



Accounts Monitoring Review

Pension scheme deficits

About our accounts monitoring reports

Charities' accounts are publicly available on our website. Each year, we monitor a sample to check compliance with the Charities Statement of Recommended Practice (SORP) and to identify issues of regulatory concern. We are publishing a series of reports on our findings, which will help trustees to manage the risks that their charity faces and improve reporting standards.

The scope and purpose of this review

This review looked at the accounts of charities with pension scheme deficits. We chose this area because of a perceived risk that they may have difficulty in meeting their pension obligations from future income and available reserves. Pension scheme deficits have become a significant issue for employers in recent years. This is because scheme assets have fallen in value at the same time as liabilities have risen, as a result of increased longevity and lower investment returns and values.

The pension arrangements that employers offer their staff are of two types, defined benefit and defined contribution.

Defined contribution schemes offer employees a pension based on the contributions that they and their employer have made. The value of the pension on retirement depends upon the amount contributed, the investment return achieved and the cost of purchasing an annuity. The risk in defined contribution schemes is borne primarily by the employee.

Defined benefit schemes offer employees a specified pension based on their length of service and their salary. Employers therefore have to ensure that the contributions to their schemes are sufficient to provide the benefits that their employees are entitled to, based on actuarial advice. Accounting standards require employers to estimate their pension liabilities and include them in their accounts, although the structure of some multi-employer schemes means that the liabilities of individual member bodies cannot be calculated. The risk in defined benefit schemes is borne primarily by the employer and it is these schemes that may report deficits.

How we carried out the review

We used the information in Part B of the Annual Return to identify charities that had reported a pension fund deficit in their most recent accounts, those with a year end during 2012 in most cases. Part B provides summary information from the annual accounts, including the pension fund assets or liabilities. Only charities with an income of over £500,000 are required to complete Part B and therefore our review has only considered these larger charities.

We identified 740 charities whose accounts reported a pension scheme deficit. We then randomly selected 97 of those charities for follow up. We reviewed the charities' trustees' annual report and accounts to assess what action each was taking to deal with its deficit.

What we found

The size of the charities' pension scheme deficits

The total pension scheme deficit across the 97 charities was £617.4m. This represents 16% of the charities' combined annual income and 4% of their total unrestricted funds. £320.2m of the total deficit was contained within three charities. The size of the individual deficits across the sample is shown in the table.

Pension scheme deficit	Number of charities	Total pension scheme deficit
More than £40m	3	£320.2m
£5m - £40m	17	£199.2m
£1m - £5m	32	£79.9m
Less than £1m	45	£18.1m
Total	97	£617.4m

The charities' defined benefit scheme arrangements

We found that 60 charities were members of multi-employer schemes, in particular those provided by local authorities. The other 37 administered their own schemes and this group includes the three charities with the largest deficits. 29 charities were also members of multi-employer schemes for which their liabilities could not be calculated, such as those provided for teachers and university lecturers. This means that the accounts of these charities will not reflect the full extent of their pension liabilities.

The charities' responses to their pension scheme deficits

We found that all of the charities had disclosed information about their pension scheme deficits in their accounts, based on actuarial advice, as required by accounting standards. The SORP requires charities to include a review of their financial position within their annual reports. However, only 31 of the charities explained the financial implications of their deficits and how they planned to deal with them in their annual reports. We recognise that the trustees of charities with relatively small deficits may have decided that this was not a significant financial risk and did not merit inclusion in the annual report. However, others with significant deficits missed the opportunity to demonstrate to donors and beneficiaries that they were tackling the problem appropriately.

For those charities which reported specific actions in their annual reports and/or accounts, they included one or more of the following:

- A plan to repay past deficits, including increased contribution rates (40 charities).
- Closing the scheme to new members, often alongside reduced terms for existing members (47 charities).
- Closing the scheme to the future accrual of benefits, in effect closing the scheme to existing members (18 charities).

