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

The guidance below was developed by the Financial Reporting Standards Committee (FRSC) of the Hong Kong Institute of Certified Public Accountants (HKICPA) and is for general reference only. The HKICPA, FRSC and the HKICPA staff do not accept any responsibility or liability, and disclaim all responsibility and liability in respect of the guidance and any consequences that may arise from any person acting or refraining from action as a result of any materials in the guidance. Members of the HKICPA and other users of this guidance should also read the full HKFRS Standards, as found in the HKICPA Members' Handbook for further reference, and seek professional advice where necessary when applying the references contained in this guidance.

The HKICPA's Standard Setting Department welcomes your comments and feedback on this guidance, which should be sent to commentletters@hkicpa.org.hk.

Accounting implications of the abolition of the MPF-LSP offsetting mechanism in Hong Kong

On 22 February 2023, the HKICPA published Financial Reporting Alert 44 to highlight the potential accounting impact of the abolition of the Mandatory Provident Fund (MPF)-Long Service Payment (LSP) offsetting mechanism (the Abolition) on entities in Hong Kong and, in particular, two broad tentative approaches to analysing the issue. This publication provides comprehensive guidance for the accounting for the impact arising from the Abolition. It should be noted that this guidance focuses on the interaction of the MPF and LSP, as MPF is the most prevalent retirement scheme in Hong Kong. The principles discussed in this guidance apply equally to other retirement schemes, e.g. Occupational Retirement Schemes Ordinance, that may also be impacted by the Abolition.

Contents **Page**

I. Background of the issue

History of the LSP and MPF

1. There are several statutory employee benefit schemes in Hong Kong, one of which is the long service payment (LSP) benefit. The LSP is calculated based on a specified formula taking into account an employee's last monthly salary and his number of years of service (subject to a cap), and is payable by the employer under certain circumstances[1]. Another is the accrued benefits[2] under the Mandatory Provident Fund (MPF) scheme in terms of which the employer makes mandatory contributions (capped at HK$1,500 per month) and voluntary contributions (if any) to the trustee who administers the assets held in a trust solely for the retirement benefits of each individual employee.

2. While LSP was intended for meeting the short-term financial needs of employees who become unemployed under specific circumstances as well as providing for retirement benefits, the sole purpose of MPF was to assist the working population to save for retirement. The timing of cash payments under the two schemes mirrors such purposes: employees have a right to LSP payments upon eligible loss of employment, while MPF entitlements are withdrawable normally only when MPF scheme members reach the age of 65.

3. LSP precedes MPF as a statutory minimum social safety net for employees in Hong Kong. Offsetting[3] of LSP against an employee's accrued retirement benefits was first introduced in 1990 when retirement schemes were voluntary in Hong Kong (i.e. before MPF) such that employers 'will not pay twice'; however, the primary purpose of LSP remained unchanged: to provide short-term financial support to employees upon loss of employment. When the MPF was introduced in 1995 through the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO), the offsetting mechanism was retained to balance the interests of employers and employees.

4. The MPFSO permits the withdrawal of accrued benefits derived from an employer's MPF contributions for the purpose of offsetting LSP payable to an employee under the Employment Ordinance (Cap. 57) (EO). Under the MPFSO, the employer can either seek a reimbursement from the approved trustee of an individual employee's MPF scheme when it has paid the LSP; or request the employee to obtain the LSP payments from the accrued benefits derived from the employer's contributions to the MPF scheme directly from the approved trustee.

Abolition of the offsetting mechanism

5. In June 2022, the Government of the HKSAR gazetted the Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Ordinance 2022 (the Amendment Ordinance). The Amendment Ordinance abolishes the use of the accrued benefits derived from employers' mandatory MPF contributions to offset severance payment (SP)[4] and LSP (the Abolition). In April 2023, HKSAR Chief Executive John Lee announced that the Abolition will officially take effect on 1 May 2025 (the Transition Date).

[1] See pages 1 and 2 of the summary prepared by the Labour Department of the HKSAR Government here for the eligibility of the LSP.
[2] Accrued benefits mean the accumulated MPF contributions plus returns generated less losses incurred.
[3] The term 'offset' used in this guidance should be interpreted in terms of general parlance as opposed to how the term is applied in accounting standards (i.e. in terms of the gross vs net presentation in the financial statements when offsetting is allowed generally only when specified criteria are met).
[4] In terms of the EO, an employee is entitled to a severance payment (SP) if he has been employed continuously for at least 24 months but is dismissed due to redundancy. The amount of SP is calculated using the same formula as the LSP; however, an employee will not be simultaneously entitled to both LSP and SP. In terms of accounting, SP is classified as 'termination benefits' for the purposes of HKAS 19 *Employee Benefits*. As SP is not subject to the same level of actuarial assumption and estimation uncertainty as the LSP, it is not covered in this guidance.

6. At a high level, the Amendment Ordinance has two effects:

   (i) The accrued benefits derived from an employer's mandatory MPF contributions may no longer be used to offset LSP/SP in respect of the employment period after the Transition Date (post-transition LSP); and

   (ii) The last month's salary immediately preceding the Transition Date (instead of the date of termination of employment) is used to calculate the portion of LSP/SP in respect of the employment period before the Transition Date (pre-transition LSP).

7. At the same time, the Government has indicated that it would launch a scheme to subsidise employers for a period of 25 years after the Transition Date on the LSP/SP payable by employers up to a certain amount per employee per year (Government Subsidy).

8. **Appendix 1** provides a summary of the offsetting mechanism and the changes introduced by the Amendment Ordinance.

The accounting issues resulting from the Abolition

9. LSP has historically been accounted for as a defined benefit plan in accordance with HKAS 19 *Employee Benefits*. The measurement of the LSP liability is subject to actuarial assumptions and estimates. Historically, many entities have accounted for the expected offset arising from the offsetting mechanism as a reduction of the LSP liability and the net LSP position may have been immaterial for their financial statements. It is also observed that many entities currently have limited or no disclosures about the LSP liability in their financial statements.

10. In light of the Amendment Ordinance, the FRSC has considered it necessary to reassess the accounting for the offsetting mechanism. This is because firstly, the Abolition has a pervasive impact – it affects all entities that are subject to the LSP provisions of the EO and that are required to make mandatory MPF contributions; and secondly, the accounting for the offsetting mechanism could become material in light of the Abolition depending on factors such as the composition and salary of an entity's workforce.

11. One of the key complexities of the accounting for the offsetting mechanism lies in the interaction between the employer MPF contributions (which have attributes of a defined contribution plan) and the entity's LSP obligation (which has attributes of a defined benefit plan), when the two plans have different accounting models in HKAS 19 and there is no specific guidance in the standard on how to account for such an interaction.

II. Two acceptable accounting approaches

12. Having given due consideration to the issue, the FRSC considered that there are two acceptable approaches to account for the offsetting mechanism and hence the impact arising from the Abolition. As the two approaches characterise the nature of the employer's right to the accrued benefits arising from its MPF contributions differently, they would result in different recognition, measurement, as well as presentation and disclosure outcomes in an entity's financial statements. In particular, the two approaches could result in a different extent and/or direction of change to the LSP liability before and after the enactment of the Amendment Ordinance (see Section III for further details). As the Amendment Ordinance was enacted in June 2022, the 'year of enactment of the Amendment Ordinance' is the financial year that includes June 2022.

