

BY FAX (NO. 2865 6603) AND BY POST

23rd August 2004

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

Dear Simon,

We refer to the circular issued by the Hong Kong Society of Accountants (HKSA) on 16th June 2004 seeking comments on the proposed convergence of Hong Kong Accounting Standards (HKAS) with International Accounting Standards (IAS).

The HKSA's pursuit of the objective of a single set of internationally recognised accounting standards is sound, allowing one set of standards to be applied to the accounts of companies in the European Union, Australia, Singapore and Hong Kong with effect from 1st January 2005. However, that objective is not, and should not, be set in stone: there are a number of implementation issues in Europe as a result of which the European Union has refused to endorse IAS 39. As a result European companies will lack consistency and comparability in accounting for hedges and derivatives until a resolution can be found.

So convergence by 1st January 2005 should not be the HKSA's holy grail. Inescapably there remains a fundamental problem with Hong Kong's proposed adoption of IAS 40 – Investment Properties (to be called HKAS 40). This problem has been acknowledged repeatedly by the HKSA and has been pointed out by many commentators, but has apparently (and in our view wrongly) been considered secondary to the need for convergence.

The problem with the proposed HKAS 40 is the requirement to show a change in the fair value of investment properties within profit or loss for the period when it arises. This requirement will prove confusing and potentially misleading to the reader of the accounts. Within the current widely-understood financial reporting framework, only realised gains and losses on non-financial assets are recognised in the profit and loss account. When IAS 40 was first issued as an exposure draft in 1999, many commentators made the point that mixing realised and unrealised gains and losses within the profit and loss account (and thereby creating confusion as to distributable earnings) would be unwise, and that such a step should only be considered within the context of a more comprehensive measure of financial performance – a project that was under active development by the International Accounting Standards Board (IASB) at that time. As you are aware, the HKSA was a proponent of this argument in 1999, and again in 2002, when the introduction of IAS 40 to Hong Kong was last raised.

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HKSA

In a press release of 4th October 2002 announcing its decision to defer the introduction of IAS 40 to Hong Kong, the HKSA noted that the introduction of IAS 40 would lead to significant fluctuations in reported earnings for property companies when compared with present practice. Whilst reiterating the importance of convergence with International Accounting Standards, the HKSA announced that it would:

“defer further consideration of an exposure draft proposing a revision to the investment property accounting standard until such time as we have a better understanding of the IASB’s proposals with regard to reporting fair value changes in the financial statements”

The HKSA’s current proposal to introduce HKAS 40 with effect from 1st January 2005 now contradicts its public position in both 1999 and 2002. Whilst the IASB has run into difficulties in framing an exposure draft for the reporting of comprehensive income, the project remains under active discussion, and the HKSA’s haste in seeking convergence with IAS for accounting periods beginning 1st January 2005 is at the cost of common sense. The HKSA and many other commentators acknowledge that there is a problem with IAS 40. Prior to a resolution of the issue of more comprehensive financial performance measurement, the introduction of HKAS 40 to Hong Kong is premature and would introduce unnecessary and confusing volatility to the reported earnings of property companies.

We urge that the HKSA withdraws its proposal to introduce HKAS 40 for accounting periods commencing 1st January 2005, and reaffirms the position it adopted consistently in 1999 and 2002, such that changes to the accounting standard for investment property will only take place once the IASB has concluded its deliberations on the reporting of comprehensive income.

Yours sincerely,



Peter Kilgour
Finance Director

Cc: Paul Winkelmann