1.0 Preamble

This document addresses the accounting for a net pension asset under Public Sector Accounting Standards (PSAS) by the Province of Ontario in relation to the Ontario Public Sector Employee Union Pension Plan (OPSEUPP).

As at March 31, 2016, OPSEUPP had an accrued asset position for accounting purposes of $520 M.

The details of the accounting valuation for the plan as of March 31, 2016 are as follows:

(all figures in $M)	**Total plan**	**50% Share of the plan**
Market related value of assets	17,380	8,690
Value of obligation	15,557	7,778
Surplus (deficit)	1,823	912
Unamortized (gains) losses	(96)	(48)
Adjustment for March 31, 2016	(583)	(292)
Asset (liability) position	1,144	572
Specific Government adjustment		(52)
Final Asset (liability) position on B/S		520

2.0 Issue to be considered

1. For accounting purposes, how should OPSEUPP be classified under PSAS?
2. As a result of the classification, how should the Province of Ontario recognize the pension surplus (for accounting purposes) of OPSEUPP in the Public Accounts?)
3. How should a pension asset of OPSEUPP be measured in the Public Accounts of the Province of Ontario?

3.0 Conclusions

1. OPSEUPP is a Joint Defined Benefit Plan under PS 3250
2. The Province of Ontario should account for the OPSEUPP as a defined benefit plan for its proportionate share of the surplus or obligation that arises under the plan.
3. The Province should record is proportionate share of the asset and apply the asset ceiling test under PS 3250. The Province believes that the asset is recoverable through the reduction of future contributions and as such, no valuation allowance is necessary.

4.0 Background information

4.1 Overview of OSEUPP

The OPSEU pension plan (the “Plan”) is jointly sponsored by the Ontario government and the executive of OPSEU. The Plan is managed by OP Trust, a 10-member Board of Trustees, five of whom are appointed by OPSEU and five by the Government. OPSEU represents the various public servants, while the Government represents employers.

OPSEU and the Government are equally responsible for ensuring the pension plan has enough money to meet its long-term pension obligations. Section 4.6 of the Plan Text notes that the Employer, shall pay into the Fund an amount equal to the aggregate amount of all contributions deducted from the members.

In addition, they appoint experienced, professional experts to the pension plan's Board.

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The assets of the Plan are held by OP Trust in trust for the beneficiaries of the plan – Ontario public servants. The Government does not have unilateral access to the assets of the trust (including changing contribution amounts, taking contribution holidays, or withdrawals). Actions of this nature require negotiation and agreement between the two sponsors.

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Commented [NP3]: However, there is a question w.r.t. unilateral access to 'surplus' vs. the assets generically. Confirm.

The Funding Policy, Board-Approved Policy, dated July 17, 2014

OP Trust provides the following regarding the use of Plan Surpluses:

OP Trust recognizes that decisions on the use of surplus are reserved to the Sponsors. However, in the interests of providing information to the Sponsors, OP Trust has recommended a number of principles for the Sponsors to consider when determining how to use surplus that arises from time to time, designed to minimize the risk to future Plan funding. They are as follows, in order:

1. Use surplus to pay for any past unfunded liability that has not been fully paid through previous valuations where amortization of prior deficits is incomplete.

2. Restore benefits previously lost due to prior deficits.

3. Restore stabilization reserves to recommended levels to protect against future adverse actuarial and investment experience.

4. If the current employee and employer contribution rates are above the normal rate specified in OP Trust Management studies, use surplus to return contributions back to the normal rate.

5. If surplus is still available, consider temporary contribution reductions as the most predictable way to reduce the surplus in the Plan.

6. When considering Plan improvements, establish a preference for temporary benefit improvements over permanent Plan changes since temporary improvements will be prepaid from existing surplus and are less likely to have an impact on future contribution rates.

7. When considering permanent Plan improvements, recommend those that better rationalize the overall Plan design, such as provisions that present an undue hardship or level of unfairness to Plan members.

Member and Employer Rate Stabilization Reserves
The Sponsors of the OPSEUPP have established two stabilization reserves to deal with surpluses when they arise. The Employer and Member Stabilization Funds are the remaining employer's and members'

share of the net actuarial gain. These funds are to be used as a buffer against any future actuarial losses that may arise.

