

HKAS 26

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Hong Kong Accounting Standard 26

Accounting and Reporting by Retirement Benefit Plans



Hong Kong Institute of
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香港會計師公會

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Hong Kong Accounting Standard 26 *Accounting and Reporting by Retirement Benefit Plans* (HKAS 26) is set out in paragraphs 1-37. All the paragraphs have equal authority. HKAS 26 should be read in the context of the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Hong Kong Accounting Standard 26

Accounting and Reporting by Retirement Benefit Plans

Scope

1. **This Standard shall be applied in the financial statements of retirement benefit plans where such financial statements are prepared.**
2. Retirement benefit plans are sometimes referred to by various other names, such as 'pension schemes', 'superannuation schemes' or 'retirement benefit schemes'. This Standard regards a retirement benefit plan as a reporting entity separate from the employers of the participants in the plan. All other Hong Kong Financial Reporting Standards apply to the financial statements of retirement benefit plans to the extent that they are not superseded by this Standard.
3. This Standard deals with accounting and reporting by the plan to all participants as a group. It does not deal with reports to individual participants about their retirement benefit rights.
4. HKAS 19, Employee Benefits, is concerned with the determination of the cost of retirement benefits in the financial statements of employers having plans. Hence this Standard complements HKAS 19.
5. Retirement benefit plans may be defined contribution plans or defined benefit plans. Many require the creation of separate funds, which may or may not have separate legal identity and may or may not have trustees, to which contributions are made and from which retirement benefits are paid. This Standard applies regardless of whether such a fund is created and regardless of whether there are trustees.
6. Retirement benefit plans with assets invested with insurance companies are subject to the same accounting and funding requirements as privately invested arrangements. Accordingly, they are within the scope of this Standard unless the contract with the insurance company is in the name of a specified participant or a group of participants and the retirement benefit obligation is solely the responsibility of the insurance company.
7. This Standard does not deal with other forms of employment benefits such as employment termination indemnities, deferred compensation arrangements, long-service leave benefits, special early retirement or redundancy plans, health and welfare plans or bonus plans. Government social security type arrangements are also excluded from the scope of this Standard.
- 7A. The Appendix to this Standard sets out additional guidance on preparing financial statements of Mandatory Provident Fund Schemes and Occupational Retirement Schemes Ordinance Schemes.

Definitions

8. **The following terms are used in this Standard with the meanings specified:**

Retirement benefit plans are arrangements whereby an entity provides benefits for employees on or after termination of service (either in the form of an annual income or as a lump sum) when such benefits, or the contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the entity's practices.

Defined contribution plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon.

Defined benefit plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' earnings and/or years of service.

Funding is the transfer of assets to an entity (the fund) separate from the employer's entity to meet future obligations for the payment of retirement benefits.

For the purposes of this Standard the following terms are also used:

Participants are the members of a retirement benefit plan and others who are entitled to benefits under the plan.

Net assets available for benefits are the assets of a plan less liabilities other than the actuarial present value of promised retirement benefits.

Actuarial present value of promised retirement benefits is the present value of the expected payments by a retirement benefit plan to existing and past employees, attributable to the service already rendered.

Vested benefits are benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

9. Some retirement benefit plans have sponsors other than employers; this Standard also applies to the financial statements of such plans.
10. Most retirement benefit plans are based on formal agreements. Some plans are informal but have acquired a degree of obligation as a result of employers' established practices. While some plans permit employers to limit their obligations under the plans, it is usually difficult for an employer to cancel a plan if employees are to be retained. The same basis of accounting and reporting applies to an informal plan as to a formal plan.
11. Many retirement benefit plans provide for the establishment of separate funds into which contributions are made and out of which benefits are paid. Such funds may be administered by parties who act independently in managing fund assets. Those parties are called trustees in some countries. The term trustee is used in this Standard to describe such parties regardless of whether a trust has been formed.
12. Retirement benefit plans are normally described as either defined contribution plans or defined benefit plans, each having their own distinctive characteristics. Occasionally plans exist that contain characteristics of both. Such hybrid plans are considered to be defined benefit plans for the purposes of this Standard.

Defined Contribution Plans

13. **The financial statements of a defined contribution plan shall contain a statement of net assets available for benefits and a description of the funding policy.**
14. Under a defined contribution plan, the amount of a participant's future benefits is determined by the contributions paid by the employer, the participant, or both, and the operating efficiency and investment earnings of the fund. An employer's obligation is usually discharged by contributions to the fund. An actuary's advice is

not normally required although such advice is sometimes used to estimate future benefits that may be achievable based on present contributions and varying levels of future contributions and investment earnings.

15. The participants are interested in the activities of the plan because they directly affect the level of their future benefits. Participants are interested in knowing whether contributions have been received and proper control has been exercised to protect the rights of beneficiaries. An employer is interested in the efficient and fair operation of the plan.
16. The objective of reporting by a defined contribution plan is periodically to provide information about the plan and the performance of its investments. That objective is usually achieved by providing financial statements including the following:
 - (a) a description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;
 - (b) statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period; and
 - (c) a description of the investment policies.