Approach 1: Account for the amount expected to be offset as a deemed employee contribution towards his LSP benefits in terms of HKAS 19.93(a)

13. Under approach 1, the accrued benefits arising from employer MPF contributions that have been vested with the employees[5] and which would be used to offset the employee's LSP benefits (offsetable accrued benefits) are treated as a *deemed* contribution by the employ*ee* towards the LSP in accordance with HKAS 19.93(a). This is because the amount of LSP that an employer has to pay is net of the offsetable accrued benefits, but such offsetable accrued benefits have already been vested with the employees. In effect, an employee is required to use 'his own money' (viz. the vested MPF benefits) to fund a portion of his own LSP benefits. As such, the offsetable accrued benefits are regarded as a deemed employee contribution to the LSP.[6]

14. It follows that the relevant offsetable accrued benefits are projected and attributed to periods of service as a reduction in service cost (negative service cost) when determining the ultimate net cost to the entity of the benefit that the employees have earned in return for their service in the current and prior periods (HKAS 19.57(a)(i) and (ii)). Consequently, the LSP obligation under approach 1 is measured on a 'net' basis in that the amount is determined after deducting the negative service cost arising from the offsetable accrued benefits.

    See Example 1 for an illustration of approach 1 before taking into account the impact of the Amendment Ordinance.

[5] Despite the fact that the benefits have been vested with the employees, they cannot withdraw the accrued benefits unless certain conditions are met.

[6] Historically, some entities might have applied the practical expedient in HKAS 19.93(b) to account for the deemed employee contributions. Whether the practical expedient continues to be applicable after the Abolition depends on whether the deemed employee contributions to the LSP remain 'independent of the number of years of service', which is the qualifying criterion for the practical expedient in HKAS 19.93(b). HKAS 19, however, does not provide any specific guidance on how to apply the 'dependent / independent of the number of years of service' criterion.

In light of the fact that the determination of the offsetable accrued benefits depends on a number of factors, and that the Amendment Ordinance introduces different rules about how the pre-transition LSP and the post-transition LSP should be determined, it is noted that following the enactment of the Amendment Ordinance, the amended LSP scheme is no longer a 'simple type of contributory plans' to which the IASB had intended the practical expedient to apply (HKAS 19.BC150I and BC150J). This is because the contributions are no longer 'linked solely to the employee's service in that period' since mandatory employer MPF contributions after the Transition Date can still be used to offset pre-transition LSP (HKAS 19.BC150J). This means it would no longer be appropriate to view the contributions as 'independent of the number of years of service' which is the qualifying criterion for the practical expedient in HKAS 19.93(b).

Accordingly, those entities that change from applying HKAS 19.93(b) to HKAS 19.93(a) following the Abolition will recognise a cumulative catch-up adjustment in profit or loss against the LSP liability in the year of enactment of the Amendment Ordinance. The cumulative catch-up adjustment is calculated as the difference at the enactment date (16 June 2022) between the carrying amount of the LSP liability calculated under HKAS 19.93(b) before the Abolition and the carrying amount of the LSP liability calculated under HKAS 19.93(a) after the Abolition. See example 2 for a detailed calculation of the carrying amount of the LSP liability under HKAS 19.93(a) after the Abolition.

Example 1 - Illustrating paragraphs 13 - 14 before taking into account the impact of the Amendment Ordinance

<u>Background information</u>

- Financial year end of the entity (employer): 30 April
- Employee joined in 2016 (Year 1); Employee is expected to leave in 2035 (Year 20)
- Annual salary: HK$120,000 (Year 1); Salary increment: 4% per annum
- MPF contribution by employer (assuming at the end of the financial year): 5% of monthly salary (monthly cap of HK$1,500, equivalent to an annual cap of HK$18,000)
- Investment return on MPF contribution: 3% per annum
- Discount rate determined in accordance with HKAS 19.83: 3% per annum
- The employee is entitled to a lump sum benefit at retirement (i.e. LSP) determined as: Last month salary x 2/3 x no. of years of service (with a cap of HK$390,000)

For simplicity, all the examples in this guidance ignore any adjustments needed to reflect the probability that the employee may leave the entity at an earlier or later date and assume no changes in actuarial assumptions. The entity attributes benefits to periods of service on a straight-line basis.

<u>The journal entries (HK$) recorded by the entity for the year ended April 2023 are as follows:</u>

Dr Employee benefits expense	7,896	
Cr Bank		7,896

To recognise the employer MPF contribution as a defined contribution plan

Dr Current service cost (CSC)	9,851	
Dr Interest expense	2,009	
Cr LSP obligation		11,860

To recognise the defined benefit obligation for the LSP in accordance with HKAS 19.70 before taking into account the deemed employee contribution as a negative service cost

Dr LSP obligation	9,753	
Cr Interest expense		1,652
Cr CSC		8,101

To recognise the deemed employee contribution as a negative service cost in accordance with HKAS 19.93(a)

Refer to **Appendix 2** for the detailed calculation.

15. Under approach 1, the enactment of the Amendment Ordinance generally reduces the amount of expected offsetable accrued benefits if the employer does not make any voluntary MPF contributions. This is because the accrued benefits derived from mandatory employer MPF contributions may no longer be used to offset an employee's post-transition LSP obligation.

16. The reduction in expected offsetable accrued benefits effectively reduces the total projected negative service cost over the entire expected service period (past, current and future) of an employee. This in turn increases the expected net cost of the LSP obligation to an entity over the entire expected service period. The revised expected net cost to an entity (i.e. benefits to the employees after deducting the offsetable accrued benefits)

determined in accordance with the Amendment Ordinance is reattributed on a straight-line basis from the date when services by employees first lead to benefits in terms of the LSP legislation[7], with a catch-up adjustment for past service cost and a corresponding increase in the LSP obligation in the year of enactment of the Amendment Ordinance. The adjustment is recognised as a past service cost in profit or loss in accordance with HKAS 19.94(a) as the Abolition was not contemplated in the original LSP legislation.

See Example 2 for an illustration of approach 1 after taking into account the impact of the Amendment Ordinance.

Example 2: Illustrating paragraphs 15 - 16 after taking into account the impact of the Amendment Ordinance

Same background information as Example 1.

Assume the entity (employer) adopts approach 1 before and after the Abolition.

<u>The journal entries (HK$) recorded by the entity in the year of enactment of the Amendment Ordinance (i.e. year ended April 2023 as the Amendment Ordinance was enacted in June 2022) are as follows:</u>

Dr Past service cost	21,581	
Cr LSP obligation		21,581

To recognise a catch-up adjustment for past service cost and a corresponding increase in the LSP obligation. [(a)] *(33,475 <“Y” in App 3> – 11,894 <“X” in App 2>)*

[(a)] Given the Amendment Ordinance was enacted on 16 June 2022, the catch-up adjustment should be determined by comparing the existing and revised LSP balances at that date. However, for simplicity, this example determines the catch-up adjustment using the LSP balance at the beginning of the financial year assuming any related movements during the 1.5 months to the enactment date are insignificant.

Dr Employee benefits expense	7,896	
Cr Bank		7,896

To recognise the employer MPF contribution as a defined contribution plan

Dr Current service cost (CSC)	8,253	
Dr Interest expense	1,683	
Cr LSP obligation		9,936

To recognise the defined benefit obligation for the LSP in accordance with HKAS 19.70 before taking into account the deemed employee contribution as a negative service cost

Dr LSP obligation	4,006	
Cr Interest expense		678
Cr CSC		3,328

To recognise the deemed employee contribution as a negative service cost in accordance with HKAS 19.93(a)

Refer to **Appendix 3** for the detailed calculation.

[7] HKAS 19.70 requires an entity to attribute benefit on a straight-line basis if an employee’s service in later years will lead to a materially higher level of benefit than in earlier years, which is generally the case with the LSP obligation.