Gains are shared equally by the employer and OPSEU, subject to the following:
(i) 50% of the gain or such other amount as may be collectively bargained shall be used for the benefit of employers, to be applied against any special payments required to be made by any employers and thereafter to reduce employers' normal costs [SA, s. 56 (c) (i)]; and
(ii) 50% of the gain or such other amount as may be collectively bargained shall be used for the benefit of Plan members [SA, s. 56 (c) (ii)].

Excerpts from Plan Text on Withdrawal of Surplus

Section 18.2 of the Plan text notes that, if the Plan is wound up in whole or in part, the assets in the Fund shall first be allocated for the provision of benefits in accordance with terms of the Plan, the Pension Benefits Act, the Income Tax Act (Canada) and any other applicable legislation or agreement between the sponsors.

Section 18.3 also notes that if after provision for benefits payable to or in respect of members of the wind up, in whole or in part, of the plan, assets remain in the Fund or the part of the Fund affected by a partial windup, such assets shall be applied as determined by OPSEU subject to the Pension Benefits Act and the Income Tax Act (Canada) for the exclusive benefit of the members and former members, their beneficiaries and dependents.

4.2 Accounting for OPSEUPP by the Province

The Province of Ontario's Public Accounts include a pension asset of $520M that represents the employers share of the OPSEUPP surplus position based on the accounting actuarial valuation for the plan. This situation has arisen because, to this point in time, the government's share of the total contributions to the Plan plus the actual investment returns on the Plan's assets have exceeded the government's share of the accumulated retirement benefit expense. The accounting for the accrued benefit obligation results from a complex process involving significant assumptions and actuarial calculations covering a very long time frame.

The Province recognizes 50% of the Accounting Surplus on the statement of financial position, which represents the Province's Share of the Pension Plan.

5.0 Question 1 – Classification of the OPSEUPP

5.1 Relevant Guidance on Classification

PS 3250 has specific application guidance to Joint Defined Benefit Plans:

Joint defined benefit plans

.079 Governments may participate jointly in defined benefit plans where the government shares the risks and rewards jointly with plan participants, represented by a sponsor or sponsors. Joint defined benefit plans are governed by a formal agreement between the sponsors, which establishes that the sponsors have shared control over the plan. A governing board is generally appointed by the joint sponsors with equal representation and a mutually agreed-upon chair.
.080 A government would consider the characteristics of the plan to determine whether it meets the definition of a joint defined benefit plan. In a joint defined benefit plan, funding contributions are shared mutually between the government and the plan members. The sponsors have control over decisions related to the administration of the plan and the level of benefits and contributions on an ongoing basis based on the terms of the contractual agreement. The sponsors share, on an equitable basis, the significant risks associated with the benefit plan. Risk would not be considered to be equitably shared in an arrangement where the government and the joint sponsors fund the plan equally but where the government retains the full risk of the accrued benefit obligation. If the government retains the residual risks it is unlikely that the plan meets the definition of a joint defined benefit plan.
.081 *When a government participates in a joint defined benefit plan, the government's risk is limited to its portion of the plan. The government should account for its portion of the plan in accordance with the standards for defined benefit plans*. [SEPT. 2001]
.082 A government may convert an existing defined benefit plan for which it is the sole sponsor to a joint defined benefit plan where the risks and benefits are shared. When converting to a joint plan, a government would consider whether there are any special accounting issues that arise, including whether the predecessor plan has been settled or partially settled and/or curtailed or partially curtailed. In assessing such issues a government would have regard to its specific circumstances and the terms of the joint defined benefit plan.

5.2 Conclusion on classification

Application of PS 3250 to Joint Defined Benefit Plans
A joint defined benefit plan is a unique retirement benefit plan where the sponsors have shared control over the plan. No one party can, by itself, control decisions around funding, benefits and other matters; funding contributions, risks and benefits are to be shared mutually between the sponsors. Paragraph .081 of PS 3250 clearly states that a government should account for its portion of the Plan in accordance with the standards for defined benefit plans. As a result, the Province of Ontario accounts for its proportionate share of the Plan and has historically recorded its share as 50% of the plan.

