羅兵咸永道會計師事務所

PricewaterhouseCoopers
33rd Floor Cheung Kong Center
2 Queen's Road Central
Hong Kong
Telephone (852) 2289 8888
Facsimile (852) 2810 9888

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

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Our Ref: THKF/MYTC/Tech

Dear Sir

Exposure Draft – Proposed Convergence of Hong Kong Accounting Standards with International Accounting Standards

We are responding to the invitation to comment on the above exposure draft. We support the proposal to achieve full convergence of the existing Statements of Standard Accounting Practice (SSAP) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) with International Accounting Standards (IAS) and SIC Interpretations issued by the International Accounting Standards Board. While we agree with most of the proposals contained in the exposure draft, we put forward below certain suggestions for your consideration.

HKAS 17 Leases

1.1 Paragraph 16 of HKAS 17 states that "…. in order to classify and account for a lease of land and buildings, the minimum lease payments are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease." It further proposed that if the lease payments cannot be allocated reliably between the land element and the buildings element of the lease, the entire lease is generally classified as a finance lease.

1.2 While we agree that, where a lease of land and buildings cannot be split into its elements the entire lease should be presumed to be a finance lease, our major concern is that there is no specific guidance given in the standard to explain the type of situation which indicates that the lease cannot be split into its elements. We consider that this should be a matter of fact rather than judgement, and should be determined consistently on a country by country basis. In Hong Kong SAR, land and buildings frequently are leased together instead of "acquired" separately. In such situation, practical problems may arise in determining the relative fair values of the two elements. Although professional valuers are often involved in determining the fair value of the leasehold interests in the land and buildings as a whole, we understand that different valuers may come up with different conclusions as to whether the land element and the buildings element can be reliably split.

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1.3 In view of the above, we suggest that the HKICPA should discuss with Hong Kong Institute of Surveyors so that a consistent approach will be adopted by professional valuers in consideration whether the lease payments can be allocated reliably between the land and the buildings elements if acquired together and in determination of the relative fair values attributable to each element. Additional guidance should be provided in the standard or in a separate interpretation to clarify this matter.

HKAS 40 Investment Property

Fair Value Model – Professional valuation

2.1 Paragraph 33A of HKAS 40 proposed to retain the current requirement in SSAP 13 that the fair value of the investment property be determined on the basis of a valuation by a qualified valuer. IAS 40 encourages but does not require an entity to determine the fair value of investment property on the basis of a valuation by an independent qualified valuer. This is also consistent with the approach on actuarial valuations in HKAS 19 *Employee Benefits* and valuation used to determine fair value in HKFRS 2 *Share-based Payment.* We are of the view that there is no clear reason for HKICPA to retain the SSAP 13 requirement on professional valuation in HKAS 40 which is an additional requirement to IAS 40. It should have been an area for preparers to decide whether an entity has sufficient basis to determine fair values reliably and for auditors to decide if there is sufficient appropriate evidence to support the numbers used.

2.2 In view of the above, we recommend that paragraph 33A of HKAS 40 should be deleted.

Transitional provisions - Fair value model

3.1 The transitional provisions for fair value model currently proposed in paragraph 80 of HKAS 40 is not adequate as it has only addressed the specific situation whereby an entity elects for the first time to classify and account for some or all eligible property interests held under operating leases as investment property. It did not address the accounting on initial application of the fair value model for freehold properties in situations as described in paragraph 3.2 below.

3.2 Due to different approaches of SSAP 13 and HKAS 40, there will be situations whereby a property previously scope out of SSAP 13 (e.g. freehold properties leased out to a reporting entity's parent or fellow subsidiary) is now required to be classified as an investment property in accordance with HKAS 40. Furthermore, HKAS 40 has also removed the de minus rule permitting the entity with investment properties with estimated open market value of less than HK$50 million or less than 15% of the carrying amount of total assets of the entity to carry those investment properties at cost. Under HKAS 40, these entities now have an option to use the fair value model to account for such properties although the properties might have previously been accounted for using different models in accordance with either SSAP 17 or SSAP 13.

3.3 We consider that further guidance on the transitional provisions for initial application of the fair value model in HKAS 40 in situations mentioned in paragraph 3.2 above should be provided. It is suggested that the introductory sentence of paragraph 80 should be amended to incorporate the original guidance in paragraph 70 of IAS 40 (2000), which states that "under the fair value model, an enterprise should report the effect of adopting this standard on its effective date (or earlier) as an adjustment to the opening balance of retained earnings for the period in which the Standard is first adopted".

Transitional provision - Cost model

4.1 If an entity previously applied SSAP 13 and took advantage of the transitional arrangements set out in paragraph 23 of that standard to state its investment property at pre September 1994 carrying value, it is now required to apply HKAS 8 for change in accounting policies when it chooses to use the cost model on initial application of HKAS 40. Since the original pre September 1994 exemption under paragraph 23 of SSAP 13 will be removed, we suggest to highlight this in the introduction section of HKAS 40.

We apologize for the late submission of the above comments and wish that you will be able to give them due consideration. If you have any questions in relation to this letter, please do not hesitate to contact Tommy Fung at 2289 1829.

Yours faithfully

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