Approach 2: Account for the employer MPF contributions and the offsetting mechanism as a funding mechanism for the LSP obligation

17. Under approach 2, in view of the historical development, policy objectives as well as the employer's rights under the LSP and MPF legislations (paragraphs 1 - 4), the employer MPF contributions and the offsetting mechanism are regarded as a funding mechanism to help employers save for the LSP obligation and is accounted for as such. This is because an entity may either pay the gross LSP to an employee and claim a reimbursement from the MPF trustee, or pay the net LSP to an employee after deducting the offsetable accrued benefits accumulated in the MPF system (paragraph 4 and **Appendix 1**). In other words, the employer has a statutory right to reimbursement or offset.

18. Following from the above characterisation, the right to reimbursement or offset is accounted for as a reimbursement asset in accordance with HKAS 19.116. That paragraph states that an entity should recognise its right to a reimbursement as a separate asset when 'it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation'. As the MPFSO and the EO stipulate that an entity will be reimbursed or be entitled to an offset when it needs to settle an LSP obligation, for mandatory employer MPF contributions the virtually certain recognition criterion is met when the contributions are made.

19. The right to reimbursement is recognised as a separate asset on the statement of financial position and is measured at fair value at the reporting date. The changes in fair value are disaggregated and recognised in the same way as for changes in the fair value of plan assets in HKAS 19, which typically comprise (not exhaustive):

    (i) interest income recognised in profit or loss (HKAS 19.125);
    (ii) return on the underlying assets, excluding the amount included in interest income per (i) above, recognised in other comprehensive income (OCI) (HKAS 19.127(b));
    (iii) additional contributions to the underlying assets; and
    (iv) payments of benefits.

20. The LSP obligation is measured on a 'gross' basis under this approach in that it is not reduced by the offsetable accrued benefits, as the employer's rights to those benefits are recognised as a separate reimbursement asset as explained above.

21. It should be noted that the fair value measurement of the reimbursement asset under approach 2 (determined in accordance with HKAS 19.116(a) and HKFRS 13 *Fair Value Measurement*[8]) is not the same as the measurement of the offsetable accrued benefits under approach 1 (determined using an actuarial valuation method in accordance with HKAS 19.67 to 98).

    See Example 3 for an illustration of approach 2 before taking into account the impact of the Amendment Ordinance.

[8] Although the reimbursement asset is measured with reference to HKFRS 13, it is exempt from the disclosure requirements thereof (HKFRS 13.7(a)).

Example 3: Illustrating paragraphs 17 - 21 before taking into account the impact of the Amendment Ordinance

Same background information as Example 1.

For simplicity, we assume the return on the reimbursement asset recognised in OCI is nil in this example (see paragraph 19(ii) above).

The journal entries (HK$) recorded by the entity for the year ended April 2023 are as follows:

Dr Reimbursement asset	7,896	
Cr Bank		7,896

To recognise the employer MPF contribution as a reimbursement asset associated with the LSP

Dr Reimbursement asset	1,549	
Cr Interest income		1,549

To recognise the interest income on the reimbursement asset[a]

Dr Current service cost	9,851	
Dr Interest expense	2,009	
Cr LSP obligation		11,860

To recognise the defined benefit obligation for the LSP in accordance with HKAS 19.70[a]

[a] HKAS 19.116(b) allows entities to recognise the components of defined benefit cost (in profit or loss or OCI) net of amounts relating to changes in the carrying amount of the reimbursement asset, i.e. a net presentation option. This example shows the gross presentation option without netting the relevant amounts.

Refer to **Appendix 4** for the detailed calculation.

22. Under this approach, the financial impacts in the year of enactment of the Amendment Ordinance are as follows:

    (a) An adjustment to the LSP obligation to reflect the change in reference date used for determining the last month's salary (i.e. just before the Transition Date) when calculating the pre-transition LSP; and

    (b) No specific impact on the measurement of the reimbursement asset arising from the Abolition except for capping it at the amount of the pre-transition LSP due to the change brought about in (a) above.

    See Example 4 for an illustration of approach 2 after taking into account the impact of the Amendment Ordinance.

Example 4: Illustrating paragraph 22 after taking into account the impact of the Amendment Ordinance

Same background information as Example 1.

Assume that the entity (employer) adopts approach 2 before and after the Abolition.

For simplicity, we assume the return on the reimbursement asset recognised in OCI is nil in this example (see paragraph 19(ii) above).

<u>The journal entries (HK$) recorded by the entity in the year of enactment of the Amendment Ordinance (i.e. year ended April 2023 as the Amendment Ordinance was enacted in June 2022) are as follows:</u>

Dr LSP obligation	10,861	
Cr Past service cost		10,861

To recognise the adjustment to pre-transition LSP[(a)]. (56,090 <“Q” in App 5> – 66,951 <“P” in App 4>)

[(a)] Given the Amendment Ordinance was enacted on 16 June 2022, this adjustment should be determined by comparing the existing and revised LSP balances at that date. However, for simplicity, this example determines the adjustment using the LSP balance at the beginning of the financial year assuming any related movements during the 1.5 months to the enactment date are insignificant.

Dr Reimbursement asset	7,896	
Cr Bank		7,896

To recognise the employer MPF contribution as a reimbursement asset associated with the LSP

Dr Reimbursement asset	1,549	
Cr Interest income		1,549

To recognise the interest income on the reimbursement asset[(b)]

Dr Current service cost	8,253	
Dr Interest expense	1,683	
Cr LSP obligation		9,936

To recognise the defined benefit obligation for the LSP in accordance with HKAS 19.70[(b)]

[(b)] HKAS 19.116(b) allows entities to recognise the components of defined benefit cost (in profit or loss or OCI) net of amounts relating to changes in the carrying amount of the reimbursement asset, i.e. a net presentation option. This example shows the gross presentation option without netting the relevant amounts.

Refer to **Appendix 5** for the detailed calculation.

III. Comparison of the two approaches

23. Referring to the above examples, the overall effects of the two accounting approaches on the respective items in the statement of financial position and the statement of comprehensive income (i) without taking into account and (ii) after taking into account the Abolition in the year of enactment of the Amendment Ordinance (FY2023), as well as for FY2024 after taking into account the Abolition are summarised overleaf.

	As at/ for the year ended 30 April 2023				As at/ for the year ended 30 April 2024	
	Approach 1		Approach 2		Approach 1	Approach 2
	Ignoring Abolition Example 1 (Note 1)	Reflecting Abolition Example 2 (Note 2)	Ignoring Abolition Example 3 (Note 1)	Reflecting Abolition Example 4 (Note 2)		
Statement of financial position (Note 3)						
Assets						
Reimbursement asset	-	-	61,079[e]	61,079[h]	-	71,123[m]
Liabilities						
LSP obligation	14,001[a]	39,405[c]	78,811[f]	66,026[i]	45,661[k]	76,508[n]
For illustrative purposes only						
LSP liability minus LSP-related assets	*(14,001)*	*(39,405)*	*(17,732)*	*(4,947)*	*(45,661)*	*(5,385)*
Statement of comprehensive income[p]						
Impact on profit / (loss)	(10,003)[b]	(35,407)[d]	(10,311)[g]	2,474[j]	(14,466)[l]	(8,650)[o]

