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Ontario

March 1, 2017

Mr. Michael Puskaric, CPA, CMA
Director, Public Sector Accounting
Public Sector Accounting Board
277 Wellington Street West
Toronto ON M5V 3H2

Dear Mr. Puskaric:

**Re: Invitation to Comment – Employment Benefits: Deferral Provisions in Sections PS 3250 and PS 3255**

Thank you for the opportunity to provide feedback on the Public Sector Accounting Board's (PSAB) Invitation to Comment on *Employment Benefits: Deferral Provisions in Sections PS 3250 and PS 3255*.

Reflecting the substance of employee-related benefits on a government's financial reports is integral to meeting user needs for transparency and accountability. The significant fiscal impact and complex nature of pension and benefit related arrangements demand that any potential changes to the existing standards be carefully considered. The recent challenges experienced in Ontario related to the interpretation and application of PSA Sections PS 3250 and PS 3255 are tangible evidence of the complexity of public sector reporting in this important area, and the need to ensure that standards will continue to serve transparency and accountability in government reporting and sound fiscal policy decisions.

Ontario supports PSAB's efforts to ensure that public sector financial reporting standards remain current and that they continue to meet the unique objectives related to transparency and accountability of the legislature and public as primary users. In this regard, pension related standards should reflect the long-term nature of pension plans and result in information that best supports (internal and external) users' needs. Since governments operate under balanced budget frameworks, PSAB is encouraged to also consider unintended negative consequences such as impacts on fiscal policy decisions.

To ensure that decisions regarding accounting standards for the public sector sufficiently consider the needs of key users, we would encourage that PSAB remove the reference to 'external' when referencing users' needs which are relevant when considering accounting standard activities. In fact, the emphasis on external users for purposes of the ITC appears inconsistent with PSAB's strategic plan which does not restrict relevance of decision making to external users. For your reference, we have attached Ontario's response to *Conceptual Framework Task Force Consultation Paper #2: Measuring Financial Performance in Public Sector Financial Statements* as an appendix to highlight our prior comments on the importance of public sector financial statements for decision making purposes, for example, in relation to balanced budget legislation.

The existing deferral provisions in Sections PS 3250 and PS 3255 which consider the long-term nature of pension plans currently reduce the year-to-year volatility on the statement of operations from changes in the market value of plan assets and changes in the accrued benefit obligations. The elimination of the deferral provisions would result in an immediate impact of paper gains or losses on the government's statement of operations, net debt and accumulated surplus/deficit. We do not believe that such volatility especially on the statement of operations under a balanced budget framework would service the 'public interest'. Furthermore, recognition of such short-term changes would not fairly reflect the impact on the government's financial position of these plans which are long-term in nature.

As at the date of this response, we note that PSAB's accounting standard on financial instruments has not yet been implemented at the senior government level. As you are aware, senior governments across Canada continue to be concerned about the introduction of unrealized gains and losses on the statement of operations which they do not feel would reflect the economic substance of the government's activities. Also, as you are aware, PSAB's Conceptual Framework project is also not completed. These two factors, taken together with the significance and complexity of reporting for employee future benefits only serves to increase governments' concerns regarding the potential direction of pension and benefit accounting standards. It will be critical that the Task Force has a robust understanding of the complete facts and complexities related to public sector pensions and the economic substance thereof.

We understand that this is a long-term project, and that it will involve several phases. In light of the complexities and interdependencies associated with each of the elements under consideration as part of this project, we would encourage PSAB to consider providing a more robust and synthesized presentation of the proposals prior to issuance of a Statement of Principles to ensure consistency between stakeholder responses and with the underlying concepts in the Handbook.

Specific responses to the detailed questions posed in the Invitation to Comment are included in the attachment to this letter. In addition to these specific responses, we would be please to meet with you to share additional background on Ontario's pension plans and our recent reporting challenges related to jointly sponsored pension plans in particular.

Thank you again for the opportunity to comment on the Invitation to Comment.

Yours sincerely,

Cindy Veinot
ADM and Provincial Controller
Office of the Provincial Controller Division

Attachment
c. Karen Hughes, Associate Deputy Minister, Office of the Treasury Board

## ATTACHMENT

1. **Do you agree that PSAB needs to consider whether the deferral provisions in the standards are appropriate?**

   Yes. Ontario supports PSAB's efforts to review Sections PS 3250 and PS 3255 considering these standards have been in effect for over 15 years and it is important to ensure that Canadian public sector pension plans remain current and reflect additional experience gained since original implementation.

