JUNE 2012 SUPPLEMENT

Qualification Programme

Module A
Financial Reporting

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Changes at a glance

Appendix 1 Revised Learning Pack Chapter 16: Employee benefits

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Introduction

This Supplement has been produced for those candidates preparing for the June 2012 examination session of the HKICPA Qualification Programme.

It is designed to be used in conjunction with the 2011 edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack and 28 December 2011, the cut-off date for examinable standards and legislation for the June 2012 examination.

The Supplement contains two sections:

The Supplement comprises a technical update on developments that will be examinable in June 2012 that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Careful study of both the Learning Pack and this supplement should ensure that you are fully prepared for the June 2012 examination session.

Good luck with your studies!

Chapter 9 Leases

Section 7 **Replace the last sentence of the section with the following:**

The IASB intends to re-expose the topic of leases during the course of 2012, and as yet there is no target date for the issue of a new IFRS, and hence new HKFRS.

Chapter 12 Construction contracts

Section 3 **Replace the last sentence of the section with the following:**

The IASB issued a revised Exposure Draft on the topic of revenue from contracts with customers in November 2011, which simplifies a number of the original proposals. There is currently no target date for the issue of a new IFRS.

Chapter 14 Revenue

Section 4 **Replace the existing section 4 with the following:**

The IASB and FASB issued an Exposure Draft (ED) in relation to revenue recognition in June 2010. A re-exposure was issued in November 2011. It is proposed that the resulting standard will replace both IAS 18 *Revenue* and IAS 11 *Construction Contracts* (and so their HKAS equivalents).

The proposals would require an entity to:

1. Identify a contract with a customer.
2. Identify separate performance obligations in the contract (such that if more than one good or service is promised, each is accounted for separately only if it could be sold separately or the customer can benefit from the good or service either alone or together with resources which are readily available).
3. Determine the transaction price as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.
4. Allocate the transaction price to the separate performance obligations in proportion to the stand-alone selling price of the goods or services underlying each performance obligation.
5. Recognise revenue when each performance obligation is satisfied by the transfer of the promised good or service to the customer.

The ED also proposes that the incremental costs of obtaining a contract are recognised as an asset if the entity expects to recover those costs.

Costs of fulfilling a contract which are not eligible for capitalisation in accordance with another standard would be capitalised only if they:

- relate directly to a contract
- generate or enhance resources which will be used to satisfy future performance obligations, and
- are expected to be recovered.

For many companies this new approach will not result in a significant change to the amount or timing of revenue recognised. In other cases there will be a change, for example, when a mobile phone contract is sold and a handset is provided free of charge, the standard would now require separate up front recognition of revenue relating to the handset.

Chapter 18

Section 6.5.2 **Add the following example before the existing example of a cash flow hedge:**

Example: Basic cash flow hedge

Randall Co expects to purchase an item of plant for 20 million South African Rand in one year's time on 31 August 20X2. In order to offset the risk of movement in the exchange rate, Randall enters into a forward contract to purchase Rand 20 million in 1 year for a fixed amount ($20,500,000). The forward contract is designated as a cash flow hedge and has an initial fair value of zero.

At the year end (31 December 20X1), the Rand has appreciated and the value of Rand 20 million is $20,650,000. The machine will still cost Rand 20 million so the company concludes that the hedge is 100% effective. Thus the entire change in the fair value of the hedging instrument is recognised directly in other comprehensive income ($):

DEBIT Forward contract	150,000	
CREDIT Other comprehensive income		150,000

The effect of the cash flow hedge is to lock in the price of Rand 20 million for the item of plant. The other comprehensive income of $150,000 will either:

(i) be reclassified to profit or loss as the machine is depreciated or
(ii) be deducted from the initial carrying amount of the machine.

Add the following example after the existing example of a cash flow hedge:

Example: Cash flow hedge – interest rate swap

On 1 January 20X1, Arlington Co lends $10 million to another entity, with a maturity date of 3 years' later on 31 December 20X3. The interest rate attached to the loan is variable at HIBOR + 2%, and interest is due annually on 31 December.

Arlington expects interest rates to decline and so simultaneously enters an interest rate swap on 1 January 20X1 in order to hedge its position. The terms of the swap are as follows:

- there is no initial cost
- the notional principal is $10 million
- Arlington will receive fixed interest at 7%
- Arlington will pay variable interest at HIBOR
- Net settlement is made annually on 31 December, and the swap is also repriced on this date.

The fair value of the swap, determined by projecting future settlement amounts using the current year's variable rate and discounting these to present value is:

31 December 20X1	$300,000
31 December 20X2	$125,000
31 December 20X3	nil

HIBOR at each of these dates is:

31 December 20X1	7%
31 December 20X2	6%
31 December 20X3	5%

All criteria for cash flow hedge accounting have been met and the hedging relationship is expected to be 100 per cent effective at inception and on an ongoing basis.

What journal entries are required in respect of the loan and cash flow hedge throughout the three year term?

Solution

The purpose of the cash flow hedge is to fix the interest receivable at 9%. Interest receivable per the terms of the loan agreement is:

31 December 20X1	$10m x (7% + 2%)	$900,000
31 December 20X2	$10m x (6% + 2%)	$800,000
31 December 20X3	$10m x (5% + 2%)	$700,000

The net settlement in respect of the swap on each of these dates is:

Date	Swap receipt at 7% $	Swap payment at HIBOR $	Swap net $
31 December 20X1	700,000	(700,000)	Nil
31 December 20X2	700,000	(600,000)	100,000
31 December 20X3	700,000	(500,000)	200,000

Therefore in each of the three years, the total amount of interest receivable (ie loan interest receivable + net position on swap) is $900,000.

The journal entries are as follows ($):

1 January 20X1

DEBIT	Loan receivable	10,000,000	
CREDIT	Cash		10,000,000

To record the inception of the loan.

(Note: no entry is required in respect of the swap as it was acquired at no cost)

31 December 20X1

DEBIT	Cash	900,000	
CREDIT	Interest receivable		900,000

To record the receipt of interest in respect of the loan.

DEBIT	Interest rate swap	300,000	
CREDIT	Other comprehensive income		300,000

To record the fair value of the interest rate swap.

31 December 20X2

DEBIT	Cash	800,000	
CREDIT	Interest receivable		800,000

To record the receipt of interest in respect of the loan.

DEBIT	Cash	100,000	
CREDIT	Other comprehensive income		100,000

To record the cash received on net settlement of the interest rate swap.

DEBIT	Other comprehensive income	100,000	
CREDIT	Interest income		100,000

To reclassify into earnings amounts in OCI on account of the cash flow hedge, so that they are matched with the relevant cash flow.

DEBIT	Other comprehensive income	175,000	
CREDIT	Interest rate swap		175,000

To adjust the carrying value of the interest rate swap to current fair value.

31 December 20X3

DEBIT	Cash	700,000	
CREDIT	Interest receivable		700,000

To record the receipt of interest in respect of the loan.

DEBIT	Cash	200,000	
CREDIT	Other comprehensive income		200,000

To record the cash received on net settlement of the interest rate swap.

DEBIT	Other comprehensive income	200,000	
CREDIT	Interest income		200,000

To reclassify into earnings amounts in OCI on account of the cash flow hedge, so that they are matched with the relevant cash flow.

DEBIT	Other comprehensive income	125,000	
CREDIT	Interest rate swap		125,000

To adjust the carrying value of the interest rate swap to current fair value of nil.

DEBIT	Cash	10,000,000	
CREDIT	Loan receivable		10,000,000

To record the repayment of the loan.

Section 8 **The existing text should be replaced with the following:**

The issue of IFRS 9 (HKFRS 9) and its subsequent expansion in 2010 represent the first stages of the culmination of a long-standing project carried out by the IASB and FASB concerned with reducing the complexity surrounding financial instruments.

HKICPA are following the lead of the IASB and it is intended that HKFRS 9 will ultimately replace HKAS 39 in its entirety. The IASB continue to work on the replacement project and in response to requests from interested parties that the accounting for financial instruments should be improved quickly, the project to replace IAS 39 (and in turn HKAS 39) is divided into five main phases.

As each phase is completed, as well as its separate project on the derecognition of financial instruments, the relevant portions of IAS 39 will be deleted and chapters in IFRS 9 will be created to replace the requirements in IAS 39. As the IASB issues new sections of IFRS 9, HKICPA will adopt these to form HKFRS 9.

Phases 1 and 2 of the project relating to the classification and measurement of financial assets and financial liabilities are now complete.

Phase 3 of the project relates to impairment methodology. The Request for Information on the feasibility of an expected loss model for the impairment of financial assets was published in June 2009. This formed the basis of an Exposure Draft, *Financial Instruments: Amortised Cost and Impairment*, published in November 2009 with a comment deadline of 30 June 2010.

A supplement to the ED was issued in January 2011. The IASB now intends to re-expose the topic during the course of 2012.

Phase 4 of the project relates to hedge accounting. Proposals have been exposed and final amendments to IFRS 9 are expected in the first half of 2012.

Phase 5 of the project relating to offsetting was completed by the IASB during 2011 and resulted in amendments to IAS 32 and IFRS 7.

