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Director, Accounting Standards
Canadian Accounting Standards Board
277 Wellington Street West, Toronto
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Dear Sir / Madam

Discussion Paper on Measurement Bases for Financial Accounting – Measurement on Initial Recognition

We are responding to the invitation to comment on the above discussion paper.

Our responses to the specific questions raised in the invitation to comment are attached. However, we would like to make the following overall points arising from our review of the paper.

- The discussion paper proposes a radical change in the measurement of assets and liabilities; moving away from the reliable and well understood historical cost principle towards a potentially very subjective fair value approach. BG Group's view is that in order to have a proper debate on the merits of fair value versus historical cost the issue needs to be considered in terms of initial recognition, subsequent re-measurement and impairment. The paper only covers the first element, and therefore does not address all of the issues associated with fair value measurement.

- Fair value or market value may in some circumstances be an appropriate measurement basis. However, this is only where there are sufficient transactions in a market to allow an equilibrium to be reached. Often transactions do not occur in a liquid market and are the subject of bi-lateral negotiations. In these circumstances, we consider that historical cost is a superior measurement basis, as any attempt to arrive at a fair value for the transaction is likely to be subjective and difficult to verify. The use of fair value in these circumstances is likely to reduce comparability both between entities, and assets and liabilities held by the same entity. In our view this is likely to erode the understandability and reliability of financial statements.

- The discussion of measurement bases should be considered together with the proposed changes (phases A and B) in Financial Statement Presentation, so that there is an integrated approach to standard setting. The current approach does not allow users to fully understand the implications of each proposed change.

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Yours faithfully,

Ashley Almanza
Chief Financial Officer

Response to Specific Questions in the Invitation to Comment

Question 1

Do you agree that the list of identified possible measurement bases (see paragraphs 33-51 of the condensed version and paragraphs 69-74 of the main discussion paper) sets out the bases that should be considered? If not, please indicate and explain any changes that you would make.

BG Response

We consider that the measurement bases listed are appropriate for consideration purposes. However, we do not consider that fair value is the most appropriate basis of measurement.

Question 2

Do you agree with the working terms and definitions, and supporting interpretations, of each of the identified measurement bases (see paragraphs 33-51 of the condensed version and paragraphs 77-96 of the main discussion paper)? If not, please explain what changes you would make. In particular, do you have any comments on the term "fair value" and its definition (in light of the discussion in paragraphs 46-48 of the condensed version and paragraphs 88-93 of the main discussion paper)?

BG Response

We do not agree with all of the definitions provided in the paper. In particular:

Fair Value
The definition of fair value in the paper as "the amount for which an asset or liability could be exchanged between knowledgeable, willing parties in an arms length transaction" leads to the conclusion that fair value equates to market value. However, this implies that assets for which there is no market (e.g. an offshore gas platform which will still produce for a few more years but which could not economically be moved to another field) have no fair value because they have no market value. In reality, the fair value is not nil, but the value in use of the asset.

The paper recommends that either market value or value in use (provided it uses market inputs) could be described as fair value. We consider it more appropriate to describe all bases individually rather than using the term "fair value" to represent more than one measurement basis.

Reproduction Cost and Replacement Cost
We believe that preparers and users would normally interpret reproduction cost as the cost of reconstructing an asset. Replacement cost would be equivalent to the definition of reproduction cost in the paper and we expect that would also be the case for most users and preparers of accounts. We would therefore suggest that reproduction cost, as defined in the paper, be renamed "replacement cost" and that the definition of replacement cost in the paper be relabelled "substitution cost".

Question 3

It is proposed that there are two fundamental sources of differences between the identified bases for measuring assets and liabilities on initial recognition:

(a) market versus entity-specific measurement objectives, and
(b) differences in defining the value-affecting properties of assets and liabilities. (See paragraph 52 of the condensed version and paragraph 97 of the main discussion paper.)