(a) App 2 Closing LSP obligation as at 30 April 2023

(b) Example 1: 7,896+9,851+2,009-1,652-8,101

(c) App 3 Closing LSP obligation as at 30 April 2023

(d) Example 2: 21,581+7,896+8,253+1,683-678-3,328

(e) App 4 Closing fair value of reimbursement asset as at 30 April 2023

(f) App 4 Closing LSP obligation as at 30 April 2023

(g) Example 3: 9,851+2,009-1,549

(h) App 5 Closing fair value of reimbursement asset as at 30 April 2023

(i) App 5 Closing LSP obligation as at 30 April 2023

(j) Example 4: 8,253+1,683-10,861-1,549

(k) App 3 Closing LSP obligation as at 30 April 2024

(l) App 3 (for the year ended 30 April 2024): 8,211 <5% contribution to MPF by employer> +1,182 <Net Interest > +5,073 <Net current service costs>

(m) App 5 Closing fair value of reimbursement asset as at 30 April 2024

(n) App 5 Closing LSP obligation as at 30 April 2024

(o) App 5 (for the year ended 30 April 2024): 1,981 <Interest expense> +8,501 <Current service cost> -1,832 <Interest income>

(p) We have assumed for simplicity purposes that the impact to OCI is nil in all the examples. In practice, it is likely that there will be remeasurements of the net defined benefit liability which are recognised in OCI, such as actuarial gains/losses and a return on reimbursement assets that is different from the amount reflected as interest income. (HKAS 19.120(c))

Notes:

(1) As mentioned above, the LSP obligation is measured on a ‘net’ basis under approach 1 and on a ‘gross’ basis under approach 2.

(2) A comparison of the one-off adjustment to the LSP obligation in the year of enactment of the Amendment Ordinance (i.e. year ended April 2023 in these examples) reveals the following:

- Approach 1 (example 2): the LSP obligation increases by HK$21,581

- Approach 2 (example 4): the LSP obligation decreases by HK$10,861

The decrease under approach 2 is due to the use of a smaller last month's salary to calculate the pre-transition LSP based on the last month's salary 'immediately preceding the Transition Date' instead of that 'immediately before termination of employment'. Although this change is also reflected in approach 1, its impact is outweighed by the reduction in negative service cost (which is attributed to the periods of service on a straight-line basis) as the accrued benefits from mandatory employer MPF contributions may no longer be offset against the post-transition LSP obligation.

Entities applying approach 2 would generally recognise a higher expense in later years as compared to approach 1 once the accrued benefits from mandatory employer MPF contributions have reached the pre-transition LSP amount (see years ending after April 2027 and the related note in Appendix 5). Ultimately, the LSP liability for a specific employee under both approaches will converge to the same amount at the time the LSP liability is expected to be settled.

(3) Under both approaches, the amount of accrued benefits derived from mandatory[9] employer MPF contributions that may be used to offset LSP is capped at the amount of the pre-transition LSP obligation, i.e. HK$94,887 in examples 2 and 4.
- Under approach 1, the cap is reflected by limiting the amount of projected total accrued benefits derived from deemed employee contributions (see 'B' in Appendix 3 and note how the total amount of 'contribution plus interest' is capped at HK$94,887 from April 2024 onwards). The cap is therefore embedded in the LSP obligation line item on the balance sheet;
- Under approach 2, the cap is reflected by capping the fair value of the reimbursement asset at HK$94,887 (see the 'fair value of reimbursement asset' section in Appendix 5 and note how the fair value is capped at HK$94,887 from April 2027 onwards). No further interest income or return on assets will be recognised once the cap has been reached and any further mandatory employer MPF contributions will be recognised as an expense (unless the fair value of the reimbursement asset drops below the pre-transition LSP liability).

24. The table below compares the two approaches on steady state application.

	Aspects	**Approach 1**	**Approach 2**
A	Employer MPF contributions	Expensed as incurred	• Recognised as reimbursement asset upon payment, taking into account the LSP liability recognised to date and the maximum amount that is eligible for offset against the LSP (the 'cap'); • Any further contributions are recognised as an expense as incurred.

[9] To the extent that accrued benefits are derived from *voluntary* employer MPF contributions or *gratuities*, those benefits may continue to be used to offset pre- and post-transition LSP irrespective of when the original contributions were made. Voluntary contributions and gratuities will therefore affect the projection of the total accrued benefits derived from deemed employee contributions (approach 1) and the valuation of the reimbursement asset (approach 2).

<table>
<tr><th></th><th>Aspects</th><th>Approach 1</th><th>Approach 2</th></tr>
<tr><td>B</td><td>LSP – current service cost (P/L) (before deducting any negative service cost)</td><td colspan="2">Same under both approaches</td></tr>
<tr><td>C</td><td>LSP – negative service cost (P/L)</td><td>Represents the deemed employee contribution to the LSP as if he is using ‘his own money’ to fund his own LSP benefits</td><td>NA</td></tr>
<tr><td>D</td><td>Defined contribution plan expense (P/L)
(HKAS 19.53)
[Linked to A]</td><td>Reflects the employer MPF contributions</td><td>Reflects the employer MPF contributions exceeding the amount of reimbursement asset that can be recognised</td></tr>
<tr><td>E</td><td>Defined benefit plan expense (P/L)
(HKAS 19.57(c))
[B – C amongst others*]</td><td>Smaller than approach 2 due to the deduction of negative service cost</td><td>Bigger than approach 1 as no negative service cost</td></tr>
<tr><td>F</td><td>LSP liability – defined benefit liability (B/S)
(HKAS 19.57(b))
[Incorporates E amongst others*]</td><td>Smaller than approach 2 as it is measured on a ‘net’ basis in that the amount is determined after deducting the negative service cost arising from the offsetable accrued benefits</td><td>Bigger than approach 1 as it is measured on a ‘gross’ basis in that the offsetable accrued benefits are recognised separately as a reimbursement asset</td></tr>
<tr><td>G</td><td>Reimbursement asset (B/S)
(HKAS 19.116)
[Linked to A]</td><td>NA</td><td>Represents the entity’s right to claim reimbursement from the MPF trustees for the offsetable accrued benefits when settling a LSP liability</td></tr>
<tr><td rowspan="2">H</td><td rowspan="2">LSP liability minus LSP-related assets (for illustrative purposes only)
[F – G]</td><td>Generally bigger than approach 2; however,</td><td>Generally smaller than approach 1; however,</td></tr>
<tr><td colspan="2">both approaches will converge to the same amount at the time the LSP liability is expected to be settled.</td></tr>
<tr><td colspan="4">* The other components have not been listed here for the sake of simplicity</td></tr>
</table>

25. Any changes in actuarial assumptions (e.g. employee turnover and mortality, discount rates, benefit levels, increases in salary etc.) will affect the LSP liability (both approaches) and the reimbursement asset (approach 2) with a corresponding adjustment to OCI as a remeasurement gain or loss (HKAS 19.120(c)). Such amounts recognised in OCI may not be subsequently reclassified to profit or loss (HKAS 19.122). For example, if the employee in the examples above resigns unexpectedly, the LSP liability and the reimbursement asset will be derecognised in full with a corresponding adjustment to OCI.

IV. Further practical considerations

26. For simplicity, the examples in this guidance are constructed on the following assumptions:
    (a) one employee who is expected to earn the right to LSP;
    (b) a constant discount rate of 3% for the LSP obligation and a constant investment return of 3% for the deemed employee contribution as well as for the reimbursement asset throughout all years (actual discount rate and return equal expected); and
    (c) no actuarial gains/losses i.e. no difference between the previous actuarial assumptions and what has actually occurred (e.g. employee turnover and mortality, discount rates, benefit levels, increases in salary etc.) and no change in any of the actuarial assumptions throughout all years.