Chapter 20 Statements of cash flows

Section 1.2.3 **Replace the text under the 'Key Terms' box with the following:**

The standard expands on the definition of cash equivalents: they are held to meet short-term cash commitments rather than for investment or other long-term purposes. They are required to:

1 be readily convertible to a known amount of cash and therefore their maturity date should normally be three months or less from their acquisition date.

2 be subject to an insignificant risk of changes in value.

Based on the definition, therefore:

- **Deposits available on demand** are cash equivalents.
- **Deposits with a fixed maturity of more than 3 months** are *not* cash equivalents.
- **Pledged deposits (amounts held by banks as security)** are *not* cash equivalents.
- **Money market holdings, short-term government bonds** and **treasury bills** are cash equivalents.
- **Equity investments** (ie holdings of ordinary shares in other companies) are *not* cash equivalents.
- **Preference share investments** are cash equivalents where acquired within a short period of their maturity and with a specified redemption date.
- Where **bank overdrafts** are repayable on demand and are treated as part of an entity's total cash management system, an overdrawn balance is included in cash and cash equivalents.
- **Loans and other borrowings** are *not* cash equivalents, but instead are classified as cash flows from financing activities.

Movements between different types of cash and cash equivalents are not included in cash flows. The investment of surplus cash in cash equivalents is part of cash management, not part of operating, investing or financing activities.

Section 3 **Insert the following text instead of that which currently forms the introduction to section 3, immediately before section 3.1.**

HKAS 7.37, 39 Consolidated statements of cash flows are prepared in the same way as a single company statement of cash flows, however they include extra line items:

- Acquisitions and disposals of subsidiaries are reported as cash flows from investing activities
- Dividends paid to the non-controlling interests are reported as cash flows from financing activities
- Dividends received from associates and joint ventures are reported as cash flows from operating activities

Cash flows that are **internal to the group** should be eliminated in the preparation of a consolidated statement of cash flows.

Example

Cann Co disposed of property, plant and equipment with a carrying value of $215,000 in the year ended 31 October. The company reported a profit on the combined disposals of $39,500. Included within the disposal figures was a machine sold to Cann's subsidiary Wood Co for $12,400.

During the year, Wood disposed of property, plant and equipment with a carrying value of $43,000, recording a loss on disposal of $5,600. All disposals were made to companies outside the group.

What amount will be reported as proceeds on disposal of property, plant and equipment in the consolidated statement of cash flows?

Solution

Cann	$000	$000
Carrying amount on disposal		215.0
Profit on disposal		39.5
		254.5
Less intercompany proceeds		(12.4)
		242.1
Wood		
Carrying amount on disposal	43.0	
Loss on disposal	(5.6)	
		37.4
Consolidated proceeds on disposal		279.5

You should also remember that adjustments made to consolidated profit for non-cash items in the reconciliation to cash flows from operating activities should reflect the amounts included within the *consolidated* statement of comprehensive income. Therefore, for example, the amount of depreciation or profit on disposal should take into account any consolidation adjustment.

Example

Landon Co acquired 80% of Crowther Co a number of years ago. In the year ended 31 December 20X1, Landon reported a depreciation charge of $560,000 and Crowther reported a depreciation charge of $320,000. At the start of that year, Landon transferred a machine to Crowther with a resulting increase in depreciation of $10,000 per annum.

The adjustment required to consolidated profit for the purposes of calculating cash flows from operating activities is therefore:

	$000
Landon – depreciation	560
Crowther – depreciation	320
Consolidation adjustment	(10)
Added back to profit in respect of depreciation	870

Section 3.1 **Add the following example to section 3.1, immediately before section 3.1.1**

Example

Extracts from the statements of financial position of the Burke Group at 31 December are as follows:

	20X2	20X1
	$000	$000
Current assets		
Inventory	664	791
Trade receivables	515	532
Cash	214	431
Current liabilities		
Trade payables	590	645

During the year ended 31 December 20X2, the Burke Group sold its controlling interest in Bryan Co for $6.5 million in cash. On the disposal date, balances included in Bryan's statement of financial position were as follows:

	$000
Current assets	
Inventory	103
Trade receivables	45
Cash	79
Current liabilities	
Trade payables	67

(a) What adjustments are required to consolidated profit in respect of working capital in order to calculate cash flows from operating activities?

(b) What is the cash flow reported in investing activities in respect of the disposal of Bryan Co?

Solution

(a) Working capital adjustments must take account of the disposal of Bryan Co:

	$000
Inventory	
b/f	791
c/f	664
Decrease	127
Less amount attributable to disposal	(103)
Decrease in inventory (added back to profit)	24
Trade receivables	
b/f	532
c/f	515
Decrease	17
Less amount attributable to disposal	(45)
Increase in receivables (deducted from profit)	28

Trade payables	
b/f	645
c/f	590
Decrease	55
Less amount attributable to disposal	(67)
Increase in payables (added back to profit)	12

(b) Proceeds from disposal of Bryan Co

	$000
Cash proceeds	6,500
Cash in Bryan Co at disposal	(79)
Proceeds from disposal of Bryan Co	6,421

Section 3.3 **Replace the existing text before the example with the following:**

The following cash flows should be included in a consolidated statement of cash flows in respect of an associate or joint venture:

- cash inflows from sales to the associate or joint venture
- cash outflows from purchases from the associate or joint venture
- dividends from the associate or joint venture
- investments in an associate or joint venture.

As transactions and balances between group companies and associates / joint ventures are not cancelled for the purpose of producing consolidated financial statements, the normal approach to adjusting consolidated operating profit for movements in working capital will ensure that cash inflows from sales to associates/joint ventures and cash outflows from purchases from associates/joint ventures are included within consolidated cash flow from operating activities.

Within the reconciliation of profit to cash flows from operating activities, however, the share of profit from a joint venture or associate must be eliminated. This is treated as a non-cash item of income and deducted from consolidated profit in calculating consolidated cash flows from operating activities.

Instead, the dividend actually received from the associate / joint venture is included in the operating cash flows section of the statement of cash flows. This is calculated by reconciling the opening investment in associate/joint venture balance to the closing balance.

Where a group invests in or divests of an associate or joint venture in the year, the associated cash flow is disclosed within the investing activities section of the statement of cash flows.

Section 3.3.1 **Delete this section entirely.**

Section 3.4 **Replace the existing section 3.4 text with the following:**

HKAS 7.25-28 Foreign exchange issues are relevant to the consolidated statement of cash flows in two situations:

(a) Where an entity has transacted during the period in a currency other than its own functional/reporting currency.

(b) Where a subsidiary has a different functional currency from that of the group.

3.4.1 Transactions in foreign currency - settled

In accordance with HKAS 21, where transactions denominated in a foreign currency have taken place during a period, and been subsequently settled, any foreign exchange gain or loss is recognised in profit or loss.

For the purposes of preparing the statement of consolidated cash flows, no adjustment is required in respect of these exchange gains or losses, as they represent amounts realised in cash flows. The following example will help you to understand this:

Example

Flora Co sold goods denominated in pounds sterling in the year ended 31 October 20X1. At the date of the transaction, a trade receivable and revenue of $40,000 were recorded after applying the spot exchange rate on the date of the transaction. Before the period end, the customer paid the amount due, which on the date of payment could be exchanged by Flora for $37,000. Accordingly, Flora recognised an exchange loss of $3,000.

HKAS 7 requires that the applicable exchange rate in the case of foreign currency cash flows is that which applied on the date of the cash flow. Therefore, $37,000 must be reported as a cash inflow within cash flows from operating activities in Flora's statement of cash flows.

As this amount is already included within profit for the year, no further adjustment is required:

	$000
Revenue	40
Exchange loss	(3)
Net revenue reported in profit	37

3.4.2 Transactions in foreign currency - unsettled

Where a foreign currency transaction has taken place during the period, however, and is not settled at the period end, any monetary items are re-translated in accordance with HKAS 21 giving rise to an exchange difference recognised in profit or loss. In addition a 'foreign currency' balance is included in the year end statement of financial position.

On preparation of the statement of cash flows, therefore:

(i) the exchange gain or loss forms an adjustment within the reconciliation of profit to cash flows from operating activities;

(ii) the exchange gain or loss is taken into account when calculating the movement in the relevant monetary balance.

The following example will help you to understand why this is the case:

Example

Webb Co purchased goods denominated in Polish Zloty during the year ended 31 December 20X2 for ZTY150,000. This was Webb's first transaction with a new supplier. At the date of purchase the ZTY:$ exchange rate was 1.25:1 and accordingly, a purchase and payable were recorded at $120,000. At the period end, Webb had not paid the amount due to the supplier and the trade payable balance was retranslated using the closing rate to $100,000, resulting in an exchange gain of $20,000.

In respect of this transaction, a $100,000 expense is therefore reported within profit ($120,000 purchases net of $20,000 exchange gain).

In preparing the statement of cash flows, HKAS 7 requires that the gain on retranslation is eliminated from profits (which include the $100,000 expense) as a non-cash item, so meaning that the transaction in Zloty has a net effect on cash of:

	$000
Expense (within profit figure)	(100)
Deduct non-cash gain	(20)
	(120)

It is clear from the scenario that no cash flow has occurred in respect of this transaction and the adjustment for movement in payables must therefore serve to eliminate the $120,000. In order to make the increase in trade payables equal to the $120,000 and so eliminate it in full, the exchange gain must once again be taken into account:

	$000
ZTY trade payables b/f	-
ZTY trade payables c/f	100
Increase	100
Remove effect of exchange gain	20
Increase in trade payables (add back to profit in reconciliation)	120

Therefore the net effect on cash flows from operating activities is nil ($100,000 expense - $20,000 gain + $120,000 increase in payables).

