16th September, 2004

Hong Kong Institute of Certified Public Accountants
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89 Queensway
Hong Kong

By Fax (2147 3293)

Dear Sirs,

Re: Exposure draft – Hong Kong Accounting Standards

I am writing to express my views on the captioned.

A) ED – HKAS 40

Under the disclosure requirement of paragraph 75 (i) (ii) and (iii), an entity shall separately disclose "*the amounts recognized in profit or loss for direct operating expenses (including repairs and maintenance) arising from investment property that* ***generated*** *and* ***did not generate*** *rental income during the period*". I believe that such requirement is unnecessary and impracticable.

In accordance with prevailing requirements, information of rental income, cash flows from non-cancellable operating leases commitment and in case of listed companies, a discussion of property rental performance in its management discussion and analysis are provided. Together with disclosure of total direct operating expenses, the financial statements would provide adequate information enabling the users to evaluate the performance of the investment property portfolio.

Moreover, the aforesaid requirement is impracticable for property that is partly vacant. As vacancy percentage varies throughout the financial period and some operating expenses e.g. advertising etc. are incurred for the whole property/portfolio, apportionment of direct operating expenses to occupied portion and vacant portion will require complex recording process, extensive time and effort and subjective judgement in allocation. Additional costs incurred to cope with this requirement may outweigh the benefit obtained, if any.

Instead of analyzing the direct operating expenses as proposed in the ED, presenting the total direct operating expenses will be much more practical and will strike a good balance between the burden of the entity and the benefit for the users of financial statements.

B) ED – HKAS 24

The ED proposes to remove the exemption of financial statements of wholly owned subsidiaries from disclosure of related party transactions and outstanding balances despite such information is available in their parent's consolidated financial statements. As these companies belong to one beneficial shareholder, disclosure of intra-group transactions will not give much additional benefit to the primary users of their financial statements, members of its ultimate holding company, but will create undue burden in preparing the accounts. While it is the current practice that auditors only accept responsibility to the members of the entities for their auditors' report, it may not be fair to require the reporting entities to account to every potential user of the financial statements by providing such excessive information. Therefore, such exemption should still be retained.

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The ED also proposes to extend the scope of related parties to include domestic partner, children, dependant, children and dependant of the domestic partner of key management personnel of the entity or its parent; and the entities controlled, jointly controlled and significantly influenced by them. Apart from the difficulty to have common interpretation of "domestic partner", there is no obligation for all the aforesaid persons to disclose their identities to the entity and there is no mandatory right for the entity to request for such information. It is too broad and is not practical for the entity to identify such persons, especially when such persons are connected with the non-executive directors of its parent. Therefore, such persons in relation to the key management personnel should be scoped out.

C) *ED – HKAS17*

The ED proposes that the land and building elements of a property are considered separately for the purposes of lease classification. The land element would be accounted for as operating lease because the lessee usually does not receive substantially all of the risks and rewards incidental to ownership in light of an indefinite economic life of land.

Due to the following unique characteristics of leasehold land , operating lease treatment should not be appropriate:-

1) as the leasehold lands for exploration for or use of non-regenerative resources have been scoped out by the ED, there will be no deterioration in other lands during their indefinite lives. The risk incidental to holding such lands, no matter through ownership or lease, will only arise from force majeures in which cases there will be no compensation to the owner nor the lessee. As a result, the lessee in substance assumes the risk of land during its lease term.

2) normally a lease only enables the lessee to obtain the right to use the underlying asset. Such right is usually not transferable and even if it can be, the transfer value is relatively small and becomes zero at the end of the lease. Change in value of the underlying asset does not have any impact on the lessee. However, in case of leasehold land, usually the lessee are free to sell his interest in land and have the right of first refusal to renew the lease upon expiry at terms agreed by the lessor (i.e. the owner). Proven by our experiences in Hong Kong, the lease coupled with such features exposes the lessee to change in land value just like the owner during the lease term, and the value of the lessee's interest in the land at the end of lease should not be presumed insignificant due to the aforesaid right of first refusal. Therefore, such lessee in substance receives the rewards of the land during its lease term.

3) when a building constructed on a leasehold land is purchased by an entity, the acquisition cost includes both the payment for acquiring the building and the remaining lease term of the land. As the cost allocation basis between these two elements could only be determined arbitrary in most cases, it is not appropriate to classify the land element as an operating lease and as such, both land and building will be classified as the entity's asset and, depending on its intention, are accounted for in accordance with SSAP22/HKAS2, SSAP13/HKAS40 and SSAP17/HKAS16. However, if an entity acquires a plot of leasehold land and constructs a building thereon, payment for leasehold land, no matter made to the government or other third parties , is required to be classified as an operating lease under the ED. As a result, different treatments are adopted despite both of the above transactions are identical in substance.

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In order to have a consistent treatment reflecting the substance and consequences of the transaction, I believe that interest in leasehold land, which is acquired without restriction on transfer and accompanied with first right of refusal for renewal pursuant to either legal entitlement or established market practice, should be accounted for by the lessee in accordance with SSAP22/HKAS2, SSAP13/HKAS40 and SSAP17/HKAS16.

Thank you for your attention.

Yours faithfully,

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