

# Investment Property Accounting in Hong Kong

Investment property portfolios are a significant component of many corporate balance sheets, and with those portfolios potentially subject to material changes in value from one year to the next, one can appreciate the added prominence and public interest given to the way these assets are accounted for.

## Accounting Treatment – Present Requirements

Investment property has been subject to specific accounting treatment in Hong Kong for a number of years. Statement of Standard Accounting Practice (SSAP) 13, “Accounting for Investment Properties”, was originally issued by the Hong Kong Society of Accountants (HKSA) in 1987 and the version currently in effect has been largely unchanged since 1994. The SSAP applies to those enterprises that prepare their financial statements in accordance with Hong Kong Statements of Standard Accounting Practice and, to an extent, achieves synonymous accounting treatment for investments regardless whether the investment is in a financial instrument or in real property.

Under SSAP 13, an investment property is an interest in land and/or buildings held solely for its investment potential (for example, capital appreciation and/or rental income). Property, or that part of a property, held for other purposes such as for operating one’s own business is not investment property even though there may also be an element of investment potential associated with holding the property.

The basic requirements of SSAP 13 are:

- Investment property is carried on the balance sheet at open market value based on a valuation carried out at balance sheet date by a qualified valuer.<sup>1</sup>
- Changes in the value of an investment property portfolio between one balance sheet date and the next are taken directly to a revaluation

reserve but only when that reserve remains in surplus. To the extent that the revaluation reserve is not in surplus, changes in the value of an investment property are reported in the income statement.

New International Accounting Standard (IAS) 40, “Investment Property” became applicable in 2001 for those enterprises that prepare their financial statements in accordance with IAS.

The basic requirements of IAS 40 are:

- Investment property is carried on the balance sheet at fair value<sup>2</sup>, based on a valuation carried out at balance sheet date.<sup>3</sup>

statements, and who hold investment property located in Hong Kong, has not been with the accounting requirements under IAS 40 as such but rather with the inability to apply IAS 40 at all. Instead of applying IAS 40, land and buildings previously reported as investment property at open market value have been required to be written back to cost and treated as an operating lease under IAS 17.

By contrast, SSAP 13 – in conjunction with SSAP 14 on leases – currently requires land and buildings leased from the Hong Kong SAR government to be accounted for as investment property when the asset is held solely for its investment potential. Enterprises that prepare Hong Kong SSAP-compliant financial statements have

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## Proposals for Change

The HKSA has a policy of converging Hong Kong SSAPs with the International Accounting Standards Board’s (IASB) standards<sup>4</sup> but it has not been possible so far to converge the requirements of SSAP 13 with IAS 40.

The main roadblock to convergence has been with the requirements of IAS 17, “Leases”. Under IAS 17, all leases are classified either as “operating leases” or “finance leases” and different accounting is applied depending on the category of lease.

Almost all land in Hong Kong is leased (rented) from the Hong Kong SAR government rather than owned outright. IAS 17 presently requires these leases to be classified as “operating” because title to the land typically does not pass at the end of the lease term.

Only when a property is owned outright or held under a finance lease does IAS 40 permit it to be accounted for as investment property, so long as it is held solely for its investment potential. At present, IAS 40 cannot be applied to assets held under an operating lease.

The financial reporting disruption encountered so far by those companies that prepare IAS-compliant financial

statements, and who hold investment property located in Hong Kong, has not been with the accounting requirements under IAS 40 as such but rather with the inability to apply IAS 40 at all. Instead of applying IAS 40, land and buildings previously reported as investment property at open market value have been required to be written back to cost and treated as an operating lease under IAS 17.

The good news going forward is that the IASB, in response to concerns expressed, has proposed a change to the way a lease is classified under IAS 17 and the definition of an investment property in IAS 40.<sup>5</sup> The effect of the changes proposed by the IASB, if implemented, would permit an interest in land and building located in Hong Kong and which is held solely for its investment potential to be accounted for as investment property under IAS 40.

The IASB is also in the midst of proposing a radical reshape of the income statement. A new “Statement of Comprehensive Income” would require that changes in fair value of assets such as investment property be presented separately from the results of current period operations – and thus would provide clarity as to the composition of net profit or loss for the period. Further details of the IASB’s project are available at <http://www.iasb.org.uk/>.

## Impact in Hong Kong

At present, the IAS would typically regard Hong Kong (leasehold) land and building as being an operating lease and therefore require it to be carried on the balance sheet at amortised cost.

SSAP 13 requires investment property to be reported

on the balance sheet typically at current open market value.

The IASB's current proposals, if implemented, would permit Hong Kong land and buildings that are held solely for investment purpose to be treated as investment property and, consequently, reported on the balance sheet at fair value, thus restoring the balance sheet treatment to the same as currently under SSAP 13.

The following example compares the present approaches under Hong Kong SSAP and IAS and the proposed approach under IAS:

Scenario: An investment property was acquired on 1 January 1992 for HK\$100m under Hong Kong SAR Government lease (50 year term). As at 31 December 2000, the fair value of the property was estimated to be \$120m. As at 31 December 2001, the fair value of the property was estimated to be \$130m. The accounting treatment in the 2001 financial statements would be:

	Under: SSAP 13	IAS at present <sup>6</sup>
Asset value on balance sheet	130	80
Impact on current period profit before tax	0	-2
Change in shareholders' equity	+ 10	-2

If, instead, the fair value of the property were estimated to be \$70m as at 31 December 2001, the accounting treatment in the 2001 financial statements would be:

	Under: SSAP 13	IAS at present
Asset value on balance sheet	70	80
Impact on current period profit before tax	-30	-2
Change in shareholders' equity	-50	-2

Comparing SSAP 13 at present with the IAS if the current proposals were implemented:

- Minimal balance sheet impact. Under SSAP 13, however, the shareholders' equity analysis would differ to the extent of the revaluation reserve.
- All changes in fair value between two balance sheet dates reported in the income statement under IAS 40 whereas SSAP 13 requires only losses below cost to be recognised in the income statement. To the extent that investment property valuations remain above cost, there would be a difference between a SSAP-based income statement and an IAS-based income statement. **HKSA**

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1 SSAP 13 provides an exemption to this requirement when an enterprise's total holding of investment property is below the greater of HK\$50m or 15% of the enterprise's total assets.  
 2 "Fair value" under IAS 40 is broadly equivalent to "open market value" under SSAP 13.  
 3 IAS 40 also permits a one-off policy election to carry investment property at cost or, as currently proposed by the IASB in the case of leaseholds, to apply the leases accounting standard. For relevance, this article focuses on the IAS 40 fair value model.  
 4 The HKSA's convergence policy was covered in *The Hong Kong Accountant*, April 2002, page 33.  
 5 Refer to Exposure Draft of Proposed Improvements to IAS, IASB May 2002, pages 165, 168, 343 & 346.  
 6 Amount reported is the cost of the lease less straight-line amortisation over the period of the lease.