Position paper for Ontario Teachers' Pension Plan

Preamble

This document addresses the accounting for pension assets by the Province of Ontario in relation to the Ontario Teachers' Pension Plan (OTPP).

The constating documents of OTPP are different from those of the Ontario Public Service Employees' Union Pension Plan (OPSEUPP), the Healthcare of Ontario Pension Plan (HOOPP), and the CAAT pension plan (CAAT). The appropriate accounting for OTTP may be different than for other pension plans in Ontario as well as pension plans in other provinces, for example New Brunswick and British Columbia, as a result of differences in the respective constating documents.

A separate document will provide further analysis on the Province's accounting in relation to OPSEUPP, HOOPP and CAAT.

Issue to be considered

In connection with the preparation and audit of the 2015-16 Public Accounts, the Office of the Auditor General of Ontario (OAG) and the government's professional accounting staff disagreed regarding the application of Public Sector Accounting Standards (PSAS) to pension assets related to two pension plans that the Province jointly sponsors –OTPP and OPSEUPP.

As described in PSAS, a pension asset arises when the government's total contributions to a plan, including income earned thereon, are greater than the cumulative retirement benefit expense recognized since the start of the plan. Contributions reflect the funding objectives of the plan. The benefit expense reflects the estimated cost of the pensions earned during the year that will be paid out to retirees in the future.

The Province's position is that the asset balance (or plan surplus for accounting purposes) in OTPP and OPSEUPP are an asset to the province and it is suitable to reflect them in the financial results.

The OAG disagrees with this position. The OAG has indicated that because the Province does not have the legally enforceable right to unilaterally access the assets of the plan, and in the absence of that right, because the Province does not have an agreement in place with the Ontario Teachers' Federation (OTF) with respect to how the surplus would be utilized such that it would provide a benefit to the Province, a pension asset in the Public Accounts is not appropriate.

Ontario had followed the same pension accounting treatment for all of the past 14 years. This had been accepted by the current Auditor General for the last two years and by the three previous Auditors Generals. There has been no change to the relevant PSAS (i.e. RETIREMENT BENEFIT, Section PS 3250) over the past 14 years.

A regulation was made to allow the public service to sign-off on the impact of the OAG's view on accounting for pension assets in Ontario's 2015-16 financial statements. The Province filed a time-limited regulation, which legislates the accounting for pension assets of its two jointly-sponsored pension plans for 2015-16 in a manner that is consistent with the fiscal outcome proposed by the Auditor General. The impact of the change resulted in an additional $10.7 billion being added to the net debt and accumulated deficit and an increase in the annual deficit of $1.5 billion.

To clarify, the government's regulated accounting for the 2015-16 Public Accounts although resulting in a consistent fiscal impact as would be reflected under the Auditor General's accounting, does not reflect the Province's interpretation of pension accounting under the PSAS.

On October 5, 2016, the Auditor General issued a qualified report on the 2015-16 Public Accounts. While the 2015-16 results were accepted by the Auditor General, the audit opinion was qualified because the comparative financial balances were not restated for the prior year to write off the pension assets. Restating the previous year's results would have had no impact on the financial results for 2015-16, including the annual deficit and net debt.

What is being asked of the Expert Advisory Panel

The Expert Advisory Panel is being asked to review and deliver advice and recommendations to the government as to the application of PSAS to Ontario's pension assets. The future accounting by the Government of its pension assets will be guided by the report of the Expert Advisory Panel.

The Expert Advisory Panel 's advice and recommendations to the government will address:

- The requirement regarding control (or shared control) with respect to recognizing a pension asset for a defined benefit plan, as it relates to the pension plans reported by the Province of Ontario, including OTPP, OPSEUPP, HOOPP, and CAAT.
- Appropriate valuation techniques to measure a pension asset that take into consideration future decision making authority by plan sponsors.
- Recommendations to the Employment Benefits Task Force of the Public Sector Accounting Board (PSAB) regarding issues that should be considered in their review of the retirement and post-employment benefits standards.

Background

Overview of OTPP

OTPP is a jointly sponsored pension plan[1] (JSPP) as defined in the *Pension Benefits Act (Ontario),* R.S.O. 1990, c. P.8 and as established under the *Teachers' Pension Act (Ontario),* R.S.O. 1990, c. T.1.

[1] **Jointly sponsored pension plans**
(2) For the purposes of this Act, a pension plan is a jointly sponsored pension plan if it has the following characteristics:
1. It provides defined benefits.
2. The defined benefits are contributory benefits.

The sponsors of OTPP are the Province of Ontario (the "Province"), through the Minister of Education and the Ontario Teachers' Federation represented by its Executive (the ”OTF") (collectively, the "sponsors").

The plan administrator of the OTPP is a board of directors. The plan administrator is an independent entity, members of which are appointed by the sponsors.

The constating documents for OTPP set out the respective rights of the sponsors, and describe the powers of the plan administrator. The OTPP is governed by:

a) The *Teachers' Pension Act* (TPA), R.S.O. 1990, c.T.1 (TPA);
b) The *Pension Benefits Act (Ontario),* R.S.O. 1990, c. P.8 (PBA) and the regulations thereunder (PBR);
c) Plan text for the OTPP ;
d) An agreement between Her Majesty the Queen in right of the Province of Ontario represented by the Minister of Education and Training and The Ontario Teachers' Federation represented by its Executive, dated July 15, 1991, as amended (The Partners' Agreement);
e) A Funding Management Policy, attached as Appendix A to the Partners Agreement (FMP);
f) The Ontario Teachers' Pension Plan; and
g) The Term Sheet agreed to by the Sponsors dated March 13, 2013 (the "2013 Term Sheet") describing the implications of the Freeze Period on the Funding Management Policy.

Three material implications for OTPP as a result of qualifying as a JSPP under the PBA are:
1. Plan Governance - Under a JSPP, the employers (or any persons or entities who make contributions on behalf of the employers or represent the employers) and the members of the pension plan (or any representatives of the members) are jointly responsible for making all decisions about the terms and conditions of the pension plan and any amendments to the pension plan. [2]
2. Funding – OTPP is exempt from solvency funding requirements under the PBR. [3]
3. Cost Sharing - In a defined benefit pension plan which does not qualify as a JSPP, the employer is solely responsible for funding any going concern unfunded liability or solvency deficiency. Given that the OTPP qualifies as a JSPP, however, the PBA permits members to be required to make contributions in respect of any going concern unfunded liability or solvency deficiency. [4]

With respect to the cost-sharing principle referred to in #3 above, the TPA contains limitations on the contributions that the Province (and other participating employers) may make under the OTPP:

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3. Members of the pension plan are required, by virtue of the documents that create and support the plan, to make contributions in respect of any going concern unfunded liability and solvency deficiency of the plan.
4. The plan satisfies such additional criteria as may be prescribed. 2005, c. 31, Sched. 18, s. 1 (2).

[2] PBR, subsection 3.1(1).
[3] PBR, subsection 1.3.1(3).
[4] PBA, subsection 1(2) and subsection 55(4).

> *5(1.1) The total amount of the contributions payable by the Minister of Education and the employers who contribute under the pension plan in respect of any year shall not exceed the amount of contributions payable by or on behalf of active plan members in respect of credited service for that year.*

Despite this general principle, under the TPA the Province is required to make additional contributions to the OTPP in the event that there are insufficient assets to make required payments out of the plan in any particular year. [5] The Province is also permitted to make additional contributions in respect of a solvency deficiency[6] (although, as noted above, solvency funding is not required under the OTPP). Notwithstanding that subsection 5(1.1) of the OTPP provides a cap on the Province's normal cost contribution obligation, rather than requiring 50/50 cost sharing, in practice there has been 50/50 cost sharing of the normal contribution cost under the OTPP since the OTPP became jointly sponsored (and for the majority of periods of time since the inception of the plan in 1917). [7] The plan text itself also provides for equal contributions, at the basic level (see sections 25(1) and 26(1)).

Currently, the Sponsors are also required to mutually agree upon how any plan deficits are to be addressed. [8] While not binding upon the Sponsors, the FMP indicates that deficits may be addressed through increases to the contribution rates, lowering the amount of indexation and/or other decreases in benefits.

Joint governance and cost sharing form two of the core features of the OTPP. Consistent with the equal sharing of risk permitted under a JSPP, there is a requirement for decisions relating to plan design and plan amendments to be made jointly by the Sponsors. In this regard, the FMP requires the Sponsors to negotiate and agree upon decisions relating to surplus utilization. Accordingly, the Sponsors can be said to have equal opportunity to benefit from surplus utilization through the negotiation process.

Additional excerpts from constating documents for OTPP relating to use of the Plan’s surplus and the sharing of responsibilities amongst the Sponsors are included in appendix E. Some important elements of these are:

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[5] TPA, subsection 5(3).

[6] TPA, subsection 5(7).

[7] See, Ontario Teachers' Pension Plan: "How Contribution Rates Have Evolved" available at: https://www.otpp.com/documents/101791209401-l5e47lc2b-23f1-44e6-b5cld22e3e50dbc3lHow+Contribution+Rates*HaverEvolved.pdf As noted above, for the period from January l, 2008 to December 31, 2008 the employee contribution rate was slightly lower than the employer contribution rate for earnings both above and below the YMPE (9.6%/11.20lo versus l0.4yo/l2Vo, respectively). It js our understanding that member contribution rates in 2008 were partially subsidized by the OTF with a credit reserve from the 1998 to 2001 pension negotiations, which accounts for this difference.

[8] See, for example, Section 3.09 and 3.11 of the FMP.

1. Paragraph 10(1)3 of the TPA provides that the Minister of Education and the executive of the OTF may enter into an agreement that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized. We note that the Sponsors have in fact entered into such an agreement, in the form of the Partners' Agreement (to which is appended the FMP).