   It is however a challenge to review and comment on elements of Sections PS 3250 and PS 3255 in isolation without consideration as to the overall direction being taken in PSAB's overall project. Responding to this Invitation to Comment while PSAB continues to review the reporting model through its Concepts Underlying Financial Performance, as well as its financial instruments standard is also challenging. Alternatives which are currently not allowed in the PSA Handbook (for example, reporting a deferral on the statement of financial position or reporting actuarial gains/losses on a statement other than the statement of operations) may or may not be acceptable and appropriate after the review of the conceptual framework is complete.

   It will therefore be important for PSAB after issuance of Invitation to Comments on specific matters and after the conceptual framework project is complete to allow the public sector community an opportunity to comment on the matters being covered collectively (prior to issuance of a Statement of Principles) to ensure consistency between recommendations and with the underlying concepts in the Handbook.

2. **(a) Which, if any, of the components of the changes in the value of the accrued benefit obligation identified in Chart 2 and paragraphs .015-.056 should be considered separately in determining the accounting for the changes in the accrued benefit obligation in the statement of operations and the statement of financial position?**

   **(b) Are there any additional components that should be separately identified and considered?**

   The Province of Ontario sponsors several pension plans. It is the sole sponsor of the Public Service Pension Plan (PSPP) and joint sponsor of the Ontario Public Service Employees Union (OPSEU) Pension Plan and the Ontario

Teachers’ Pension Plan (OTPP). In addition to the Provincial sponsored plans, pension benefits for employees in the hospital and colleges sectors are provided by the Healthcare of Ontario Pension Plan (HOOPP) and the Colleges of Applied Arts and Technology Pension Plan (CAATPP) respectively, and are included in the Province’s financial statements.

A primary objective of government financial statements is to demonstrate accountability by the government to the public and its legislature. Financial statements are a vehicle by which governments demonstrate whether they did or did not do what they intended and why or why not. Government financial statements should therefore be clear and understandable to the public. Pension plans are long-term in nature. Because of the long-term nature of pension plans, government’s long-term accountability should be demonstrated to the public with respect to pension plans. Standards on retirement benefits in the PSA Handbook should consider the long-term accountability of government to the public.

While it is useful to understand the different components resulting in change in the accrued benefit obligation, treating separately these different components will not resulting in any meaningful improvement in the accountability of the government. It will only result in additional complexity for both financial statement preparers and users. Public interest will not be better served treating demographic assumptions differently than other economic assumptions for example. The components are assumptions long-term in nature associated with a long-term obligation. They reflect management’s best estimate.

While experience adjustments are firmer in the sense they relate to actual experience and prior assumptions, they still should be viewed in light of the long-term nature of a pension obligation. Assumptions are long-term in nature and will evolve over time. Adjustments one year may be offset in future years. Short-term recognition would not demonstrate better the long-term accountability of the government.

3. **Which view of how to break down the investment return component of the changes in the value of plan assets identified in paragraphs .057-.065 is more appropriate for determining the accounting for the changes in plan assets in the statement of operations and the statement of financial position?**

Ontario considers the current expected and unexpected return breakdown to be appropriate.

The decision to sell a plan asset (an investment) and realize a gain or loss is not an indicator of how well a government is managing its pension plans. It is not an indicator of the return on plan assets. It is an investment decision most often made by the Board of the pension plan, beyond the control of the government. Because an investment gain is realized, does not mean the funds are available to be used to meet the government's general obligations. The funds are to be used for long-term pension obligations and will either be reinvested or used to pay out benefits to the plan members. Therefore the realized and unrealized gain/loss break down is not appropriate for determining the change in plan assets on the statement of operations.

The current expected and unexpected return breakdown is appropriate. While the estimate of expected return on plan assets is somewhat subjective, it does need to be supported based on management's best estimate. It needs to be appropriately supported based on prior historical returns and future projections. It is not arbitrarily determined by the government. It is audited by the government's auditor on an annual basis.

4. **Are there any other views of how to break down the investment return component of the changes in the value of plan assets that should be considered for determining the accounting for the changes in plan assets in the statement of operations and the statement of financial position?**

   No additional views are noted. The current break down of investment return between expected and unexpected return is appropriate.

5. **Are there any additional aspects of the components of the changes in the value of the accrued benefit obligation and plan assets that should be considered for determining their accounting in the statement of operations and the statement of financial position that have not been identified in paragraphs .018-.065?**

   Please refer to the responses to questions 2 and 3.

