新鴻基地產發展有限公司

2002 AUG 16 AM 11:33

14th August, 2002

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

Dear Sir,

Re: Exposure Draft
Proposed Improvements to International Accounting Standards
Proposed Revisions to IAS 40

We refer to your letter dated 5th June, 2002 inviting comments from interested parties on the proposals contained in the exposure draft issued by The International Accounting Standards Board proposing amendments to a number of International Accounting Standards. As a major property development and investment company in Hong Kong with securities listed on the Stock Exchange of Hong Kong Limited we welcome action by the Hong Kong Society of Accountants ("HKSA") to enhance accounting practices which are beneficial to Hong Kong as a financial centre but like to express our concerns on certain current or proposed accounting standards of The International Accounting Standards Board which in our view may not be suitable for adoption in Hong Kong due to the unique circumstances of Hong Kong which economy is heavily dependent on real estate business. We are particularly concerned with the HKSA's intention to issue an exposure draft on SSAP 13 in order to converge with the IAS 40 and we set out below areas which we have comments:-

(1) Recognition of fair value changes of investment property as operating profits in financial statements

It is a recognised fact that property companies in Hong Kong constitute a significant share in terms of asset value and market capitalisation of all the companies listed on the Stock Exchange of Hong Kong Limited and experience has shown that any fluctuations in their profits have an undue influence on market sentiment and hence stock prices of all stocks. It is our submission that any unwarranted change to the present accounting treatment of value of investment properties may have grieve consequences on the entire stock market. We submit that HKSA should <u>**not**</u> adopt the practice of requiring fair value changes of investment properties be recognised in income statements as the existing standard, SSAP 13, is already serving the users and investors very well. We summarise below the grounds for our disagreement:-

(a) Confusion to investors

The fair value changes of investment properties do not represent actual realisation of the gain or loss over carrying cost of the investment property and is a non cash item which has no effect on the cash flow of the company whether such changes should result in a profit or loss. The recognition of such profit or loss may give a wrong impression to investors of the financial condition of the company. Investors may have difficulties in differentiating the true operating income of a company and profits resulted from fair value changes.

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(b) Result in abnormal fluctuation in operating profits

History has shown that Hong Kong has a more volatile property market than most western countries. The recognition of profit resulting from fair value changes will no doubt lead to further increase in volatility in the profit level of companies and especially property companies, it would also undermine the usual measurement of performance of the management such as price earning ratio and return on equity ratio rendering the same misleading. Further, any profit arising may not be distributed to shareholders as such are not represented by cash flow. The adoption of the IAS 40 will aggravate the fluctuation in profits of companies by boosting profits during bloom times and accelerate profit declines during recessions. This, in our view would become a dis-stabilising factor to the financial market of Hong Kong.

(c) "Fair Value" is subject to subjective considerations

It is our submission that fair value is subject to subjective factors and assumptions as it is quite common even for professional valuers to have significant disagreement in the valuation of a property. If the fair value cannot be determined accurately, the profit of the company may also be misleading.

(d) Possible misleading comparison

There are concerns that the recognition of fair value changes may lead to misleading comparison of the performance of listed companies. The profit from property revaluation may over shadow the true operating income. It may also create difficulty for investors to compare results of the same company for different financial periods.

(e) Manipulation of profit

Recognition of fair value changes may lead to temptation for management of companies to manipulate profits. For example in the case of a property company with substantial amount of investment properties, the increase of 1% in value in its property portfolio could have a dramatic effect on its operating profit.

(f) Conceptual Inconsistency with IAS 39

Unlike assets or investments that are acquired for trading purposes, investment properties are acquired and held for long term, more like equity investments. For these kind of long term, non-trading assets, we believe the more appropriate accounting treatment is to report fair value changes in the equity and take them to the profit and loss account when realised. It is dubious that an entity should be made suffered a loss in a financial year just because it has not realised an investment property which happens to stand at a higher value at the last balance sheet, while the property is in fact profitable in terms of rental return and its fair value still exceeds its historical cost. In this respect, we would like to draw your attention to the IAS 39 : Financial Instruments, under which financial assets have to be classified as held for trading, held to maturity or available for sale. Those classified as held to maturity carry at historical cost, while the others are fair valued at

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balance sheet date. The change in fair value of the available-for-sale portfolio is to be recognised as a special component of equity and is available to be passed through the profit and loss account when actually sold. More importantly, one of the proposed amendments to IAS 39 is to remove the option to report fair value changes for available-for-sale financial assets in the profit and loss account.

In our point of view, investment properties, by nature, are very much like the available-for-sale investments and by analogy, should be given the same accounting treatment as that specified in the IAS 39. We, therefore, take the view that we should either reaffirm the existing SSAP 13 or take the IAS 39 as the benchmark or guidepost when contemplating any amendments or revisions rather than converge with the IAS 40. To do otherwise will only create conceptual confusions and inconsistencies instead of eliminating inconsistencies in our conceptual framework of accounting.

(2) Disagreement to owner operator properties not to be classified as Investment Property

We do not see any significant difference between a hotel property managed by the owner and one managed by a third party as the core income of both hotels is derived from the letting of rooms. If a hotel property managed by a third party can be classified as an investment property, we disagree not to classify a hotel managed by the owner in the same manner.

We sincerely hope that HKSA will seriously consider our views expressed above. If you wish to discuss with us on any of our comments and views, please feel free to contact us.

Yours faithfully,
For and on behalf of
Sun Hung Kai Properties Ltd.

Bernard W. M. Pun

c.c. The Real Estate Developers Association of Hong Kong
The Federation of H.K. Hotel Owners
Cheung Kong (Holdings) Ltd.
Swire Properties Ltd.
Henderson Land Development Co. Ltd.
New World Development Co. Ltd.
Hang Lung Group Ltd.
Sino Land Co. Ltd.
Great Eagle Holdings Ltd.
Hysan Development Co. Ltd.
Wharf (Holdings) Limited