2. The Plan Documentation (specifically the FMP) and applicable legislation allow for the Sponsors to utilize surplus in a variety of ways, depending on the funded status of the OTPP. These surplus utilization options include the following avenues through which the Province may receive a financial benefit through the utilization of surplus (the three "zones" describe different levels of surplus, a greater amount of surplus being required in order for the next "zone" to come into play):

a. In the Restoration Zone, a Restoration Contribution Reduction may be approved once certain other requisite conditions have been met.

b. In the Temporary Improvement Zone, surplus may be utilized to provide a temporary contribution reduction (i.e., a contribution holiday), either as a stand-alone measure or in combination with other surplus utilization options (i.e., benefit improvements or surplus withdrawal).

c. In the Permanent Improvement Zone, surplus may be utilized to permanently reduce the current contribution obligations of the employers and the members, either as a stand-alone measure or in combination with changes to benefits.

Notwithstanding the foregoing, under the FMP the Sponsors have the discretion to, by mutual agreement, utilize surplus in any other manner.

3. Any enforceable legal right to obtain some value from any surplus pursuant to the Partners' Agreement (and FMP appended thereto) would be grounded in the law of contract. As the relevant provisions of the FMP require the Sponsors to agree upon the manner in which surplus is to be utilized, neither Sponsor has a legally enforceable right to unilaterally utilize surplus in the OTPP. As such, the provisions in the FMP that contemplate the ability for the Province to receive a financial benefit through the utilization of surplus would not, in and of themselves, give rise to a legally enforceable right. What the Province does have, however, is a right to negotiate with the OTF the use of surplus that may arise under the plan, at least in the context of an actuarial valuation that discloses surplus and that is to be filed with the regulators.

4. When negotiations occur is laid out in the Partners' Agreement. The Partner's Agreement requires that any actuarial funding valuation submitted to the pension regulators must be "actuarially balanced" (Section 57 of the Partners' Agreement). This must occur at least once every three years, but can occur every year if the partners agree. If a preliminary funding valuation shows a funding surplus or deficit then the joint sponsors must negotiate how this surplus or deficit is resolved prior to filing the funding valuation.

Accounting for OTPP by the Province

Since fiscal year 2001-2002, the Province has recorded a pension asset for OTPP on the Statement of Financial Position. A pension asset has arisen because the government's share (50%) of the total contributions to OTPP 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 as is required by RETIREMENT BENEFITS, Section PS 3250.

The different objectives of funding and accounting for a pension plan are addressed in Section PS 3250 as follows:

> *.008 Determining whether a retirement benefit plan should be funded and the amount to be funded each period is a financial management matter. The funding objective is to determine an acceptable policy for financing the estimated ultimate cost of a benefit plan. An actuarial valuation for funding purposes is performed to calculate the contributions required to secure the benefits promised.*
>
> *.009 The accounting objective is to measure and report the obligation for employee retirement benefits and to attribute the costs of those benefits to the periods in which the related services are rendered. To meet that objective, a method is needed to determine the amount of the obligation for retirement benefits outstanding, which represents the liability at the financial statement date, and the value of the benefits employees earned during the period, which represents the expense of that period. …*
>
> *.010 Because the objectives of determining the most appropriate funding policy are not necessarily the same as those of determining the most appropriate accounting method, the liability for accounting purposes may not be the same as the amount due but not yet funded at the financial statement date according to the funding plan. In addition, the retirement benefit expense of the period for accounting purposes may not be the same as the contribution computed in the period for funding purposes.*

Paragraph PS 3250.051 includes an explicit acknowledgement that the accounting position and funding position can be quite different, as follows: "Contributions reflect the funding objectives of the Plan. The benefit expense reflects the accounting objectives and may differ for a number of reasons…"

OTPP's most recent preliminary funding valuation reported a preliminary funding surplus of $13.2 billion as at January 1, 2016, as reported on the OTPP website. The OTPP's public financial statements showed a deficit for accounting purposes of $1.8 billion in its financial statements as at December 31, 2015. OTPP's financial statements are prepared under accounting standards for pension plans in Part IV of the CPA Canada Handbook ("Part IV"), which is a different accounting framework than the Province uses for its financial reporting and is also a different framework than is used to calculate the funding surplus or deficit. Accounting for employee future benefits requires the use of assumptions and methodologies to calculate both the obligation incurred to date and the value of the assets already set aside to meet those obligations. Accounting frameworks differ in standards that must be applied in determining appropriate assumptions and methodologies. Further, the assumptions and methodologies used in developing a "funding valuation" on a going concern basis may also differ from those required by accounting standards. These differences result in a number of different valuations for the same plan, depending on the purpose of the valuation and can be affected by certain choices made between acceptable options within each framework. A summary of the main differences between the methodologies used to calculate a going concern funding valuation, OTPP's accounting valuation and the Province's accounting valuation is shown in Appendix H.

Specifically, the discount rate has a significant impact on the overall position of the plan. A lower discount results in a higher liability and a higher discount rate results in a lower liability, all else being equal. Put another way, a higher estimate of the time-value of money makes the promises made today that will be paid out in the future cheaper. Both the PSAS accepted discount rate based on the expected asset return and the IFRS required discount rate of corporate/government bonds are "best estimate" rates. They must both be based on management's best estimate of the applicable discount rate. In both cases the estimates must be supportable. The difference result not from one being more "right" or "wrong" than the other but from fundamentally different approaches within the accounting standards to what the discount rate should be. The rationale for using a corporate or government bond approach is that a pension promise is akin to a bond as it is a promise to pay a series of cash flows in the future regardless of what the asset returns actually are (which could be higher or lower than expected). The rationale for using an asset return approach is that it represents the amount of contributions that, combined with investment returns, should be sufficient to pay the promised benefits, particularly as pension plans will often invest in higher risk/higher return assets then simple corporate bonds. Typically the funding discount rate falls between the bond discount rate and the expected asset return, but it differs in that it does not purport to be the "best estimate" of the discount rate, but is designed to indicate the contributions that are required to fund the promised benefits, with an additional conservative margin for adverse deviations. Note that over the long term the difference between funding valuations and accounting valuations would diminish as the impact of the discount rate unwinds and the asset valuation methods converge.

In practice, the discount rates used in the financial statements of government sponsored and joint defined benefit pension plans prepared under Part IV of the CPA Canada Handbook (Section 4600) use diverse methodologies. For example, in Alberta 7 plans prepare their financial statements under Part IV with reference to IFRS (same framework as OTPP). Of these none use a government bond discount rate and all use a discount rate calculated with some reference to a rate of return on invested assets, which may include factors for expenses, diversification and rebalancing. The analysis of a number of government sponsored plans is included as Appendix [**G**]. The analysis demonstrates that a significant number of government sponsored plans use a discount rate aligned to an asset investment return rather than a bond discount rate. OTPP is in the minority of plans that choose to use the rate required by IFRS, resulting in a lower discount rate and higher liability.

The above analysis indicates that the presentation of a deficit in the OTPP financial statements while the Province of Ontario calculates a surplus under PSAS requirements does not mean that there is no accounting surplus and therefore no asset for the Province. It would be acceptable under the Part IV framework for OTPP to have selected, as an accounting policy, a discount rate based on an asset return which would be closer to that used by the Province which would eliminate a significant element of the differences between the net surplus/deficit for accounting purposes in the OTPP statements and the net surplus/deficit of the Province's share of OTPP for accounting purposes in the Public Accounts.

Financial statements for the Province have been prepared over the prior 14 years in accordance with the CPA Canada Public Sector Accounting (PSA) Handbook. Unqualified audit reports have been received for each of the years from the OAG on the Public Accounts.

RETIREMENT BENEFIT, Section PS 3250 of the PSA Handbook addresses the accounting of obligations for employee retirement benefits in government financial statements. The Province has followed this standard over the prior 14 years. Over this period of time, there have been no consequential changes to Section PS 3250. As a result Ontario has followed the same pension accounting treatment for OTPP over the past 14 years.

The prior pension accounting for OTPP had been accepted by the current Auditor General for the last two years and by the three previous Auditors Generals during this period of time.

Over the prior 14 years, the Province has classified OTPP as a joint defined benefit plan as per Section PS 3250 (this classification will be discussed more in this document). Over this period of time, the pension expense and pension liability (asset) for OTPP reported by the Province is reflected in Appendix F.

History regarding the PSA standards

As mentioned, the financial statements for the Province have been prepared over the prior 14 years in accordance with the PSA Handbook.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150 prescribes that, in developing and applying accounting policies, all primary sources of GAAP should be applied. Primary sources of GAAP are Sections PS 1200-PS 3510, Public Sector Guidelines and appendices and illustrative material to those pronouncements. Only when there are no primary sources of GAAP that relate to the transactions or events under consideration, or more specific guidance is needed, does an entity consider other primary sources of GAAP dealing with similar issues and also the concepts described in FINANCIAL STATEMENT CONCEPTS, Section PS 1000. Section PS 1000 is not, however, a "primary source of GAAP" under the PSA Handbook.

The primary sources of GAAP specific to the accounting for pension assets is RETIREMENT BENEFITS, Section PS 3250 (issued in September 2001 replacing the prior EMPLOYEE PENSION OBLIGATIONS, Section PS 3250 which was based on Accounting Statement No. 5).

Other primary sources of GAAP that deal with similar issues might be considered where additional interpretation or guidance is needed. For the issues dealt with in this paper - recognition and measurement of a joint defined benefit plan - this could include standards that relate to joint control, as OTPP is a joint defined benefit plan, standards that relate to the definition of an asset and standards that relate to measurement uncertainty:

- GOVERNMENT PARTNERSHIPS, Section PS 3060 (issued in October 1999)
- ASSETS, Section 3210 (issued in June 2015, effective from April 1, 2017)
- MEASUREMENT UNCERTAINTY, Section PS 2130 (issued in April 2005)

There have not been consequential changes to any of the above standards since their introduction into the PSA Handbook. Furthermore, all the standards were developed several years ago with the exception of ASSETS, PS 3210 which is effective in for periods beginning on or after April 1, 2017. Section PS 3210 provides additional guidance on the various components of the existing asset definition found in Section PS 1000; it does not change the definition.