3.4.3 Foreign subsidiary

The cash flows of a foreign subsidiary must be translated into the functional currency of the group for inclusion in the consolidated statement of cash flows.

The applicable exchange rate is the spot rate on the dates of the cash flows, however the average rate for a period may be used if this approximates to the actual rate. HKAS 21 does not allow the use of the closing rate.

Chapter 26 Presentation of financial statements

Presentation of Items of Other Comprehensive Income (Amendments to HKAS 1) was issued in July 2011. In your Learning Pack, the following amendments should be made to Chapter 26:

Section 1.1.1 **Under the heading 'New', replace 'Statement of comprehensive income' with 'Statement of profit or loss and other comprehensive income'.**

Expand the sentence under the first table to read The use of these terms in practice is not mandatory; for example an entity may continue to use the title 'balance sheet' instead of 'statement of financial position'. In this Learning Pack, we shall use 'statement of comprehensive income' rather than 'statement of profit or loss and other comprehensive income'.

Section 1.4.1 & 1.4.2 **In the proforma statements of comprehensive income, replace the other comprehensive income section with the following:**

Other comprehensive income		
Items that will not be reclassified to profit or loss		
Gains on property revaluation	933	3,367
Actuarial gains/(losses) on defined benefit pension plans	(667)	1,333
Share of other comprehensive income of associates	400	(700)
Income tax relating to items that will not be reclassified	(350)	(2,100)

Items that may be reclassified to profit or loss		
Exchange differences on translating foreign operations	5,334	10,667
Cash flow hedges	(24,667)	22,667
Income tax relating to items that may be reclassified	5,017	(7,234)
Other comprehensive income, net of related income tax	(14,000)	28,000

Section 1.4.3 **Replace the first section of text, up to and including (i) Total comprehensive income with the following:**

HKAS 1.81A, 82

In addition to the profit or loss section and other comprehensive income section, the following should be presented in the statement of comprehensive income:

(a) profit or loss

(b) total other comprehensive income

(c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.

In addition, the profit or loss section should include line items that present the following amounts for the period:

(a) revenue

(b) finance costs

(c) share of the profit or loss of associates and joint ventures accounted for using the equity method

(d) tax expense

(e) a single amount for the total of discontinued operations.

The section then continues 'The following items must also be disclosed….'

Section 1.4.4 **Replace existing text with the following:**

HKAS 1.82A, 90-91, 94

Other comprehensive income items should be presented classified by nature and grouped into those items which, in accordance with other HKFRS:

(a) will not be reclassified subsequently to profit or loss, and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

Items of other comprehensive income should be presented either

- net of related tax effects, or
- before related tax effects, with one amount shown for the aggregate amount of income tax relating to those items.

Where the second approach is adopted, the amount of tax should be allocated between those items which may be reclassified subsequently to profit or loss and those which will not.

Reclassification adjustments relating to components of other comprehensive income should be disclosed either in the statement of comprehensive income or in the notes to the accounts. These are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in previous periods. Users can use this information to assess the impact of reclassifications on profit or loss.

Section 2 Delete point number 1.

Answers to exam practice questions

The answer to the Chapter 16 Employee benefits question should be replaced with the following:

(a) New treatment of actuarial gains and losses

Statement of financial position

- On moving to the new standard, an entity which currently defers actuarial gains and losses may have to recognise a higher pension deficit (or lower surplus) in the statement of financial position. This may impact those entities practically in terms of compliance with debt covenants.
- On an ongoing basis, the amount reported in the statement of financial position will be more volatile, as the smoothing effects of deferring a proportion of gains/losses is disallowed.

Statement of comprehensive income

- Total comprehensive income will also become more volatile when the new rules are adopted, as there is no option to defer a proportion of actuarial gains and losses.
- The change will be more marked for those entities which previously recognised actuarial differences in profit or loss, since not only will the amounts recognised increase, but they will also be recognised in other comprehensive income rather than profit or loss. This should result in **less** volatile profits but **more** volatile total comprehensive income.

(b) (i)

	Obligation $000	Assets $000	Net (SOFP) $000	Net (SOCI) $000
20X8 b/f	20,000	20,000	-	
Net interest at 8%	1,600	1,600		-
Current service cost	1,250			1,250
Past service cost	1,000			1,000
Benefits paid	(987)	(987)		
Contributions paid in		1,000		
	22,863	21,613		
Remeasurement losses	137	(113)		250
20X8 c/f	23,000	21,500	1,500	

20X9 b/f	23,000	21,500		
Net interest at 9%	2,070	1,935		135
Current service cost	1,430			1,430
Settlement	(5,700)	(5,400)		See below
Benefits paid	(1,100)	(1,100)		
Contributions paid in		1,100		
	19,700	18,035		
Remeasure-ment losses	700	(195)		895
20X9 c/f	20,400	17,840	2,560	

- During 20X8, there is an improvement in the future benefits available under the plan and as a result there is a past service cost of $1 million, being the increase in the present value of the obligation as a result of the change.
- During 20X9, Rhodes sells part of its operations and transfers the relevant part of the pension scheme to the purchaser. This is a settlement. The overall gain on settlement is calculated as:

	$000
Present value of obligation settled	5,700
Fair value of plan assets transferred on settlement	(5,400)
Cash transferred on settlement	(200)
Gain	100

(ii) Statement of financial position

	20X8	20X9
	$000	$000
Net defined benefit liability	1,500	2,560

Statement of comprehensive income

	20X8	20X9
Profit or loss	$000	$000
Current service cost	1,250	1,430
Past service cost	1,000	-
Gain on settlement	-	(100)
Net interest	-	135
Other comprehensive income		
Remeasurement loss on defined pension plan	250	895

Technical Update – Flashcards

Chapter 18 Financial instruments

On page 101, add the following text to the final bullet point on the right hand side:

The right of set off must be immediately available and exercisable by either party.

On page 108, add the following extra bullet point to the box on the left hand side of the page:

- Information about rights of offset and related arrangements.

Chapter 26 Presentation of financial statements

On page 150, replace the 'Other comprehensive income' section of the statement of comprehensive income with the following:

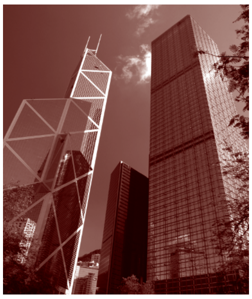
Other comprehensive income:

Items that will not be reclassified to profit or loss		
Gains on property revaluation	X	X
Income tax relating to items that will not be reclassified to profit or loss	(X)	(X)
Items that may be reclassified to profit or loss		
Cash flow hedges	(X)	X
Exchange gain on translating foreign operations	X	X
Income tax relating to items that may be reclassified to profit or loss	(X)	(X)
Other comprehensive income for the year, net of income tax	X	X

Appendix 1:
Chapter 16 (Learning Pack)
Employee benefits

Considerable amendments have been made to HKAS 19 *Employee Benefits* in late 2011, after publication of the 2011 edition Module A Learning Pack . These changes affect the whole of Chapter 16, so for the sake of simplicity we have rewritten the chapter so it reflects all of the amendments made.

You should ignore Chapter 16 included in your Learning Pack and replace it with the revised version here.


chapter 16

Employee benefits

Topic list

1 HKAS 19 *Employee Benefits*
2 Short-term employee benefits
3 Post-employment benefits
4 Defined contribution plans
5 Defined benefit plans
6 Termination benefits

Learning focus

An increasing number of companies and other entities now provide a pension and other employee benefits as part of their employees' remuneration package. In view of this trend, it is important that there is standard best practice for the way in which employee benefit costs are recognised, measured, presented and disclosed in the sponsoring entities' accounts. You must ensure that you understand and can apply the rules of HKAS 19 as amended in 2011.

Learning outcomes

In this chapter you will cover the following learning outcomes:

		Competency level
Account for transactions in accordance with Hong Kong Financial Reporting Standards		
3.04	**Employee benefits**	2
3.04.01	Identify short-term employee benefits in accordance with HKAS 19 and apply the recognition and measurement principles in respect of short-term employee benefits	
3.04.02	Distinguish between defined contribution plans and defined benefit plans	
3.04.03	Account for defined contribution plans	
3.04.04	Identify termination benefits in accordance with HKAS 19 and apply the recognition and measurement principles in respect of termination benefits	

1 HKAS 19 *Employee Benefits*

Topic highlights

HKAS 19 *Employee Benefits* provides guidance on the accounting treatment to be applied to short-term employment benefits, post-employment benefits (pensions), other long-term employment benefits and termination benefits. Amendments to the standard in 2011 reduced the complexity of accounting for employee benefits.

Before we look at HKAS 19, we should consider the nature of employee benefit costs and why there is an accounting problem which must be addressed by a standard.