Defined Benefit Plans

17. **The financial statements of a defined benefit plan shall contain either:**
 - (a) **a statement that shows:**
 - (i) **the net assets available for benefits;**
 - (ii) **the actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits; and**
 - (iii) **the resulting excess or deficit; or**
 - (b) **a statement of net assets available for benefits including either:**
 - (i) **a note disclosing the actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits; or**
 - (ii) **a reference to this information in an accompanying actuarial report.**

If an actuarial valuation has not been prepared at the date of the financial statements, the most recent valuation shall be used as a base and the date of the valuation disclosed.

18. **For the purposes of paragraph 17, the actuarial present value of promised retirement benefits shall be based on the benefits promised under the terms of the plan on service rendered to date using either current salary levels or projected salary levels with disclosure of the basis used. The effect of any changes in actuarial assumptions that have had a significant effect on the actuarial present value of promised retirement benefits shall also be disclosed.**

19. **The financial statements shall explain the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits.**
20. Under a defined benefit plan, the payment of promised retirement benefits depends on the financial position of the plan and the ability of contributors to make future contributions to the plan as well as the investment performance and operating efficiency of the plan.
21. A defined benefit plan needs the periodic advice of an actuary to assess the financial condition of the plan, review the assumptions and recommend future contribution levels.
22. The objective of reporting by a defined benefit plan is periodically to provide information about the financial resources and activities of the plan that is useful in assessing the relationships between the accumulation of resources and plan benefits over time. This objective is usually achieved by providing financial statements including the following:
- (a) a description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;
 - (b) statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period;
 - (c) actuarial information either as part of the statements or by way of a separate report; and
 - (d) a description of the investment policies.

Actuarial Present Value of Promised Retirement Benefits

23. The present value of the expected payments by a retirement benefit plan may be calculated and reported using current salary levels or projected salary levels up to the time of retirement of participants.
24. The reasons given for adopting a current salary approach include:
- (a) the actuarial present value of promised retirement benefits, being the sum of the amounts presently attributable to each participant in the plan, can be calculated more objectively than with projected salary levels because it involves fewer assumptions;
 - (b) increases in benefits attributable to a salary increase become an obligation of the plan at the time of the salary increase; and
 - (c) the amount of the actuarial present value of promised retirement benefits using current salary levels is generally more closely related to the amount payable in the event of termination or discontinuance of the plan.
25. Reasons given for adopting a projected salary approach include:
- (a) financial information should be prepared on a going concern basis, irrespective of the assumptions and estimates that must be made;
 - (b) under final pay plans, benefits are determined by reference to salaries at or near retirement date; hence salaries, contribution levels and rates of return must be projected; and

- (c) failure to incorporate salary projections, when most funding is based on salary projections, may result in the reporting of an apparent overfunding when the plan is not overfunded, or in reporting adequate funding when the plan is underfunded.
26. The actuarial present value of promised retirement benefits based on current salaries is disclosed in the financial statements of a plan to indicate the obligation for benefits earned to the date of the financial statements. The actuarial present value of promised retirement benefits based on projected salaries is disclosed to indicate the magnitude of the potential obligation on a going concern basis which is generally the basis for funding. In addition to disclosure of the actuarial present value of promised retirement benefits, sufficient explanation may need to be given so as to indicate clearly the context in which the actuarial present value of promised retirement benefits should be read. Such explanation may be in the form of information about the adequacy of the planned future funding and of the funding policy based on salary projections. This may be included in the financial statements or in the actuary's report.

Frequency of Actuarial Valuations

27. In many countries, actuarial valuations are not obtained more frequently than every three years. If an actuarial valuation has not been prepared at the date of the financial statements, the most recent valuation is used as a base and the date of the valuation disclosed.

Financial Statement Content

28. For defined benefit plans, information is presented in one of the following formats which reflect different practices in the disclosure and presentation of actuarial information:
- (a) a statement is included in the financial statements that shows the net assets available for benefits, the actuarial present value of promised retirement benefits, and the resulting excess or deficit. The financial statements of the plan also contain statements of changes in net assets available for benefits and changes in the actuarial present value of promised retirement benefits. The financial statements may be accompanied by a separate actuary's report supporting the actuarial present value of promised retirement benefits;
 - (b) financial statements that include a statement of net assets available for benefits and a statement of changes in net assets available for benefits. The actuarial present value of promised retirement benefits is disclosed in a note to the statements. The financial statements may also be accompanied by a report from an actuary supporting the actuarial present value of promised retirement benefits; and
 - (c) financial statements that include a statement of net assets available for benefits and a statement of changes in net assets available for benefits with the actuarial present value of promised retirement benefits contained in a separate actuarial report.

In each format a trustees' report in the nature of a management or directors' report and an investment report may also accompany the financial statements.