27. In practice, however, entities will often be dealing with more complex situations, such as (a) groups of employees where an entity can only form expectations of who will be entitled to LSP and at which points in time on a cohort basis; (b) the discount rate for the LSP obligation and the return on deemed employee contributions or reimbursement assets may not be the same; and (c) changes in actuarial assumptions and experience adjustments.

28. In light of the above, entities should consider the following when applying this guidance:
    (a) Estimate the number of employees that will earn the right to LSP and the timing of the LSP payments, with corresponding adjustments to the deemed employee contributions or the reimbursement asset;
    (b) Beware that the market yields on high quality corporate bonds by reference to which the discount rate for the LSP obligation is determined (HKAS 19.83) may not be the same as the return on deemed employee contributions or the reimbursement asset; and
    (c) Any actuarial gains/losses arising from changes in actuarial assumptions and experience adjustments as well as the difference between the projected interest income and the actual return of the reimbursement asset would be recognised in OCI.

29. Furthermore, the MPFSO and the EO stipulate that the accrued benefits derived from an employer's MPF contributions for an employee may only be used to offset *that* employee's LSP. The impact of this on both approaches is that the projected total accrued benefits derived from deemed employee contributions (approach 1) and the reimbursement asset (approach 2) must not exceed the portion of *that* employee's LSP obligation that is eligible for offset. From a practical point of view, entities should consider whether they can reasonably estimate the relevant amounts under the respective approaches for each employee, e.g. by obtaining sufficient appropriate information to determine the individual employee's offsetable accrued benefits in his MPF account to the extent material.[10]

V. Selection of accounting policy and transition

30. Prior to the Abolition, the net liability for the LSP may have been immaterial for many entities due to the offsetting mechanism, so there had not been much related disclosure in terms of accounting policy, presentation in the statement of financial position, the amounts recognised in the statement of comprehensive income, or the type of post-employment employee benefits in terms of which they are accounted for.

31. There is no specific guidance in HKAS 19 on how to account for the offsetting mechanism and the FRSC considers the related issues highly complex. This guidance provides new

[10] See section 6 of TechWatch 161 issued in March 2016 for a discussion of the limits imposed by the Personal Data (Privacy) Ordinance on an employer's access to an employee's MPF account data.

information to help entities assess their situation and account for the impact arising from the Abolition. Consistent with the principles in paragraph 8.6 of the *IASB and IFRS Interpretations Committee Due Process Handbook* (IASB and IFRS IC DPH), the explanatory material in this guidance may provide additional insights that might change an entity's understanding of the principles and requirements in HKFRS Standards and, because of this, an entity might determine that it needs to change its related accounting policies.

32. As a result of this guidance, therefore, entities have to determine whether their accounting policies for (i) the offsetting mechanism in general and (ii) the impact arising from the enactment of the Amendment Ordinance in particular remain appropriate. In making this assessment, entities should bear in mind that a voluntary change in accounting policy is permitted only if the change results in the financial statements providing reliable and more relevant information about the effects of the offsetting mechanism and the Abolition (HKAS 8.14(b)). Any resulting change in accounting policy should be applied retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the impracticability constraint in HKAS 8.50-53.

33. In the article *Agenda decisions—time is of the essence,* Sue Lloyd, former Vice-Chair of the IASB and former Chair of the IFRS Interpretations Committee, explained the considerations about agenda decisions as a form of explanatory materials and stated that "*… the Board has acknowledged that agenda decisions often provide new information that should be seen as helpful and persuasive (for example, by integrating requirements in the Standards with material in the Basis for Conclusions and Illustrative Examples). This means that a company does not have an error simply because its application of IFRS Standards was inconsistent with an agenda decision."*

VI. Disclosures

34. Regardless of which accounting policy is adopted by an entity for the LSP obligation and the associated offsetting mechanism, it should provide details thereof in accordance with paragraph 117 of HKAS 1 *Presentation of Financial Statements* if the related accounting policy information is material. An entity should also provide relevant disclosures in relation to a defined contribution plan (e.g. MPF) and a defined benefit plan (e.g. LSP) as required by HKAS 19.53-54 and 135-152 respectively to the extent material. In particular, entities should provide a description of the plan amendment as required by HKAS 19.139(c) in the year of enactment of the Amendment Ordinance.

35. Given that the crux of the issue lies in the interaction between MPF and LSP and the two approaches described in this guidance characterise the interaction differently for accounting purposes, entities should provide clear disclosures that are consistent with the accounting characterisation to the extent the information is material. Below are some points for consideration:

    (a) **Approach 1:** the interaction is reflected through the recognition of a negative service cost. Disclosures should therefore be made about (inter alia) the basis for such a characterisation, how the negative service cost is estimated, projected and attributed to periods of service, the actuarial assumptions involved, the cap to which the negative service cost is subject and how its measurement is subsumed within the LSP liability.

    Employer MPF contributions are recognised as an expense when incurred in terms of the basic principles of a defined contribution plan under this approach and are subject to the disclosure requirements of HKAS 19.53 and 54.

(b) **Approach 2:** the interaction is reflected through the recognition of a reimbursement asset. Disclosures should therefore be made about (inter alia) the basis for such a characterisation, the discount rate for the purposes of recognising interest income, how the fair value of the reimbursement asset is determined and the cap to which it is subject.

In addition, entities should disclose a reconciliation from the opening balance to the closing balance of the reimbursement asset in accordance with HKAS 19.140(b) and 141, as well as describe the relationship between the reimbursement right and the related obligation (HKAS 19.140(b)).

With regard to those employer MPF contributions that are not accounted for as an expense, the disclosure requirement of HKAS 19.53 would not be applicable. Nevertheless, entities would still need to disclose information about employer MPF contributions for key management personnel in accordance with HKAS 19.54.

36. In the event that an entity has changed its accounting policy with respect to the LSP obligation and the offsetting mechanism, it should provide the following disclosures in accordance with HKAS 8.29 with regard to a voluntary change in accounting policy:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
(i) for each financial statement line item affected; and
(ii) if HKAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

VII. Time to implement the guidance

37. As mentioned above, the FRSC acknowledges that given the highly complex nature of this issue and the lack of specific guidance in extant literature, an entity should be entitled to *sufficient time* to determine its accounting policy and implement any necessary policy change (for example, an entity may need to obtain new or more detailed information, formulate additional estimates or adapt its systems to implement a change). This is by analogy to the time allowed for entities to implement changes resulting from agenda

decisions published by the IFRS Interpretations Committee as set out in paragraph 8.6 of the IASB and IFRS IC DPH[11].

38. Determining how much time is sufficient to implement the change is a matter of judgement that depends on an entity's particular facts and circumstances. There is no specific time frame for implementing the change. However, entities are expected to consider this guidance and implement any necessary accounting policy change *on a timely basis*.

VIII. Further update to the guidance

39. The FRSC will consider the need for further guidance in relation to the Government Subsidy in due course (paragraph 7). The Government Subsidy does not yet meet the recognition criteria of any element of the financial statements based on an assessment of relevant facts and circumstances at the time of writing. When preparing their financial statements, entities should consider the latest developments with respect to the Government Subsidy and evaluate the impact of those developments on their financial statements. This includes the need to provide any relevant subsequent event disclosures about the Government Subsidy based on relevant facts and circumstances up to the time the financial statements are authorised for issue.

[11] Paragraph 8.6 of the IASB and IFRS IC DPH states that "… It is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, an entity may need to obtain new information or adapt its systems to implement a change)."

Appendix 1 - Summary of the offsetting mechanism and the changes introduced by the Amendment Ordinance

The offsetting mechanism

1. HK employers are obliged by law to:
   (a) make monthly contributions to a MPF for their employees to provide for the latter's retirement benefits; and
   (b) make a LSP to employees when they are dismissed by the employer (conditions apply), resign at age 65 or above or on grounds of ill health, or die.