The three charities with the largest pension scheme deficits all reported that they are paying additional contributions as part of their plans to clear their deficits. Two of these charities have also closed their schemes to new members. This is consistent with our finding that a much higher proportion of the charities which administered their own schemes had taken action to deal with their deficits compared to those which were part of multi-employer schemes. In particular, 16 of the 18 charities that had closed their schemes to the future accrual of benefits were from the group that administered their own schemes.

It should be noted that closing a scheme or limiting its membership and benefits will help to manage the charity's future financial risk, but will not deal with the liability that has already been incurred. This liability may itself still change significantly over time.

The impact of the pension scheme deficits on the charities' going concern

A pension scheme deficit is not a debt, but an actuarial estimate of the liability that an employer will need to fund, usually over the long term. Nevertheless, a charity with a deficit will need to plan for the additional costs that it will be required to meet. This will involve setting aside future income and/or unrestricted funds, those which are available for expenditure on the charity's objects at the trustees' discretion.

We considered the extent to which the reports from the charities' auditors highlighted concerns over the impact of pension scheme deficits on the ability of individual charities to continue as going concerns. We found that none of the audit reports were qualified, although two contained an emphasis of matter paragraph about going concern. An emphasis of matter draws users' attention to matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements.

What action we took

We looked in more detail at 7 charities that appeared to face significant challenges because their pension scheme deficits were particularly large compared to both their unrestricted funds and annual income. These 7 charities reported deficits in excess of both their total unrestricted funds and 20% of their annual income. All were members of local government schemes and none had closed their membership of those schemes to the future accrual of benefits. They include the two charities with audit reports that contained an emphasis of matter on going concern.

One of the 7 charities has not submitted accounts since those for its 2010 year end and is now in liquidation. Its main source of income was central government grants. Another charity provides housing services. It is reducing its deficit through a programme of additional annual contributions. It has also agreed an indemnity for the pension liabilities of staff transferred to it since 2011 with the local authority for the area in which it operates.

We found that the other 5 charities have similar characteristics. They provide leisure, museum and social care services and are dependent on funding from local authorities. All of their annual reports and accounts recognise that meeting the charity's pension obligations is a significant issue. For three charities, their existence as going concerns is based on assurances of continuing financial support from their funding local authority. A fourth charity ceased trading in 2013. Its activities have been transferred to its parent charity and the funding local authority has provided an indemnity to that charity for the pension scheme deficit. The final charity's annual report and accounts do not state whether its funding local authority has provided assurances of continuing financial support or the actions it is taking to deal with its pension scheme deficit. We will be contacting the charity to obtain up to date information from them. Three of the four charities that are still trading have submitted more recent accounts since the sample was selected. The pension scheme deficits of all three charities have increased, leaving them even more dependant on financial support from their funding local authority.

A separate finding was that 7 of the 97 charities in the sample had negative unrestricted funds, two of which are included in the group of charities discussed above. The other five charities reported deficits that are approximately 3% of their annual income and so should be manageable. However, negative unrestricted funds are in themselves a matter of regulatory interest, since this may indicate financial problems that are being managed either by drawing on restricted funds or through borrowing. As a result of this finding, we will be reviewing a sample of charities with negative unrestricted funds as part of our 2014 programme.

Lessons for other charities

The findings from our review act as a reminder to the trustees of charities with defined benefit pension schemes that they should have a clear, up to date, picture of their charity's financial obligations and a plan to manage the likely future contribution increases. This will involve setting aside future income and/or unrestricted funds. Trustees should use their charity's annual report to explain how they are tackling the potentially serious risk of a pension scheme deficit.

Where an employer has a pension scheme deficit, The Pensions Regulator requires the employer and pension scheme trustee to agree a recovery plan to deal with it. Trustees in this position should take prompt professional advice on the financial implications and the action required. Where charities are dependant on local authority support to meet their obligations, they should agree a plan for doing so with their funding local authority. [The Pensions Regulator](#) has published guidance on its website to assist employers in dealing with their pension scheme deficits.