29. Those in favour of the formats described in paragraphs 28(a) and 28(b) believe that the quantification of promised retirement benefits and other information provided under those approaches help users to assess the current status of the plan and the likelihood of the plan's obligations being met. They also believe that financial statements should be complete in themselves and not rely on accompanying

statements. However, some believe that the format described in paragraph 28(a) could give the impression that a liability exists, whereas the actuarial present value of promised retirement benefits does not in their opinion have all the characteristics of a liability.

30. Those who favour the format described in paragraph 28(c) believe that the actuarial present value of promised retirement benefits should not be included in a statement of net assets available for benefits as in the format described in paragraph 28(a) or even be disclosed in a note as in 28(b), because it will be compared directly with plan assets and such a comparison may not be valid. They contend that actuaries do not necessarily compare actuarial present value of promised retirement benefits with market values of investments but may instead assess the present value of cash flows expected from the investments. Therefore, those in favour of this format believe that such a comparison is unlikely to reflect the actuary's overall assessment of the plan and that it may be misunderstood. Also, some believe that, regardless of whether quantified, the information about promised retirement benefits should be contained solely in the separate actuarial report where a proper explanation can be provided.
31. This Standard accepts the views in favour of permitting disclosure of the information concerning promised retirement benefits in a separate actuarial report. It rejects arguments against the quantification of the actuarial present value of promised retirement benefits. Accordingly, the formats described in paragraphs 28(a) and 28(b) are considered acceptable under this Standard, as is the format described in paragraph 28(c) so long as the financial statements contain a reference to, and are accompanied by, an actuarial report that includes the actuarial present value of promised retirement benefits.

All Plans

Valuation of Plan Assets

32. **Retirement benefit plan investments shall be carried at fair value. In the case of marketable securities fair value is market value. Where plan investments are held for which an estimate of fair value is not possible disclosure shall be made of the reason why fair value is not used.**
33. In the case of marketable securities fair value is usually market value because this is considered the most useful measure of the securities at the report date and of the investment performance for the period. Those securities that have a fixed redemption value and that have been acquired to match the obligations of the plan, or specific parts thereof, may be carried at amounts based on their ultimate redemption value assuming a constant rate of return to maturity. Where plan investments are held for which an estimate of fair value is not possible, such as total ownership of an entity, disclosure is made of the reason why fair value is not used. To the extent that investments are carried at amounts other than market value or fair value, fair value is generally also disclosed. Assets used in the operations of the fund are accounted for in accordance with the applicable Hong Kong Financial Reporting Standards.

Disclosure

34. **The financial statements of a retirement benefit plan, whether defined benefit or defined contribution, shall also contain the following information:**
- (a) **a statement of changes in net assets available for benefits;**
 - (b) **a summary of significant accounting policies; and**

(c) a description of the plan and the effect of any changes in the plan during the period.

35. Financial statements provided by retirement benefit plans include the following, if applicable:
- (a) a statement of net assets available for benefits disclosing:
 - (i) assets at the end of the period suitably classified;
 - (ii) the basis of valuation of assets;
 - (iii) details of any single investment exceeding either 5% of the net assets available for benefits or 5% of any class or type of security;
 - (iv) details of any investment in the employer; and
 - (v) liabilities other than the actuarial present value of promised retirement benefits;
 - (b) a statement of changes in net assets available for benefits showing the following:
 - (i) employer contributions;
 - (ii) employee contributions;
 - (iii) investment income such as interest and dividends;
 - (iv) other income;
 - (v) benefits paid or payable (analysed, for example, as retirement, death and disability benefits, and lump sum payments);
 - (vi) administrative expenses;
 - (vii) other expenses;
 - (viii) taxes on income;
 - (ix) profits and losses on disposal of investments and changes in value of investments; and
 - (x) transfers from and to other plans;
 - (c) a description of the funding policy;
 - (d) for defined benefit plans, the actuarial present value of promised retirement benefits (which may distinguish between vested benefits and non-vested benefits) based on the benefits promised under the terms of the plan, on service rendered to date and using either current salary levels or projected salary levels; this information may be included in an accompanying actuarial report to be read in conjunction with the related financial statements; and
 - (e) for defined benefit plans, a description of the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits.

36. The report of a retirement benefit plan contains a description of the plan, either as part of the financial statements or in a separate report. It may contain the following:
- (a) the names of the employers and the employee groups covered;
 - (b) the number of participants receiving benefits and the number of other participants, classified as appropriate;
 - (c) the type of plan - defined contribution or defined benefit;
 - (d) a note as to whether participants contribute to the plan;
 - (e) a description of the retirement benefits promised to participants;
 - (f) a description of any plan termination terms; and
 - (g) changes in items (a) to (f) during the period covered by the report.

It is not uncommon to refer to other documents that are readily available to users and in which the plan is described, and to include only information on subsequent changes.

Effective Date

37. The accounting practices set out in this Standard should be regarded as standard in respect of financial statements relating to periods beginning on or after 1 January 2005.

Appendix A

Guidance on Preparing Financial Statements of Mandatory Provident Fund Schemes and Occupational Retirement Schemes Ordinance Schemes

This guidance accompanies, but is not part of, HKAS 26.