2. An employer's mandatory MPF contribution is calculated as: 5% × employees' relevant income

   The contribution is capped at HK$1,500/employee/month.

3. The LSP is calculated as: Last month's salary × 2/3 × no. of years of service

   Last month salary is capped at HK$22,500. The amount of LSP payable per employee is capped at HK$390,000.

4. The EO and the MPFSO provide that an employer can offset the accrued benefits derived from an employer's MPF contributions against the LSP.

   For example, assume an entity dismisses an employee and needs to pay him a LSP of HK$100 applying the formula in point 3 above (i.e. before applying the offset). Assume further that the accrued benefits from the employer's MPF contributions to date for this employee is HK$75. The employer only needs to pay the employee a LSP of HK$25 and the employee can claim the remaining HK$75 from the MPF trustee. Alternatively, the employer can pay the employee the full LSP of HK$100 and claim a reimbursement of HK$75 from the MPF trustee. No top-up needs to be made to the MPF trustee after the 'withdrawal' of the HK$75 used as part-payment for the LSP.

Changes introduced by the Amendment Ordinance

5. The Amendment Ordinance introduces the following two key changes:

	Pre-amendment	**Post-amendment**
1st change The amount of accrued benefits derived from employer MPF contribution that may be used to offset LSP	Accrued benefits derived from both mandatory and voluntary contributions made by the employer before, on and after the Transition Date may be used to offset LSP	Accrued benefits derived from mandatory employer contributions may not be used to offset post-transition LSP *Note:* • *accrued benefits derived from mandatory employer contributions made pre-, on or post-transition may continue to be used to offset pre-transition LSP* • *accrued benefits derived from voluntary employer contributions and gratuities made pre-, on or post-transition may continue to be used to offset pre- and post-transition LSP*
2nd change Calculation basis for last month's salary	Last month's salary immediately before termination of employment	Pre-transition LSP: last month's salary immediately preceding the Transition Date Post-transition LSP: last month's salary immediately before termination of employment

Appendix 2 - Illustration of approach 1 (before taking into account the impact of the Amendment Ordinance)

Please note that the numbers presented throughout this appendix have been rounded, and thus may not add up precisely to the totals provided.

										Year of enactment			Transition year (transition date: 1 May 2025)													
			Apr-16	Apr-17	Apr-18	Apr-19	Apr-20	Apr-21	Apr-22	Apr-23	Apr-24	Apr-25	Apr-26	Apr-27	Apr-28	Apr-29	Apr-30	Apr-31	Apr-32	Apr-33	Apr-34	Apr-35				
Year			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20				
	Salary increase /discount rate																									
Annual salary	4%	a	120,000	124,800	129,792	134,984	140,383	145,998	151,838	157,912	164,228	170,797	177,629	184,734	192,124	199,809	207,801	216,113	224,758	233,748	243,098	252,822				
Project benefit at retirement (last monthly salary x year of service x 2/3)																								**280,913**	A	(Projected LSP obligation to be paid after 20 years services) = $252,822/12*20*2/3
Project benefit at retirement attributed to year of service		b = A/20	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046				
Gross benefit (LSP)																										
Opening obligation		c	-	8,010	16,501	25,494	35,011	45,077	55,715	66,951	78,811	91,322	104,513	118,413	133,053	148,465	164,682	181,739	199,670	218,514	238,309	259,095				
Interest	3%	d = c*3%	-	240	495	765	1,050	1,352	1,671	2,009	2,364	2,740	3,135	3,552	3,992	4,454	4,940	5,452	5,990	6,555	7,149	7,773				
Current service cost		e = b/(1+3%)^h	8,010	8,250	8,498	8,753	9,015	9,286	9,564	9,851	10,147	10,451	10,765	11,088	11,420	11,763	12,116	12,479	12,854	13,239	13,637	14,046	215,233			(Current service costs without offsetting the MPF contributed by employer)
Closing obligation		f	8,010	16,501	25,494	35,011	45,077	55,715	66,951	78,811	91,322	104,513	118,413	133,053	148,465	164,682	181,739	199,670	218,514	238,309	259,095	**280,913**				
Deemed contribution from employee																										
5% contribution to MPF by employer		g = a*5%	6,000	6,240	6,490	6,749	7,019	7,300	7,592	7,896	8,211	8,540	8,881	9,237	9,606	9,990	10,390	10,806	11,238	11,687	12,155	12,641				
No. of year of investment of the 5% contribution to MPF		h	19	18	17	16	15	14	13	12	11	10	9	8	7	6	5	4	3	2	1	-				
Contribution plus interest to Year 20	3%	i = g*(1+3%)^h	10,521	10,623	10,726	10,830	10,936	11,042	11,149	11,257	11,367	11,477	11,588	11,701	11,814	11,929	12,045	12,162	12,280	12,399	12,520	12,641		231,007	B	(Projected amount to be offset against the LSP obligation, being the sum of 'Contribution plus interest' from Y1 to Y20)
Attributed contribution		j = B/20	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550	11,550				
																								49,906		(Projected amount of the net LSP liability with offset of MPF at the end of 20 years)
Attributed contributions ('discounted')																										
Opening		k		6,587	13,569	20,964	28,791	37,069	45,817	55,057	64,810	75,098	85,946	97,376	109,416	122,089	135,425	149,452	164,197	179,694	195,972	213,065				
Interest	3%	l = k*3%		198	407	629	864	1,112	1,375	1,652	1,944	2,253	2,578	2,921	3,282	3,663	4,063	4,484	4,926	5,391	5,879	6,392				
Negative benefit		m = j/(1+3%)^h	6,587	6,785	6,988	7,198	7,414	7,636	7,865	8,101	8,344	8,595	8,852	9,118	9,391	9,673	9,963	10,262	10,570	10,887	11,214	11,550	176,995			(Negative service cost used to 'offset' the gross LSP benefit)
Closing		n	6,587	13,569	20,964	28,791	37,069	45,817	55,057	64,810	75,098	85,946	97,376	109,416	122,089	135,425	149,452	164,197	179,694	195,972	213,065	**231,007**				
																							38,238			(Net current service cost with consideration of the offset of MPF)
Liability to be recorded by the employer								X																		
Opening LSP obligation		o		1,423	2,931	4,529	6,220	8,008	9,898	11,894	14,001	16,224	18,567	21,037	23,638	26,376	29,257	32,287	35,473	38,820	42,337	46,030				
Interest	3%	p = o*3%		43	88	136	187	240	297	357	420	487	557	631	709	791	878	969	1,064	1,165	1,270	1,381				
Net current service costs - current service cost less negative benefit		q = e-m	1,423	1,466	1,510	1,555	1,602	1,650	1,699	1,750	1,803	1,857	1,912	1,970	2,029	2,090	2,152	2,217	2,284	2,352	2,423	2,495				
Closing LSP obligation		r	1,423	2,931	4,529	6,220	8,008	9,898	11,894	14,001	16,224	18,567	21,037	23,638	26,376	29,257	32,287	35,473	38,820	42,337	46,030	**49,906**				

Appendix 3 - Illustration of approach 1 (after taking into account the impact of the Amendment Ordinance)

Please note that the numbers presented throughout this appendix have been rounded, and thus may not add up precisely to the totals provided.