This proposal and its conceptual implications are the subject of chapters 4 and 5. Do you agree that these are the fundamental sources of differences between asset and liability measurement bases on initial recognition? If not, please indicate the fundamental sources of differences you have identified, and provide the basic reasons for your views. For any different fundamental sources you have identified, please indicate how these might be examined and tested.

BG Response

We agree that the measurement bases identified in the paper, namely fair value (market value); historical cost; current cost; net realisable value; value in use; and deprival value, differ in the degree that market measurement objectives are used as opposed to entity-specific measurement objectives. Our view is that entity-specific measurement objectives are more relevant when measuring assets and liabilities.

We consider that the a priori expectation that there is only one market price is not correct (see response to Question 7). We do not consider that the differences in (b) above adequately explain this.

Question 4

The paper analyzes the market value measurement objective and the essential properties of market value.

- *(a) Do you believe that the paper has reasonably defined the market value objective and the essential properties of market value for financial statement measurement purposes (see paragraphs 54-56 and 105-112 of the condensed version and paragraphs 99-110 and 236-241 of the main discussion paper)? If not, please explain why not, and what changes you would propose, or different or additional considerations that you think need to be addressed.*
- *(b) Do you agree with the proposed definition of "market" (see paragraphs 55-56 of the condensed version and paragraphs 107-110 of the main discussion paper)? If not, please explain why you disagree, and indicate any changes you would make and any issues that you believe should be given additional consideration.*
- *(c) Do you agree with the fair value measurement objective as proposed, and its derivation from the market value measurement objective (see paragraph 102 of the condensed version and paragraphs 111, 228 and 229 of the main discussion paper)?*

BG Response

We consider the definitions in (a) and (b) above to be appropriate. However we disagree with the conclusion in (c) for the reasons set out in our response to question 2 above.

Question 5

Do you agree with the definition and discussion of entity-specific measurement objectives (see paragraph 57 of the condensed version and paragraphs 112-116 of the main discussion paper) and their relationship to management intentions (see paragraph 58 of the condensed version and paragraphs 117-121 of the main discussion paper)? If not, please explain why you disagree.

BG Response

We have no objections to the definition in the paper and consider that entity-specific measurement objectives are more useful to investors and creditors as they are more relevant and reliable.

Question 6

Do you agree with the comparison of market and entity-specific measurement objectives (see paragraph 59 of the condensed version and paragraph 122 of the main discussion paper) and with the proposed conclusion that the market value measurement objective has important qualities that make it more relevant than entity-specific measurement objectives for assets and liabilities on initial recognition (see paragraphs 60-61 of the condensed version and paragraphs 123-129 of the main discussion paper)? If not, please explain your views.

BG Response

We do not agree with the proposed conclusion. In many instances, where there is no liquid market, entity-specific measurement objectives are both more relevant and more reliable.

We believe that liabilities and assets held for ongoing use in the business which are entity specific are better stated using entity-specific measurement objectives, particularly when they cannot be readily transferred or exchanged at an economic price (as in the example in Q2 above). An entity-specific value better captures the cash-generating potential to the business from ongoing use, which is generally more relevant to the majority of investors, who are interested in the cash-generating ability of the business as a whole rather than the individual sale value of the assets on a break-up basis.

This latter point is particularly relevant if the conclusion that market value is the most appropriate measure was extended to subsequent measurement of all assets and liabilities. For example, if a long-term, high-value, depreciating asset (e.g. a large piece of plant), which will be held for its entire useful life, were to be stated at market value at each period end, the income statement is likely to reflect large gains and losses over the years which would never be realised in cash and which would have limited, if any, relevance to the performance of the business.

In the case of assets and liabilities which are not part of the core business, but are held for disposal, a market value objective may be more appropriate, as market (disposal) value better represents cash-generating potential. However, recognition at market value would not satisfy the prudence principle as it could generate a gain in the income statement in advance of realisation. We also have concerns over reliability of measurement and cost-benefit considerations under a market value model, particularly where a liquid market does not exist.

Question 7

(a) It is reasoned that there can be only one market (fair) value for an asset or liability on a measurement date (see paragraph 62 of the condensed version and paragraphs 131-138 of the main discussion paper). Do you agree with this conclusion? If not, please explain why you disagree.