<u>Accounting Analysis</u>

<u>Question 1 – Recognition of a pension asset</u>

The analysis below addresses whether the Province's share of the pension surplus in OTPP represents an asset to the Province of Ontario for purposes of preparation of the Public Accounts.

Standards in the PSA Handbook

The focus of the following analysis is on the accounting requirements in RETIREMENT BENEFIT, Section PS 3250 as this standard specifically addresses the accounting for pension assets. The following highlights some key concepts and guidance contained in this standard.

RETIREMENT BENEFIT, Section PS 3250 – Purpose and Scope

The purpose and scope of Section PS 3250 is included in paragraph .001 which states:

PURPOSE AND SCOPE

> *.001 This Section establishes standards on how to account for and report <u>obligations for employee retirement benefit</u>s in government financial statements. Other employee future benefits are specifically dealt with in POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255.*

Obligations for retirement benefits are further explained in RETIREMENT BENEFITS, Section PS 3250, paragraph .003 as follows:

> *.003 <u>Obligations for **retirement benefits**</u> result from a promise by a government to provide these benefits to employees because of retirement in return for their services. Pensions and other retirement benefits, such as extended health care and life insurance benefits, are a form of compensation offered for services rendered and accrue over the years employees render those services. The fundamental accounting task is to determine the amount of the obligation for retirement benefits to attribute to each period of employee service. Determining such amounts involves not only accounting for past transactions and events; it also requires forecasts of future events, such as inflation, investment returns, medical costs and employee turnover and mortality.*

RETIREMENT BENEFITS, Section PS 3250 applies to the accounting for OTPP in the Province of Ontario's financial statements as the pension plan represents an obligation of the Province to provide retirement benefits to the members of the plan in return for their services.

RETIREMENT BENEFIT, Section PS 3250 – Types of pension plans

RETIREMENT BENEFITS, Section PS 3250 addresses the accounting for different types of pension plans including:

- defined benefit plans (of which joint defined benefit plans are a subset),
- defined contribution plans, and
- multi-employer and multiple-employer benefit plans.

The definition of a joint defined benefit plan is included in the glossary to Section PS 3250 as follows:

> *A **joint defined benefit plan** is a contractual arrangement between the government and another sponsor or sponsors representing plan participants that has all of the following characteristics:*
>
> *(a) the sponsors co-operate toward achieving the significant clearly defined common goal of providing retirement benefits in exchange for services rendered by the employees;*
>
> *(b) funding contributions are shared mutually between the government and the plan members, represented by the non-government sponsor;*

> *(c) the sponsors share control of decisions related to the administration of the retirement benefit plan and to the level of benefits and contributions on an ongoing basis; and*
>
> *(d) the significant risks associated with the retirement benefit plan are shared on an equitable basis between the government and the plan members, represented by the non-government sponsor.*
>
> *The contractual arrangement establishes that the sponsors have shared control over the retirement benefit plan, and ensures that neither party is in a position to control the plan unilaterally. Nevertheless, overall, there must be an equitable relationship between the funding by the government of the retirement benefit plan, the extent of control it is able to exercise over the plan and the risks and benefits that accrue to the government from the plan.*

Additional guidance on identifying JDBPs is in Section PS 3250 paragraphs .79 to .80 which similarly highlights the importance of both shares control and shared risks and rewards in a JDBP:

> *.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.*

A joint defined benefit plan (JDBP) is a unique sort of retirement benefit plan where the sponsors have shared control over the plan. As a result, 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. OTPP meets the definition of a JDBP as the Province and OTF are sponsors of the plan. The OTPP is a contractual arrangement between the Province and OTF in which:

(a) the sponsors co-operate toward achieving the significant clearly defined common goal of providing retirement benefits in exchange for services rendered by the employees (addressed in paragraph 8 of the Partners’ Agreement for example);

(b) funding contributions are shared mutually between the government and the plan members, represented by the non-government sponsor (addressed in paragraph 5(1.1) of the TPA for example);

(c) the sponsors share control of decisions related to the administration of the retirement benefit plan and to the level of benefits and contributions on an ongoing basis (addressed in paragraph 8 of the Partners' Agreement for example) ; and

(d) the significant risks associated with the retirement benefit plan are shared on an equitable basis between the government and the plan members, represented by the non-government sponsor (addressed in paragraph 5(1.1) of the TPA for example).

There is no uncertainty regarding the joint control of OTPP shared by the Province of Ontario and the Ontario Teachers Federation. The TPA, the Partners' Agreement and the plan text collectively set out this shared control and that the Province of Ontario has an equitable sharing of the risks and rewards (surpluses and deficits) of the plan based on the definition of a joint defined benefit plan.

The classification of OTPP as a JDBP has been consistent since 2001 and has been accepted by the OAG.

RETIREMENT BENEFIT, Section PS 3250 – Accounting for a JDBP

RETIREMENT BENEFITS, Section PS 3250 paragraphs .081 to .082 mandate the accounting for a JDBP in the financial statements of the government sponsor. As OTPP meets the definition of a JDBP for the reasons noted above, the Province should follow this guidance which states:

> *.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.*

Section PS 3250.81 clearly states that "The government should account for its portion of the plan in accordance with the standards for defined benefit plans". It is clear from this that only the government's portion of the plan is included in the government's financial statements consistent with the requirements of Section PS 3250 (recognition) and the measurement of that portion is based on the requirements of Section PS 3250 (measurement). This paper discusses the two elements of recognition and measurement separately.

The balance sheet recognition guidance for retirement benefits is stated in Section PS 3250.016 to .017:

> *.016 The statement of financial position should report the retirement benefit liability and the statement of operations should report the expenses for retirement benefits on the basis of the value of the benefits attributed to employee service to the financial statement date. [SEPT. 2001]*
>
> *.017 The components of the retirement benefit liability are:*
>
> > *(a) accrued benefit obligation including the effects of plan amendments, settlements and curtailments;*
> >
> > *(b) plan assets, if any; and*
> >
> > *(c) unamortized actuarial gains and losses.*

As the OTPP is a funded plan there are plan assets that are recognized as part of the retirement benefit liability. When plan assets and the impact of unamortized actuarial gains and losses exceed the accrued benefit obligation then there is an "Accrued benefit asset" (ABA). An ABA is defined in Section PS 3250 as follows:

> GLOSSARY - *An **accrued benefit asset** is the amount of any asset recognized on a government's statement of financial position in respect of employee retirement benefits before deducting any valuation allowance that may be required. It is the sum of the government's accumulated cash contributions less the sum of the current and prior years' benefit expenses (before any change in the valuation allowance).*

Accordingly, the portion of the government's plan to be recognized includes their share of the accrued benefit obligation and also their share of the plan assets. In the case of the Province's portion of OTPP there is no uncertainty regarding the *existence* of an ABA for the government's portion of the plan, based on the best estimate assumptions used in measuring the accrued benefit obligation and plan assets, measured in accordance with Section PS 3250 guidance for these items. As noted above an ABA is defined as the government's sum of the accumulated cash contributions less the sum of the current and prior years' benefit expenses (before any change in the valuation allowance). For a jointly sponsored plan this is the government's accumulated cash contributions less the sum of the government's share of the current and prior years' benefit expenses that are attributable to the government under the joint defined benefit plan. The Province's portion of OTPP resulted in an ABA of $10.1 billion as at March 31, 2016. There is no uncertainty regarding the occurrence of the cash contributions made (including interest earned thereon) measured in accordance with Section PS 3250 and the existence of the government's obligation. As Paragraph 3250.80 *requires* a government to account for its portion of the plan in accordance with the standards for defined benefit plans, this would include the recognition of any asset that meets the definition of an ABA under the standard.

Further, Section PS 3250 paragraph 3250.50 refers to the presentation of the ABA; this amount is presented in the financial statements, net of any valuation allowance. This indicates that an ABA should be recognized in the financial statements, but measured in reference to the limit on the carrying amount of the asset - essentially a measurement requirement rather than a recognition requirement, as an ABA could be measured at anything from $nil to its full amount. Note that the *measurement* of any net asset is subject to guidance in Section PS 3250 paragraphs .50-.59 and is discussed later in this paper.

To recognize only their share of the liability and not their share of the plan assets, or to recognize only a net liability (accrued benefit obligation exceeds plan assets) but never a net asset (when plan assets exceeds the accrued benefit obligation, subject to the valuation allowance guidance discussed in the Measurement section below), would indicate that the government does not share equitably in the risks <u>and</u> rewards of the plan because they bear the risk of increased liabilities without being able to bear the rewards of investment returns on the plan assets and the plan would not therefore be a joint defined benefit plan.

Concept of Shared Control and asset recognition

Included in the definition of a JDBP is the concept of shared control. Points (c) and (d) of the definition of a JDBP require shared control of decisions relating to administration, levels of benefits and contributions between the sponsors; and the sharing of risks between the government and the plan members. The concept of Shared Control resulting in a recognition of an asset may be seen to conflict with the definition of an asset under FINANCIAL STATEMENT CONCEPTS, Section PS 1000 and ASSETS, Section PS 3210, as part of the definition of an asset is that the government can control the economic resource and access to the future economic benefits. Joint control does not equate to control, therefore the introduction of ASSETS, Section PS 3210 raises the question as to whether the recognition of any asset for which there is only shared control is precluded under PSAS.

The Province's position is that PSAS does not preclude asset recognition for assets under joint control and specifically for plan assets of joint defined benefit plans for the following reasons:

- As discussed above GENERALLY ACCEPTED ACCOUNTING PRINCIPLES Section PS 1150 states that a reporting entity applies every primary source of GAAP that deals with the transactions and events encountered by that entity. Section PS 3250 is a primary source of GAAP for dealing specifically with joint defined benefit plans and, as noted above, requires the government to account for their portion of the plan – both the accrued benefit obligation and plan assets in accordance with Section PS 3250. As such, reference to Section PS 3250 is sufficient to indicate that the recognition criteria are met for joint defined benefit plan assets, no further source of PSAS guidance need be considered.