			Apr-16	Apr-17	Apr-18	Apr-19	Apr-20	Apr-21	Apr-22	Year of enactment Apr-23	Apr-24	Apr-25	Transition year (transition date: 1 May 2025) Apr-26	Apr-27	Apr-28	Apr-29	Apr-30	Apr-31	Apr-32	Apr-33	Apr-34	Apr-35			
Year			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20			
	Salary increase /discount rate																								
Annual salary	4%	a	120,000	124,800	129,792	134,984	140,383	145,998	151,838	157,912	164,228	170,797	177,629	184,734	192,124	199,809	207,801	216,113	224,758	233,748	243,098	252,822		**94,887**	LSP accrued before the Transition Date (Based on last monthly wages before Transition Date x year of service x 2/3)
Project benefit at retirement (last monthly salary x year of service x 2/3)																								**235,344** A	(Projected LSP obligation to be paid after 20 years of services: - Pre-transition LSP: based on the wages for April 2025; - Post-transition LSP: based on last monthly wages before termination) = $170,797/12*10*2/3+$252,822/12*10*2/3
Project benefit at retirement attributed to year of service		b = A/20	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767			
Gross benefit (LSP)																									
Opening obligation		c		6,711	13,824	21,358	29,332	37,765	46,677	56,090	66,026	76,508	87,559	99,204	111,470	124,382	137,968	152,257	167,280	183,067	199,651	217,065			
Interest	3%	d = c*3%		201	415	641	880	1,133	1,400	1,683	1,981	2,295	2,627	2,976	3,344	3,731	4,139	4,568	5,018	5,492	5,990	6,512			
Current service cost		e = b/(1+3%)^h	6,711	6,912	7,119	7,333	7,553	7,780	8,013	8,253	8,501	8,756	9,019	9,289	9,568	9,855	10,150	10,455	10,769	11,092	11,424	11,767	180,318		(Current service costs without offsetting the MPF contributed by employer)
Closing obligation		f	6,711	13,824	21,358	29,332	37,765	46,677	56,090	66,026	76,508	87,559	99,204	111,470	124,382	137,968	152,257	167,280	183,067	199,651	217,065	**235,344**			
Deemed contribution from employee																									
5% contribution to MPF by employer		g = a*5%	6,000	6,240	6,490	6,749	7,019	7,300	**7,592**	**7,896**	8,211	8,540	8,881	9,237	9,606	9,990	10,390	10,806	11,238	11,687	12,155	12,641			
No. of year of investment of the 5% contribution to MPF		h	19	18	17	16	15	14	13	12	11	10	9	8	7	6	5	4	3	2	1	-			(Projected amount to be offset against the LSP obligation) As a result of the Amendment Ordinance, the accrued benefits derived from mandatory employer MPF contributions may only be used to offset pre-transition LSP (calculated based on the last monthly wages before Transition Date x year of service x 2/3), i.e. $94,887 in this example. Therefore, the accrued benefits is capped at $7,803 in 2024 (being $94,887 less the forecast cumulative amount from previous years) and no further deemed employee contribution is projected thereafter.
Contribution plus interest	3%	i = g*(1+3%)^h (until FY2023; see remarks in last column for FY2024 onwards)	10,521	10,623	10,726	10,830	10,936	11,042	11,149	11,257	7,803	-	-	-	-	-	-	-	-	-	-	-		94,887 B	
Attributed contribution		j = B/20	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744	4,744			
																								140,457	(Projected amount of the net LSP liability with offset of MPF at the end of 20 years)
Attributed contributions ('discounted')																									
Opening		k		2,706	5,574	8,611	11,826	15,226	18,820	22,615	26,621	30,847	35,303	39,998	44,943	50,149	55,627	61,388	67,445	73,810	80,496	87,518			
Interest	3%	l = k*3%		81	167	258	355	457	565	678	799	925	1,059	1,200	1,348	1,504	1,669	1,842	2,023	2,214	2,415	2,626			
Negative benefit		m = j/(1+3%)^h	2,706	2,787	2,870	2,957	3,045	3,137	3,231	3,328	3,427	3,530	3,636	3,745	3,858	3,973	4,093	4,215	4,342	4,472	4,606	4,744	72,702		(Negative service cost used to 'offset' the gross LSP benefit)
Closing		n	2,706	5,574	8,611	11,826	15,226	18,820	22,615	26,621	30,847	35,303	39,998	44,943	50,149	55,627	61,388	67,445	73,810	80,496	87,518	**94,887**			
																							107,616		(Net current service cost with consideration of the offset of MPF)
Liability to be recorded by the employer										Y															
Opening LSP obligation		o		4,005	8,250	12,747	17,506	22,538	27,858	33,475	39,405	45,661	52,256	59,207	66,527	74,233	82,341	90,869	99,835	109,257	119,154	129,547			
Interest	3%	p = o*3%		120	248	382	525	676	836	1,004	1,182	1,370	1,568	1,776	1,996	2,227	2,470	2,726	2,995	3,278	3,575	3,886			
Net current service costs - current service cost less negative benefit		q = e-m	4,005	4,125	4,249	4,376	4,508	4,643	4,782	4,926	5,073	5,226	5,382	5,544	5,710	5,882	6,058	6,240	6,427	6,620	6,818	7,023			
Closing LSP obligation		r	4,005	8,250	12,747	17,506	22,538	27,858	33,475	39,405	45,661	52,256	59,207	66,527	74,233	82,341	90,869	99,835	109,257	119,154	129,547	**140,457**			

Appendix 4 - Illustration of approach 2 (before taking into account the impact of the Amendment Ordinance)

Please note that the numbers presented throughout this appendix have been rounded, and thus may not add up precisely to the totals provided.

										Year of enactment			Transition year (transition date: 1 May 2025)											
			Apr-16	Apr-17	Apr-18	Apr-19	Apr-20	Apr-21	Apr-22	Apr-23	Apr-24	Apr-25	Apr-26	Apr-27	Apr-28	Apr-29	Apr-30	Apr-31	Apr-32	Apr-33	Apr-34	Apr-35		
Year			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20		
	Salary increase /discount rate																							
Annual salary	4%	a	120,000	124,800	129,792	134,984	140,383	145,998	151,838	157,912	164,228	170,797	177,629	184,734	192,124	199,809	207,801	216,113	224,758	233,748	243,098	252,822		
Project benefit at retirement (last monthly salary x year of service x 2/3)																							**280,913** A	(Projected LSP obligation to be paid after 20 years services) = $252,822/12*20*2/3
Project benefit at retirement attributed to year of service		b = A/20	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046	14,046		
Gross benefit (LSP)										P														
Opening obligation		c		8,010	16,501	25,494	35,011	45,077	55,715	66,951	78,811	91,322	104,513	118,413	133,053	148,465	164,682	181,739	199,670	218,514	238,309	259,095		
Interest expense	3%	d = c*3%		240	495	765	1,050	1,352	1,671	2,009	2,364	2,740	3,135	3,552	3,992	4,454	4,940	5,452	5,990	6,555	7,149	7,773		
Current service cost		e = b/(1+3%)^remaining years of service	8,010	8,250	8,498	8,753	9,015	9,286	9,564	9,851	10,147	10,451	10,765	11,088	11,420	11,763	12,116	12,479	12,854	13,239	13,637	14,046	215,233	(Current service costs without offsetting the employer MPF contribution)
Closing obligation		f	8,010	16,501	25,494	35,011	45,077	55,715	66,951	78,811	91,322	104,513	118,413	133,053	148,465	164,682	181,739	199,670	218,514	238,309	259,095	**280,913**		
Fair value of reimbursement asset																								
Opening		g		6,000	12,420	19,282	26,610	34,427	42,760	51,635	61,079	71,123	81,797	93,132	105,163	117,924	131,452	145,786	160,965	177,032	194,030	212,006		
Interest income	3%	h = g*3%		180	373	578	798	1,033	1,283	1,549	1,832	2,134	2,454	2,794	3,155	3,538	3,944	4,374	4,829	5,311	5,821	6,360		
Employer contribution		I = a*5%	6,000	6,240	6,490	6,749	7,019	7,300	7,592	7,896	8,211	8,540	8,881	9,237	9,606	9,990	10,390	10,806	11,238	11,687	12,155	12,641		(Pre-funding of LSP through employer MPF contribution)
Closing		j	6,000	12,420	19,282	26,610	34,427	42,760	51,635	61,079	71,123	81,797	93,132	105,163	117,924	131,452	145,786	160,965	177,032	194,030	212,006	**231,007**		
Net defined benefit liability net of reimbursement asset (for illustrative purposes only; gross presentation on statement of financial position)																								
Present value of defined benefit obligation and net defined benefit liability			8,010	16,501	25,494	35,011	45,077	55,715	66,951	78,811	91,322	104,513	118,413	133,053	148,465	164,682	181,739	199,670	218,514	238,309	259,095	280,913		
Fair value of reimbursement asset			(6,000)	(12,420)	(19,282)	(26,610)	(34,427)	(42,760)	(51,635)	(61,079)	(71,123)	(81,797)	(93,132)	(105,163)	(117,924)	(131,452)	(145,786)	(160,965)	(177,032)	(194,030)	(212,006)	(231,007)		
Net			2,010	4,081	6,211	8,401	10,650	12,955	15,316	17,731	20,199	22,716	25,281	27,890	30,541	33,230	35,953	38,705	41,482	44,279	47,089	**49,906**		

