恒隆地產
HANG LUNG PROPERTIES

13th August 2004

Mr. Simon Riley
Technical Director (Financial Reporting)
Hong Kong Society of Accountants
4th Floor Tower Two, Lippo Centre
89 Queensway
Hong Kong

Dear Sir,

Re: <u>Exposure Draft for Hong Kong Accounting Standard 40 "Investment Property"</u>

We are writing to express our serious concerns again on the proposed changes on accounting for investment properties as stipulated in the Exposure Draft for Hong Kong Accounting Standard 40 "Investment Property" ("HKAS 40"). This issue was discussed two years ago and had received the Society's full support to postpone the proposed changes. Nonetheless, the same matter was raised again by the Society recently with a view to enforce HKAS 40 by 1st January 2005. We understand that this sudden move is indeed part of the final phase of the Society's convergence project to align all Hong Kong accounting standards in line with International Accounting Standards on the same date.

While principally we are in full support of the Society's objective to internationalize all local accounting standards, we strongly disagree with the proposed changes required by HKAS 40 to deal with the revaluation surplus and deficit arising from annual valuation of investment properties in the income statement. Such requirement would result in significant distortions to the annual results of a property company and the related financial ratios. The volatility in reported profit is definitely misleading to the ordinary user of accounts. The profit and loss of a property company would then be dependent on the opinion of "professional" valuers, which could be rather subjective. Practical difficulties would also arise in complying with the listing rules on notifiable transactions, as the profit test is one of the criteria to decide whether a transaction is notifiable or not. Also, the Profits Tax position with the Hong Kong Inland Revenue Department regarding the unrealized gains in the fair value of investment properties that will be dealt with through the profit and loss account may need to be ascertained. Most of these arguments have already been raised in our letter to the Society in August 2002, and we strongly believe that they are still valid today and the arguments contained therein are also shared by other major real estate developers.

We would like to emphasize that we have no objection to account for investment properties at fair value. However, it is questionable why the revaluation movements must be recognized in the income statement. Under the fair value model of HKAS 39 "Financial Instruments: Recognition and Measurement", the fair value changes of financial assets are dealt with in the income statement or directly in the equity depending on the classification of financial assets as designated by the company at initial recognition. The fair value changes of available-for-sale

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HANG LUNG PROPERTIES LIMITED 28/F Standard Chartered Bank Bldg.
4 Des Voeux Road Central, Hong Kong Tel:28790111 Fax:28686031
恒隆地產有限公司 香港中環德輔道中四號渣打銀行
大廈二十八樓 電話:28790111 傳真:28686031

investments are indeed required to be recognized directly in equity but not in the income statement. It is the fair value changes of those financial assets *that are designated for trading purposes* that should be passed through the profit and loss account. In this connection, we recommend that the Society should seriously consider *elaborating* the fair value model for investment properties in a way similar to that for financial assets under HKAS 39. This would require, first of all, for a company to classify investment properties between available-for-sale and held for trading at initial recognition (or at the first time of adoption of the standard). Like HKAS 39, certain criteria would have to be fulfilled for either classification, such as management intention and records of investment property trading. Then the changes arising from subsequent revaluation would have to be taken directly to the corresponding revaluation reserves in respect of available-for-sale investment properties, or in the income statement for investment properties designated for trading purpose.

We note that the available-for-sale option was previously considered by the International Accounting Standard Board ("the Board") as mentioned in the IASC Basis for Conclusions on IAS 40 (2000), but no details were provided as to why this particular argument was considered not acceptable by the Board. It could be an area of which HKAS 40 has not been fully addressed to.

As you may appreciate, our above suggestion is an outcome during the progress of learning how to work with a fair value model for investment properties, which is encouraged by the Board as expressed on their discussion papers. It could well be a step ahead of the present version of HKAS 40 (and IAS 40).

We recognize that it is not easy for the Society to persuade the Board to adopt our above suggestion before the deadline of applying HKAS 40 on 1st January 2005. Nevertheless, we did see that great improvements on IAS 40 have been achieved by allowing interests in leasehold land to be accounted for as investment properties instead of operating leases. This proves that, as long as the Board has been brought into full attention about the serious consequences of applying the new accounting standard for investment properties in Hong Kong, our concerns will be resolved with satisfactory responses in foreseeable future. It follows that, while pending for the Board to make a decision, we should be in a position to either delay the implementation of HKAS 40, or to apply HKAS 40 with modifications as suggested above.

Thank you for your kind attention.

Yours faithfully,
For and on behalf of
Hang Lung Properties Limited

Nelson Yuen
Managing Director

cc: The Real Estate Developers Association of Hong Kong