- If other primary sources of GAAP are considered then it is relevant to consider GOVERNMENT PARTNERSHIPS, Section PS 3060 which also includes the concept of shared control. Under Section PS 3060, joint control is sufficient for asset recognition. It is therefore consistent with this primary sources of GAAP to recognize an asset for a jointly controlled defined benefit plan, subject to measurement guidance including impairment considerations.

The similarity between the definitions of a JDBP and a government partnership are demonstrated in Appendix B to this paper, and support Section PS 3060 as being a relevant primary source of GAAP dealing with similar circumstances, should it be considered necessary to go outside of the requirements of Section PS 3250 to look for further clarification and guidance on recognition.

Under Section PS 3060 a critical condition for a Government partnership is shared control. Section PS 3060 explicitly acknowledges that under shared control "none of the partners is in a position to exercise unilateral control over the government partnership" (PS 3060.20), yet the accounting model required by Section PS 3060 for non- GBPs[9] is that of proportionate consolidation which is the picking up of a pro rata share of assets, liabilities, revenues and expenses of the partnership. Joint defined benefit plans are excluded from the scope of Section PS 3060 on the basis that control is shared with employees rather than with a party outside of the reporting entity (3060.06 footnote 3). This reason indicates that such plans are excluded because of a closer relationship between the government and the other party than normally exists for government partnerships. Even when an independent third party shares control, Section PS 3060 still requires the recognition of a share in an asset subject to joint control, indicating that the PSAS framework does not require unilateral control in order to support asset recognition when there is joint control. It would not be appropriate to use Section PS 1000 to over-ride the requirement in Section PS 3060 for proportionate consolidation, and similarly it is not appropriate to use Section PS 1000 to over-ride the requirement in Section PS 3250 to account for the government's portion of a joint defined benefit plan.

The concept of shared control is not addressed in the definition and guidance of an asset in FINANCIAL STATEMENT CONCEPTS, Section PS 1000 and ASSETS, Section PS 3210. Although shared control is not included in FINANCIAL STATEMENT CONCEPTS, Section PS 1000, it has been a concept in the PSA Handbook since the introduction of Sections PS 3060 and PS 3250. On the introduction into the PSA Handbook of Section PS 1000 or Section PS 3210, the concept of shared control was not removed from Sections PS 3060 and PS 3250. This indicates that PSAB did not consider Section PS 3250 (or Section PS 3060) to be inconsistent with the general concepts in Section PS 1000.

Conclusion on recognition

Therefore the Province has concluded that PSAS permits the conceptual recognition of a pension plan asset in respect of a joint defined benefit plan and does not require that all recognized assets must be subject to unilateral control. The Province's share of OTPP's pension surplus meets the definition of an Accrued Benefit Asset under Section PS 3250. The measurement of that accrued benefit asset is determined by reference to the guidance in PS 3250 regarding the Limit on the Carrying Amount of an Accrued Benefit Asset, which is discussed in Question 2 of this position paper.

[9] Government business partnerships (GBPs) are accounted for under the modified equity method rather than proportionate consolidation.

<u>Question 2 – Measurement of a pension asset</u>

For an asset to be recognized it must be reliably measureable. Section PS paragraphs 3250.050 to .059 address how to measure a pension asset. "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." Paragraphs .052 to .059 go on to explain what the standard means by expected future benefit and how a government may benefit from the ABA. Section PS 3250.50-.59 are included here for completeness and ease of reference:

> ***Limit on the carrying amount of an accrued benefit asset (i.e. Asset Ceiling Test)***
>
> *.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 <u>A government may benefit from an accrued benefit asset</u> either by withdrawing surplus assets or <u>by taking a contribution holiday</u> 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.*
>
> *.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 3250.050 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.

Note that for purposes of Section PS 3250.053 the Province has determined that the accrued benefit asset equals the adjustment benefit asset (due to unamortized actuarial gains exceeding unamortized actuarial losses).

Paragraph .052 states that a government may benefit from an ABA by either i) withdrawing surplus assets from the plan or ii) by taking a contribution holiday or receiving a refund of contributions. It is an explanatory paragraph on how a government may benefit from an accrued benefit asset and why an valuation allowance may be needed, rather than detailing the test to be applied. Part of this justification is to note that that an ABA may be impaired when "the government is not entitled to benefit from [the ABA] fully". Examples of when a government may not be entitled to benefit from the ABA fully are given, such as a regulatory moratorium on pension surplus withdrawals or uncertainties as to a government's legal right to use a plan's accounting surplus.

As such, the Province's present legal rights to utilize a surplus to reduce future contributions must be analyzed. Our interpretation of this guidance is that it presents a lower threshold than legal enforceability. Specifically, the amount of Pension Asset that gets recorded needs to be subject to considerations around any legal uncertainties. This consideration involves significant professional judgment. However, it is our view that uncertainty does not need to be reduced to zero in order to recognize a Pension Asset.

While the Province does not have a unilateral legal right to reduce their contribution levels without agreement from the OTF because OTPP is by nature a JDBP subject to joint control, they are entitled to an equitable share of the risks and rewards of the JDBP, essential to the definition of a JDBP. Paragraph .052 does not state that being "entitled to benefit" means having a current legally enforceable right to take contribution holidays or withdraw surplus. Under the plan text and Partners' Agreement means that if funding surpluses occur the partners <u>must</u> negotiate the use of the funding surplus (at least once every three years) and the Province is entitled to negotiate a reduction in contributions in respect of their share of the surplus. Under the Partners' agreement any funding surplus must be dealt with so that the funding valuation becomes actuarially balanced. In other words when there is a funding surplus over a certain range the "status quo" cannot be maintained, the surplus must be reduced by a combination of reductions in contributions, increases in benefits or withdrawals of surplus. While the Province might choose to accept an increase benefits rather than reduce funding at their discretion, the OTF cannot force the Province to increase benefits instead of reducing contributions. In other words the Province can avoid that their portion of the surplus is utilized only through increased benefits. Therefore the Province is entitled to negotiate their share of the JDBP and take contribution holidays in future negotiations and can effectively use their power in negotiations to benefit from the ABA. Note that while the negotiations are based on funding surplus amounts rather than accounting surplus amounts any differences would be captured in the mechanics of the calculation of the expected future benefit rather than precluding an ability to benefit from any of the accounting surplus.

Further, paragraph PS 3250.055 indicates "The objective of the standard in paragraph PS 3250.050 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". Many generally accepted accounting frameworks use “expected” in a number of principles and is typically used in the probabilistic sense – something is expected when it is probable at some level, it does not equate to certainty. The Province has an expectation that they will benefit fully from the ABA by exercising their current rights under the plan arrangements to negotiate the use of current and future surpluses in the form of contribution holidays. This position is supported by the review of the constating documents that indicate:

1. The TPA prohibits the total amount of the contributions payable by the Province (and other participating employers) to exceed the amount of contributions paid by or on behalf of active members in respect of credited service for the year (subject to certain exceptions for payment of a solvency deficiency and where there are insufficient cash and liquid assets in the fund). In practice, this has resulted in 50/50 sharing of the regular contribution costs between the participating employers (including the Province) and plan members since the OTPP became jointly sponsored.
2. The history of surplus utilization after the OTPP became a jointly sponsored plan and prior to the date that the FMP was established demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the financial benefits of surplus utilization, although surplus was not shared equally each time (refer to Appendix G for a history of surplus utilization for OTPP). Since the time the FMP was established, the OTPP has not reached the requisite level of surplus such that the Sponsors could negotiate its utilization under the Temporary Improvement Zone or Permanent Improvement Zone.
3. The inability for either party to unilaterally require surplus to be utilized in a particular manner (subject to the OTF Call Right), and the requirement to negotiate and agree (or in the absence of agreement, arbitrate) presents the Sponsors with an equal opportunity to benefit from surplus utilization.
4. One could argue that the obligation to bargain in "good faith" found in the Partners' Agreement may include the obligation to take into account the "sharing" principles described elsewhere in this opinion, given that the OTPP is a jointly-sponsored plan. Under the plan contributions are generally borne equally by the Province and the employees. Employees benefit economically from both an increase in benefits and from a reduction of contributions. The Province benefits economically directly from a reduction in contributions. This makes it reasonable that at least some contribution reductions would be agreed to by the joint sponsors as a highly unequal weighting towards increases in benefits would not balance the interests of taxpayers and therefore may be unlikely to be a reasonable outcome of “good faith” negotiations between the Province and the OTF.

   This is further supported by the historical actions of the parties, which reflect a history of working together to resolve both funding deficits and use of funding surpluses should also be considered. As previously discussed in respect of conditional indexing, a decrease in benefits by the employees were offset by an increase in payments by the Province. Similarly as the sponsors agreed to restore indexation, this increase in benefits resulted in a decrease in the amount of future contributions that the Province would have otherwise had to pay to the plan in the amount of $7.8 billion ($4.3B for the 2016 change,$1.98 for the 2015 change, and $1.68 for the 2014 change). This demonstrates that historically and over the long term an equitable sharing of the deficits and surpluses has resulted in changes in the Province's contributions, even when there are decreases or increases to benefits for employees.

5. In the event that the Sponsors cannot agree upon how surplus is to be utilized in the Restoration Zone, the Temporary Improvement Zone or the Permanent Improvement Zone, the matter can be submitted to an arbitration board of three arbitrators. Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, the arbitral award must meet certain mandatory conditions set forth in the Partners' Agreement. Among other things, the arbitral award is required to ensure that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners' Agreement).

