ACCOUNTING FOR PENSION LIABILITIES
UNDER THE NEW CHARITIES STATEMENTS OF RECOMMENDED PRACTICE (SORPS)
INTRODUCTION:

From 1 January 2015, all UK charities preparing “true and fair” accounts must apply one of two new SORPs. For charities eligible to use the Financial Reporting Standard for Smaller Entities (FRSSE), trustees will be able to choose between applying the FRSSE SORP or the FRS 102 SORP.

For charities participating in non-associated multi-employer defined benefit pensions schemes, where the scheme is in deficit, it’s time to consider the required accounting treatment. It is worth noting at this point that the FRSSE will be withdrawn for accounting periods ending on or after 1 January 2016 and it will be replaced by requirements based on the measurement and recognition requirements of FRS 102 but with reduced disclosures.

In commenting on the accounting changes, charity pensions expert, David Davison says:

“I welcome the clarity and consistency the new FRS 102 SORP provides for charities participating in multi-employer defined benefit pension schemes.

“However, changes to the recognition and measurement requirements need to be managed by charities which have not previously recognised pension liabilities and by those charities already recognising liabilities, where an alternative methodology could be considered.

“Charities should certainly be considering the implications of the new FRS 102 SORP well in advance of the financial year-end to ensure they are prepared for the impact and are aware of the options open to them.”

David is a director and owner of Spence and Partners and a member of the ICAS Pensions Committee.

The following guidance, prepared by the ICAS Charities Committee, considers the accounting treatment of multi-employer pension liabilities by charities under both FRS 102 and the FRSSE.
FRS 102

Under FRS 102, the approach adopted depends on whether or not sufficient information is available to meet the recognition and measurement criteria set out in part 28 of FRS 102 on ‘Post-employment: defined benefit pensions’.

Sufficient information is available

If sufficient information is available to meet the criteria, the charity must recognise its net defined benefit liability and the net change in that liability during the period. The net defined benefit liability is arrived at by deducting the present value of its obligations from the fair value of its share of pension scheme assets. This approach will be familiar to charities which currently recognise their share of a pension scheme deficit under FRS 17 ‘Retirement benefits’.

It is worth highlighting that some charities which have not previously recognised their share of a scheme deficit may have to do so under FRS 102. Under FRS 17, there is no requirement for an entity to account for its share of a scheme deficit unless it is able to identify its share of the underlying assets on a consistent and reasonable basis. However, under FRS 102, this accounting policy option is only available in the absence of sufficient information. Judgement on this matter will come into play for those charities not currently recognising their share of a scheme’s net deficit. Such charities will need to consider whether sufficient information is available even if they previously considered that information not to be consistent and reasonable. It may be necessary to approach the scheme actuary for a view on the impact of the difference between ‘a consistent and reasonable basis’ and ‘sufficient information’.

Sufficient information is not available

If sufficient information is not available to require a charity to recognise a net defined benefit liability, then the charity should account for the scheme as if it were a defined contribution scheme: an approach also possible under FRS 17. However, a charity in this position will now need to recognise any liabilities arising from an agreement with the pension scheme trustees to fund a deficit. Under old UK GAAP, recognition of such a liability was a grey area but the required accounting treatment under FRS 102 is clear.

Under such an agreement, the charity must recognise a liability on its Balance Sheet for the contributions payable to the extent that they relate to a deficit and the resulting expense is recognised in the Statement of Financial Activities (SoFA).

If the liability is not expected to be wholly settled within 12 months after the end of the reporting period, then the liability must be measured at its present value. The unwinding of the discount must be recognised as a finance cost in the SoFA in the period in which it arises.
The Financial Reporting Council (FRC) has recently amended FRS 102 to clarify that if an entity recognises a defined benefit liability, it must not recognise any additional liabilities in respect of an agreement to fund a deficit. This is due to the two different approaches being different methods of measuring the same thing.

However, the two different approaches could give rise to two different measurements. It is likely that the reported financial position of charities would be stronger if the pension scheme were accounted for as a defined benefit plan:

- **Funding agreement.** An agreement with pension scheme trustees to fund, and thus eliminate, a deficit in a pension scheme calculates the scheme’s liabilities using a prudent set of assumptions, as required by pension law. It is from those assumptions that the present value of the scheme deficit would be calculated.