Part 1 – Introduction

Objective

1. This Appendix sets out additional guidance on preparing financial statements of Mandatory Provident Fund Schemes (“MPF schemes”) and Occupational Retirement Schemes Ordinance Schemes (“ORSO schemes”) (hereafter collectively referred to as “schemes”). This Appendix is based on the Mandatory Provident Fund Schemes Ordinance (“MPFSO”) and the Occupational Retirement Schemes Ordinance (“ORSO”) in effect as at 31 December 2003.
2. The MPFSO contains numerous specific disclosure requirements and the preparers of financial statements of schemes registered under the MPFSO would need to refer to the detailed disclosure requirements contained therein.
3. To be of value to the users, the information for schemes should be provided on a timely basis. MPF schemes and ORSO schemes are required to submit their audited financial statements to the Mandatory Provident Fund Schemes Authority (“MPFA”) not later than six months after the financial year-end.

Form and context in which the financial statements of a MPF scheme or an ORSO scheme appear

4. It is common for the financial statements of a MPF scheme or an ORSO scheme to be presented as part of an annual report that provides additional information about the scheme.
5. The form and context in which the financial statements appear can have a significant effect on the overall message conveyed to the users. It is therefore important that where an annual report is prepared, the separate components of the report are consistent with each other and do not omit any information which could affect the view given by the annual report as a whole. For example, the review of the financial development of the scheme in the trustees’/administrator’s report would need to be both a fair review and consistent with the financial statements.
6. When preparing scheme financial statements one would have to consider the contents of the remainder of the annual report in order to ensure that the financial statements submitted to members, employers and the MPFA are not misleading in form or context.

Types of schemes

7. Schemes are normally described as either defined contribution schemes or defined benefit schemes, each having their own distinctive characteristics. Occasionally schemes exist that contain characteristics of both. Such hybrid schemes are considered to be defined benefit schemes for the purposes of this Appendix. A MPF scheme can only be a defined contribution scheme. An ORSO scheme, however, may be either a defined contribution scheme or a defined benefit scheme.

Scheme arrangements

8. There are many different types of scheme arrangements. It is particularly important to establish the precise arrangements in effect when drawing up the financial statements.
9. A scheme may be either “governed by a trust” or “the subject of or regulated by an insurance arrangement”. An “insurance arrangement” is, in effect, a contract with an authorised insurer in respect of a scheme (see also paragraphs 12 and 13 below). Schemes, which are the subject of or regulated by an insurance arrangement, may be “insured” or “fully insured” schemes.

Directly invested schemes

10. A directly invested scheme is a scheme, generally governed by trust, whose assets will usually comprise one or more investments including shares, securities, holdings in unit trusts or investment funds. Such schemes may use “in-house” investment managers employed by the trustees or an external investment manager.
11. Some directly invested schemes invest in managed funds administered by insurance companies that are run on unit trust principles. They must not be confused with insured schemes.

Insured schemes

12. An “insured scheme” is one where the relevant employer pays premiums/contributions to the insurer in return for which the insurer undertakes to return the principal plus investment earnings in respect of members of the scheme. Under an insurance arrangement, premiums/contributions are paid to the insurer and become his property. An insurance arrangement will not necessarily guarantee the benefits promised under the scheme rules. These schemes will generally be insurance arrangements which fall within the definition of Class G or H of long term business as set out in Part 2 of the First Schedule to the Insurance Companies Ordinance.
13. A “fully insured scheme” is one where insurance policies, such as group endowment policies, are effected in respect of each member and which match and fully guarantee the benefits to be paid to individual members. These schemes fall within the definition of Class I of long term business as set out in Part 2 of the First Schedule to the Insurance Companies Ordinance.
14. Care needs to be taken as insurers also issue policies generally known as “managed fund” policies which are in substance investment management contracts, by which insurers contract with individual schemes to manage or invest their assets. Under such asset management contracts, assets of the schemes do not become the property of the insurer. Typically, the insurer offers participation in one or more funds operated on similar lines to unit trusts or other investment funds. Managed funds may be unitised (i.e. represented by units in, or a proportion of, a fund which are valued periodically to take account of reinvested income and capital growth) or

segregated, whereby the investments of particular schemes are distinguished from each other.

15. In each of the above contracts, the liability of the life assurance company depends upon the terms of the policy. However, the liability of the employer to his employees and pensioners is governed by the terms of the scheme the employer has set up. If it is a defined benefit scheme the contract will require periodic actuarial valuations to ensure that the funding is sufficient to meet the eventual liabilities promised by the employer.
16. Most small companies use insured schemes because the insurer will generally undertake much of the administration of the scheme.