HKAS 19.5

1.1 Employee benefits

Companies generally provide their employees with a package of pay and benefits, which may include some or all of the following:

- Short-term benefits including:
  - Wages and salaries
  - Contributions to Mandatory Provident Fund
  - Paid annual leave
  - Paid sick leave
  - Paid maternity/paternity leave
  - Profit shares and bonuses paid within 12 months of the year end
  - Paid jury service
  - Paid military service
  - Non-monetary benefits, eg medical care, cars, free goods
- Post-employment benefits, eg pensions and post-employment medical care
- Other long-term benefits, eg profit shares, bonuses or deferred compensation payable later than 12 months after the year end, sabbatical leave, long-service benefits
- Termination benefits, eg early retirement payments and redundancy payments

Benefits may be paid to the employees themselves, to their dependants (spouses, children, etc) or to third parties.

1.2 The accounting problem

In the case of the **short term benefits** listed above, the employee will receive the benefit at about the same time as he or she earns it. The accounting is therefore relatively straightforward with the costs of providing the benefit recognised as an expense in the employer's financial statements.

Accounting for the cost of **deferred employee benefits** is less clear cut. This is because of the long time scale, complicated estimates and uncertainties involved in these types of benefit. In addition, the costs could be viewed in a number of ways, for example as deferred salary to the employee or as a deduction from the employee’s true gross salary.

In the past, entities accounted for these benefits simply by making a charge to the profit or loss of the employing entity on the basis of actual payments made. This led to substantial variations in reported profits of these entities and disclosure of information on these costs was usually sparse.

1.2.1 The accounting solution

HKAS 19 addresses the problem described above by prescribing how employee benefits should be recognised and measured.

The standard requires an entity to recognise:

(a) A **liability** when an employee has provided a service in exchange for benefits to be received by the employee at some time in the future.

(b) An **expense** when the entity receives the economic benefits from a service provided by an employee regardless of when the employee received or will receive the benefits for providing the service.

The application of these basic rules to each of the categories of employee benefits described in Section 1.1 is provided in HKAS 19 and described throughout the remainder of this chapter. First, however, we must consider a number of important definitions within the standard.

HKAS 19.8

1.3 Definitions

You should refer back to the following definitions as necessary as you work through the rest of this chapter.

Key terms

Definitions of employee benefits

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.

Short-term employee benefits are employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.

Post-employment benefits are employee benefits (other than termination benefits and short-term employee benefits) which are payable after the completion of employment.

Termination benefits are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

(a) **an entity's decision to terminate an employee's employment before the normal retirement date, or**

(b) **an employee's decision to accept an offer of benefits in exchange for the termination of employment.**

Other long-term employee benefits are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.

Definitions relating to classification of plans

Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Defined benefit plans are post-employment benefit plans other than defined contribution plans.

Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) Pool the assets contributed by various entities that are not under common control; and

(b) Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned

Definitions relating to the net defined benefit liability (asset)

The net defined benefit liability (asset) is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

The deficit or surplus is:

(a) the present value of the defined benefit obligation less

(b) the fair value of plan assets (if any).

The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

Plan assets comprise:

(a) Assets held by a long-term employee benefit fund
(b) Qualifying insurance policies

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Definitions relating to defined benefit cost

Service cost comprises:

(a) *current service cost* which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

(b) *past service cost*, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and

(c) any gain or loss on settlement.

Net interest on the defined benefit liability (asset) is the change during the period in the net defined benefit liability (asset) that arises from the passage of time.

Remeasurements of the net defined benefit liability (asset) comprise:

(a) actuarial gains and losses

(b) the return on plan assets, excluding amounts included in net interest on the defined benefit liability (asset); and

(c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from:

(a) Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), and

(b) The effects of changes in actuarial assumptions.

The return on plan assets is interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less:

(a) any cost of managing plan assets; and

(b) any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.

A settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of employees that is set out in the terms of the plan and included in the actuarial assumptions.

(HKAS 19)

2 Short-term employee benefits

Topic highlights

Short-term employee benefits are those benefits that are expected to be settled wholly before 12 months after the end of the period in which the employees provide the related services. The cost of the benefits to be paid in exchange for the employee's services should be recognised in the period on an accruals basis.

As mentioned in Section 1.1, short-term employee benefits include:

- Monetary benefits such as wages and salaries, annual leave, sick leave, maternity leave, and profit shares and bonuses paid within 12 months.
- Non-monetary benefits such as medical care, housing and company cars.

HKAS 19.11

2.1 Recognition and measurement

HKAS 19 requires that short-term employee benefits are recognised in the period in which the related service is provided by the employee as:

(a) a liability (after deducting any amount already paid), and

(b) an expense unless another standard (such as HKAS 2 or HKAS 16) requires or permits inclusion in the cost of an asset.

The amount recognised should not be discounted.

Where the amount already paid exceeds the undiscounted amount of the benefits, the resulting asset should be recognised as a prepayment to the extent that it will lead to a reduction in future payments or refund.

The standard explains how these rules are applied in the case of short-term compensated absences and profit-sharing and bonus plans.

2.2 Short-term paid absences

HKAS 19.13-18

Short-term paid absences include paid holiday leave, sick leave, maternity or paternity leave and jury service leave. These are classified by the standard as either:

- accumulating compensated absences, or
- non-accumulating compensated absences.

Accumulating absences are those that can be carried forward and used in future periods if the current period's entitlement is not used in full; non-accumulating absences are those which cannot be carried forward and lapse if the current year entitlement is not used.

2.2.1 Accounting treatment

The cost of accumulating absences should be recognised as an expense when the employee provides the service which results in entitlement to such absences. Where there is an unused entitlement at the reporting date, a liability is recognised, based on an estimated amount.

The cost of non-accumulating absences should be recognised as an expense when the absences occur.

Example: Sick pay

An entity has 10 employees, each of whom is entitled to 7 days of paid sick leave per annum. Unused sick leave may be carried forward for one year. Current year leave must be used before carried forward leave. At 31 December 20X8, each employee had, on average, two days of leave unused. Based on past experience the entity expects 8 employees to take no more than 7 days of sick leave in the coming year. The remaining 2 employees are expected to take 9 days each.

Assuming that each sick day costs the entity $60, what liability for sick leave must be accrued in the statement of financial position as at 31 December 20X8?

Solution

A liability must be recognised in the statement of financial position to the extent that the entity expects to have to pay sick leave next year as a result of the entitlement that has accumulated at 31 December 20X8:

2 employees x 2 days x $60 = $240

		$	$
DEBIT	Employee expense	240	
CREDIT	Liability		240

Being sick leave entitlement at 31 December 20X8 expected to be paid next year

HKAS 19.19-24

2.3 Profit-sharing schemes and bonus plans

HKAS 19 requires that an entity recognises the expected cost of profit-sharing and bonus payments only when:

- the entity has a present legal or constructive obligation to make such payments as a result of past events, and
- a reliable estimate of the obligation can be made.

In this case an expense and liability should be recognised.

Often conditions are attached to bonus payments, for example an employee must still be in the entity's employment when the bonus becomes payable.

Therefore an estimate should be made based on the expectation of the level of bonuses that will ultimately be paid. A reliable estimate can only be made when:

- the formal terms of the plan include a formula to determine the amount of the benefit;
- the entity determines the amount payable before the financial statements are authorised for issue; or
- past practice provides clear evidence of the amount of a constructive obligation.

Example: Bonus plan

Lowdown Co has a contractual agreement to pay a total of 5 per cent of its net profit each year as a bonus. The bonus is divided between the employees who are with the entity at its year end. The following data is relevant:

Net profit	$2,000,000
Average employees	50
Employees at start of year	60
Employees at end of year	40

Required

How should the expense be recognised?

Solution

An expense should be recognised for the year in which the profits were made and therefore the employees' services were provided, for:

$2m × 5% = $100,000

Each of the 40 employees remaining with the entity at the year end is entitled to $2,500. A liability of $100,000 should be recognised if the bonuses remain unpaid at the year end.

3 Post-employment benefits

Topic highlights

There are two types of retirement benefit plan:

- Defined contribution plans
- Defined benefit plans

HKAS 19.26-30

3.1 Types of post-employment benefits

Post employment benefits are those benefits provided to employees after they have stopped working. They may include:

- retirement benefits (pensions), and
- other benefits such as post-employment life insurance or medical care.

Post-employment benefit schemes are often referred to as '**plans**'. Employers (and sometimes employees) make regular contributions to the plan and this money is invested in long-term assets such as stocks and shares.

The return on the plan assets, and sometimes the proceeds of the sale of plan assets, is used to pay for the post-employment benefits.

There are two types of post-employment benefit plans:

- defined contribution, and
- defined benefit.

3.1.1 Defined contribution plans

These plans involve fixed amounts (normally a percentage of an employee's salary) being paid into the plan each year. These amounts, or contributions, may be made by the employer and current employees.

The level of benefits paid out to former employees is resultant on how the plan's investments have performed. In other words there is no guarantee of a fixed amount of benefit.

3.1.2 Defined benefit plans

These plans involve fixed amounts being paid out of the plan to former employees as benefits. The fixed amount is normally calculated as a percentage (based on the number of years' service) of final salary.

As before, contributions are made by the employer (and possibly current employees) and these are invested. The level of contributions is not, however, fixed. Instead it is set at an amount that is expected to result in sufficient investment returns to meet the obligation to pay the defined post-retirement benefits.

Where it appears that there are insufficient assets in the fund, the employer will be required to make increased contributions; where it appears that there are surplus assets in the fund, the employer may stop paying contributions for a period (known as a contributions holiday).