6.0 Question 2 – Recognition of surplus

6.1 Standards in the PSA Handbook

The following standards were considered relevant when determining whether an asset can be recognized on the Public Accounts:

.081 *When a government participates in a joint defined benefit plan, the government's risk is limited to its portion of the plan. The government should account for its portion of the plan in accordance with the standards for defined benefit plans*. [SEPT. 2001]

.050 *An accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. A change in valuation allowance should be recognized in the statement of operations for the period in which the change occurs.* [SEPT. 2001]

.051 A government with a defined benefit plan may have an accrued benefit asset for accounting purposes. An accrued benefit asset arises when the government's total contributions to the plan, including interest earned thereon, are greater than the retirement benefit expense recognized since the start of the plan. Contributions reflect the funding objectives of the plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons, including the fact that actuarial gains and losses are deferred and amortized in future periods.

.052 A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. The accrued benefit asset may become impaired when there is a plan surplus for accounting purposes that the government is not entitled to benefit from fully. For example, there may be a regulatory moratorium on pension surplus withdrawals or uncertainties as to a government's legal right to use a plan's accounting surplus.

6.2 Analysis

PS 3250.50 requires that an accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance. When a defined benefit plan gives rise to an accrued benefit asset, a government should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. This comparison between the adjusted benefit asset and the expected future benefit informs whether a valuation allowance is required and if so, how much of a valuation allowance should be recorded.

PS 3250.52 contemplates that there are two ways in which a government can benefit from an accrued benefit asset. A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions. As such, an expected future benefit would include the ability to either withdraw plan assets from the plan or reduce future contributions.

PS3250.52 also goes on to consider that an accrued benefit asset may become impaired when there is a plan surplus that the government is not entitled to benefit from fully. The paragraphs in the standard that follow determine how a government would go about considering the extent of any impairment, which would give rise to a valuation allowance. In order to make this determination, the government is required to consider the “expected future benefit”, which would effectively create a ceiling for the asset. Here the guidance diverges between benefit expected to be realized through future reductions in contributions and those to be realized through withdrawal of surplus.

Specifically with respect to withdrawal of surplus, PS 3250.59 is very clear that expected future benefit can only be asserted where the government has a current legally enforceable right to withdraw assets from the Plan. This guidance was considered as to whether it should be applied to cases where the expected future benefit related to the Pension Asset is expected to be realized through reduced contributions, however it was concluded that the guidance does not apply in this situation. While PS 3250.59 does introduce the concept of a legally enforceable right, it does so solely in the context of a government's future withdrawal of a Plan surplus, and not in the context of a government's reduction of future contributions.

OPSEUPP has established two rate stabilization funds, being one for the employers and one for the employees. The Funding Management Policy establishes that gains must be shared equally amongst the sponsors. As actuarial gains are generated, the Province has the ability to use its 50% of the gain to reduce contributions.

6.3 Conclusion

The Province should account for OPSEUPP as a joint defined benefit plan, which means applying PS 3250 defined benefit accounting for its share of the plan. As the plan is in an asset position, the Province should reflect its proportion of the asset (50%) subject to any valuation allowance.

7.0 Question 3 – Measurement of a pension asset

7.1 Standards in the PSA Handbook

The following standards are relevant to determining how the Pension Asset should be measured

.053 To determine the extent to which an accrued benefit asset may be impaired, the government first determines the adjusted benefit asset. The adjusted benefit asset is the accrued benefit asset less net unamortized actuarial losses (determined on a basis using market value of assets).
.054 The adjusted benefit asset is then compared to the expected future benefit. When the expected future benefit exceeds the adjusted benefit asset, the accrued benefit asset is not impaired and, accordingly, no valuation allowance is required. The chart included as Appendix A to this Section is intended to set out the relationship between the various defined terms.
.055 The objective of the standard in paragraph PS 3250.50 is to limit a government's accrued benefit asset to the amount it can realize in the future. The expected future benefit is a calculated amount representing the benefit a government expects to realize from a plan surplus. An expected future benefit includes any withdrawable surplus or reduction in future contributions.
.056 A government determines its expected future benefit as the sum of:
a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and

b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

.057 A government's expected future accruals for service for the current number of active employees are determined on a basis consistent with that used to determine its accrued benefit obligation. These expected future accruals for service, less required employee contributions and minimum contributions