   As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described herein: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

Further to Section PS 3250.052 discussion regarding entitlement to benefit PS 3250.059 provides further guidance on what this means in respect of an entitlement to withdraw surplus. "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." PS 3250.59 is clear that expected future benefit available from surplus withdrawal can only be asserted where the government has a current legally enforceable right to withdraw assets from the Plan. Section PS 3250.59 introduces the concept of a legally enforceable right, however 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. Had PSAB intended legal enforceability to be the test, they would have included that notion throughout the guidance (for example in paragraph .052), instead of only raising it in the context of a withdrawal of surplus.

Based on the above analysis, the Province believes that the uncertainties around how and when to utilize a surplus in the OTPP do not result in an inability or lack of entitlement to utilize the surplus in accordance with Section PS 3250.52.

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

PS 3250.53 to .58 lay out a mathematical calculation that determines 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 PS3250.055, 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", where realization includes a reduction in future contributions. 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 PS 3250, specifically that the amount of an asset is limited to the "expected future benefit" as that expected future benefit is defined in paragraph .56.

Therefore in accordance with PS 3250.56 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.

Through withdrawal of the surplus (Section PS 3250.056 (b)

In relation to the ability of a government to benefit from a surplus through the withdrawal of the surplus, paragraph 3250.059 indicates "The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal."

The TPA for OTPP does not provide for a potential withdrawal of surplus funds. Section 10(1), item 3 states:

> 10(1) The Minister of Education and the executive of The Ontario Teachers' Federation may enter into an agreement that provides for the following matters:
>
> 3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members.

Therefore, the conditions under which a surplus may be withdrawn from the fund is outlined outside of the text of the TPA itself, as OTF and the Province must reach mutual agreement on these terms in the form of the OTPP Funding Management Policy, as envisioned in Section 10(1).3 above.

Section 4.06 of the OTPP Funding Management Policy states:

> Side Agreement: The commitment value shall be used to provide a surplus distribution referred to in Section 4.04(d) or a temporary benefit improvement referred to in Section 4.04(e) only if the partners have entered into a written agreement governing the manner in which the contributions by the Minister and the Employers may be adjusted to offset any surplus distribution or temporary improvement of benefits that is reflected in the value of the liabilities.

4.04(d) and 4.04(e) refer to actions that may be taken in the event that"...assets exceed current liabilities" (Section 4.04), meaning a surplus.

As Section 4.06 stipulates, a written agreement must be established between the sponsors (the Province and the OTF) to provide a surplus distribution, the Province does not have a legally enforceable right to withdraw assets from OTPP until such an agreement is reached.

The consent of the OTF would need to be obtained to be able to access surplus assets in OTPP through a withdrawal. As the Province does not have consent of OTF to withdrawal the plan surplus (for example at the end of fiscal year 2015-16), no expected future benefit should be recognized by the government based on its ability to withdrawal surplus from the plan.

The Province’s position is that there is no amount of expected future benefit included in respect of withdrawable plan surplus as government does not have a legally enforceable right to the surplus. The OAG agrees with this position.

Through reducing future contributions (Section PS 3250.056 (a))

PS 3250.56(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. Note that in the case at hand, the calculations are done on a 50% basis since the starting point, per PS 3250.81 and as set out in the fact summary above, is that the government accounts for its portion of the Plan. For this same reason, employee contributions are also excluded in this case since they would represent the teachers' portion of the Plan.

PS 3250.55 indicates that the expected future benefit is a calculation that represents the benefit a government expects to realize from a plan surplus. The expected future benefit would operate as a ceiling on the Pension Asset value to be recorded in the accounts. For example, if the Pension Asset were $150, but the expected future benefit calculated as described above were $100, a valuation allowance of $50 would be recorded against the Pension Asset and the asset recorded in the government's financial statements would be reduced to $100.

There are two parts to the calculation of expected future benefit. The first part of the calculation is the sum of the present value of the expected future accruals for service for the current number of active employees. This amount is required to be calculated using consistent assumptions as those used for the calculation of the accrued benefit obligation itself. It is therefore relatively straightforward and is typically calculated based on the Province's share of the current service cost reported in the actuarial valuation taken into perpetuity unless there is evidence to indicate the workforce will significant diminish over time (for example a closed plan).

The second part of the calculation is the present value of required employee contributions and minimum required contributions by the government itself, regardless of any surplus. The main area for judgment in the above calculation is in the determination of future minimum contributions required to be made by the government regardless of any surplus. There is no further guidance in S 3250 as to how this calculation should be performed and what restrictions or parameters should be factored into this calculation.

Determining the number of years of contributions to include should involve an assessment of the facts and circumstances of the plan and should consider uncertainty. With respect to this uncertainty, there are a number of considerations that may be relevant. Uncertainties should be evaluated taking into consideration the contractual agreements between the Sponsors that provide for the sharing of risks and benefits and specifically in respect of assessing the minimum contributions required by the plan agreements the following:

- One view of minimum contributions might be that the agreed upon level of contributions are the minimum contributions until they are altered in the plan text. As this can only happen with agreement from OTF it cannot be assumed that changes will be made and therefore that the contribution formula as stated in the current agreements will continue in perpetuity. This view provides the most conservative view of minimum payments. However as the current contribution amounts are greater than the government's share of the annual current service cost for the existing workforce this indicates that continued contributions at this rate will result in ever increasing surpluses. Extrapolating the surpluses, at a certain point other requirements that are currently incorporated into the plan text, such as provisions in the Income Tax Act that limit the accumulation of surplus in a plan will apply to reduce the contributions. The effect of these caps on contributions would have to be estimated but cannot be ignored as they form part of the current contribution arrangements. Modelling could be performed to develop expectations as to when these CRA limited could be expected to be reached assuming no changes in the contribution levels. As is the most conservative view (highest minimum contributions) the impact of this has been considered, as discussed below.

- An alternative view of the minimum contributions required by the plan is that there is a contractual obligation under the Partners' Agreement that the Province and OTF negotiate and set both the benefits and the contributions every three years. A failure to agree might lead to mediation or arbitration, but not an assumption of the 'status quo'. On this basis it could be argued that any agreed upon contribution levels are mandatory for only a three year period, after which the contributions must be renegotiated to stay the same, increase or decrease, such that the stated contribution level in the plan text constitute minimum payments for only three years. This view might be overly aggressive in that the plan text requires an actuarially balanced funding valuation, so to the extent that a funding deficit currently existed a contribution holiday (contributions lower than the annual cost of the plan) could not be negotiated.
- Other views of what the minimum contributions are would fall between these two views, such as that the current funding level is set to ensure that there is no funding deficit over a 11 year period and after that changes in contributions would be negotiated. This view has been used in calculating the actuarial calculation of the asset ceiling as noted in the table below.
- The specific framework within the Funding Management Plan for OTPP that contemplates specific funding zones and when contribution reductions will be discussed by the sponsors. Modelling could be performed to help estimate when the different funding zones will be reached and probability of contribution reductions may be increased.
- The historical actions of the parties, which reflect a history of working together to resolve both funding deficits and use of funding surpluses should also be considered. As previously discussed, most recently in 2014, 2015 and 2016 with respect to OTPP, the sponsors agreed to restore indexation, which resulted in a decrease in the amount of future contributions that the Province would have otherwise had to pay to the plan in the amount of $7.8 billion ($4.3B for the 2016 change,$1.98 for the 2015 change, and $1.68 for the 2014 change).

In determining the range of possible outcomes, it is noted that measurement uncertainty may exist (PS 2130.03). This paragraph also notes that many items are measured using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action. As noted in PS 2130.13, "As a result of the estimation process, a government would be able to determine a range of reasonably possible amounts in accordance with assumptions that are realistic, supportable, internally consistent, and consistent with planned courses of action. The range of reasonably possible amounts would exclude amounts at the outer edges of possibility since such amounts, while possible, are considered to be outside the best estimate range. Relevant information available to the government to develop a reasonable range includes past experience, precedents, and opportunities to reach alternative arrangements."

Actuarial reports were completed to assess the requirement for a valuation allowance. The results of those reports are summarized here:

Plan	Asset recorded by Province (in billions)	Asset ceiling computed (in billions) and assumption re: years of contributions	Number of years contributions could be made without resulting in a valuation allowance
OTPP	$ 10.1	$29.3 (based on 11 years of contributions noted in the funding report as the period additional contributions are required)	33

The number of years that contributions are assumed in determining the asset ceiling are those minimum contributions that are required to be made “regardless of any surplus" (3250.56(a)). There is no guidance on the meaning of minimum contributions for purposes of this calculation in PS 3250. For purposes of the OTPP, 11 years has been used. However, it is worth noting that up to 33 years of contributions could be factored into this calculation before the calculation would result in a conclusion that the OTPP asset is impaired.

An important consideration in performing these asset ceiling calculations is how long contributions will be required to be made. Under the Partners' Agreement, the parties are mandated to negotiate benefits and contributions every three years as a minimum and if agreement is not reached, it is reasonable to expect that a change in contributions might occur rather than the 'status quo' being retained.

However, in addition to the above calculations, we have considered the impact of the provision in the Income Tax Act that limits the amount of surplus that can be held in a plan. Based on preliminary analysis assuming no changes to management's assumptions, contribution levels and benefits provided to employees, we believe that the OTPP will be required to begin using its surplus through a reduction in contributions in between 10 and 15 years into the future. Taking this timing into account, the pension asset ceiling is in excess of the pension asset recognized (pension asset ceiling of between $19.9 Billion and $22.3 Billion); therefore indicating that no valuation allowance is required.

We would be happy to share this analysis with you, in addition to the actuarial reports we have already provided.