HKAS 19.32-39

3.2 Multi-employer plans

Multi–employer plans were defined above in Section 1.3. They are retirement benefit plans in which various entities contribute assets to a pool. These pooled assets are then used to provide benefits to employees of the various contributing entities.

HKAS 19 requires that an entity should **classify** such a plan as a defined contribution plan or a defined benefit plan, under the terms of the plan (including any constructive obligation that exceeds the formal terms of the plan).

If the multi-employer plan is a defined contribution plan, it is accounted for as normal, by recognising the contributions made to the plan as an expense.

If, on the other hand, the multi-employer plan is a **defined benefit plan**, then HKAS 19 requires the entity to account for it as a defined benefit plan. However, it should do so only on a proportional basis. In other words it recognises its proportionate share of the obligation, assets and cost associated with the plan. It should also make all of the normal disclosures for defined benefit plans.

However, determining the extent to which an entity participates in a defined benefit multi-employer plan may be problematic. Therefore, it may be difficult to determine reliably the appropriate proportionate share of the relevant data. In this case, where there is **insufficient information** to determine the relevant amounts to use defined benefit accounting, then the entity should recognise the plan as a defined contribution plan. However, it should also make as many additional disclosures as possible to enable users to understand the nature of the plan. For example, an entity should disclose that the plan is, in fact, a defined benefit plan and information about any known surplus or deficit.

4 Defined contribution plans

Topic highlights

Contributions to a defined contribution plan are recognised as an expense in the period in which they are payable.

HKAS 19.51-52

4.1 Recognition and measurement

Accounting for defined contribution plans is relatively straightforward:

(1) **Contributions** to a defined contribution plan should be recognised as an **expense** in the period they are payable (except to the extent that labour costs may be included within the cost of assets).

(2) Any liability for **unpaid contributions** that are due as at the end of the period should be recognised as a **liability** (accrued expense).

(3) Any **excess contributions** paid should be recognised as an asset (prepaid expense), but only to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.

Where contributions are not payable during the period (or within 12 months of the end of the period) in which the employee provides the services to which they relate, the amount recognised should be discounted, to reflect the time value of money.

Example: Defined contribution plan

Highlife Co agrees to contribute 4 per cent of employees' total remuneration into a post-employment plan each period.

In the year ended 31 December 20X1, the company paid total salaries of $16 million. A bonus of $4 million based on the income for the period was paid to the employees in March 20X2.

The company had paid $760,000 into the plan by 31 December 20X1.

Required

Calculate the total expense for post-employment benefits for the year and the accrual which will appear in the statement of financial position at 31 December 20X1.

Solution

	$
Salaries	16,000,000
Bonus	4,000,000
	20,000,000 × 4% = $800,000

		$	$
DEBIT	Staff costs expense	800,000	
CREDIT	Cash		760,000
	Accrual		40,000

HKAS 19.53

4.2 Disclosure

HKAS 19 requires that the following is disclosed in respect of defined contribution schemes:

(a) A **description** of the plan
(b) The amount recognised as an **expense** in the period

5 Defined benefit plans

Topic highlights

Defined benefit plans are recognised in the statement of financial position. Changes in the plan are broken down into their constituent parts and recognised in profit or loss or other comprehensive income immediately.

5.1 Introduction to accounting treatment

As we have already discussed, contributions made to defined benefit plans may vary considerably from year to year. The accounting treatment applied to defined contribution plans is therefore not appropriate here, as expensing contributions would result in volatile profits.

Instead, HKAS 19 requires a net defined benefit liability (asset) to be shown in the statement of financial position. This is defined as the deficit or surplus in a defined benefit plan and is calculated as:

(a) the present value of the defined benefit obligation (ie the obligation to pay future benefits to employees) less

(b) the fair value of any plan assets

Where the present value of the defined benefit obligation exceeds the fair value of plan assets, a plan is in deficit and an overall net defined benefit liability is recognised; where the fair value of plan assets exceeds the present value of the defined benefit obligation, a plan is in surplus and an overall net defined benefit asset is recognised.

Both the present value of the obligation and the fair value of the plan assets are normally calculated and advised by an actuary. HKAS 19 provides guidance on this. The role of the accountant is therefore to recognise the changes in these amounts from year to year in accordance with HKAS 19.

5.1.1 Constructive obligation

HKAS 19.61

In determining the extent of the obligation to provide retirement benefits, an entity must assess not only its legal obligation under the formal terms of a defined benefit plan, but also any constructive obligation that arises from the entity's informal practices.

Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits, for example, where a change in an entity's informal practices would cause unacceptable damage to its relationship with employees.

HKAS 19.57

5.2 Accounting steps

HKAS 19 provides a 4 step approach to accounting for defined benefit plans:

1 Determine the deficit or surplus	(i) Use an actuarial technique in order to make a reliable estimate of the cost to the entity of providing the post-employment benefit that employees have earned in current and past periods (ii) discount that benefit to determine the present value of the defined benefit obligation (iii) deduct the fair value of plan assets from the present value of the defined benefit obligation
2 Determine the amount of the net defined benefit liability (asset)	The amount of deficit or surplus calculated in step 1 may require adjustment for the effect of limiting a net defined benefit asset to the asset ceiling.
3 Determine amounts to be recognised in profit or loss	These may include: (i) current service cost (ii) past service cost and gain or loss on settlement (iii) net interest on the defined benefit liability (asset)
4 Determine remeasurements to be recognised in other comprehensive income	These may include: (i) actuarial gains and losses (ii) return on plan assets excluding amounts included in net interest on the defined benefit liability (asset) (iii) any change in the effect of the asset ceiling excluding amounts included in net interest on the defined benefit liability (asset).

Each of these steps is considered in more detail in the following sections of the chapter.

HKAS 19.58,-59

5.3 Step 1 - Determine the deficit or surplus

Measurement of the deficit or surplus is not required at every period end. However it must be made sufficiently regularly such that reported amounts are not materially different from the actual value at the reporting date.

HKAS 19 encourages, but does not require, the use of a qualified actuary.

The cost of providing future benefits in respect of current and past services should be estimated using an actuarial technique, the **projected unit credit method**.

HKAS 19.67-68,75-80

5.3.1 Estimation of future cost using the projected unit credit method

The projected unit credit method assumes that each period of an employee's service gives rise to an additional 'unit' of future benefit. Each of these units is measured separately and they are added together to calculate the total obligation.

In measuring the obligation, the actuary must make a number of **actuarial assumptions**, both demographic and financial, for example:

- What the defined benefits will be (this depends upon factors such as length of service and final salary)
- When benefits will be paid (this depends upon retirement age)
- How many employees will draw a pension (this depends upon factors such as mortality rate)

The standard requires actuarial assumptions to be unbiased and mutually compatible. They should also be based on '**market expectations**' at the year end, over the period during which the obligations will be settled.

HKAS 19.83-86

5.3.2 Discount the future benefit to present value

After the future cost of the defined benefit obligation has been measured, it must be discounted to present value using an appropriate discount rate.

The standard requires that this is determined **by reference to market yields at the end of the reporting period on high quality corporate bonds**.

In the absence of a 'deep' market in such bonds, the yields on comparable government bonds should be used as reference instead.

The corporate bonds that are used to determine a discount rate should have a term to maturity that is consistent with the expected maturity of the post-employment benefit obligations, although a single weighted average discount rate is sufficient.

HKAS 19.8,113-115

5.3.3 Fair value of plan assets

In order to determine the deficit or surplus, the fair value of plan assets must be deducted from the present value of the defined benefit obligation.

Plan assets are:

(a) assets such as stocks and shares, held by a fund that is legally separate from the reporting entity, which exists solely to pay employee benefits.

(b) insurance policies, issued by an insurer that is not a related party, the proceeds of which can only be used to pay employee benefits.

Investments which may be used for purposes other than to pay employee benefits are not plan assets.

The standard requires that the plan assets are measured at fair value, defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. HKAS 19 includes the following specific requirements:

(a) The plan assets should exclude any contributions due from the employer but not yet paid.

(b) Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, such as trade and other payables.

HKAS 19.63-64

5.4 Step 2 - Determine the amount of the net defined benefit liability (asset)

In the statement of financial position, the amount recognised as a **defined benefit liability (or asset)** should be the following.

(a) The **present value of the defined obligation** at the year end, **minus**

(b) The **fair value of the assets of the plan** as at the year end (if there are any) out of which the future obligations to current and past employees will be directly settled.

Where there is a net defined benefit asset, the amount of this may be limited by the 'asset ceiling'. We shall discuss this in more detail later in the chapter.

HKAS 19.120

5.5 Step 3 - Determine amounts to be recognised in profit or loss

The change in the net defined benefit liability (asset) as measured by an actuary at the start and the end of a financial period can be attributed to contributions made into the plan, payments made out of the plan and three further components:

(a) service costs
(b) net interest on the net defined benefit liability (asset), and
(c) remeasurements.

The first two of these components are recognised in profit or loss. The third is recognised in other comprehensive income and is dealt with in section 5.6.

5.5.1 Service costs

Service costs include:

- current service cost, being the increase in the present value of the defined benefit obligation resulting from employee services during the current period
- past service cost, being the change in the obligation relating to employee services in prior periods arising from amendments or curtailments to the pension plan
- gains or losses on settlement of a defined benefit plan.

