

However, there is not a clear common understanding regarding materiality as applied to disclosures. In practice the default position of many preparers, auditors and regulators is that disclosure of essentially all applicable matters required by accounting standards is necessary, which results in excessive volume in financial statements. It is relatively straightforward to identify immaterial disclosure omissions through application of a checklist and challenge to the preparer to justify the omission. The burden of proof seems to be firmly with the preparer to justify the non-inclusion of items which are either not material or are borderline. We are also placed in a position where we need to collect information from our significant operations in order to demonstrate to auditors and/or regulators that an item is not material; having done this the option which minimises regulatory risk is to disclose the item, even if it is not particularly material. This tends to lead to excessive disclosure of relatively immaterial items.

We believe that ESMA can help to promote cultural change which ensures that all important information, and only important information, is disclosed.

Q2: Do you think ESMA should issue guidance in this regard?

We would support non-mandatory guidance from ESMA to aid the consistency of understanding and application of the concept of materiality. However, as a company whose shares are listed in both London and New York, we believe that it is important that ESMA involves the US SEC in the development of any guidance with the objective of ensuring that there will be consistent interpretation and enforcement in both the EU and US markets. Clearly, any guidance issued should be fully consistent with IFRS.

We find that the SEC's materiality guidance set out in Staff Accounting Bulletins (SABs) 99 and 106 is clear and largely appropriate for dealing with misstatements in terms of recognition and measurement. However, SAB 99 was issued 13 years ago, and could perhaps be refreshed in the light of developments in financial reporting over the intervening period. As mentioned above, we would find guidance addressing the materiality of disclosures to be particularly useful as disclosures are not specifically addressed in the SEC guidance.

Q3: In your opinion, are 'economic decisions made by users' the same as users making 'decisions about providing resources to the entity'? Please explain your rationale and if possible provide examples.

While we understand the distinction set out in the consultation paper, in practice we believe that the two types of decisions mean the same thing. Economic decisions made by users would encompass both decisions about management's stewardship and governance of the company as well as its valuation. Decisions about providing resources ultimately are a decision on whether to buy or sell the company's shares or provide credit, but clearly judgements around the quality of management will influence these decisions. For all practical purposes we would not draw a distinction between the two concepts.

Q4: Is it your understanding that the primary user constituency of general purpose financial reports as defined by the IASB in paragraph 13 includes those users as outlined in paragraph 16 above? Please explain your rationale and if possible provide further examples.

On the whole we agree with the list of primary users of financial reports set out in paragraph 16 of the ESMA Consultation Paper, namely existing and potential investors, lenders and other creditors. However, we do not consider current and past employees, in their capacity of future recipients of remuneration and retirement benefits, to be primary users of financial statements. In our experience the level of regulation of defined benefit pension plans and companies' funding obligations to them is such that individual current and past employees are not primary users in the same sense as investors, lenders and other creditors.

Q5a: Do you agree that the IASB's use of the word 'could' as opposed to, for example, 'would' implies a lower materiality threshold? Please explain your rationale in this regard.

Q5b: In your opinion, could the inclusion of the expression 'reasonably be expected to' as per the Auditing Standards, lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes. Have you seen any instances of this in practice?

While a distinction could be inferred between the use of the words "could" and "would", we would expect both terms, in practice, to be interpreted in the same way. In practice we would expect the word "could", as used by the IASB, to mean the same as "could reasonably be expected to", as used in the ISAs. We do not believe that "could" is intended to include all possible eventualities, however unlikely, and believe that some kind of reasonability threshold is intended to apply.

Q6a: Do you agree that the quantitative analysis of the materiality of an item should not be determined solely by a simple quantitative comparison to primary statement totals such as profit for the period or statement of financial position totals and that the individual line item in the primary statement to which the item is included should be assessed when determining the materiality of the item in question? Please explain your rationale in this regard.

Q6b: Do you agree that each of the examples provided in paragraph 22 a – e above constitute instances where the materiality threshold may be lower? Are there other instances which might be cited as examples? Please explain your rationale.

We agree that simple quantitative thresholds should not solely be used, rather that both quantitative and qualitative factors should be considered. We believe that the guidance set out in the SEC's SAB 99, which requires both qualitative and quantitative factors to be considered, is helpful in this regard.

