Expert advisory panel agrees with Ontario in pension accounting issue (February 14, 2017)

Credit Implications: Potentially positive

Credit Ratings: DBRS AA(Low), Moody's Aa2, S&P A+, Fitch AA-, All outlooks stable

Yesterday, an expert accounting advisory panel engaged by the Province of Ontario to review the province's accounting practices for pension assets released its report. The report sided with the province in concluding that the province's share of the net pension assets of both the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Sector Employees' Union Pension Plan (OPSEUPP) should be recognized as an asset in Ontario's financial statements. The panel concluded that it should be reported for the following reasons:

- Recognizing the asset will provide a faithful representation of the province's financial position
- The accounting surplus in the plan has a future economic benefit
- The government controls access to that accounting surplus
- The accounting surplus exists as the result of past transactions and events
- It would be misleading not to recognize the province's share of the assets in Public Accounts.

For the full report Click Here

The implications of this conclusion is that the province will have more financial flexibility to achieve its financial targets if it chooses to return to the pension accounting treatment it had used in the past. Adopting the Auditor General's treatment has resulted in an upward adjustment to the accumulated deficit as well as higher pension expense in fiscal 2015-16 and in future years. More information about these adjustments is provided below in the "Background" section.

The Auditor General is reviewing the report and is expected to comment in the near future. For the Province of Ontario's fiscal 2015-16 results, the Auditor General issued a qualified opinion because, although the statements adopted the Auditor General's pension accounting treatment for fiscal 2015-16, it did not retroactively restate the comparative 2014-15 public accounts and, therefore, by not correcting the error in accounting treatment, it constituted a departure from Public Sector Accounting Standards (PSAS).

At the same time, the preparer of the financial statements (Treasury Board Secretariat) who felt that they were and have always been in compliance with PSAS, signed off on fiscal 2015-16 results, but only following the adoption by the Province of Ontario of the Auditor General's accounting interpretation for the treatment of net pension assets for 2015–16 through a time-limited regulatory amendment (the "Pension Adjustment").

Background

In our Ontario Talking Points (January 27, 2017) research note we provided the following background information on this issue.

Could you clarify Ontario's course of action given the Auditor General of Ontario's qualified opinion on Pension Accounting?

- Although the pension expense is a non-cash charge, it is still very important to achieving the balanced budget target in Fiscal 2017-18, since Ontario's results are reported based on accrual accounting and not cash.

- The Province has engaged an expert panel of accountants to assess the issue.
- The issue being assessed is whether the Province can record an asset for the jointly sponsored plans under the accounting standards. The Province believes that an asset should be reported.
- The panel will focus on the accounting question, but will also provide advice on how to measure an asset, assuming it concludes that it should be reported. The calculation is sensitive to management's assumptions, including the discount rate which reflects management's best estimate of long-term returns on the assets which is currently at 6.25% and consistent with rates used by most other senior Canadian governments.
- Background – Ontario Public Accounts 2015-16: In Ontario's fall fiscal and economic update, the government adopted the Auditor General's accounting interpretation for the treatment of net pension assets for 2015–16 through a time-limited regulatory amendment (the "Pension Adjustment"). The impact of the change resulted in an additional $10.7bln being added to the net debt and accumulated deficit and an increase of $1.5bln to the annual deficit for 2015–16. Consistent with the accounting treatment adopted in the Public Accounts of Ontario 2015–2016, the medium-term fiscal outlook provided reflects a cautious approach to forecasting the projected annual Pension Adjustment. This cautious approach results in an estimated potential impact of $2.2bln in 2016–17, $2.8bln in 2017–18, and $3.7bln in 2018–19 to the annual Pension Adjustment.

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