Current service costs normally arise in each financial year; past service costs and gains or losses on settlement arise only where a pension plan is amended, curtailed or settled in a period. We shall therefore concentrate on current service costs here and consider past service costs and gains or losses on settlement in more detail in section 5.7.

The current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period. This increase arises from the fact that most defined benefit pensions provide an incremental benefit for each year of service. The current service cost is calculated using the **projected unit credit method** which we mentioned earlier.

Consider a situation where a defined benefit plan provides for a benefit of 2.5 per cent of the employee's salary in his/her final year, for each full year of service. The pension is payable from the age of 65. If an employee is expected to earn $10,000 in his final year of employment, then each year of service will result in an extra $250 for each year of retirement (assuming a 40 year working life). If the employee is expected to live for 15 years after retirement, the benefit payable is the discounted value at retirement date of $250 per annum for 15 years. The current service cost is the present value of this discounted amount.

The current service cost increases the plan obligation and is charged to operating expenses in profit or loss.

5.5.2 Net interest on the net defined benefit liability (asset)

HKAS 19.83, 123

Annual interest arises in respect of both the defined benefit obligation and the plan assets:

(i) An interest charge arises on the unwinding of the discount on the defined benefit obligation as time passes, and

(ii) Interest income is recognised on the plan assets.

HKAS 19 requires that these two interest elements are calculated on a net basis as:

Net defined benefit liability (asset) x discount rate

- The net defined benefit liability (asset) should be determined as at the **start** of the accounting period, taking account of changes during the period as a result of contributions paid into the scheme and benefits paid out.
- The **discount rate** is that determined by reference to **market yields** (at the year end) on high quality fixed-rate corporate bonds.

The net interest cost is charged to finance costs in profit or loss.

5.6 Step 4 - Determine amounts to be recognised in other comprehensive income

HKAS 19.122, 127

The third component of changes in a net defined benefit liability (asset) is remeasurements. These are recognised in other comprehensive income and are never reclassified to profit or loss.

Remeasurements may include:

(a) Actuarial gains and losses;

(b) The return on plan assets (excluding amounts included in net interest on the net defined benefit liability (asset)); and

(c) Any change in the effect of the asset ceiling (excluding amounts included in net interest on the net defined benefit liability (asset)).

The asset ceiling is a complication that is not relevant in every case, so it is dealt with separately, later in the chapter.

5.6.1 Actuarial gains and losses

HKAS 19.128

We have already seen, in section 5.3.1, that in measuring the defined benefit obligation, the actuary must make a number of **actuarial assumptions** regarding issues such as mortality and salary increases**.**

Actuarial gains and losses arise from changes to the defined benefit obligation because of changes in actuarial assumptions and experience adjustments:

- **Actual events:** The calculation of the plan obligation and the current service cost is based on estimates of numbers of employees remaining in the plan during the current year as well as estimates about salary changes during the current year. Where staff leave or salaries are increased by amounts different from those expected, the year end obligation will be different from that previously expected.
- **Actuarial assumptions are revised:** The valuation of the plan obligation depends upon a number of what are called actuarial assumptions. These include the discount rate, estimates of staff remaining in the plan until retirement, projected salaries on retirement, mortality rates and the length of time over which benefits need to be paid. These estimates can be changed as the entity, or its actuaries, reassess the future.

- **Actual returns on plan assets:** The valuation of the plan assets includes an estimated rate of return for the current year. At the year end the plan assets may have grown by an amount different from that expected.

Such actuarial gains and losses are recognised in other comprehensive income.

5.6.2 Return on plan assets

A new valuation of the plan assets is carried out at each period end, using current fair values. Any difference between the new value, and what has been recognised up to that date (normally the opening balance, interest, and any cash payments into or out of the plan) is treated as a "remeasurement" and recognised in other comprehensive income.

Example: Defined benefit plan

The following information relates to a defined benefit pension plan operated by Snow Co:

	$m
Present value of defined benefit obligation at 1 January 20X1	100
Present value of defined benefit obligation at 31 December 20X1	120
Fair value of plan assets at 1 January 20X1	60
Fair value of plan assets at 31 December 20X1	55
Current service cost	18
Contributions made into the scheme	12
Payments made to members of the scheme	15

The yield on a high quality corporate bond is 5%.

Calculate amounts to be recognised in profit or loss and other comprehensive income in the year ended 31 December 20X1 and the value of the net defined benefit liability in the statement of financial position at that date.

Solution

	Obligation	Assets	Net defined benefit liability
	$m	$m	$m
At 1 January 20X1	100	60	40
Current service cost	18		
Contributions		12	
Payments	(15)	(15)	
Interest (5% x 100m)/(5% x 60m)	5	3	
	108	60	
Remeasurements (β)	12	(5)	
At 31 December 20X1	120	55	65

In the **statement of comprehensive income**, the following amounts will be recognised:

	$m
In profit or loss	
Current service cost	18
Net interest on net defined benefit liability (5 - 3)	2
In other comprehensive income	
Remeasurement losses on defined benefit liability (12 + 5)	17

[Note that the remeasurement in relation to both the asset and liability is a loss as it decreases the asset and increases the liability.]

In the **statement of financial position**, the net defined benefit liability of $65m (120 – 55) will be recognised.

Self-test question 1

JSX, a listed entity, has a defined benefits pension scheme. The following information relates to the pension scheme for the year ended 31 October 20X8:

	$
Current service cost	362,600
Contributions to scheme	550,700
Benefits paid	662,400
Fair value of scheme assets at 1 November 20X7	10,660,000
Fair value of scheme assets at 31 October 20X8	11,204,000
Present value of defined benefit obligation at 1 November 20X7	13,290,000
Present value of defined benefit obligation at 31 October 20X8	14,210,000

The yield on a high quality corporate bond was 4 per cent.

Calculate the amount to be recognised in other comprehensive income in respect of the pension scheme for the year ended 31 October 20X8.

(The answer is at the end of the chapter)

5.7 Further issues – past service costs and settlements

Topic highlights

Past service costs arise when a pension plan is amended or curtailed; they are recognised immediately in profit or loss.

Settlements occur when plan benefits are reduced. Gains or losses on settlement are recognised in profit or loss immediately.

Although we have now met the most common items which reconcile the plan surplus or deficit at the start and end of a period, there are two further complications which you must be able to deal with:

- past service cost
- settlements

5.7.1 Past service cost

HKAS 19.102-106

Past service costs arise as a result of the amendment or curtailment of a defined benefits plan.

A plan **amendment** arises when an entity introduces a new defined benefits plan, withdraws an existing plan, or changes the benefits payable under an existing plan.

A **curtailment** occurs when an entity significantly reduces the number of employees covered by a plan.

In either case, the past service cost is the resulting change in the present value of the defined benefit plan. The past service cost may be positive where new benefits are introduced or negative where existing benefits are withdrawn. The amount is advised by an actuary.

Past service costs are recognised as an expense in profit or loss at the earlier of the following dates:

(a) when the plan amendment or curtailment occurs

(b) when the entity recognises related restructuring costs in accordance with HKAS 37 or termination benefits in accordance with HKAS 19 (see section 6).

5.7.2 Settlements

HKAS 19.109,111

A **settlement** occurs when an employer enters into a transaction to eliminate all or part of its post-employment benefit obligations, for example, a one-off transfer of obligations under a plan to an insurance company through the purchase of an insurance policy.

The gain or loss on a settlement is the difference between:

(a) The **present value of the defined benefit obligation** being settled, as valued on the date of the settlement; and

(b) The **settlement price**, including any plan assets transferred and any payments made by the entity directly in connection with the settlement.

Any gains or losses on settlement are recognised immediately in profit or loss when the settlement occurs.

Self-test question 2

A defined benefit plan provides for retirement benefits at the rate of 1 per cent of salary per annum for all employees from the commencement of their employment. On 31 December 20X1, the defined benefit obligation is measured at $18 million and the plan assets have a fair value of $15.5 million. Corresponding amounts at 31 December 20X2 are $22.5 million and $16 million.

On 1 January 20X2, the rules of the plan are changed to provide for benefit at the rate of 2 per cent of salary for employees with 15 or more years' service and the defined benefit obligation on the new basis is $20 million. Other relevant information is as follows:

- Current service cost is $3 million for the year ended 31 December 20X2
- Market yields on high quality corporate bonds were 4% at 1 January 20X2 and 4.5% at 31 December 20X2
- An overall remeasurement loss of $1.2 million was identified.

Required

What amount is recognised in profit or loss in respect of the defined benefit plan in the year ended 31 December 20X2?

(The answer is at the end of the chapter)

Space looks too big

HKAS 19.64-65, 83

5.8 Further issues – the asset ceiling

In section 5.4 we said that a net defined benefit asset is limited by the 'asset ceiling'. This term relates to a threshold established by HKAS 19 to ensure that any pension surplus is carried at no more than its recoverable amount. In other words, the net defined benefit asset is restricted to the amount of cash savings available to the entity in the future.

HKAS 19 defines the asset ceiling as: 'the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan'.

The standard further requires that the discount rate used to calculate the present value of future economic benefits is the same as that used to calculate the net interest on the net defined benefit liability (asset) ie a rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds.