6. **Are there any significant considerations for determining the accounting for each component of the changes in the value of the accrued benefit obligation and plan assets in the statement of operations and the statement of financial position that have not been identified in paragraphs .070-.091?**

Please refer to the responses to questions 2 and 3.

7. **Are there any alternatives for recognition of the changes in the value of the accrued benefit obligation and plan assets in the statement of operations and the statement of financial position that have not been identified in paragraphs .092-.109 and .115-.120?**

   Responding to the questions in the Invitation to Comment regarding accounting for the components of the change in the value of the accrued benefit obligation and plan assets is made more difficult as PSAB is currently reviewing the reporting model through its Concepts Underlying Financial Performance project. Alternatives which are currently not allowed in the PSA Handbook (for example, reporting a deferral on the statement of financial position or reporting actuarial gains/losses on a statement other than the statement of operations) may or may not be acceptable and appropriate after the review of the conceptual framework is complete.

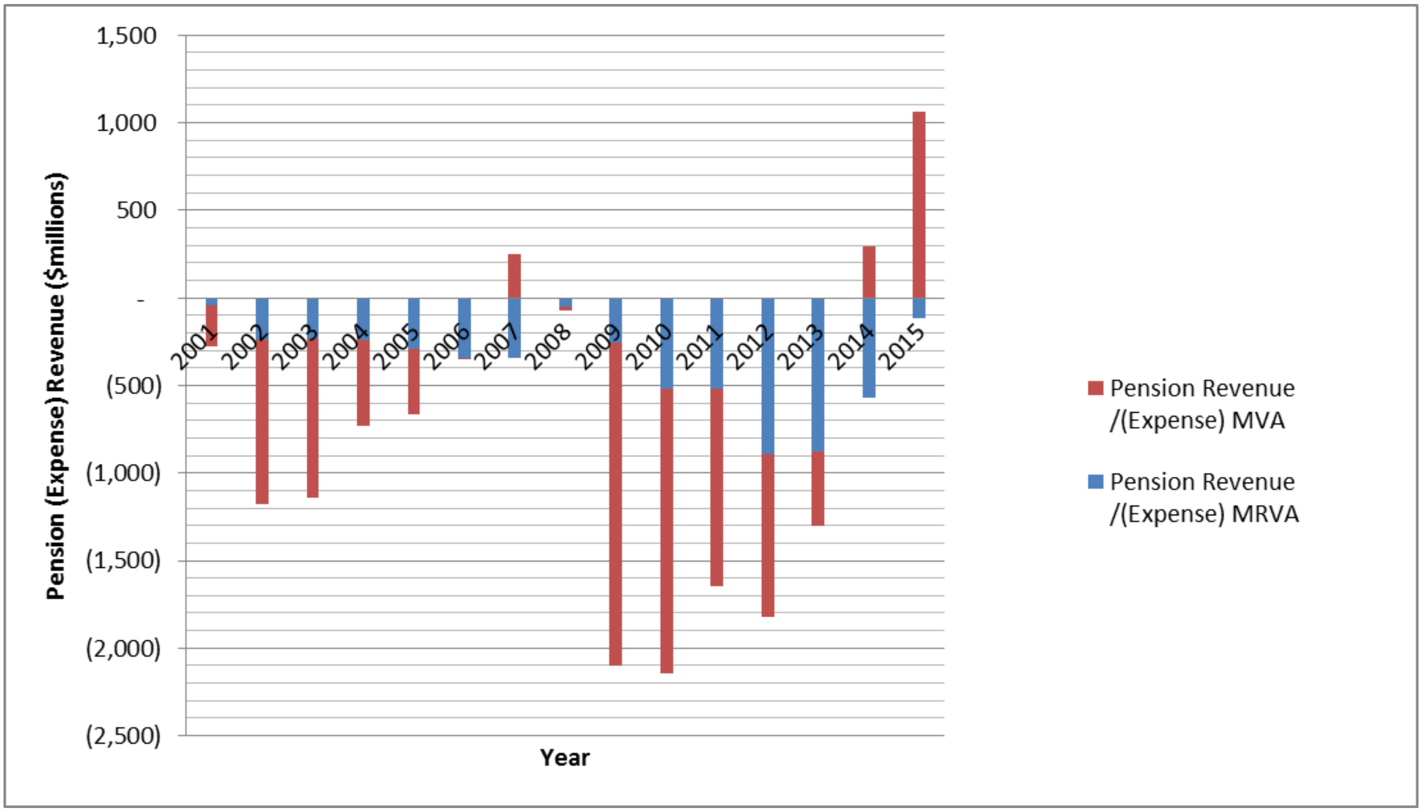
8. **Are there any alternative amortization periods and/or amortization bases under the deferred recognition alternative that have not been identified in paragraphs .110-.114?**

   Amortization of actuarial gains and losses over the expected average remaining service life of the related employee group is generally accepted as it recognizes the long-term nature of pension plans and reflects the particular circumstances of each pension plan's employee group.