the government is required to make regardless of any surplus, are then discounted back to the current period to determine the present value. The interest rate used to calculate this present value is the expected rate of return on plan assets used to determine the benefit expense in the period.
.058 When administration expenses are paid by the plan and included in the normal cost calculation, a best estimate of the future administration expense is included in the expected future accruals for service. When administration expenses are paid by the plan and not included in the normal cost calculation, the rate of return on plan assets is adjusted to reflect the deduction of the administrative expenses.
.059 A key factor in determining a government's expected future benefit from a defined benefit plan with a plan surplus for accounting purposes is the ability of the government to withdraw assets from the plan. The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal. It excludes any withdrawable plan surplus a government is currently required, or intends, to allocate to employees. A government may not anticipate obtaining a legally enforceable right to withdraw a portion of a plan surplus to which it is not currently entitled, whether on the basis of precedent or otherwise. Accordingly, when withdrawal of plan surplus requires the approval of employees or an appropriate regulatory authority or a court of law, a government excludes any amount subject to this restriction from its expected future benefit until such approval has been obtained. A change in the allocation of surplus between a government and its employees is incorporated into the calculation of the expected future benefit only when it has been agreed to and, when required, approved by the appropriate regulatory authorities

7.2 Calculating the limit on the carrying amount of an accrued benefit asset

Section PS 3250 paragraphs .053 to .058 lay out a mathematical calculation that determines the value of the adjusted benefit asset and the expected future benefit, and tests whether a government can expect to recover its accrued benefit asset through a withdrawal of surplus or through the reduction of future contributions. The stated objective of this exercise, as set out in Section PS3250 paragraph .055, is to limit the amount of the government's accrued benefit asset to the amount "it can realize in the future." The expected future benefit is further described as "a calculated amount representing the benefit a government expects to realize from a plan surplus". A valuation allowance is recorded against the pension asset to limit the asset value, if necessary, based on this analysis. This is a prescriptive test under Section PS 3250, specifically that the amount of an asset is limited to the "expected future benefit" as defined in Section 3250 paragraph .56.

Therefore in accordance with Section PS 3250 paragraph .56 the Province calculated the expected future benefit as the sum of:

a) the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus; and

b) the amount of the plan surplus that can be withdrawn in accordance with the existing plan and any applicable laws and regulations.

Each of these is discussed separately.

7.3 Considerations re: withdrawal of the surplus (Section PS 3250 paragraph .056 (b))

In relation to the ability of a government to benefit from a surplus through the withdrawal of the surplus, Section 3250 paragraph .059 indicates "The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal."

For OPSEUPP, the Funding Policy does not contemplate surplus withdrawal and so for the purposes of this analysis, it is assumed that any surplus withdrawal would have to be negotiated between the sponsors.

There are no provisions in the HOOPP Plan text to permit the withdrawal of a surplus. PS 3250.59 indicates that the expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal. As there is no certainty that the Province will be able to access the OPSEUPP Surplus through withdrawal, the Province does not rely on withdrawal of surplus to support the measurement of the OPSEUPP asset.

7.4 Considerations re: reduced future contributions (Section PS 3250 paragraph .056 (a))

Section PS 3250 paragraph .056(a) sets out that the government's calculation of expected future benefit would be the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the government is required to make regardless of any surplus.

In the event of a surplus, the OP Trust recommends to the sponsors that certain principles be followed when determining how to use the surplus. The recommendation from the OPT Trust is to use surpluses to fund any unfunded liabilities or restore cuts to benefits due to prior deficits, before moving into replenishing stabilization reserves, reducing contributions, and then restoring benefits. As such, there are two significant indicators that lead the Province to believe that future contributions can be reduced, which are:

1. The Province has its own stabilization reserve that can be utilized to reduce future

contributions (so the Province has some autonomy and segregation of its 50% of the surplus)

2. The Funding Principles of the plan put an emphasis on restoring unfunded liabilities (which will reduce contributions in the future), and reducing current contributions, before enhancing benefits.

In determining the expected future benefit of the asset, the Province has looked at the present value of its expected future accruals for service for the current number of active employees, less the present value of required employee contributions and minimum contributions the Province is required to make regardless of any surplus. As there are no minimum contributions that the Province is required regardless of surplus, the expected future benefit will exceed the plan asset because the expected future benefit will equate to the expected future accruals for service for the current active employees (less employee contributions).

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7.8 Conclusion on measurement

The OPSEUPP is in a surplus position and can recognize an asset on the balance sheet. The measurement of that asset is subject to the asset ceiling test. The expected future benefit from the asset is the amount of contributions that could be reduced in the future from this surplus. As management has its own stabilization reserve and the Funding Policy promotes contribution reduction ahead of benefit improvement, the expected future benefit exceeds the net plan asset, which means that no valuation allowance should be recorded.