

QUESTION FOUR

- a) Discusses the nature of and differences between a defined contribution plan and a defined benefit plan and how they are accounted for in the financial statements.

(10 marks)

Smith operates a defined benefit pension plan for its employees. At 1 January 2014 the fair value of the pension plan assets was £2,600,000 and the present value of the plan liabilities was £2,900,000.

The actuary estimates that the current and past service costs for the year ended 31 December 2014 is £450,000 and £90,000 respectively. The past service cost is caused by an increase in pension benefits and takes effect from 31 December 2014. The plan liabilities at 1 January and 31 December 2014 correctly reflect this increase.

The pension plan paid £240,000 to retired members on 31 December 2014. On the same date, Smith paid £730,000 in contributions to the pension plan and this included £90,000 in past service costs.

At 31 December 2014 the fair value of the plan assets is £3,400,000 and the present value of the plan liabilities is £3,500,000.

Discount rate	=	8%
Expected return on assets	=	4%

REQUIREMENT:

- b) Show, including the relevant extracts from the financial statements, the accounting treatment for the pension plan for the year ended 31 December 2014 under FRS 102 'Retirement Benefits'

(10 marks)

(TOTAL 20 MARKS)

QUESTION FOUR

There are two types of pension schemes.

DEFINED CONTRIBUTION SCHEMES

A pension or other retirement benefit scheme into which an employer pays regular contributions fixed as an amount or as a percentage of pay and will have no legal or constructive obligation to pay further contributions if the scheme does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

An individual member's benefits are determined by reference to contributions paid into the scheme in respect of that member, usually increased by an amount based on the investment return on those contributions.

Defined contribution schemes may also provide death-in-service benefits. For the purposes of this definition, death-in-service benefits are not deemed to relate to employee service in the current and prior periods.

These schemes do not present a problem for the reporting company, as they should simply charge the contributions payable in respect of the accounting period within operating profit. If the amount actually paid is more or less than the amount payable, a prepayment or accrual will appear in the balance sheet in accordance with normal accounting practice.

DEFINED BENEFIT SCHEMES

A pension or other retirement benefit scheme other than a defined contribution scheme.

Usually, the scheme rules define the benefits independently of the contributions payable, and the benefits are not directly related to the investments of the scheme. The scheme may be funded or unfunded.

Problems

This type of scheme presents problems in respect of :

- a) Valuing the scheme assets
- b) Estimating the scheme liabilities
- c) Measuring and recognising the cost to the employing company

Objective of FRS 17

The objective of the FRS is to ensure that:

- a) Financial statements reflect at fair value the assets and liabilities arising from an employer's retirement benefit obligations and any related funding
- b) The operating costs of providing retirement benefits to employees are recognised in the accounting period(s) in which the benefits are earned by the employees, and the related finance costs and any other changes in value of the assets and liabilities are recognised in the accounting periods in which they arise
- c) The financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities

BALANCE SHEET (EXTRACT)

2016
£1000

Present value of scheme obligation (3500)

Present value of scheme assets 3400

Net scheme obligation (100)

PROFIT + LOSS ACCOUNT (EXTRACT)

2016
£1000

Current service cost 450

Past service cost 20

Net Finance cost (232 - 104) 128

STRGCL

2016
£1000
206

Actuarial gain on scheme assets

Actuarial loss on scheme obligation (68)

Net actuarial gain 138

4b

PLAN ASSETS

21000

Fair Value of plan assets at 1-1-16

2600

Interest on plan assets ($8\% \times 2600$)

208

Contributions

730

Benefits paid

(240)

Actuarial gain (BAC FID)

206

Fair Value of plan assets at 3-12-16

3400

PLAN OBLIGATIONS

Present Value of obligation at 1-1-16

2900

Current service cost

450

Past service cost

90

Interest cost ($8\% \times 2900$)

232

Benefits paid

(240)

Actuarial loss

68

Present value of obligation at 3-12-16

3500