   It could be considered to allow a government to elect to amortize actuarial gains and losses over a shorter period as allowed by IPSAS. This election may be appropriate for example, when a pension plan is declining in membership or when the majority of plan members are currently retired.

9. **Are there any alternatives for valuing plan assets that have not been identified in paragraphs .121-.128?**

   Valuing plan asset at market value or market related value is appropriate. Our research indicates that Ontario and most other senior governments across Canada use market related asset values in calculating pension expense. From Ontario's perspective, market related values are reflective of the long-term nature of pension plans. For illustrative purposes, we have included below comparative impacts on pension expense for the Ontario Teachers' Pension Plan using both the status quo (market related value) and market values.




As expected the surplus/deficit impact of Ontario Teachers' Pension Plan is more extreme when plan assets are valued at market value rather than market related value.

**10. Are there any significant arguments relating to any recognition alternatives in the statement of operations (paragraphs .092-.109) and the statement of financial position (paragraphs .115-.120), and plan asset valuation options (paragraphs .121-.128) that have not been identified?**

Please refer to the response to question 7.

**11. How should each component of the changes in the value of the accrued benefit obligation and plan assets be recognized in the statement of operations and the statement of financial position?**

Ontario considers the current deferred recognition of the changes in the value of the accrued benefit obligation and plan assets in the statement of operations to be most appropriate in meeting user needs and serving the public interest.

Immediate recognition of changes in accrued benefit obligations and plan assets in the annual surplus/deficit would not enhance the accountability and transparency in reporting of government financial position and results to the legislature or the public. It does not consider the long-term nature of a pension plan. Public interest is not better served by a standard which would present year-over-year volatility on the statement of operations and negatively impact fiscal policy decisions. Financial reporting should reflect government decision making, not drive decision making. For example, it would not be beneficial if actions were taken to reduce volatility by deciding to eliminate defined benefit pension plans.

No recycling removes all volatility from the statement of operations and therefore does not impact budget to actual comparisons or balanced budget legislation. This option however reduces the significance of the surplus/deficit and accumulated surplus/deficit balances. It will create a second measurement of performance for the government. Determining the bottom line of the government will not be as clear and obvious.

Deferred recognition in the annual surplus/deficit is more appropriate as it recognizes the long-term nature of pension plans.

The recycling option (deferred recognition) is more of a balanced approach. Deferred recognition in the annual surplus/deficit recognizes the long-term nature of pension plans. Recognizing the changes over an extended period better reflects the long settlement period of the pension obligation and the long-term investment horizon of plan assets. Volatility in the annual surplus/deficit (inconsistent with the long-term nature of pension plans) is reduced by smoothing out the effect of the changes and allowing short-term fluctuations to be offset. It allows the budgeting process to incorporate future amortization of the changes in subsequent periods, thus not distorting the projected or reported fiscal position of the government.

Regarding the recycling option, determining the alternatives available is made more difficult as PSAB is currently reviewing the reporting model through its Concepts Underlying Financial Performance project. Alternatives which are currently not allowed in the PSA Handbook (for example, reporting a deferral on the statement of financial position or reporting actuarial gains/losses on a statement other than the statement of operations) may or may not be acceptable and appropriate after the review of the conceptual framework is complete.

**12. On what basis should plan assets be valued?**

Ontario supports continuing to allow choice to value plan assets at market value or market related value as allowed in Section PS 3250. Unexpected returns associated with a change in value of plan assets would continue to be included as a component of the actuarial gains and losses. The actuarial gains and losses would continue to be amortized to the statement of operations over the expected average remaining service life of the related employee group.

Based on our research, market related value is widely used by governments throughout Canada, likely because it recognizes the long-term nature of pension plans and the assets held to fund the future obligations. Recognizing short-term changes in the value of long-term plan assets on the statement of operations is not an appropriate indicator of the financial resources available to the government over the long-term. Information on the market value of plan assets is still available to financial statement users in the notes to the financial statements.