Pooling agreement or arrangement

17. A “pooling agreement or arrangement” is a convenient way of administering two or more schemes together, as permitted by the ORSO. Under a pooling agreement a number of individual schemes can participate through a master trust deed or a master insurance policy depending on whether the pooling agreement is governed by a single trust or is the subject of or regulated by an insurance arrangement (or a series of insurance arrangements which are of the same class or description). In the case of a pooling agreement governed by trust, the assets of its participating schemes are vested with the administrator of the agreement. This kind of arrangement or agreement governed by a single trust must be managed by a registered trust company as required by the ORSO. In the case of a pooling agreement regulated by insurance arrangement, the administrator of the pooling agreement must be an insurer authorised to carry on business under the Insurance Companies Ordinance. In relation to a pooling agreement, and its participating schemes, the ORSO requires that proper accounts and records are kept, such that the value of the assets attributable to, and the liabilities of, each of its participating schemes are readily determinable from such accounts and records.

Forms of MPF schemes

18. A registered MPF scheme, which must be a defined contribution scheme, may take one of the following three forms as defined in section 2 of the MPFSO:
 - a. Master trust scheme;
 - b. Employer sponsored scheme; or
 - c. Industry scheme.

MPF schemes are required to be “directly invested schemes established under trust”. The MPFSO requires that every MPF scheme shall be administered, managed and maintained by an approved trustee.

Constituent funds

19. An MPF scheme may have one or more constituent funds, each of which must be approved by the MPFA and each of which will have a different investment policy, so that members of the scheme have a choice in investing their accrued benefits.

Part 2 - Definitions

20. The terms used in this Appendix follow closely with those set out in the MPFSO and ORSO. Accordingly, some of the terms used in this Appendix are not the same as those used in the Standard even though they have the same meaning. The following table sets out the terms used in this Appendix and the equivalent terms used in the Standard.

Terms used in the appendix	Equivalent terms used in the Standard
Retirement Schemes	Retirement Benefit Plans
Schemes	Plans
Members	Participants
Accrued Benefits	Promised Retirement Benefits

21. In addition to the definitions set out in the Standard, the following terms are used in this Appendix with the meanings specified:

a. *Accrued benefits*

The benefits for service up to a given point in time, whether vested rights or not. They may be calculated in relation to current earnings or projected earnings.

b. *Actuarial assumptions*

The set of assumptions as to rates of return, inflation, increase in earnings, dividend rate, and mortality etc, used by the actuary in an actuarial valuation or other actuarial calculations. There are both financial and demographical assumptions. Financial assumptions include the valuation rate of interest, the rate of earnings increases and the rate of any pension increases. Demographical assumptions include mortality and rates of early retirement and withdrawal.

c. *Actuary's certificate*

In the case of defined benefit schemes, an actuary's certificate is required. This is a statement by an actuary on the ability of the scheme assets to meet the aggregate vested liability of the scheme as well as the adequacy of the scheme assets plus future contributions to meet promised benefits.

The financial statements and the actuary's certificate are two separate reports, having fundamentally different objectives. The former is a record of the financial transactions and current size and disposition of the assets and liabilities of the scheme and the latter is a statement based on an investigation into, and report on, the present and future ability of the scheme to meet the accrued and prospective obligations to its members. These two reports would need to be presented in conjunction with each other.

d. *Additional voluntary contributions¹*

The contributions (over and above the mandatory or regular contributions, if any, required from a member or employer by the scheme rules or law) which a member or employer elects to pay in order to secure additional benefits to the member.

¹ The term "Additional voluntary contributions" also includes the special contributions under the MPFSO.

e. *Administrator*

The term “administrator” refers to the trustee if a scheme is governed by trust or the insurer if a scheme is the subject of or regulated by an insurance arrangement or, in any other case, the person who is principally responsible for the management of the scheme and its assets otherwise than as a person who is solely concerned with the investment and custody of the assets.

f. *Aggregate past service liability*

As defined in section 2(1) of the ORSO.

g. *Aggregate vested liability*

As defined in section 2(1) of the ORSO.

h. *Associates*

As defined in section 2(1) of the ORSO and Schedule 8 to the MPFSO.

i. *Past service liability*

As defined in section 2(1) of the ORSO. Under the ORSO, the past service liability for a defined benefit scheme is defined as the value on that particular day, as determined by an actuary, of the benefit entitlement under the scheme of, or in respect of, the members which, having regard to his qualifying service, could reasonably be expected to be received prospectively or contingently or, where appropriate, both; the actuary having made a reasonable allowance the effects of mortality, what he considers to be prospective future salary increases, withdrawal from service rates and such other factors (if any) as he considers relevant.²

j. *Self investment*

Investment of all or part of a scheme’s assets in the business of the employer of members of the scheme and any Associates, and includes money currently due to the scheme but held by the employer or any Associates, such as employer and employee contributions.

k. *Vested liability*

As defined in section 2(1) of the ORSO.

² The definition of a past service liability for a defined benefit scheme in the ORSO should be noted when applying paragraph 23 of the Standard.

Part 3 – Additional guidance on accounting and disclosures

Content of financial statements

22. In addition to the report content of a retirement scheme as specified in the Standard, the financial statements of a MPF scheme would comprise a revenue statement and a statement of movement in capital account of the scheme and, for each constituent fund, a revenue statement, a statement of assets and liabilities and a statement of movement in capital account. A revenue statement and a statement of movement in capital account of a scheme may be combined in order to form a statement of changes in net assets available for benefits as required under the Standard.

