

QUESTION SIX

Baker 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. This pension plan was closed to new entrants from 1 January 2013 but is open to future service accrual for the employers already in the scheme.

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

	<u>£m</u>
Present value of obligation at 1 January 2013	240
Present value of obligation at 31 December 2013	280
Fair value of plan assets at 1 January 2013	210
Fair value of plan assets at 31 December 2013	250
Current service cost	24
Pension benefits paid	22
Total contributions paid to the scheme for the year to 31 December 2013	19

	1 January 2013
Discount rate	6%
Expected return on plan assets	8%

Pension Plan B

Under the terms of the plan, Baker 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 December 2013	28
Contributions paid by company for year to 31 December 2013	12
Contributions paid by employees for year to 31 December 2013	10

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 Baker which:

- Discusses the nature of and differences between a defined contribution plan and a defined benefit plan with specific reference to the two schemes.
(10 marks)
- Shows the accounting treatment for the two pension plans for the year ended 31 December 2013 under FRS 17 'Retirement Benefits'
(10 marks)

MARKS

QUESTION SIX

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.

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 Baker, 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.

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

A curtailment is an event that reduces the expected years of future service of present employees or reduces for a number of employees, the accrual of defined benefits for some or all of their future service. Curtailments have the effect of reducing obligations relating to future service. The fact that no new employees are to be admitted to Plan A does not constitute a curtailment because future service qualifies for pension rights for those in the scheme prior to 1 January 2013.

Employee Benefits (2)

a) from information sheet - define two different types + relate to question. describe differences between the two + how they are accounted for. "FRS102 section 28" - See model answer.

b) Profit + Loss Account

	£m
Pension Contributions Paid - Plan B (administrative expense)	12
Current service cost (admin expense)	(24)
Interest on liabilities	Interest receivable (14.4)
Expected return on assets	
	16.8

Balance Sheet at 31-12-13.

	£m.
Fair value of plan assets	250
Present value of obligation	(280)
Net pension scheme obligation	<u>(30)</u>

Statement of recognised gains + losses

Actuarial ~~loss~~ on obligation	(23.6)
Actuarial gain on assets	26.2
Net actuarial gain on Pension Scheme	<u>2.6.</u>

(W1) Plan A.

(A) Liabilities

	£m.
Present value of obligation at 1-1-13	(240)
Current service cost	(24)
Pension Benefits Paid.	~~22~~
Interest on liabilities	(14.4)
Actuarial Gain (<u>Loss</u>) (Bal fig)	(23.6)
Present Value of obligation at 31-12-13	(280)

$$\text{Interest on liabilities} = 6\% \times 240 = \del{23.6} 14.4$$

(B) Assets

	£m.
Fair Value of plan assets at 1-1-13	210
Contributions	19
Expected return on plan assets.	16.8
Pension benefits paid	(22)

Actuarial Gain (Bal fig)	<u>26.2</u>
Fair Value of plan assets 31-12-13	250

$$\text{Expected return } 8\% \times 210 = 16.8$$