(b) It is proposed that differences between apparent market values for seemingly identical assets or liabilities on initial recognition may be attributable to:

(i) differences between the value-affecting properties of assets or liabilities traded in different markets, or

(ii) entity-specific charges or credits. (See paragraph 63 of the condensed version and paragraphs 131-138 of the main discussion paper.) However, the paper notes the existence of multiple markets for some assets and liabilities, and the possibility that they may be due to market access restrictions that require further investigation (see paragraphs 74-82 of the condensed version and paragraphs 95-109 of the main discussion paper).

Do you agree with these proposals, within the caveats and discussion presented? If not, please explain why you disagree.

BG Response

BG does not agree with these proposals.

BG's view is that there is likely to be more than one market value on a given date. A market, as defined by the paper, requires there to be sufficient transactions that an equilibrium will be reached. The market is the combination of a large enough number of players (each with their own entity-specific assumptions) that the range of possible outcomes narrows to an acceptable limit. However, if the market has a finite number of players, with a particular profile of geographic location, economic status etc, there is no guarantee that the outcome it would achieve would be the same as that in a market in a different country / economic group etc.

This is not the result of differences between the properties of the assets and liabilities themselves, nor solely attributable to entity-specific charges or credits. It is the result of the composition and liquidity of the markets involved and the expectations, risk-tolerance and objectives of their individual constituents.

Question 8

Do you agree that a promise to pay has the same fair value on initial recognition whether it is an asset or a liability, and that the credit risk associated with a promise to pay enters into the determination of that fair value with the same effect whether it is an asset or liability (see paragraph 65 of the condensed version and paragraphs 142-147 of the main discussion paper)? If you do not agree, please explain the basis for your disagreement.

BG Response

We agree with the concept that a promise to pay has the same market value, whether it is an asset or a liability.

Question 9

The paper makes the following proposals with respect to defining the unit of account of the asset or liability to be measured on initial recognition:

(a) The appropriate individual item or portfolio unit of account on initial recognition is generally the unit of account in which the reporting entity has acquired the asset or incurred the liability (see paragraphs 67-70 of the condensed version and paragraphs 149-154 of the main discussion paper).
(b) The appropriate level of aggregation for non-contractual assets on initial recognition is the lowest level of aggregation at which an identifiable asset is ready to contribute to the generation of future cash flows through its sale or use (see paragraphs 71-73 of the condensed version and paragraphs 157-161 of the main discussion paper).

Do you agree with these proposals within the caveats and discussion presented? If not, please explain why, and in what respects, you disagree.

BG Response

We agree with point (a) above. In respect of point (b), the implications of the proposal are not entirely clear from the discussion in the paper. Paragraph 72 cites the example of equipment which is purchased and subsequently configured for specialised use in an assembly line. The proposal seems to be that it should be recognised at its (post-configuration) market value once it is ready for use. Does this mean that it should not be recognised at all whilst it is being configured and the purchase cost charged initially to expense, then credited back once configuration is complete? Or is it proposed that it will be carried in assets under construction at cost, then restated to market value once configuration is complete, with a gain or loss recognised in the income statement?

Under either treatment, the amount subsequently depreciated in the income statement against revenues generated by the asset would not be the cash amount the entity paid to purchase and configure the asset, but whatever the market value happened to be on the date it was completed. BG's view is that this does not reflect the economic reality of the transaction, which is the amount it actually cost the entity to achieve the revenue.

We also note that the paper does not take the same approach with inventories of finished and partly finished goods. It recommends that goods manufactured by the entity should continue to be held at cost until the point of revenue recognition, on the grounds that initial recognition occurred as the raw materials were purchased and processed. Similarly, goods bought for resale should be held at cost until sold, as the profit on sale represents the return achieved for the retailing activities performed by the entity. We agree and believe the same approach should also be applied to non-contractual assets held for use by the entity. We would also observe that this approach implies that subsequent recognition of assets and liabilities should be at historical cost (subject to recoverability) rather than market value.