Determining the minimum contribution levels required to calculated the expected future benefit involves significant judgements, estimation and assumptions about future funding surplus levels that should be made on a consistent basis with the best estimates used in developing the accrued benefit obligations and plan asset amounts. However, the fact that judgements, estimates and assumptions need to be made in respect of calculated expected future benefit should not imply that no asset can be recognized or that it cannot be reliably measureable. Pension plans, by their nature, include significant estimates - whether they be related to the value of assets held by the plan that are not publicly traded (e.g. investments in private companies and real assets) or in the present value of the projected benefit obligation that is based on a series of economic assumptions related to inflation, salary escalation, mortality and the rate of return that the assets in the plan will earn over the period that benefit payments are paid to pensioners. Any change in these assumptions will have an impact on the accounting surplus, so to apply a test requiring no uncertainty to the recognition of an asset is inconsistent with the accounting for pension plans as a whole. Further, the term used to describe the cap in the asset ceiling test is "expected future benefit". Expected does not equate to certainty.

The assumptions used in the calculation of the accrued benefit obligation are required to be the “government’s best estimate of expected long-term experience and short-term forecasts” (3250.42) and each key assumption must be based on the government’s best estimate of those future events that have an effect on the accrued benefit obligation (3250.41). This approach is designed to recognize the long-term nature of the retirement promises with appropriate consideration of, but not undue influence of, experience expected in the short-term. 3250.57 requires that the future service cost calculation included in the calculation of the valuation allowance be determined on a consistent basis with that used to determine the accrued benefit obligation itself. The Province of Ontario has determined the discount rate to be used in valuing the pension obligation related to OTPP by referencing the expected rate of return on Plan Assets, which is one of the acceptable references suggested on PS 3250.44.

The OAG and the Government differ regarding whether it needs to be “expected” that the Government will benefit from the surplus in OTPP through future contribution reductions or whether it needs to be “legally enforceable”. The OAG considers there needs to be the same level of assurance the government will benefit from the surplus through reduced contributions (legal enforceable) as is required in paragraph .059. The Government considers that it needs to be expected that future economic benefits are to be obtained as reflected in the definition of an asset in Section PS 1000 and as reflected in the definition of “expected future benefit” defined in the glossary to Section PS 3250 with consideration as to uncertainties as to the right to use a plan surplus.

Other guidance in the PSA Handbook on measurement

Furthermore MEASUREMENT UNCERTAINTY, Section PS 2130 provides guidance on dealing with measurement uncertainty through additional disclosure in the financial statements, which we believe would be a useful addition to the current year financial statements. PS 2130 also provides guidance on how to deal with measurement uncertainty and includes the following guidance:

> *.12 The estimation of the amount of an item to be accrued or disclosed in financial statements may be based on information that provides a range of amounts. When a particular amount within such a range appears to be a better estimate than any other, that amount would be used. When uncertainty exists, estimates used would attempt to ensure that assets, revenues and gains are not overstated and that liabilities, expenses and losses are not understated. Estimates of the financial effect are determined using professional judgment, supplemented by experience of similar transactions and, in some cases, reports from independent experts. Estimates include any additional evidence provided by subsequent events occurring after the financial statement date.*
>
> *.13 As a result of the estimation process, a government would be able to determine a range of reasonably possible amounts in accordance with assumptions that are realistic, supportable, internally consistent, and consistent with planned courses of action. The range of reasonably possible amounts would exclude amounts at the outer edges of possibility since such amounts, while possible, are considered to be outside the best estimate range. Relevant information available to the government to develop a reasonable range includes past experience, precedents, and opportunities to reach alternative arrangements.*

We acknowledge that the estimate of the valuation allowance, and in fact pension plan accounting as a whole, is subject to measurement uncertainty. As previously noted, accounting for pension plans involves significant estimates in all aspects of the accounting whether that be in valuation of non-traded assets, estimation of the economic assumptions used to value current service cost and the projected benefit obligation or the valuation allowance. One of the key assumptions impacting the measurement of the pension asset is the discount rate which reflects management's best estimate of rate of return. The rate used by the government is permissible under PSAB and consistent with rates followed by other senior Canadian governments. Historical results since the inception of the plans corroborate the reasonableness of the rates used by management and the continued appropriateness for purposes of determining pension expense and pension assets on the Province's books.

Impact of valuation allowance

The impact of the OAG's view is that no pension accounting surplus could ever be recognized in the Province's Public Accounts for JDBPs until the joint sponsor agrees to a change in the plan text for the Province to take a contribution holiday. Any ABA would therefore be fully provided for through a valuation allowance. The impact of this in the statement of operations can be counterintuitive with pension expense being higher in years when the impact of greater funding or greater investments returns is recorded and a gain (income) in years when the impact of an increase in expected pension benefits or lower than expected investment returns is recorded. **[NTD – statements to be supplement by the visual aid requested by the Minister]**

For information purposes, refer to Appendix D for a comparison of the pension expense, surplus (deficit), net debt and net debt-to-GDP of the Province over the prior 10 years following the Auditor General's approach to pension accounting compared with following the Province's interpretation of the PSAS.

Comparison to other provinces

For your information, included in Appendix C is the legal opinion prepared by lawyers, Koskie Minsky, comparing access to the pension surplus of OTPP relative to pension plans in British Columbia. The Province of British Columbia does not include a pension asset in their financial statements as the Province has given up any rights to the surplus in the Joint Trust Agreements. The provision was established to support the independence of the four pension plan Boards. As a result the accounting by British Columbia is appropriately different than the accounting by Ontario for OTPP.

Conclusion on measurement

There is significant estimation and judgements to be applied in determining how to measure the valuation allowance under Section PS 3250, including the determination of the minimum contributions required by the current plan arrangements. The Province concluded that the attributes of the joint defined benefit plan arrangements for the OTPP entitle them to access to their portion of any plan surplus through the right to negotiate its use to the Province's benefit and that this results in an expected future benefit through the use of any plan surplus.

The Province has applied reasonable estimates of the plan's funding status necessary to determine what minimum contributions are required under the current plan contribution arrangements. Based on the results of those models to date no valuation allowance appears to be required and the OTPP pension assets should continue to be recorded on the books of the Province.

Appendix A – Guidance in the PSA Handbook - FINANCIAL STATEMENT CONCEPTS, Section PS 1000 and ASSETS, Section PS 3210

Guidance in FINANCIAL STATEMENT CONCEPTS, Section PS 1000

.35 **Assets** are economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained.

.36 Assets have three essential characteristics:

(a) they embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows;

(b) the public sector entity can control the economic resource and access to the future economic benefits; and

(c) the transaction or event giving rise to the public sector entity's control has already occurred. [Former paragraph PS 1000.36 retained in Archived Pronouncements.]

.37 An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph. Thus, for example, an item does not qualify as an asset of a government if the item involves:

(a) no future economic benefit;

(b) future economic benefit, but the government cannot obtain it; or

(c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred.

(paragraph PS 1000.38 deleted) [Former paragraph PS 1000.38 retained in Archived Pronouncements.]

.39 **Financial assets** are assets that could be used to discharge existing liabilities or finance future operations and are not for consumption in the normal course of operations.

.40 A financial asset is any asset that is:

(a) cash;

(b) a realizable asset that is convertible to cash;

(c) a contractual right to receive cash or another financial asset from another party;

(d) a contractual right to exchange financial instruments with another party under conditions that are potentially favourable to the government;

(e) an equity instrument of another entity;

(f) an investment in a government business enterprise or government business partnership;

(g) a financial claim on an outside organization or individual; or

(h) an inventory or item for sale that meets the criteria in FINANCIAL STATEMENT PRESENTATION, paragraph PS 1201.055. [Former paragraph PS 1000.40 retained in Archived Pronouncements.]

.41 Non-financial assets include tangible capital assets, and other assets such as prepaid expenses and inventories of supplies.

.42 **Non-financial assets** are acquired, constructed or developed assets that do not normally provide resources to discharge existing liabilities, but instead:

(a) are normally employed to deliver government services;

(b) may be consumed in the normal course of operations; and

(c) are not for sale in the normal course of operations.

RECOGNITION

.52 Recognition is the process of including an item in the financial statements of an entity. Recognition consists of the addition of the amount involved into item totals on a financial statement together with a narrative description of the item (for example, receivables, user fees, grants) in a statement. Similar items may be grouped together in the financial statements for the purpose of presentation.

.53 Recognition means inclusion of an item within one or more individual statements and does not mean disclosure in the notes to the financial statements. Notes either provide further details about items recognized in the financial statements, or provide information about items that do not meet the criteria for recognition and thus are not recognized in the financial statements.

.54 The recognition criteria below provide general guidance on when an item is recognized in the financial statements. Whether a particular item is recognized or not will require the application of professional judgment in considering whether the specific circumstances meet the recognition criteria.

.55 The recognition criteria are as follows:

(a) the item has an appropriate basis of measurement, and a reasonable estimate can be made of the amount involved; and

(b) for an item that involves obtaining or giving up future economic benefits, it is expected that such benefits will be obtained or given up.

.56 It is possible that an item will meet the definition of an element but still not be recognized in the financial statements because it is not expected that future economic benefits will be obtained or given up or because a reasonable estimate cannot be made of the amount involved. It may be appropriate to provide information about items that do not meet the recognition criteria in notes to the financial statements. "Expected" is used with its usual general meaning and refers to that which can reasonably be anticipated, contemplated or believed on the basis of available evidence or logic but is neither certain nor proved. The use of the word in the recognition criteria is intended to acknowledge that economic activities occur in an environment characterized by uncertainty. It is not intended to accommodate the recognition of items that do not meet the definition of one of the elements of financial statements. By implication, recognition would, therefore, not be appropriate without the occurrence of a past transaction or economic event that gives rise to an asset, liability, revenue or expense as defined in this Section.

.57 Purchased natural resources and Crown lands are recognized in government financial statements. However, when natural resources and Crown lands have been inherited by the government in right of the Crown and have not been purchased, they are not given accounting recognition as assets in government financial statements. These items are not recognized as assets because the costs, benefits and economic value of such items cannot be reasonably and verifiably quantified using existing methods. Similarly, art and historic treasures are also not recognized as assets.

