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Mr. Alvin Wong,
President,
Hong Kong Society of Accountants,
4th Floor, Tower Two, Lippo Centre,
89 Queensway,
Hong Kong.

Dear Mr. Wong,

Adoption of IAS 40 Principles in Proposed Revision of SSAP 13

We understand that the Hong Kong Society of Accountants (HKSA) is planning to issue an exposure draft proposing a wholesale revision to Hong Kong Statement of Standard Accounting Practice 13 (SSAP 13) covering accounting for investment properties, which will incorporate the provisions of International Accounting Standard 40 (IAS 40).

The HKSA is taking this step in pursuit of its stated strategy of achieving convergence for Hong Kong SSAPs with the International Accounting Standards (IAS) promulgated by the International Accounting Standards Board (IASB). This is a sensible objective. However, even after the incorporation of certain proposed changes to IAS 17 and IAS 40, there remains a major problem with IAS 40, and the adoption of a revised SSAP 13 in Hong Kong would have very serious implications for the local financial market. We are very concerned at this prospect.

In summary, the problem is that IAS 40 requires investment properties to be carried at valuation with gains or losses on changes in fair value to be included in the income statement (the "fair value model"), or alternatively, to be re-stated at depreciated cost (the "cost model"). We consider this directive to be fundamentally flawed, and would respectfully point out that the HKSA was also of this opinion when IAS40 was produced as an exposure draft in 1999. The HKSA wrote to the IASC in a letter dated 19th October 1999 in response to the specific question: "Do you agree that changes in the fair value of investment property should be recognised in net profit or loss for the period?" as follows:

> "No we do not agree...............Recognising changes in the fair value of investment properties in net profit or loss may lead to large fluctuations in profit or loss in situations where the property market is volatile......... This treatment will confuse the reader, may not be meaningful and is unlikely to present a true and fair view. It is also inconsistent with IAS 16 and IAS 39...................We note that the G4+1 is working on a project on performance reporting which involves the preparation of a comprehensive statement reflecting the performance of an enterprise. We believe that it would be premature to require the reporting of the change in fair value of an investment property in income until there are resolutions of various substantial issues about performance reporting."

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A review of other responses to E64 (and specifically of the answers to the question quoted in the above paragraph) from national accounting bodies, standards setting bodies, financial analyst groups, accounting firms, industry groups and individual companies shows consistent support for the HKSA's views.

A common theme of E64 respondents in 1999 was that fair value accounting for investment properties could not be treated in isolation from a more comprehensive solution to total performance reporting. In essence, whilst it was accepted conceptually that rental income and capital appreciation are measurable elements of management performance, mixing these two elements in a profit and loss account/income statement would be misleading. The G4+1 report referenced in the HKSA letter formed the basis of discussion for this issue, and since 1999 performance reporting remains an active project of the IASB that has not yet been resolved. Respondents to E64 raising these specific points included (in addition to the HKSA):

- The Institute of Chartered Accountants in England and Wales (UK)
- The Chartered Institute of Management Accountants (UK)
- Japanese Institute of Certified Public Accountants (Japan)
- Association for Investment Management and Research (USA)
- International Organization of Securities Commissions
- Deloitte Touche Tohmatsu
- Ernst & Young
- KPMG
- Pricewaterhouse Coopers
- National Association of Real Estate Investment Trusts (USA)
- British Property Federation (UK)

In short, there was a considerable body of opinion in 1999, including all the Big Four accounting firms and IOSCO, that either did not consider it appropriate to recognise changes in fair value in net profit or loss or forecast problems as a result of doing so.

Our over-riding concern is that the adoption of IAS 40 principles in Hong Kong would lead to significant (and unwarranted) fluctuations in reported profit and create confusion and uncertainty. The topic of financial performance reporting is in a transitional phase, and an expanded statement of comprehensive income could combine gains and losses of varying types which could be classified appropriately and widely understood. However, the IASB is not yet at that point, and issuing an exposure draft to revise SSAP 13 during this transition is unnecessary.

We support the view expressed by the HKSA in 1999, and submit that the HKSA should defer the release of the exposure draft for SSAP 13 until such time as there has been a resolution within the international accounting community of the issue of performance reporting.

Yours sincerely,

Martin Cubbon

Martin Cubbon
Group Finance Director