Basis of accounting

Scheme arrangements

23. In the case of directly invested schemes, or schemes participating in a pooling agreement governed by a single trust, the statement of assets and liabilities will show the nature of the investments of the scheme. Where the investments of schemes participating in a pooling agreement governed by a single trust are not individually identifiable for the purposes of this disclosure, it is recommended that the analysis of the investments would be provided in respect of the entire pool, in a note to the financial statements, together with disclosure of the scheme's share of that pool.
24. In the case of fully insured schemes, where policies have been purchased in the name or names of individual members and the scheme has no further obligations in respect of payment of benefits to those members, it is not appropriate for them to be included in the statement of assets and liabilities. Instead the cost of acquiring the policies would be treated as the cost of discharging the retirement obligation at the time of purchase. Where such policies constitute the entire assets of a scheme, the revenue statement of such schemes will be confined to a statement of the transactions of the scheme (i.e. contributions received and passed to the insurance company and benefits paid by the insurance company to the beneficiaries).
25. In the case of insurance arrangements that fall within the definition of Class G or H of the Insurance Companies Ordinance, the insurance policies (or more accurately, the right to claim under such policies) will be reported as an asset in the statement of assets and liabilities. The financial statements will also disclose the obligation of the scheme to pay benefits. Such obligation is normally based on the total accumulated contributions and declared returns credited to the accounts of the members of the scheme at the date of the statement of assets and liabilities.

Contributions received by trustees pending allocation to members' investment accounts

26. Contributions which can be clearly identified as scheme assets (for example, cheques made payable to certain MPF schemes) and which are held in a MPF scheme's bank account pending investment should be presented as cash in the financial statements of the MPF scheme. In those instances where contributions cannot be identified as scheme assets (for example, cheques made payable to the trustee only without the scheme name) and which are held temporarily in the trustee's client account should be presented as a receivable in the financial statements of the MPF scheme.

Long-term insurance policies

27. If long-term insurance policies are held which match, and fully guarantee, the retirement benefit obligations of the scheme in respect of specific individual members, the acquisition costs of the policy would be treated as the cost of discharging the obligations at the time of purchase. Such a policy would not be included in the statement of assets and liabilities.
28. All other long-term insurance policies would be included in the statement of assets and liabilities.

Forfeitures

29. Where an employee leaves a scheme, part or all of the employer's contributions plus the investment return thereon in respect of that member may not be paid to the member. These forfeitures may be applied (depending upon the rules of the scheme) in reducing the contributions of the employer, or be retained in the scheme for the benefit of members, or be returned to the employer. Forfeitures that have not been designated for the benefit of existing members of the scheme as at the financial year end and which have not been returned to the employer would be treated as liabilities of the scheme.

Additional voluntary contributions (AVCs)

30. Where AVCs are made to purchase added years or additional specific benefits within the provisions for benefits under the principal scheme, they would be included as contributions receivable from members and be separately shown in the scheme's statement of movement in capital account and the assets acquired with them would be included in the statement of assets and liabilities.
31. Where AVCs are separately invested in such a way that the proceeds from the investment determine the benefit to the members, they would be disclosed separately from the transactions and the assets and liabilities of the scheme but accounted for within the financial statements of the scheme or the notes thereto.

Additional financial statement disclosures**Constituent funds**

32. In respect of each of the constituent funds of an MPF scheme, the following would be disclosed:
- a. Statement of assets and liabilities
 - i. Total value of investments
 - ii. Bank balances
 - iii. Amounts of subscription receivable
 - iv. Dividends and other receivables
 - v. Amounts payable on redemption
 - vi. Other liabilities
 - vii. Bank loans and overdrafts or other borrowings
 - viii. Total value of all assets

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- ix. Total value of all liabilities
 - x. Net asset value
 - xi. Number of units in issue for a unitised fund
 - xii. Net asset value per unit for a unitised fund
- b. Revenue statement
- i. Total investment income, broken down by category
 - ii. Total other income, broken down by category, including security lending
 - iii. Equalisation on issue and cancellation of units for a unitised fund
 - iv. Investment management fees
 - v. Trustee fees
 - vi. Custodian fees
 - vii. Compensation fund levy paid to the MPFA
 - viii. Fees paid to any Associates of the trustee, custodian or investment manager
 - ix. Safe custody and bank charges
 - x. Auditors' remuneration
 - xi. Interest on borrowings
 - xii. Legal and other professional fees
 - xiii. Other expenses
 - xiv. Taxes
 - xv. Amounts transferred to and from the capital account
- c. Statement of movement in capital account
- i. Value of the constituent fund at the beginning of the year
 - ii. Number of units issued and the amounts received on issue (after equalisation if applicable) for unitised funds or amounts of subscriptions for non-unitised funds
 - iii. Number of units redeemed and the amounts paid on redemption (after equalisation if applicable) for unitised funds or amounts of redemptions for non-unitised funds
 - iv. Amounts transferred to and from the revenue account
 - v. Value of the constituent fund at the end of the year