Question 10

It is suggested that, in many cases, the best market source on initial recognition is the market in which the asset or liability being measured was acquired or issued. However, some significant situations are noted in which a different source may be appropriate, and research is proposed into possible multiple markets (see paragraphs 75-82 of the condensed version and paragraphs 162-182 of the main discussion paper). Do you agree that the paper provides a reasonable analysis of market sources and their implications on initial recognition? If not, please provide reasons for disagreeing, and indicate any additional analysis or research you would think should be carried out.

BG Response
We would agree that the best market source on initial recognition is the acquisition market because it better reflects the costs incurred by the entity in achieving the revenue recognised in the income statement.

We do not agree with the suggestion (referred to in paragraph 82 of the condensed discussion paper) that the entity should use whichever market price is the most advantageous to it as we anticipate that this approach would create substantial additional administrative costs for minimal benefit.

Question 11

The paper concludes that transaction costs, as defined, are not part of the fair value of an asset or liability on initial recognition (see paragraphs 86-87 of the condensed version and paragraphs 193-200 of the main discussion paper). Do you agree with the proposed definition of transaction costs? Do you agree with the above conclusion? If you disagree, please explain your reasons and what you believe the implications of your different view would be for fair value measurement of assets and liabilities on initial recognition.

BG Response

We do not agree that transaction costs are not part of the market value of the asset or liability, especially when the value in question is that of the acquisition market. In most cases, all market participants would have to incur such acquisition costs. These costs form part of the cost of the asset as they are incurred directly to secure future economic benefits.

Question 12

Do you agree with the proposal that, when more than one measurement basis achieves an acceptable level of reliability, the most relevant of these bases should be selected (see paragraph 89 of the condensed version and paragraph 202 of the main discussion paper)? If not, please explain why you disagree, and indicate how you would settle trade-offs between the relevance and reliability of alternative measurement bases.

BG Response

We do not agree with this proposal, because we anticipate that it could result in similar items being recognised on different measurement bases and thus reduce comparability of financial information.

We would also note that there are trade-offs to be made between relevance, comparability, understandability and cost-benefit. If a single line item in the financial statements contains some items at market value and some at historical cost (because market value is not reliably measurable) both comparability and understandability are compromised.

Question 13

Do you agree with the two proposed sources of limitations on measurement reliability — estimation uncertainty and economic indeterminacy — and supporting discussion (see paragraphs 90-100 of the condensed version and paragraphs 204-216 of the main discussion paper)? If not, please explain your view.

BG Response

We agree with the points highlighted in the discussion on measurement reliability. We would add that the existence of multiple market prices makes it harder to achieve reliable measurement of market value in many cases. We consider that reliability is a key qualitative characteristic of financial statements.

Question 14

Do you agree that fair value is the most relevant measure of assets and liabilities on initial recognition of assets and liabilities, and therefore should be used when it can be estimated with acceptable reliability (see analyses of fair value and alternative bases in chapter 7, and discussion of measurement date on initial recognition in paragraphs 179-180 of the condensed version and paragraphs 410-415 of the main discussion paper)? If not, please explain why.

BG Response

We do not agree with this conclusion, assuming fair value is taken to equate to market value (see response to question 2 above). We believe that entity-specific measurement (i.e. historical cost) is more relevant to investors who are interested in the cash generating ability of the business as a whole (see response to questions 6 and 9 above) and we believe that measuring market value reliably will not be consistently achievable.

Question 15

Do you agree that fair value is not capable of reliable estimation in some common situations on initial recognition (see paragraph 104 of the condensed version and paragraphs 232-277 of the main discussion paper)? More specifically, do you agree that:

- *(a) A single transaction exchange price should not be accepted to be equal to fair value unless there is persuasive evidence that it is (see paragraphs 106-114 of the condensed version and paragraphs 243-252 of the main discussion paper), and*
- *(b) A measurement model or technique cannot be considered to achieve a reliable estimation of the fair value of an asset or liability when the estimate depends significantly on entity-specific expectations that cannot be demonstrated to be consistent with market expectations (see paragraphs 115-118 of the condensed version and paragraphs 263-268 of the main discussion paper)?*

Please provide explanations for your views on these questions if they differ significantly from the conclusions and supporting arguments presented in the paper.

