

QUESTION FIVE

Lincoln plc operates two pension schemes as follows :

Pension Plan A

Both employees and employers contribute to the scheme. On retirement employees are guaranteed a pension which is based upon the number of years' service within the company and their final salary.

The following details relate to the plan for the year ended 31 March 2013.

	<u>£m</u>
Present value of obligation at 1 April 2012	200
Present value of obligation at 31 March 2013	210
Fair value of plan assets at 1 April 2012	180
Fair value of plan assets at 31 March 2013	190
Current service cost	21
Pension benefits paid	19
Total contributions paid to the scheme for the year to 31 March 2013	17

	1 April 2012
Discount rate	7%
Expected return on plan assets	9%

Pension Plan B

Under the terms of the plan, Lincoln does not guarantee any return on the contributions paid into the fund. The company's legal obligation is limited to the amount that is contributed to the fund.

The following details relate to the scheme:

	<u>£m</u>
Fair value of plan assets at 31 March 2013	32
Contributions paid by company for year to 31 March 2013	14
Contributions paid by employees for year to 31 March 2013	12

The company would like advice on how to treat the two plans under FRS17 'Retirement Benefits'

Required:

Draft a report suitable for presentation to the directors of Lincoln which:

- a) Discusses the nature of and differences between a defined contribution plan and a defined benefit plan with specific reference to the two schemes.

(7 marks)

- b) Show the accounting treatment for the two pension plans for the year ended 31 March 2013 under FRS 17 'Retirement Benefits'. Your answer should include an explanation of current service cost, interest cost and actuarial gains/losses.

(13 marks)

(TOTAL 20 MARKS)

Marks

5 a)

A defined contribution plan is a pension plan where an employer pays fixed contributions into a separate fund and has no legal or constructive obligation to pay further contributions. Any actuarial and investment risks of defined contribution plans are assumed by the employee. The pension received by the employee depends on the investment returns of the plan.

Plans that are not defined contribution plans are deemed to be defined benefit plans, where an element of risk remains with the employer. An employer's obligation under a defined benefit plan is to provide the agreed amount of benefits to current and former employees.

7 In a defined benefit scheme it is the employer that underwrites the vast majority of costs so that if investment returns are poor or costs increase the employer needs to either make adjustments to the scheme or to increase the level of contribution. Alternatively, if investment returns are good, then contribution levels could be reduced. In a defined contribution scheme the contributions are paid at a fixed level and, therefore, it is the scheme member who is shouldering these risks. If they fail to take action by increasing contribution rates when investment returns are poor or costs increase, then their retirement benefits will be lower than they had planned for.

For defined contribution plans, the cost to be recognised in the period is the contribution payable in exchange for service rendered by employees during the period. The accounting treatment is straightforward because the employer's obligation for each period is determined by the amount to be contributed for that period.

For defined benefit plans, the amount recognised in the balance sheet should be the present value of the defined benefit obligation (that is, the present value of future payments required to settle the obligation resulting from employee service in the current and prior periods), as adjusted for any invested past service cost, and reduced by the fair value of plan assets at the balance sheet date.

In the case of Lincoln plc, pension plan A is a defined benefit plan as the employer has the investment risk as the company is guaranteeing a pension based on the service lives of the employees in the scheme.

Pension plan B is a defined contribution scheme because the employer's liability is limited to the contributions paid.

b) Plan A

	<u>Assets</u>	<u>Million</u>
1/2	BIF	180
1/2	Expected return $9\% \times 180$	16.2
1/2	Contribution paid	17
1/2	Benefits paid	(19)
1	Actuarial loss	(4.2)
	CIF	<u>190</u>

Obligation

	BIF	200
1/2	Current service cost	21
1/2	Benefits paid	(19)
1/2	Interest cost $7\% \times 200$	14
1	Actuarial gain	(6)
	CIF	<u>210</u>

Current service cost

- the increase in the present value of the scheme liabilities expected to arise from employee service in the period

Interest cost

- the expected increase during the period in the present value of the scheme liabilities because the benefits are now period closer to settlement

Actuarial gains/losses

- changes in actuarial deficits or surpluses that arise because events have not coincided with the actuarial assumptions made for the last valuation (experience gains and losses), or the actuarial assumptions have changed

Balance Sheet 3/13/13

Present value of obligation	(210)
Fair value of plan assets	<u>190</u>
Liability	<u>(20)</u>

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1/2	Current service cost	21
1/2	Interest cost	(14)
1/2	Expected return	<u>16.2</u>
	Net return	<u>2.2</u>
	Net expense	<u>18.8</u>

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1/2	Actuarial loss	(4.2)
1/2	Actuarial gain	<u>16</u>
	Net loss	<u>11.8</u>

Plan B

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1	Pension contributions payable	<u>14m</u>
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