Where the net defined benefit asset is reduced to the asset ceiling threshold, the related write down is treated as a **remeasurement** and recognised in **other comprehensive income.**

Example

Rowan Co operates a defined benefit pension scheme for its employees. At 1 January 20X1 the present value of the defined benefit obligation was $5 million and the fair value of the plan assets was $5.7 million. Equivalent values at 31 December 20X1 were $5.94 million and $7.1 million.

For the year ended 31 December 20X1:

- Current service cost was $1.5 million
- The interest rate applicable to the net defined benefit asset was 3%
- Contributions of $2 million were made to the plan
- $800,000 was paid out to former employees of Rowan

The present value of future economic benefits in relation to the plan is $1.1 million.

What amount of remeasurement is recognised in other comprehensive income in the year ended 31 December 20X1?

Solution

	Obligation	Assets	Net defined benefit asset
	$000	$000	$000
At 1 January 20X1	5,000	5,700	700
Current service cost	1,500		
Contributions		2,000	
Payments	(800)	(800)	
Interest (3% x 5m)/(3% x 5.7m)	150	171	
	5,850	7,071	
Remeasurements (β)	90	29	
At 31 December 20X1	5,940	7,100	1,160
Remeasurement due to asset ceiling			(60)
Asset ceiling			1,100

Therefore the total remeasurement amount recognised in other comprehensive income is:

	$000
Remeasurement loss on obligation	90
Remeasurement gain on assets	(29)
Remeasurement loss due to asset ceiling	60
Net remeasurement loss	121

5.9 Summary of accounting treatment

This section summarises the accounting treatment that we have met so far.

Opening figures	Net defined benefit liability (asset): • Present value of obligation, less • Fair value of plan assets As advised by actuary.	
Contributions	As advised by the actuary	DEBIT Plan assets CREDIT Cash / other assets
Benefits paid	Pension payments made to retired former employees	DEBIT Plan obligation CREDIT Plan assets
Current service cost	Increase in plan obligation as a result of one extra year's service. As advised by actuary	DEBIT Operating expense (profit or loss) CREDIT Plan obligation

Past service cost	Change in plan obligation as a result of improvement or withdrawal of benefits.	Improvement of benefits: DEBIT Operating expense (profit or loss) CREDIT Plan obligation Withdrawal of benefits: DEBIT Plan obligation CREDIT Operating expense (profit or loss)
Gains or losses on settlement	Difference between the present value of the obligation on settlement date and the settlement amount.	Loss on settlement: DEBIT Operating expense (profit or loss) CREDIT Plan obligation Gain on settlement: DEBIT Plan obligation CREDIT Operating expense (profit or loss)
Net interest on net defined benefit liability (asset)	Based on high quality corporate bond yield at end of period and net defined benefit liability (asset) at start of period. Discount rate % x net defined benefit liability (asset) b/f	DEBIT Finance cost (profit or loss) CREDIT Plan obligation And DEBIT Plan assets CREDIT Finance cost (profit or loss)
Remeasurements	Due to actuarial differences, the actual return on plan assets differing from the return calculated within net interest and change in the effect of the asset ceiling. Calculated as a balancing figure	DEBIT Other comprehensive income CREDIT Plan obligation / assets Or DEBIT Plan obligation / assets CREDIT Other comprehensive income
Closing figures	Net defined benefit liability (asset): • Present value of obligation, less • Fair value of plan assets As advised by actuary	

HKAS 19.63-64

5.10 Disclosure of defined benefit plans

5.10.1 The statement of financial position

In the statement of financial position, the amount recognised as a **net defined benefit liability** should be calculated as:

	$
Present value of defined benefit obligation at year end	X
Fair value of plan assets at year end	(X)
Net defined benefit liability	X/(X)

If this total is a **negative amount**, there is a net defined benefit asset and this should be shown in the statement of financial position as the **lower** of (a) and (b) below.

(a) The net defined benefit asset as calculated above
(b) The asset ceiling (see section 5.8)

HKAS 19.120

5.10.2 The statement of comprehensive income

The following amounts should be recognised in profit or loss:

- Current service cost
- Past service cost
- Gain or loss on settlement
- Net interest on the net defined benefit liability (asset)

Remeasurements should be recognised in other comprehensive income.

Self-test question 3

Lewis, a public limited company, has a defined benefit plan for its employees. The present value of the future benefit obligations at 1 January 20X7 was $890m and fair value of the plan assets was $1,000 million. Further data concerning the year ended 31 December 20X7 is as follows:

	$millions	
Current service cost	127	
Benefits paid to former employees	150	
Contributions paid to plan	104	
Present value of benefit obligations at 31 December	1,100	As valued by professional actuaries
Fair value of plan assets at 31 December	1,230	
Interest cost (gross yield on 'blue chip' corporate bonds)	10%	

On 1 January 20X7 the plan was amended to provide additional benefits with effect from that date subject to a minimum employment period of eight years. The present value of the additional benefits was calculated by actuaries at $30 million.

The present value of future economic benefits available to Lewis in respect of the plan was $120 million at 31 December 20X7.

Required

Prepare the required notes to the statement of comprehensive income and statement of financial position for the year ended 31 December 20X7.

Assume the contributions and benefits were paid on 31 December 20X7.

(The answer is at the end of the chapter)

6 Termination benefits

Topic highlights

Termination benefits are recognised as a liability and expense when an entity is demonstrably committed to them.

Termination benefits are those employee benefits provided in exchange for the termination of an employee's employment as a result of either:

- an entity's decision to terminate an employee's employment before the normal retirement date; or
- an employee's decision to accept an offer of benefits in exchange for the termination of employment.

These benefits are dealt with separately in HKAS 19 as unlike other benefits, the event which gives rise to an obligation is the termination rather than the service of the employee.

HKAS 19.165

6.1 Recognition

HKAS 19 states that termination benefits should be recognised in full as a liability and an expense at the earlier of:

(i) when the entity can no longer withdraw the offer of termination benefits; and

(ii) when the entity recognises costs for a restructuring that is within the scope of HKAS 37 and involves the payment of termination benefits.

HKAS 19.169

6.2 Measurement

Termination benefits are measured in accordance with the nature of the employee benefit:

- If the termination benefits are an enhancement of post-employment benefits, they are accounted for as such.
- Otherwise:
  - if the termination benefits are expected to be settled wholly before 12 months after the end of the annual reporting period in which the termination benefit is recognised, then they are accounted for as short-term employee benefits.
  - If the termination benefits are not expected to be settled wholly before 12 months after the end of the annual reporting period, then they are accounted for as other long-term employee benefits.

Topic recap

- **HKAS 19** *Employee Benefits* provides guidance on the accounting treatment to be applied to short-term employment benefits, post-employment benefits (pensions), other long-term employment benefits and termination benefits.
- Short-term employee benefits are those benefits that are expected to be settled wholly before 12 months after the end of the annual reporting period. The cost of the benefits to be paid in exchange for the employee's services should be recognised in the period on an accruals basis.
- There are two types of retirement benefit plan:
  - Defined contribution plans
  - Defined benefit plans
- Contributions to a defined contribution plan are recognised as an expense in the period in which they are payable.
- With a defined benefit plan, a net defined benefit liability (asset) is recognised in the statement of financial position. This is calculated as the present value of plan obligations less the fair value of plan assets.
- Where a net defined benefit asset is recognised, an 'asset ceiling' limits the amount recognised.
- The net defined benefit liability (asset) moves due to:
  - Contributions made into the plan
  - Payments made out of the plan
  - Service costs
  - Net interest arising on the net defined benefit liability (asset)
  - Remeasurements, including actuarial gains and losses
- Service costs and net interest arising on the net defined benefit liability (asset) are recognised immediately in profit or loss.
- Service costs include current service cost, past service cost and gains or losses on settlements.
- Remeasurements are recognised immediately in other comprehensive income and may not be reclassified to profit or loss.
- Termination benefits are recognised as a liability and expense when an entity can no longer withdraw the offer of termination benefits, or, if earlier, when the entity recognises costs for a restructuring within the scope of HKAS 37.

Answers to self-test questions

Answer 1

	Assets	Obligation
	$	$
At 1 November 20X7	10,660,000	13,290,000
Current service cost		362,600
Contributions	550,700	
Benefits paid	(662,400)	(662,400)
Net interest (4% x b/f assets/obligation)	426,400	531,600
Remeasurement loss on plan obligation (β)		688,200
Remeasurement gain on plan assets (β)	229,300	
At 31 October 20X8	11,204,000	14,210,000

The remeasurement loss recognised in other comprehensive income is $458,900 (688,200 – 229,300)

Answer 2

The past service cost measured as the increase in the defined benefit obligation is $20m - $18m = $2 million.

