



15 August 2002

Deputy Director, Accounting  
Hong Kong Society of Accountants  
4/F, Tower Two, Lippo Centre  
89 Queensway  
Hong Kong

Dear Sirs,

Exposure Draft : Improvements to International  
Accounting Standards

We refer to the exposure draft issued by the Hong Kong Society of Accountants (“HKSA”) and express our concern on the proposed changes on International Accounting Standard 40 “Investment Property” (“IAS 40”). HKSA intends to amend SSAP 13 “Accounting for Investment Properties” by following the amendments under ISA 40.

We consider that the adoption of IAS 40 would have a significant impact on the financial statements of Hong Kong property companies that have a portfolio of investment properties. Our major concern is the requirement to report any change in fair value of investment properties in the income statement.

For example:

	<u>Fair value of property</u>	<u>Rental income</u>	<u>Change in fair value</u>	<u>Results</u>
	HK\$m	HK\$m	HK\$m	HK\$m
Year 1	10,000	600	-	600
Year 2	11,000	660	1,000	1,660
Year 3	12,100	726	1,100	1,826
Year 4	10,890	653	(1,210)	(557)

1. It is a common valuation method in Hong Kong to capitalise future rental income for property valuation. The income statements for Year 2 and 3 would no longer depend on the operating results for the reporting year. Instead the results for Year 2



and 3 include certain future rental income which does not belong to the reporting year (unrealised gains). The change in fair value is not an inflow of economic benefits during the year arising from operation. Therefore, we consider that to account for future economic benefits in the current year is not appropriate.

2. For Year 4, the decrease in fair value of investment property in effect is a reversal of future rental income which has been accounted for in previous year(s) because of wrongful treatment of rental income in Year 2 and 3. Therefore, the decrease in fair value of investment property is not an amortisation or impairment loss and should not dealt with in the income statement.
3. The recognition of change in fair value of investment property in income statement distort the company's operating results and would not give a "true and fair view" of the results from operation for that fiscal year.
4. It is doubtful that whether such unrealised gains are available for dividend distribution. We require HKSA to advise on this point as soon as possible.
5. Certain financial ratios, such as earnings per share, return on equity, return on asset, dividend payout ratio, P/E ratio etc. would also be distorted if unrealised gains and losses on investment property valuation were included.
6. It would distort the cumulate gain or loss when the time of realisation of investment property (compared with historical value) because certain gain or loss has been recognised in previous year(s).
7. The fair value model of investment property is inconsistent with alternative treatment for Investments in Securities (SSAP 24). Investment property and securities are held long term by the company for investment potential. Under the alternative treatment, unrealised gains and losses on securities that are not held for trading purposes are dealt with in reserves, until the security is disposed of or determined to be impaired, at which time the cumulative gain or loss is included in net profit or loss for the year whereas unrealised gains and losses on investment property are dealt with in the income statement.

We would also point out that due to the volatility of the Hong Kong property market and the investment property portfolio held by Hong Kong property companies was such a magnitude that the amount of change in fair value of investment properties would be very significant.



# 新世界發展有限公司

New World Development Company Limited

We append the adjusted consolidated results of our company for the past five years taking into account the proposed amendment to IAS 40. You will find that the fluctuation in the Hong Kong property market materially affect the results of a property company due to change in fair value of investment properties. The adjusted results distort the operating results and mislead public investors.

	<u>Net profit</u>	<u>Change in fair value</u>	<u>Adjusted results</u>
	HK\$m	HK\$m	HK\$m
FY 2001	220.50	127.00	347.50
FY 2000	215.00	938.60	1,153.60
FY 1999	1,328.40	(2,591.60)	(1,263.20)
FY 1998	2,142.90	(10,962.10)	(8,819.20)
FY 1997	5,312.00	4,930.40	10,242.40

In view of the above, we do not support the fair value model as proposed by International Accounting Standards Board. We recommend to maintain the existing accounting treatment under SSAP 13.

We sincerely hope that, due to the unique property market in Hong Kong, HKSA to reconsider how to apply IAS 40 in Hong Kong to avoid undesirable results for Hong Kong property companies and undue hardship in the downturn of the property market.

Thank you for your attention.

Yours sincerely,



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Chief Accountant