.58 In the absence of appropriate public sector recognition and measurement criteria for intangibles, all intangibles, including those that have been purchased, developed, constructed or inherited in right of the Crown, are not recognized as assets in government financial statements. The intangible often called "human capital" that embodies the talent or intellectual capital of government employees is not recognized as an asset under existing accounting principles.

.59 Items recognized in government financial statements are accounted for in accordance with the accrual basis of accounting. The accrual basis of accounting recognizes the effect of transactions and events in the period in which the transactions and events occur, regardless of whether there has been a receipt or payment of cash or its equivalent. Accrual accounting recognizes a liability until the obligation or condition(s) underlying the liability is partly or wholly satisfied. Accrual accounting recognizes an asset until the future economic benefit underlying the asset is partly or wholly used or lost.

MEASUREMENT

.60 Measurement is the process of determining the amount at which an item is recognized in the financial statements. There are a number of bases on which an amount can be measured. Government financial statements are, however, prepared primarily using the historical cost basis of measurement, whereby transactions and events are recognized in financial statements at the amount of cash or cash equivalents paid or received or the fair value ascribed to them when they took place. Other bases of measurement are also used, but only in limited circumstances.

(a) Replacement cost is the amount that would be needed currently to acquire an equivalent asset. This may be used, for example, when inventories are valued at the lower of historical cost and replacement cost.

(b) Realizable value is the amount that would be received by selling an asset. This may be used, for example, to value portfolio investments. Market value may be used to estimate realizable value when a market for an asset exists.

.61 Present value is the discounted amount of future cash flows expected to be received from an asset or required to settle a liability. Present value is not a basis of measurement, but a valuation technique that may be used within historical cost-based or current-value models. This technique is used in the government reporting model, for example, to estimate the cost of retirement benefits, when determining the estimated total expenditure for closure and post-closure care of a solid waste landfill site, and when determining the "grant portion" of concessionary loans and portfolio investments.

.62 Government financial statements are prepared on the basis that recognized economic resources used up are measured in financial terms with no adjustments made for the effect of a change in the general purchasing power of the currency during the period. Although a government's performance in the management of its service potential 2 is generally a focus more appropriate to the nature and objectives of government, it cannot entirely be measured in financial terms.

2. Service potential embodies both the quality of service provided and the efficiency with which it is provided.

.63 Financial statements are prepared on the assumption that the government is a going concern, meaning it will continue in operation, and will be able to realize assets and discharge liabilities and meet its statutory obligations in the normal course of operations for the foreseeable future.

Guidance in ASSETS, Section PS 3210

Economic resources

.06 Economic resources embody value because they enable an entity to meet its objectives, such as the provision of public goods and services, redistribution of wealth, generation of cash inflows or reduction of cash outflows.

.07 To embody value as an economic resource, there must also be some restriction on its availability. For example, the air we breathe generally cannot be an economic resource unless access to it is restricted.

.08 Economic resources can arise from, but are not limited to, the following:

(a) contracts or agreements (for example, accounts receivable and leases);
(b) another government's legislation (for example, transfers receivable);
(c) government's own legislation (for example, taxes, fines and penalties);
(d) voluntary contributions (for example, donations); or
(e) construction and development (for example, roads).

.09 Economic resources can be:

(a) financial in nature (for example, cash, accounts receivable and investments); or
(b) non-financial in nature (for example, tangible capital property, prepaid items and inventories of supplies).

.10 Without an economic resource, future economic benefits cannot be obtained. For example, a fire truck (the economic resource) needs to exist before it can provide fire suppression services (the future economic benefits).

Future economic benefits

.11 The essence of assets are their future economic benefits. Assets embody future economic benefits that allow public sector entities to achieve their objectives. The future economic benefits embodied in assets involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows or to reduce cash outflows.

.12 Often the public is the beneficiary of the goods and services provided by a public sector entity. For example, assets such as fire trucks are used to provide fire suppression services to the public. Hospital buildings and medical equipment are used to provide health care services. Parks, schools and libraries provide recreational, educational and research opportunities to the public. Water treatment plants provide goods, such as potable water. Such assets benefit public sector entities as they assist in achieving the entity's primary objective of providing public goods and services. This benefit is different from the benefit that the public receives.

.13 The future economic benefits embodied in an asset may also be in the form of generating future cash inflows. Cash inflows benefit the public sector entity because cash can be used to purchase or to provide goods and services, redistribute wealth or settle liabilities. Benefits in the form of cash inflows relate to resources, such as loans receivable, inventory for resale and portfolio investments. Also, some public sector resources generate cash inflows because they have user fees associated with them.

.14 The future economic benefits may also take the form of a capacity to reduce cash outflows. For example, this may be the case when betterment of a tangible capital asset reduces the cost of providing goods and services.

.15 There is a close association between incurring a cost and the generation of an asset. However, not all costs result in a future economic benefit. For example, costs incurred to maintain the current service capacity of an asset do not provide a future economic benefit. Also, a public sector entity may obtain an asset without incurring costs. For example, items that have been donated to the public sector entity may provide that entity with future economic benefits and, hence, satisfy the definition of assets.

Control

.16 A public sector entity controls the economic resource and access to the future economic benefits when it:

(a) can benefit from the economic resource through its capacity to provide goods and services, to provide future cash inflows or to reduce cash outflows;

(b) can deny or regulate access to those benefits by others; and

(c) is exposed to the risks associated with the economic resource.

.17 An entity that controls an economic resource has the ability to benefit from the economic resource. For example, a recipient of a transfer benefits from the transfer as it can use the transfer to provide goods or services.

.18 An entity that controls an economic resource has the ability to deny or regulate access to the future economic benefits associated with the economic resource by others. For example, an entity controlling a bus has the ability to deny or regulate access to the related transportation services.

.19 An entity that controls an economic resource is exposed to the risks associated with the economic resource. For example, the entity may hold an investment, the value of which may decline and result in a loss.

.20 Some economic resources are subject to certain external restrictions that specify the purpose(s) for which resources are to be used. For example, there may be external restrictions imposed on the public sector entity's own assets, as is the case with some sinking fund investments. Such restrictions on the use of an economic resource do not negate the public sector entity's control of the economic resource.

.21 Although control may be seen as applying to an asset as a whole, the concept can also be applied to individual rights related to the asset. For example, a single leased asset embodies different economic benefits. It may give the lessee the right to use the property and the lessor the right to receive rents and any residual value. Thus, both parties may have assets corresponding to their respective rights.

.22 Control of an economic resource and of access to the future economic benefits are essential characteristics of an asset, whereas possession or ownership is not. For example, a public sector entity may control the economic resource and access to the future economic benefits through a capital lease arrangement yet not own the economic resource.

.23 A public sector entity's ability to regulate an economic resource does not, in and of itself, constitute control of an asset. A public sector entity may establish the regulatory environment in an industry or sector within which organizations operate and impose conditions or sanctions on their operations. For example, a pollution control authority may have the ability to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority's interest extends only to the regulatory use of the economic resources and does not include the ability to control access to the future economic benefits.

.24 A public sector entity may act as trustee when it administers trusts on behalf of the beneficiaries specified in the agreement or statute. As trustee, the public sector entity merely administers the assets, following the terms and conditions set out in the agreement. It does not control the asset because it does not have access to the future economic benefits. Those benefits flow to the beneficiaries.

Appendix B - Definitions of a Joint Defined Benefit Plan and Government Partnership

The definition of a government partnership is provided in GOVERNMENT PARTNERSHIPS, paragraph PS 3060.06. GOVERNMENT PARTNERSHIP, Section PS 3060 was introduced into the PSA Handbook in October 1999.

The definition of a joint defined benefit plan is provided in the glossary to RETIREMENT BENEFITS, Section PS 3250. RETIREMENT BENEFITS, Section PS 3250 was introduced into the PSA Handbook subsequent to Section PS 3060 in September 2001.

Both standards use similar wording in the definitions of a government partnership and of a joint defined benefit plan illustrating the development of Section PS 3250 considered the content in Section PS 3060.

Below is a comparison of the two definitions as currently in the PSA Handbook (consistent wording between the two definitions are underlined):

	Definition of a government partnership (GP)	Definition of a joint defined benefit plan (JDBP)	Comparison
Introductory paragraph	A **government partnership** is not a government organization but is a contractual arrangement [2] between the government and a party or parties outside of the government reporting entity [3] that has all of the following characteristics:	A **joint defined benefit plan** is a contractual arrangement between the government and another sponsor or sponsors representing plan participants that has all of the following characteristics:	Consistent in concept with the wording in the GP definition being more general.
Criteria 1	(a) the partners co-operate toward achieving significant clearly defined common goals;	(a) the sponsors co-operate toward achieving the significant clearly defined common goal of providing retirement benefits in exchange for services rendered by the employees;	
Criteria 2	(b) the partners make a financial investment in the government partnership;	(b) funding contributions are shared mutually between the government and the plan members, represented by the	Consistent in concept with the definition of a GP focusing on investments in the partnership and the

		non-government sponsor;	definition of a JDBP focusing on contributions into the plan.
Criteria 3	(c) the partners share control of decisions related to the financial and operating policies of the government partnership on an ongoing basis; and	(c) the sponsors share control of decisions related to the administration of the retirement benefit plan and to the level of benefits and contributions on an ongoing basis; and	Consistent in concept with the wording in the GP definition being more general.
Criteria 4	(d) the partners share, on an equitable basis, the significant risks and benefits associated with the operations of the government partnership.	(d) the significant risks associated with the retirement benefit plan are shared on an equitable basis between the government and the plan members, represented by the non-government sponsor.	
Concluding paragraph	The contractual arrangement establishes that the parties have shared control over the government partnership, regardless of the difference in their ownership interest. Nevertheless, overall, there must be an equitable relationship between the financial investment of the government in the government partnership, the extent of control it is able to exercise over the activities of the government partnership, and the risks and benefits that accrue to the government from the	The contractual arrangement establishes that the sponsors have shared control over the retirement benefit plan, and ensures that neither party is in a position to control the plan unilaterally. Nevertheless, overall, there must be an equitable relationship between the funding by the government of the retirement benefit plan, the extent of control it is able to exercise over the plan and the risks and benefits that accrue to the government from the plan.	

	government partnership. Government partnerships may be structured as operations under shared control, assets under shared control or organizations under shared control. [Former paragraph PS 3060.06 retained in Archived Pronouncements.]		