Notes to the financial statements

33. In addition to those required under the Standard, the notes to the financial statements of a MPF or an ORSO scheme would include the following disclosures, when applicable. The notes to the financial statements of a MPF scheme would be presented in respect of each constituent fund as well as for the scheme itself. It would therefore need to be made clear in the text of each note whether it applies to all funds and the scheme, or only to certain of them.

a. Transactions with Associates

The following would be disclosed:

- i. A description of the nature of any transactions entered into, during the financial year, with the investment manager of the constituent fund (including any of its delegates) or any entity in which those parties or their Associates have a material interest, together with a statement confirming that these transactions have been entered into in the ordinary course of business and on normal commercial terms.
- ii.
 - the total aggregate value of the transactions effected through brokers who are Associates of the trustee or investment manager of the constituent fund or of the investment manager's delegates;
 - the percentage of such transactions in value to the total transactions in value of the constituent fund during the year;
 - the total brokerage commission paid to such brokers in relation to transactions effected through them;
 - the total brokerage commission paid in respect of the constituent fund; and
 - the average rate of commission effected through such broker.
- iii. Details of all transactions which are outside the ordinary course of business or not on normal commercial terms entered into, during the financial year, with the investment manager of the constituent fund (including any of its delegates) or any entity in which these parties or their Associates have a material interest.
- iv. Name of the investment manager of the constituent fund (including any of its delegates) or any Associates of such company if any of them becomes entitled to profits from management of the constituent fund and the amount of profits to which each of them becomes entitled.
- v. Where the constituent fund does not have any transactions with Associates of the investment manager or of its delegates during the year, a nil statement to that effect.
- vi. The basis of the fee charged for the investment management of the constituent fund and the name of the investment manager of the constituent fund (including any of its delegates). In addition, where a performance fee is charged to the constituent fund, the basis of calculation and amount of performance fee charged would be separately disclosed.

- b. Details of any soft commission arrangements relating to dealings in the property of the constituent fund or a nil statement if no such arrangements exist during the year.
- c. State the amount of any advertising expenses, promotional expenses or commissions or brokerage fees payable to the MPF intermediaries of the registered scheme deducted from the constituent fund during the year.
- d. State whether the borrowings entered into are secured or unsecured and the duration of the borrowings.
- e. Details of any contingent liabilities and commitments of the constituent fund.
- f. If the free negotiability of any asset is restricted by statutory or contractual requirements, this would be stated.
- g. Defined contribution schemes
 - i. For a defined contribution scheme, the accumulated scheme benefits (aggregate past service liability) will normally be the amount shown as the balance of the capital account at the financial year-end.
 - ii. The aggregate vested liability of a defined contribution scheme at the financial year-end would be disclosed in a note to the financial statements.
- h. Defined benefit schemes
 - i. The note to the financial statements referring to the aggregate past service liability of a defined benefit scheme would include the following:
 - the name of the actuary of the scheme and his professional qualifications;
 - a short statement regarding the main assumptions used by the actuary in determining the accumulated scheme benefits (past service liability) of the scheme. This disclosure would include assumptions such as those relating to salary increases, life expectancy of members and investment returns;
 - a statement to the effect that the use of such actuarial assumptions gives rise to a figure that may not be directly comparable with the basis of valuation of net assets available for benefits which have been presented in accordance with generally accepted accounting principles in Hong Kong;
 - where, in the opinion of the actuary, the assets of the scheme were not sufficient to meet its aggregate vested liability and/or its aggregate past service liability at the date of the actuarial review, the recommended funding rate and funding period(s) required to ensure that the assets of the scheme will be sufficient to meet its aggregate vested and/or aggregate past service liabilities, would be disclosed;
 - the date as at which the actuary carried out his review;

- if the aggregate past service liability was not calculated as at the same date as the financial year end of the scheme, a note would be added to emphasise this fact; such a note might take the following form:

“The aggregate past service liability was last calculated by the actuary of the scheme [name] as at [date]. The net assets available for benefits as shown on page [] of these financial statements are stated as at [date]. In considering these two figures, it should be borne in mind that changes in membership, contributions and other circumstances of the scheme between those dates will mean that these two figures are not comparable.”

- ii. The aggregate vested liability of a defined benefit scheme, as calculated by the actuary of the scheme, would be disclosed in a note to the financial statements. This note would state the date as at which the aggregate vested liability was calculated and, if that date was different from the financial year-end of the scheme, a statement similar to that indicated in sub-paragraph (i) above would also be included. It may also be appropriate, in some circumstances, to refer to the information contained in sub-paragraph (i) above.
- i. If the assets of a scheme consist of restricted investments (as defined in the MPFSO or the ORSO as applicable), then this would be disclosed in a note to the financial statements, together with details of the nature and value of the investment involved.
- j. Where long-term insurance policies form a material part of the net assets of the scheme, the main characteristics relevant to the overall investment criteria, for instance whether the policies are with or without profits, would be disclosed.
- k. Insurance policies purchased to match and guarantee a scheme’s retirement benefit obligation in respect of specific individuals as stipulated in paragraph 27 would be disclosed by way of a note. Particulars of policies and the names of the insurer would also be disclosed.
- l. MPF schemes - Mandatory Provident Fund Schemes (General) Regulation section 81