Appendix 5 - Illustration of approach 2 (after taking into account the impact of the Amendment Ordinance)

Please note that the numbers presented throughout this appendix have been rounded, and thus may not add up precisely to the totals provided.

Year	Salary increase /discount rate		Apr-16 1	Apr-17 2	Apr-18 3	Apr-19 4	Apr-20 5	Apr-21 6	Apr-22 7	Year of enactment Apr-23 8	Apr-24 9	Apr-25 10
Annual salary	4%	a	120,000	124,800	129,792	134,984	140,383	145,998	151,838	157,912	164,228	170,797
Project benefit at retirement (last monthly salary x year of service x 2/3)												
Project benefit at retirement attributed to year of service		b = A/20	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767
Gross benefit (LSP)										Q		
Opening obligation		c		6,711	13,824	21,358	29,332	37,765	46,677	56,090	66,026	76,508
Interest	3%	d = c*3%		201	415	641	880	1,133	1,400	1,683	1,981	2,295
Current service cost		e = b/(1+3%)^remaining years of service	6,711	6,912	7,119	7,333	7,553	7,780	8,013	8,253	8,501	8,756
Closing obligation		f	6,711	13,824	21,358	29,332	37,765	46,677	56,090	66,026	76,508	87,559
Fair value of reimbursement asset												
Opening		g		6,000	12,420	19,282	26,610	34,427	42,760	51,635	61,079	71,123
Interest income	3%	h = g*3% (until FY 2026; see note from FY2027 onwards)		180	373	578	798	1,033	1,283	1,549	1,832	2,134
Employer contribution		I = a*5% (until FY 2026; see note from FY2027 onwards)	6,000	6,240	6,490	6,749	7,019	7,299.92	7,592	7,896	8,211	8,540
Closing		j	6,000	12,420	19,282	26,610	34,427	42,760	51,635	61,079	71,123	81,797
Net defined benefit liability net of reimbursement asset (for illustrative purposes only; gross presentation on statement of financial position)												
Present value of defined benefit obligation and net defined benefit liability			6,711	13,824	21,358	29,332	37,765	46,677	56,090	66,026	76,508	87,559
Fair value of reimbursement asset			(6,000)	(12,420)	(19,282)	(26,610)	(34,427)	(42,760)	(51,635)	(61,079)	(71,123)	(81,797)
Net			711	1,404	2,076	2,722	3,337	3,917	4,456	4,947	5,385	5,762

Year	Transition year (transition date: 1 May 2025) Apr-26 11	Apr-27 12	Apr-28 13	Apr-29 14	Apr-30 15	Apr-31 16	Apr-32 17	Apr-33 18	Apr-34 19	Apr-35 20			
Annual salary	177,629	184,734	192,124	199,809	207,801	216,113	224,758	233,748	243,098	252,822		94,887	LSP accrued before the Transition Date (Based on last monthly wages before Transition Date x year of service x 2/3)
Project benefit at retirement (last monthly salary x year of service x 2/3)												235,344 A	(Projected LSP obligation to be paid after 20 years of services: - Pre-transition LSP: based on the wages for April 2025; - Post-transition LSP: based on last monthly wages before termination)
Project benefit at retirement attributed to year of service	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767	11,767			= $170,797/12*10*2/3+$252,822/12*10*2/3
Gross benefit (LSP)													
Opening obligation	87,559	99,204	111,470	124,382	137,968	152,257	167,280	183,067	199,651	217,065			
Interest	2,627	2,976	3,344	3,731	4,139	4,568	5,018	5,492	5,990	6,512			
Current service cost	9,019	9,289	9,568	9,855	10,150	10,455	10,769	11,092	11,424	11,767	180,318		(Current service costs without offsetting the employer MPF contribution)
Closing obligation	99,204	111,470	124,382	137,968	152,257	167,280	183,067	199,651	217,065	**235,344**			
Fair value of reimbursement asset													
Opening	81,797	93,132	94,887	94,887	94,887	94,887	94,887	94,887	94,887	94,887			
Interest income	2,454	1,755	-	-	-	-	-	-	-	-			
Employer contribution	8,881	-	-	-	-	-	-	-	-	-			(Pre-funding of LSP through employer MPF contribution)
Closing	93,132	94,887	94,887	94,887	94,887	94,887	94,887	94,887	94,887	**94,887**			
		Note											
Net defined benefit liability net of reimbursement asset (for illustrative purposes only; gross presentation on statement of financial position)													
Present value of defined benefit obligation and net defined benefit liability	99,204	111,470	124,382	137,968	152,257	167,280	183,067	199,651	217,065	235,344			
Fair value of reimbursement asset	(93,132)	(94,887)	(94,887)	(94,887)	(94,887)	(94,887)	(94,887)	(94,887)	(94,887)	(94,887)			
Net	6,072	16,582	29,494	43,080	57,370	72,393	88,180	104,763	122,177	140,457			

Note: Accrued benefits from mandatory employer MPF contributions (i.e. principal plus interest) pre-, at- and post-transition date can be used to offset the pre-transition date LSP liability (i.e. $94,887 in this example).
The reimbursement asset is therefore capped at $94,887 and the interest income for FY2027 is capped at $1,755 (being $94,887 less the opening balance of the reimbursement asset).

In practice, there may be complexity in how to limit the FV of reimbursement asset to the pre-transition LSP liability given past MPF contributions continue to accrue interest (or incur losses) until the ultimate retirement date. This is especially the case when the return on the reimbursement assets could be negative. In other words, even if the FV of reimbursement asset has reached the pre-transition LSP threshold in a previous year, the fair value can drop in future years due to losses in the MPF fund. In this case, future employer MPF contributions will once again be eligible to form part of the reimbursement asset to fund the pre-transition LSP balance.

For the sake of simplicity, this example assumes no further interest accrual on the reimbursement asset after the $94,887 threshold has been reached. Mandatory employer MPF contributions after this date will be accounted for as a normal defined contribution plan, i.e. Dr expense; Cr bank.