We believe that materiality thresholds may be either higher or lower than simple quantitative benchmarks, depending on the impact of the qualitative factors. We agree that in the circumstances set out in paragraph 22 of the Consultation Paper a lower materiality threshold than normal would usually be appropriate. In contrast, materiality decisions affecting items which only impact balance sheet reclassifications or other comprehensive income would tend to use a higher threshold.

Q7: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions, including those that arose in earlier periods and are of continued applicability in the current period, in determining materiality decisions. Please explain your views in this regard.

Yes, we agree that prior period misstatements and omissions should be considered in the current period. As an SEC registrant we are explicitly required to use both the “iron curtain” and “rollover” methods under the SEC’s SAB 106 guidance, and believe that this is an appropriate means for assessing materiality for the current period.

Q8: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions as referred to in paragraphs 23 to 26 above in determining materiality? Please explain your views in this regard and provide practical examples, if applicable.

Yes, we agree that preparers should assess the impact of uncorrected immaterial errors, aggregation of individually immaterial misstatements or omissions and netting of misstatements. We believe that this assessment is already done by most companies.

Q9a: Do you believe that an accounting policy disclosing the materiality judgments exercised by preparers should be provided in the financial statements?

Q9b: If so, please provide an outline of the nature of such disclosures.

Q9c: In either case, please explain your rationale in this regard.

We understand that significant materiality judgements exercised by preparers are covered by the accounting judgements required to be disclosed by IAS 1 paragraph 122, and so are required to be disclosed. Such disclosures might include a statement that an operating segment was considered immaterial for separate disclosure, and so has been aggregated with other segment information.

Q10: Do you agree that omitting required notes giving additional information about a material line item in the financial statements constitutes a misstatement? Please explain your rationale in this regard.

We do not necessarily agree that the omission of additional information about a material line item in the financial statements constitutes a misstatement. We believe that both quantitative and qualitative factors should be considered in assessing whether there is a misstatement, and these factors will depend on the nature of the line item in question and the nature of the required additional information. Required reconciliations may be replaced with text which provides appropriate relevant information. For example, the reconciliation of opening to closing goodwill could be substituted by a simple sentence when there have been no major movements. In some cases additional information might not be considered useful to users of the financial statements and so could be omitted, for example minor adjustments or reclassifications of comparative financial information may relate to a material line item, but it is not always necessary to provide the disclosures related to these adjustments required by IAS 8.

Q11: Do you believe that in determining the materiality applying to notes which do not relate directly to financial statement items but are nonetheless of significance for the overall assessment of the financial statements of a reporting entity:

- (a) the same considerations apply as in determining the materiality applying to items which relate directly to financial statement items; or**
- (b) different considerations apply; and**
- (c) if different considerations apply, please outline those different considerations.**

We believe that the same materiality framework should be applied to all notes. Both quantitative and qualitative factors should be considered when determining whether a note is necessary, and also the degree of aggregation that is appropriate when a note is presented.

We believe that there is a particular risk of unnecessary information being disclosed in the financial instruments notes required by IFRS 7 "Financial instruments: Disclosures" for non-financial institution entities. We fully accept the need for appropriate disclosure of financial risks and of the related impacts and sensitivities. However, we believe that there is a tendency for companies to provide all of the disclosures required by the standards, and this results in disclosures which overwhelm the reader of the financial statements. We would welcome guidance which enables companies to aggregate and summarise their disclosures to enable users to "see the wood for the trees".

Q12: In your opinion, how would the materiality assessment as it applies to interim financial reports differ from the materiality assessment as it applies to annual financial reports?

The materiality assessment regarding interim reports in terms of recognition and measurement should be the same as for annual reports – a quantitative benchmark percentage of profit, equity or assets is used initially, depending on the nature of the item in question, and this is then supplemented with additional qualitative analysis.

However, the purpose of condensed financial statements prepared for interim periods is significantly different to that of annual financial statements. As stated in paragraph 6 of IAS 34 "Interim financial reporting", interim financial statements are intended to provide an update on the latest complete set of annual financial statements. As such, the level of disclosure required is correspondingly reduced and only material matters arising during the interim period need be disclosed – it is not appropriate for interim reports to repeat information that is substantially the same as in the previous annual report. The same quantitative and qualitative materiality criteria should be used to determine whether a transaction or change which occurred during the interim period should be disclosed.