The following would also be disclosed:

- i. The fees for administrative expenses deducted or deductible by the trustee from the scheme members’ accounts under the MPF Regulation.
- ii. The contributions and contribution surcharge (if any) paid and payable by, and recovered from, scheme members and (where appropriate) their employers.
- iii. The total return derived from investing in the funds of the scheme (taking into account any capital appreciation and depreciation).
- iv. The total amount of accrued benefits that were paid, and of accrued benefits that became payable but were not paid, to or in respect of scheme members.
- v. The amount of accrued benefits transferred to and from the scheme.

Part 4 - Notes on legal requirements in Hong Kong

34. MPF schemes are governed by the MPFSO and ORSO schemes are governed by the ORSO. The following paragraphs, based on the MPFSO and ORSO in effect at 31 December 2003, are for guidance only and are not a substitute for reference to the detailed requirements of the MPFSO and the ORSO.

MPFSO

35. Section 81 of Mandatory Provident Fund Schemes (General) Regulation (“General Regulation”) provides that the approved trustee of a registered scheme must prepare a balance sheet of the scheme showing a true and fair view of its financial position and also a statement of account of the scheme showing a true and fair view of its financial transactions, for each of its financial periods.
36. Section 86 of the General Regulation provides that the approved trustee of a registered scheme must prepare a scheme report for the scheme for each of its financial periods.
37. Section 87 of the General Regulation provides that the approved trustee of a registered scheme must prepare an investment report of the scheme for each of its financial periods.
38. The financial statements, the auditor’s report thereon, the scheme report and the investment report form part of the consolidated report prescribed under section 89 of the General Regulation. Section 110(3)(a) of the General Regulation stipulates that the consolidated report must be included in the annual statement prescribed under section 22A(1) of the MPFSO.
39. Guideline II.4 on Annual Statements of Registered Schemes prescribes:
- a. the statistical information in relation to a registered scheme under section 110(2)(d) of the General Regulation; and
 - b. the information in relation to the constituent funds of a registered scheme that should be included in the financial statements and the investment report of the scheme under sections 81 and 87 of the General Regulation respectively.
40. An MPF scheme, whether employer sponsored, master trust or industry scheme, may consist of one or more constituent funds. Section 6 of Schedule 1 to the General Regulation provides that the assets of a constituent fund of a registered scheme may be invested in an approved pooled investment fund (“APIF”). Section 6(1) of the General Regulation provides that an investment fund is an APIF for the purposes of the Regulation if it is an insurance policy, authorised unit trust or authorised mutual fund that complies with the requirements set out in section 17(2) of Schedule 1 to the General Regulation and is approved by the MPFA. Section 17(2)(h) of Schedule 1 to the General Regulation stipulates that the financial statements, investment reports and auditor’s reports of an APIF must be lodged with the MPFA and additional information relating to those statements and reports must be provided to the MPFA whenever the MPFA requests.

ORSO

41. Section 20(1)(a) of the ORSO requires the administrator of a registered scheme to keep proper accounts and records as regards all assets, liabilities and financial transactions of the scheme and to cause to be prepared financial statements in respect of each financial year.

42. Section 20(2) of the ORSO requires that the financial statements shall show a true and fair view of the financial transactions of the scheme during the financial year and of the disposition, at the last day of the financial year, of its assets and liabilities and shall contain any such other information as the Registrar of Occupational Retirement Schemes may specify in guidelines issued by him.
43. Under section 67(1C) of the ORSO,
- a. “grouping of companies” means companies that are associated companies or are within a group of companies and includes associated companies of a member of a group of companies;
 - b. “group of companies” means a holding company and its subsidiaries;
 - c. companies are regarded as being associated companies if –
 - i. one of the companies holds, or is entitled to control the exercise of, 20% or more of the voting power in the other company’s general meetings;
 - ii. one of the companies is a subsidiary of an associated company; or
 - iii. they are partners under a written partnership agreement.
44. For schemes participating in a pooling agreement, financial statements of each of the schemes, rather than the pooling agreement itself, would be prepared. Section 20(7C)(a) of the ORSO requires the appointment of a common accounting year for each of the schemes within the pooling agreement. Financial statements of such schemes would be prepared on the basis of the appointed common accounting year unless exemption has been given by the Registrar of Occupational Retirement Schemes under section 20(7C) of the ORSO.

Appendix B

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at July 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 26.

The International Accounting Standard comparable with HKAS 26 is IAS 26 *Accounting and Reporting by Retirement Benefit Plans*.

There are no textual differences between HKAS 26 and IAS 26. However, HKAS 26 includes an appendix that sets out additional guidance on preparing financial statements of Mandatory Provident Fund Schemes and Occupational Retirement Schemes Ordinance Schemes.