Highlights of the german pension fund

Experience, Human Nature

There is a legal separation between the employer and the pension institution with the German pension fund. It offers lifelong retirement benefits. The coverage of biometric risks – and not merely its function as an investment instrument – was one of the social requirements emphasized by the European Parliament but not adopted in the final draft.

The plan guarantees participants a right to their benefits guarantees, a compulsory redemption of contributions, thus the employer guarantees the payment of the retirement benefits in the event that the pension fund should be bankrupted.

Members will benefit from timely and accurate disclosure of information.

The activities are subject to the monitoring of the Germany Supervisory Authority.

Recognition has been given to trying to create a level playing field amongst service providers. The pension fund is the only financing instrument for which the complete subcontracting of biometric risks, asset management and administration is possible.

The tax features make it attractive. The German Government adopted the recommendation on tax relief to contributions as well as the deductibility of pension costs as a business expense. The pension plan makes it easier for internationally mobile employees to transfer their pension rights.

I selected German Volkswagen Company and analyzed its pension plan (attached) according to its annual balance sheet. Volkswagen places pension benefits under the liabilities column on the balance sheet. The pension benefits plans are under-funded according to the balance sheet.

How Volkswagen Accounts for Pension Provisions Financial Reporting

PENSION PROVISIONS

The actuarial valuation of pension provisions is based on the projected unit credit method inrespectof defined benefit plans in accordance with IAS 19. The valuation is based not only on pension payments and vested entitlements known at the balance sheet date, but also reflects

future salary and pension trends. Actuarial gains and losses are recognized directly in equity, net of deferred taxes.

PROVISIONS FOR TAXES

Tax provisions contain obligations resulting from current taxes. Deferred taxes are presented in separate items of the balance sheet and income statement

DEFERRED TAXES

Deferred tax assets are generally recognized for taxable temporary differences between the tax base of assets and their carrying amounts in the consolidated balance sheet, as well as on tax loss carry forwards and tax credits provided it is probable that they can be used in future periods.

Deferred tax liabilities are generally recognized for all taxable temporary differences between the tax base of liabilities and their carrying amounts in the consolidated balance sheet.

Deferred tax liabilities and assets are recognized in the amount of the expected tax liability or tax benefit, as appropriate, in subsequent fiscal years, based on the expected enacted tax rate at the time of realization. The tax consequences of dividend payments are not taken into account until the resolution on appropriation of earnings available for distribution has been adopted.

Deferred tax assets that are unlikely to be realized within a clearly predictable period are

reduced by valuation allowances. Deferred tax assets and deferred tax liabilities are offset where taxes are levied by the same taxation authority and relate to the same tax period.

(Volkswagen 2007)

In a defined-benefit plan, the employer guarantees that the employee will receive a definite amount of benefit upon retirement, regardless of the performance of the underlying investment pool. A defined benefit plan promises a specified monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount, such as $100 per month at retirement.

Alternatively, more commonly, it may calculate a benefit through a plan formula that considers such factors as salary and service — for example, 1 percent of average salary for the last 5 years of employment for every year of service with an employer.

In the defined-contribution plan the employer makes predefined contributions for the employee, but the final amount of benefit received by the employee depends on the investment's performance. In these plans, the employee or the employer (or both) contribute to the employee's individual account under the plan, sometimes at a set rate, such as 5 percent of earnings annually.

These contributions are invested on the employee's behalf. The employee will ultimately receive the balance in their account, which is based on contributions plus or minus investment gains or losses. Examples of defined contribution plans include 401(k) plans, 403(b) plans, employee stock ownership plans, and profit-sharing plans.

Cost and liability determined in this way for a pay-related plan are clearly " insufficient" when compared, for example, to the IAS19 or SFAS87 methodology, but the available deductions are generally more favorable than those allowed for by the various external pension vehicles (support funds, " Pensionskassen", direct insurances and also reinsurance contracts for book reserve plans.)

" These approaches have suffered under less favorable tax rules (tax limits on funding or taxation as employee income) or insurance supervisory law with prohibitively high insurance premiums (based on an interest rate of 2. 75 percent)."

In the United States a retirement plan is usually, tax exempt or tax-deferred. The employer will contribute along with the employee in most cases towards a fund set aside for the employee's future retirement benefits savings fund. The employer on the employee’s behalf invests the funds; the employee then receives benefits upon retirement.

The employee often has the option for early retirement, but savings benefits for the retirement plan in this case will be at a reduced amount. There has been a growing concern in recent years in the United States with companies filing bankruptcy and people losing their retirement, thus not all plans are secure investments for retirement.

Comparing to American and German pension plans I can say that German pension plans are much stronger, guaranteed and beneficial for retirees. The reasons are probably different state policies. Germany is more socialistic country comparing to America. In Germany social services and benefits are huge comparing to America, for example in Germany healthcare is free and every individual are entitled to receive free healthcare and other medical services.

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