Accounting implications of the government subsidy scheme for the abolition of the MPF offsetting arrangement

In June 2022, the Government of the HKSAR (HKSARG) gazetted the Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Ordinance 2022 to abolish the Mandatory Provident Fund (MPF)-Long Service Payment (LSP) and Severance Payment (SP) offsetting mechanism (the Abolition).

In April 2023, the Chief Executive of the HKSAR announced that the Abolition will officially take effect on 1 May 2025 (the Transition Date). At the same time, the HKSARG has indicated that it would launch a scheme to subsidise the post-transition portion of LSP/SP payable by employers.

On 22 November 2024, the Finance Committee of the Legislative Council approved the creation of a commitment for implementing the subsidy scheme for the Abolition (LSP Subsidy)[1].

This publication provides guidance on the accounting implications of the LSP Subsidy. It is an extension of the Educational guidance on the accounting implications of the abolition of the MPF-LSP offsetting mechanism in Hong Kong published by the HKICPA in July 2023 (July 2023 Guidance) and should be read therewith.

1) Main features of the LSP Subsidy

The HKSARG will subsidise a portion of the post-transition LSP payable by an employer up to a certain amount per employee per year for a period of 25 years after the Transition Date. In terms of the LSP Subsidy, an employer's share of the post-transition LSP is calculated as follows:

- **For the first $500,000** of all LSP paid by an employer in a year, the employer's share of post-transition LSP per employee is the lower of:
    - (a) the amount of post-transition LSP for that employee multiplied by a specified sharing ratio (e.g. 50% in the first year after the Abolition takes effect); and

[1] The subsidy scheme covers SP as well; however, as explained in footnote 4 to the July 2023 Guidance, this series of guidance focuses on the accounting for LSP; for simplicity, the rest of the document refers to LSP only.

(b) a specified capped amount (e.g. $3,000 in the first year after the Abolition takes effect)[2].

- **Beyond the first $500,000** of all LSP paid by an employer in a year, the employer's share of post-transition LSP per employee is the amount of post-transition LSP for that employee multiplied by a specified sharing ratio.

The specified employer's sharing ratio and the capped amount are progressively increased over the 25-year subsidy period. See Appendix for the full LSP Subsidy table.

2) Accounting for the LSP Subsidy

As the HKSARG's commitment for the LSP Subsidy was approved by the relevant authorities in November 2024, a question may arise as to the timing of recognition and the measurement of the LSP Subsidy. Considering the features of the LSP Subsidy and its interaction with the LSP obligation, which is accounted for as a defined benefit scheme under HKAS 19 *Employee Benefits*, there is no specific guidance in HKFRS Accounting Standards on whether such an interaction should be reflected in accounting, and if so, how to account for it. While there may be other acceptable accounting alternatives, the FRSC considers that a generally acceptable method is to account for it as a government grant in accordance with HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* which is explained below.

Accounting for the LSP Subsidy as a government grant

The LSP Subsidy meets the definition of a government grant in accordance with HKAS 20.3 as it is 'assistance by [the HKSAR] government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity…'. The recognition of government grant is governed by paragraphs 7 and 20 of HKAS 20:

'7 *Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:*

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.'

'20 *A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable.'*

According to the Labour Department's website on the abolition of MPF offsetting arrangement, 'the [HKSARG] will disburse the subsidy to employers on a reimbursement basis. Employers should pay [LSP] to employees in accordance with the provisions under the Employment Ordinance and then submit applications for disbursement of [the LSP Subsidy]. Employers should prepare all supporting documents required when submitting their applications to facilitate approval of applications and disbursement of subsidies as soon as possible.'

The 'reasonable assurance' recognition threshold in HKAS 20 is higher than that for the recognition of a liability for a defined benefit obligation in HKAS 19. In respect of recognition of LSP Subsidy under HKAS 20, given the approval of the commitment of the subsidy by the relevant authorities in November 2024, the uncertainties generally lie with the criterion in paragraph 7(a). In particular, given the long-tail nature of the LSP liability, an entity's

[2] No cap from the 10th year after the Abolition takes effect.

ultimate entitlement of the related LSP Subsidy would depend on a number of factors some of which are not entirely within the control of the entity, and the associated uncertainties could take a long time to resolve – for example, notwithstanding a long service period, an employee under continuous employment would forfeit his LSP entitlement if he voluntarily resigns before the age of 65 on grounds other than ill health.

In view of the above, it is expected that under most circumstances there would not be reasonable assurance that the conditions associated with the LSP Subsidy would be met until an employer has paid or is about to pay the LSP to their employees in accordance with the Employment Ordinance. From that point there would be reasonable assurance that the LSP Subsidy would become receivable, as the subsequent application, vetting and verification process is considered perfunctory as long as the employer has complied with relevant laws and regulations. Accordingly, consistent with the guidance in paragraph 20 of HKAS 20, the recognition criteria for the LSP Subsidy receivable under paragraph 7(a) of HKAS 20 is generally met when the employer has paid or is about to pay the LSP to the employee and is eligible to claim the related LSP Subsidy from the HKSARG.

In light of the above, assuming that an entity is eligible for and will apply for the LSP Subsidy, under most circumstances that subsidy is recognised as a receivable when the employer has paid or is about to pay the LSP to the employee; further, as that receivable is a compensation for LSP expense already incurred by the employer, the amount is recognised in profit or loss of the period in which it becomes receivable.

Under limited and specific circumstances, it may be possible that the reasonable assurance threshold is met earlier than the payment of the LSP by the employer, for example, if the concerned employee is approaching retirement age, his employment would be terminated once he reaches that age and there is reasonable assurance that the employer will settle the LSP when due (e.g. the company has set aside separate funds for the obligation and there is reasonable assurance that such funds will be used for this purpose). Such cases should be assessed individually with care in terms of the exercise of judgment regarding the reasonable assurance threshold based on their respective facts and circumstances.

Entities applying SME-FRS and HKFRS for Private Entities

The accounting treatment above is also applicable to entities applying SME-FRS as the criteria for recognising government grants in accordance with section 12.1 of SME-FRS are the same as those in HKAS 20.

For entities applying HKFRS for Private Entities, section 24.4(b) thereof requires an entity to recognise in income ‘a grant that imposes specified future performance conditions on the recipient […] only when the performance conditions are met’. The performance condition in this context is payment of the LSP by the employer to the employee. As such, the related LSP Subsidy is recognised as a receivable with a corresponding income in profit or loss when the employer has paid the LSP to the employee.

<u>January 2025</u>

Appendix

Employer's Share of Post-abolition Severance Payment/Long Service Payment (SP/LSP) under the Subsidy Scheme for Abolition of MPF Offsetting Arrangement[3]

Year after the abolition	**Employer's share per employee (as % of post-transition portion of SP/LSP payable)**	
	First $500,000 of all SP/LSP paid by an employer in a year	**Beyond the first $500,000 of all SP/LSP paid by an employer in a year**
1 - 3	50%, capped at **$3,000**	50%
4	55%, capped at **$25,000**	55%
5	60%, capped at **$25,000**	60%
6	65%, capped at **$25,000**	65%
7	70%, capped at **$50,000**	70%
8	75%, capped at **$50,000**	75%
9	80%, capped at **$50,000**	80%
10	80%	85%
11	80%	90%
12	85%	95%
13	85%	100%
14 - 19	90%	100%
20 - 25	95%	100%

[3] Extracted from Legislative Council Finance Committee paper FCR(2024-25)37 discussed on 22 November 2024.