BG Response

We agree with the conclusion that market value is not measurable in many common situations. In these circumstances, we believe that historical cost is more reliable. If a "fair" value measurement basis is required, it may be achieved by using entity-specific models and techniques.

Question 16

Do you agree with the paper's analyses and conclusions with respect to the comparative relevance and reliability of:

- *(a) historical cost (see paragraphs 120-137 of the condensed version and paragraphs 281-319 of the main discussion paper);*
- *(b) current cost — reproduction cost and replacement cost (see paragraphs 138-154 of the condensed version and paragraphs 320-361 of the main discussion paper);*
- *(c) net realizable value (see paragraphs 155-161 of the condensed version and paragraphs 362-375 of the main discussion paper);*
- *(d) value in use (see paragraphs 162-169 of the condensed version and paragraphs 376-392 of the main discussion paper); and*
- *(e) deprival value (see paragraphs 170-178 of the condensed version and paragraphs 393-409 of the main discussion paper)?*

Please provide reasons for any disagreements, and any advice you may have as to additional analysis or research that you believe should be carried out.

BG Response

Historical cost
We agree that historical cost must be supplemented by a recoverability test in order to ensure that the balance sheet is not overstated. We also agree that historical cost is an entity-specific measurement, but do not agree that this is necessarily a weakness, as discussed in our response to question 6.

We do not agree that market value better satisfies the cost-revenue matching objective than historical cost (please see our response to question 9).

In respect of the analysis on predictive value, we consider that historical cost provides a better indication of future net income of the entity, whereas market value provides a better measure of future cash flows from assets and liabilities if they were to be disposed in the short term, rather than held for use. For assets that are not held for disposal in the short-term, therefore, we do not see market value as being the better measurement basis and consider that an entity-specific basis would be more appropriate.

Finally, we agree that use of historical cost will be a practical necessity in most cases. Furthermore, we see limited benefit in carrying a small group of assets and liabilities at market value if the majority are at historical cost, especially if this would result in different treatments for similar items.

Current Cost
The paper considers that both replacement cost and reproduction cost are more relevant values on initial recognition than historical cost because they are better indicators of current cost but concedes that they will rarely be reliably measurable. We believe there are material limitations on the reliability of these measurement bases. We also have concerns about carrying some items at historical cost and others at current cost, even if they are similar in nature.

Value in Use, Net Realisable Value and Deprival Value
We believe these are all useful tools for assessing the recoverability of an historical cost valuation.

Question 17

The paper discusses substitutes for fair value when the fair value of an asset or liability cannot be reliably estimated on initial recognition. Do you agree that, when other measurement bases are used as substitutes for fair value on initial recognition, they should be applied on bases as consistent as possible with the fair value measurement objective (see paragraph 186 of the condensed version and paragraph 417 of the main discussion paper)? If not, please explain why.

BG Response

We do not agree that fair value is the best measure on initial recognition and therefore assessment of the other measures as substitutes for it is not relevant.

Question 18

Do you agree with the proposed hierarchy for the measurement of assets and liabilities on initial recognition (see chapter 8)? If not, please explain your reasons for disagreeing and what alternatives you might propose.

BG Response

We do not agree with the proposed hierarchy. We consider that the historical cost convention should be preserved and that the other measures are relevant only to test the recoverability of assets carried at historical cost.

Question 19

Do you have comments on any other issues or proposals, including the proposals for further research (see paragraph 189 of the condensed version and paragraph 441 of the main discussion paper)? If so, please provide them.

BG Response

The paper limits its scope to measurement on initial recognition but the authors observe that the conclusions also require an assessment of subsequent measurement. We strongly agree with this and consider that further discussions on measurement should include an assessment of both initial recognition and subsequent measurement.