Market value is an alternative, simple and objective measure which represents the value of the assets set aside to meet the pension obligations at a point in time. It is easily understandable and is consistent with the market value of the plan assets as reported in the pension plan's stand alone financial statements. Market value is also more consistent with the basis of measurement currently in Section PS 1000 which is part of the conceptual framework in the PSA Handbook to be followed by all public sector entities; however user needs may not best be met by its application in relation to these long-term assets.

Allowing choice provides government with the most flexibility based on their assessment of the needs of their financial statement users considering the long-term nature of pension plans.

13. **Do you measure plan assets at market value or market-related value? If market-related value, please describe how it is determined.**

The Province of Ontario values sponsored and joint sponsored pension plan assets by adjusting to market value over a period of five years in accordance with Section PS 3250, paragraph .035 (i.e. at market related value). Unexpected returns associated with a change in value of plan assets are included as a component of the actuarial gains and losses. Actuarial gains and losses are amortized to the statement of operations over the expected average remaining service life of the related employee group.

For illustrative purposes, please see the attached graph (included in the response to question 9) comparing the relative impact on pension expense for the Ontario Teachers' Pension Plan under both the MRVA and MVA approaches. Since senior governments operate under balanced budget frameworks, the MVA approach would prove problematic and not result in a fair comparison of the government's performance in relation to the approved budget.

14. **What is your accounting policy of recognizing actuarial gains and losses (deferred or immediate recognition) arising from post-employment benefits and compensated absences that do not vest or accumulate? Please explain why that accounting policy was chosen.**

    Post-Employee benefits such as Long-Term Income Protection (LTIP), Work Safety and Insurance (WSIB), continuation of employee benefits such as supplementary health and hospital, dental for employees on LTIP or WSIB are all event-driven and the Province recognizes the liability when the event that obligates the government occurs (i.e. when the employee goes on LTIP or goes on WSIB). An actuarial valuation is performed each year and actuarial gains and losses are recognized immediately. As benefits are not tied to length of service, actuarial gains and losses are not deferred or amortized.

    Compensated absences (i.e. Management Compensation Options) accumulate but do not vest as there is no cash value upon termination or retirement. Liabilities are accrued while benefits are accumulated but actuarial gains or losses are recognized immediately.

    Legislative severances that accumulate and vest (i.e. employees accrue one week of pay under legislative severance for every year of service for a maximum of 1/2 of an employee's annual salary) are accounted for in accordance with Section PS 3250 where actuarial gains and losses are deferred and recognized over the expected remaining average service life of the related employee group. As benefits are earned over the service life, experience gains and losses are amortized accordingly.

15. **Are there any specific issues with, or related to, Sections PS 3250 and PS 3255 that have not been identified in the "Background to the project" section (page ii) that PSAB should consider in this project?**

    Yes. Additional issues PSAB's Employment Benefits Task Force should address in this project are:

    - Inconsistencies between the employment benefit standards and other standards in the PSA Handbook. For example, the deferral mechanisms in

Section PS 3250 are inconsistent with the definitions of assets and liabilities and with the recognition guidance in Section PS 1000. Such conceptual inconsistency makes it more difficult to apply the concepts in developing appropriate accounting policies when Section PS 3250 is not clear on a particular issue or different interpretations could be made.

- Application of the guidance on defined benefit plans to joint defined benefit plans, specifically whether to apply the standard's measurement guidance to the plan as a whole or to the government's portion of the plan.
- How "minimum contributions" and "regardless of any surplus" should be interpreted in the context of the Asset Ceiling Test, including whether the surplus considered is a funding surplus or an accounting surplus.
- Significant differences that can exist between the financial position of a plan reported in its own financial statements and that reported in the financial statements of the government sponsor, largely because of different discount rates required by different accounting frameworks. This can be confusing to users trying to assess the underlying financial health of the plan and the assets and liabilities of the sponsor in respect of that plan. Significant differences can arise between the amounts reported for accounting purposes and those reported for funding purposes that can also be confusing to users when both valuations are made publicly available sometimes in the same document. PSAB's Employment Benefits Task Force should consider the concepts underlying the discount rate used in measuring pension obligations for accounting purposes, and whether additional disclosures regarding the purpose of the accounting valuation compared to a funding valuation may be helpful to users of government financial statements.
- A review should be performed of the valuation allowance guidance in the standards to ensure the guidance is clear and complete.
- A review should be performed of the guidance on accounting for multi-employer plans in the standards to ensure the guidance is clear and complete.

16. **Would you be interested in participating in future field tests, which may involve using actual benefit plan data to identify the financial implications of various alternatives?**

Yes. Ontario would be interested and willing to participate in future field testing on this important project.