- **Scheme’s share of a net deficit.** In accounting for the scheme as a defined benefit plan, an actuary will use financial assumptions which reflect a more current market assessment. These assumptions are likely to be less prudent than those used to arrive at a funding agreement.

**Comparison of FRS 17 and section 28 of FRS 102**

While there are similarities between FRS 17 ‘Retirement benefits’ and section 28 of FRS 102 on ‘Employee’ benefits’, each charity applying FRS 102 should review in detail the requirements for section 28 and module 17 of the Charities SORP (FRS 102) to ensure that it complies with all requirements appropriate to its circumstances. The Charities SORP also includes additional material on the fund accounting aspects of retirement benefits.

**Impact on financial sustainability**

Any charity (including those applying the FRSSE) which has significant pension liabilities should be considering at board level their impact on the financial sustainability of the charity and whether continued membership of the pension scheme is sustainable. Where a charity’s balance sheet is taking a major hit for the first time, it will be essential to share the outcome of the board’s deliberations with its financial supporters whether these are grant-givers, banks or other lenders, or commissioners to mitigate as far as possible the likelihood that support will be withdrawn as a direct consequence of recognition of such liabilities. These deliberations should include a review of any banking or loan covenants which could be breached as a result of any changes in accounting policy.

Charities should also be mindful to comply with disclosure requirements around going concern and auditors and independent examiners will need to consider the implications for their reports of any going concern issues arising from pension scheme liabilities.
THE FRSSE (2015)

Under the FRSSE (2015), charities which participate in multi-employer defined benefit schemes may need to make some very finely balanced judgements so that they comply with all relevant requirements.

Those charities which currently recognise their share of the net deficit under the FRSSE (2008) should continue to do so. In addition, consideration should be given to the material in section 17 of the Charities SORP (FRSSE), for example on fund accounting and the treatment of a defined benefit scheme and disclosures relating to a defined benefit scheme.

For charities which do not currently recognise their share of the net deficit under the FRSSE (2008), on the grounds that their share of the deficit could not be determined on a consistent and reasonable basis, can continue to apply this policy.

For those charities which continue to account for a multi-employer scheme as a defined contribution scheme, the Charities SORP (FRSSE) sets out the following guidance.

“…. [a charity] may retain its existing accounting policy when accounting for an agreement to make contributions to fund a deficit in the scheme provided the policy reflects accepted practice. Again, if the charity does not have an existing accounting policy for such agreements it should refer to FRS 102 when developing its accounting policy.”

“Accepted practice” is defined as compliance with old UK GAAP. Under old UK GAAP whether a charity taking a defined contribution approach should then recognise liabilities arising from an agreement to fund a scheme deficit is a grey area: the Charities SORP (FRSSE) provides no clarification on this point.

Charities in this position which currently recognise such liabilities in their balance sheet should continue to do so, as charities should first have regard to their own existing accounting policies. For other charities which do not, there is a requirement to consider the material in section 28 of FRS 102 which requires the recognition of liabilities arising from an agreement to fund a deficit. However, a requirement to consider the material is not the same as a requirement to comply with its content and the FRSSE (2015) makes that clear. It therefore appears that such charities will continue to have a choice of treatment.

It would be easy to get tied up in knots at this point, as a charity which has chosen not to recognise liabilities relating to an agreement in the past and has instead disclosed them as contingent liabilities could support their non-recognition under the FRSSE (2015) on the grounds that it should first have regard to its own existing accounting policies.
Accounting periods commencing on or after 1 January 2016
As the FRSSE is to be withdrawn for periods commencing on or after 1 January 2016, with requirements for smaller entities being replaced by requirements based on FRS 102, any relief from the non-recognition of liabilities arising from a funding agreement will be short-lived.

IN CONCLUSION
There will clearly be challenges for trustees, auditors and independent examiners where the course of action under FRS 102 or the FRSSE (2015) requires finely balanced judgements to be made. With the new SORPs only being implemented from 1 January 2015, some of the more detailed issues around their implementation have yet to be fully aired. Therefore, the trustees of charities participating in multi-employer defined benefit pension schemes, in discussion with their charity’s auditor or independent examiner, should have or should in early course be considering how to account for pension liabilities under the appropriate SORP.