Net interest is calculated using the **year-end** market rate on a high quality corporate bond. This rate is applied to the net defined benefit liability at the **start of the year.**

Therefore the total charge to profit or loss is:

	$
Current service cost	3,000,000
Past service cost	2,000,000
Net interest 4.5% × (18m - 15.5m)	112,500
	5,112,500

Answer 3

Statement of financial position

	$m
Net defined benefit asset	120

Note to the statement of comprehensive income

Defined benefit expense recognised in profit or loss

	$m
Current service cost	127
Past service cost	30
Interest cost 10% x (1,000 - 890)	(11)

Defined benefit costs recognised in other comprehensive income

Remeasurement gain on defined benefit pension plan (176 – 114 - 10) (W)	52

Workings

Changes in the present value of the defined benefit obligation

	$m
Opening defined benefit obligation	890
Current service cost	127
Past service cost	30
Interest cost 10% x 890m	89
Benefits paid	(150)
Remeasurement loss (β)	114
Closing defined benefit obligation	1,100

Changes in the fair value of plan assets

	$m
Opening fair value of plan assets	1,000
Interest 10% x 1,000	100
Contributions	104
Benefits paid	(150)
Remeasurement gain (β)	176
Closing fair value of plan assets	1,230

Asset ceiling test

	$m
Closing fair value of plan assets	1,230
Closing defined benefit obligation	(1,100)
Closing net defined benefit asset	130
Asset ceiling	(120)
Remeasurement loss	10

Exam practice

Employee benefits

29 minutes

(a) HKAS 19 as amended in July 2011 requires that all actuarial gains and losses (or remeasurements) are recognised immediately in other comprehensive income. Prior to these amendments, entities were permitted to defer actuarial gains and losses in excess of 10% of the value of the plan assets or obligation and recognise them over an extended period, either in profit or loss or in other comprehensive income.

Required

What will be the effect of the new requirements on the financial statements of entities which previously chose to defer actuarial gains and losses? (4 marks)

(b) The following information relates to the defined benefit employee compensation scheme of Rhodes Co:

Present value of obligation at start of 20X8 ($'000)	20,000
Market value of plan assets at start of 20X8 ($'000)	20,000

	20X8	*20X9*
	$'000	$'000
Current service cost	1,250	1,430
Benefits paid out	987	1,100
Contributions paid by entity	1,000	1,100
Present value of obligation at end of the year	23,000	20,400
Market value of plan assets at end of the year	21,500	17,840
Yield on corporate bonds at end of year	8%	9%

During 20X8, the benefits available under the plan were improved. The resulting increase in the present value of the defined benefit obligation was $1 million.

On the final day of 20X9, Rhodes Co divested of part of its business, and as part of the sale agreement, transferred the relevant part of its pension fund to the buyer. The present value of the defined benefit obligation transferred was $5.7 million and the fair value of plan assets transferred was $5.4 million. Rhodes also made a cash payment of $200,000 to the buyer in respect of the plan.

Assume that all transactions occur at the end of the year.

Required

(i) Calculate the net defined benefit liability as at the start and end of 20X8 and 20X9 showing clearly any remeasurement gain or loss on the plan each year. **(6 marks)**

(ii) Show amounts to be recognised in the financial statements in each of the years 20X8 and 20X9 in respect of the plan. **(6 marks)**

(Total = 16 marks)

Appendix 2:
Chapter 16 (Flashcards)
Employee benefits

Considerable amendments have been made to HKAS 19 *Employee Benefits* in late 2011, after publication of the 2011 edition Module A Flashcards . These changes affect the whole of Chapter 16, so for the sake of simplicity we have rewritten the chapter so it reflects all of the amendments made.

You should ignore Chapter 16 included in your Flashcards and replace it with the revised version here.

16: Employee benefits

Topic List

It is important that there is a standard best practice for the way in which employee benefit costs are accounted for.

HKAS 19 was amended in 2011 to simplify the accounting for defined plans.

HKAS 19 | Post-employment benefits

HKAS 19

HKAS 19 *Employee Benefits* deals with all employee benefits, not just pensions.

Objectives

An entity should recognise an expense as it consumes the economic benefits of employee service in exchange for employee benefits and a liability where these are to be paid in the future.

Short term employee benefits

The cost of these benefits is recognised in the period in which the employee provides service on an accruals basis.

Termination benefits

Recognise as a liability and an expense at the earlier of:

(i) when the entity can no longer withdraw the offer of termination benefits

(ii) when the entity recognises cost for a restructuring that is within the scope of HKAS37 and involves the payment of termination benefits.

HKAS 19 | **Post-employment benefits**

Defined contribution plans

- A fixed contribution is paid to the plan each year
- The resultant benefit is unguaranteed and depends on how investments have performed

- Contributions are recognised as an expense in the period payable
- Accrual/prepayment may arise

Disclosure
- Description of plan
- Expense in period

Defined benefit plans

- A fixed benefit is paid on retirement
- Contributions will vary and are set at a level which is expected to result in sufficient returns to meet the obligation to pay a fixed benefit

Net defined benefit liability/asset is shown in SOFP:

PV of defined benefit obligation	X
Less: FV of plan assets	(X)
Net defined benefit liablity (asset)	X/(X)

Changes in the PV of obligation and FV of plan assets are accounted for individually.

Page 91 **16:** Employee benefits

HKAS 19 | Post-employment benefits

Defined benefit plans - accounting steps

(1) Determine the deficit or surplus	– use actuarial technique to estimate future obligation – discount obligation to present value – deduct fair value of plan assets.
(2) Determine amount of net defined benefit liability (asset)	– if surplus calculated in Step 1, may require adjustment for asset ceiling
(3) Determine amounts to be recognised in profit or loss	– current service cost – past service cost – gains or losses on settlements – net interest on net defined benefit liability (asset)
(4) Determine remeasurements to be recognised in other comprehensive income	– actuarial gains and losses – return on plan assets not included in net interest – change in effect of asset ceiling excluding amounts included in net interest.

HKAS 19 | **Post-employment benefits**

Discount rate	In all cases the appropriate discount rate is determined by reference to market yields on high quality corporate bonds at the period end.
Asset ceiling	Where a plan is in surplus, the defined benefit asset is limited to the present value of future economic benefits in relation to the plan.
Current service costs	Increase in pension obligation due to employee service in the current period. Advised by actuary.
Past service costs	Change in pension obligation relating to employee service in prior periods due to amendments/curtailments. Advised by actuary.
Gains or losses on settlement	Arise where an employer eliminates all or part of its employee benefit obligations. Calculated as the difference between: (1) The present value of the obligation being settled on settlement date (2) The settlement price
Net interest on net defined benefit liability (asset)	Net defined benefit liablity (asset) b/f × discount rate (see above).
Remeasurements	Calculated as a balancing figure to reconcile opening net defined benefit liability (asset) to closing. Arise due to changes in actuarial assumptions and experience adjustments.

Page 93 **16:** Employee benefits

HKAS 19

Post-employment benefits

Accounting summary - Defined benefit plans

	Obligation	Assets		
b/f	X	X		
Contributions made into the scheme		X	Dr Assets	Cr Cash
Benefits paid	(X)	(X)	Dr Obligation	Cr Assets
Current service cost	X		Dr Operating expense	Cr Obligation
Past service cost (increase benefits)	X		Dr Operating expense	Cr Obligation
Past service cost (decrease benefits)	(X)		Dr Obligation	Cr Operating expense
Loss on settlement	X		Dr Operating expense	Cr Obligation
Gain on settlement	(X)		Dr Obligation	Cr Operating expense
Net interest on net defined benefit liability (asset)	X	X	Dr Finance cost and Dr Assets	Cr Obligation Cr Finance cost
Remeasurements	X/(X)	X/(X)	Dr OCI and Dr Obligation/assets	Cr Obligation/assets Cr OCI
c/f	X	X		

HKAS 19 | Post-employment benefits

	PV of obligation	*FV of assets*		
At start of period	(X)	X		
Contributions paid		X	Dr Asset	Cr Cash
Benefits paid out	X	(X)	Dr Obligation	Cr Asset
Expected return on plan assets		X	Dr Asset	Cr Investment income
Unwinding of discount	(X)		Dr Finance cost	Cr Obligation
Current service cost	(X)		Dr Operating exp	Cr Obligation
	(X)	X		
Actuarial differences (balancing figure)	X/(X)	X/(X)		
At end of period as advised by actuary	(X)	X		

Contributions paid	– Advised by actuary
Expected return on plan assets	– % x FV of assets at start of period
Unwinding of discount	– % x PV of obligation at start of period
Current service cost	– Increase in obligation as result of extra year of employee service. Calculated using projected unit credit method
Actuarial gains or losses	– Arise because actuarial assumptions ≠ actual events

Accounting treatment

1 Recognise immediately in profit or loss, or

2 Recognise immediately in other comprehensive income, or

3 Defer where within 10% corridor

HKAS 19 | **Post-employment benefits**

Calculation of gains/losses outside 10% corridor

Unrecognised gains/(losses) b/d		X
Actuarial gain/(loss) on plan assets		X
Actuarial gain/(loss) on PV obligation		X
Total unrecognised gain/(loss)		X
Corridor limits; *higher* of:		
10% b/d plan assets	X	
10% b/d PV obligation	X	
		(X)
Gain/(loss) outside 10% corridor		X

Cumulative actuarial gains/losses outside the 10% corridor are amortised to P/L over the expected average remaining working lives of the plan employees.

Past service cost

Arise where extra benefit is provided which → extra obligation.

Obligation after extra benefit	X
Obligation before extra benefit	(X)
Past service cost	X

Recognise in profit or loss over vesting period

Curtailment = entity reduces benefits available

Settlement = employer settles some/all obligation by paying a lump sum

↓

Gains or losses recognised in full in the financial year in which they occur

Asset ceiling

If pension plan is in surplus, carrying amount in SOFP is restricted to the total of present values of

- unrecognised actuarial losses
- unrecognised past service costs
- refunds expected from the plan
- reductions in future contributions due to surplus

Notes