In addition to consistent wording, the concepts in the definitions of a government partnership and a joint defined pension plan are similar.

While similar in concept and wording, the definition of a joint defined pension plan is more specific than the general definition of a government partnership. GOVERNMENT PARTNERSHIPS, Section PS 3060 is a general standard for all types of government partnerships. Alternatively RETIREMENT BENEFITS, Section PS 3250 addresses specific types of employee retirement benefits including joint defined pension plans.

There is one principle in the JDBP paragraphs in Section PS 3250. Paragraph .081 indicates "*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]". This principle is consistent with the proportionate consolidation method included in Section PS 3060.

Appendix C – Analysis of the British Columbia pension plans in relation to OTPP (prepared by lawyers, Koskie Minsky)

BRITISH COLUMBIA PLANS

In British Columbia, the Municipal Pension Plan, the Colleges Pension Plan, the Teachers' Pension Plan and the Public Sector Pension Plan were all converted from employer sponsored pension plans to jointly sponsored plans in accordance with the Public Sector Pension Plans Act, S.B.C. 1999, c.44 (the PSPPA").

A. British Columbia Municipal Pension Plan (the "MPP")

The MPP is governed by:

(a) Municipal Pension Plan Joint Trust Agreement (consolidated), updated to September 30, 2015 (the "MPP Trust Agreement"); and

(b) Municipal Pension Plan Rules effective April 1, 2000 (current to November 19, 2015).

Under the MPP Trust Agreement, the following rules govern the Sponsors of the MPP and the Board of Trustees of that arrangement in regard to Plan surpluses:

The Board of Trustees may amend the MPP to utilize surpluses under section 11.5, provided that the conditions in 11.5(a) and (b) are met. These provisions permit the Board of Trustees to utilize Plan surpluses to improve Plan benefits for Plan members, provided that the surplus is sufficient to fund the benefit improvement "based on the open group of Plan Members and using a twenty-five year amortization schedule for the Plan actuarial excess to be used to fund the benefit improvement". Any benefit improvement made by the Board of Trustees cannot result in increased contribution rates nor can it create an unfunded liability. Any such improvement must also be consistent with the Trustees' fiduciary responsibilities. Within these parameters, however, the Board of Trustees of the MPP does have the authority to utilize Plan surpluses on an ongoing basis.

The MPP Partners may also amend the MPP using ongoing surpluses in accordance with section 11.3 of the MPP Trust Agreement. This section permits the Partners to direct the Board of Trustees to amend the Plan rules and requires the Board of Trustees to comply with that direction so long as three conditions are met: (a) the Partners first receive and consider the advice of the Board respecting the proposed amendment, (b) the proposed amendment is compliant with the Trustees' fiduciary responsibilities and (c) the proposed amendment will not result in the Plan failing to be funded in accordance with the PBSA going concern funding requirements. Significantly, the MPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution in the event that the MPP Partners cannot agree on surplus utilization. This contrasts with the OTPP Partners'

Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses.

Accordingly, under the MPP, both the Partners and the plan administrator may utilize Plan surpluses by amending the Plan terms in regard to either or both of contribution rates and benefits.

It should be noted that, during a Transitional Period, the use of actuarial gains in the MPP is prescribed by Appendix "B" to the MPP Joint Trust Agreement. During the Transitional Period, all gains must first be used to eliminate unfunded liabilities. Then, actuarial gains must be applied to both (a) reconfigure employer contribution rates and (b) make specified benefit improvements. Employer contribution rates are to be reconfigured by eliminating the 'doubling' feature of employer contribution rates applicable to employees in certain Plan membership categories once they reach either 45 or 50 years of age (depending on the employment category). The transitional provisions prescribe the new base rates for each of the 5 categories of members in the BC, but also stipulate that employer contribution rates for two of the five categories will be increased beyond those base rates to reflect the differential current service cost for those two groups. The surplus implications of the reconfiguration of employer contribution rates are not predictable, and depend, at least in part, on the relationship between the 'base rates' under the transitional provisions and the actual rates being paid by employers at the time of the reconfiguration. Once the employer contribution rates are reconfigured and the specified benefit improvements are made, then 50% of any additional actuarial excesses must be used to fund a contribution rate stabilization reserve, and the balance of the actuarial excess must be transferred to the Inflation Adjustment Account to an aggregate total of $1 billion. The contribution rate stabilization reserve is intended to be shared on an equal (50/50) basis between Plan members and employers in order to maintain or reduce future contribution rates. Until such time as the objectives identified for the Transitional Period are fulfilled, there is no discretion left to either the Partners or the Board of Trustees to utilize ongoing MPP surpluses.

B. British Columbia Public Service Pension Plan (''PSPP")

The PSPP Joint Trust Agreement contains provisions regarding the authority of the Partners and the Board of Trustees to utilize ongoing surpluses that are equivalent to the provisions cited above with respect to the MPP. Accordingly, under the PSPP, both the Partners and the Board of Trustees have the authority, in the circumstances and subject to the conditions described in relation to the MPP, to utilize ongoing surpluses to reduce contributions or improve Plan Member benefits.

In this regard, section 10.3(c) of the PSPP Joint Trust Agreement expressly provides the Board of Trustees[10] with the authority to apply ongoing surpluses (the term used in the PSPP Joint Trust

[10] It is noteworthy that s. 14(c) of the PSPP Joint Trust Agreement stipulates that the Trustees are not acting in a fiduciary capacity when they make decisions that apply ongoing surpluses, and may take account of the financial and other interests of the party that appointed them.

Agreement is "surplus assets") in one or more of the following manners:

1. transfer all or portions of surplus assets to the reserve established within the Pension Fund for stabilising contribution rates;

2. transfer all or portion of the surplus assets to the Inflation Adjustment Account;

3. apply all or a portion of the surplus assets to an equal reduction or elimination of Employer and Plan Member contributions to the Basic Account for a period of time;

4. apply all or a portion of the surplus assets to fund changes to the PSPP's benefit provisions provided that any change to benefits does not result in contribution rate increases, does not create or increase an unfunded liability, is consistent with the Trustees' fiduciary obligations and does not conflict the requirement (in s. 13.5) that, upon the termination and wind-up of the PSPP any remaining assets are to be equally shared between the employees and the employers.

At the same time, as is the case for the MPP, the Partners have the authority, pursuant to s.11.3 of the PSPP Joint Trust Agreement, to direct the Board of Trustees to amend the PSPP Plan rules and change either or both of the PSPP's contribution rates or benefits so long as the Partners have received and considered the advice of the Board respecting both the cost and administrative impact of any proposed amendments, the amendment is not inconsistent with the Trustees' fiduciary responsibilities or any funding policy adopted by the board and the proposed amendment will not result in the PSPP failing to be funded in accordance with British Columbia's Pension Benefits Standards Act. Significantly, the PSPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution in the event that the MPP Partners cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses.

Section 15.4 of the PSPP Joint Trust Agreement provides that certain benefit improvements must be made using Plan surpluses that are identified in actuarial valuations dated March 31, 2001 and March 31, 2002. Unlike with respect to the MPP, the PSPP does not appear to have an indefinite 'Transitional Process' that commits all ongoing surpluses until the Transitional objectives are accomplished. Rather, the PSPP Trustees and Partners have had discretionary authority with respect to ongoing PSPP surpluses

C. British Columbia Teachers Pension Plan ("TPP")

The TPP is governed by:

(a) a Joint Trust Agreement made as of April 2, 2001 between Her Majesty the Queen in right of the Province of British Columbia as represented by the Minister of Finance and Corporate Relations (the "Government") and the British Columbia Teachers' Federation ("BCTF");

(b) the TPP Rules.

The Joint Trust Agreement contains provisions permitting both the Partners and the TPP Board of Trustees to amend the Plan rules using ongoing Plan surpluses (section 11 of the Joint Trust Agreement). These provisions are the equivalent of the MPP Joint Trust Agreement provisions regarding the same matters, as described above. In particular, it is significant that the TPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution for either Partner in the event that the they cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses.

As well, Appendix "B" to the TPP Joint Trust Agreement adopts special funding rules for a "Transitional Period" during which the Board of Trustees is directed to use surpluses to achieve specified contribution and benefit improvement outcomes. The transitional objectives for the TPP are not the same as for the MPP, although they entail both contribution rate changes and benefit improvements. In the case of the TPP, however, the transitional provisions build in a 4% reduction in the employer contribution rate from its July 1, 2010 level. As with the MPP, the Transitional Period is of indefinite duration, and only ends when the transitional objectives have been satisfied. During the transitional period, all ongoing surpluses are committed to the transitional objectives and no ongoing surpluses are available for discretionary reductions in contributions or surplus withdrawals.

D. British Columbia Colleges Pension Plan ("CPP")

The CPP is governed by:

(c) the CPP Joint Trust Agreement made April 4, 2011; and

(d) the CPP rules, effective June 22, 2012 (current to April 1, 2016).

The CPP Joint Trust Agreement allocates powers and authorities with respect to ongoing surpluses in the same way as the other BC Plans.

The Partners have the authority (s.14(2) of the Joint trust Agreement) to direct the Board to amend the Plan rules, and the Plan Board is required to amend those rules, provided that the Partners "first receive and consider the advice of the Board respecting both the cost and the administrative impact of implementing the proposed amendment" and the proposed amendment is not inconsistent with applicable law or the Trustees' fiduciary responsibilities. Significantly, the CPP constating documents contain no right of recourse to arbitration or other final and binding dispute resolution in the event that the CPP Partners cannot agree on surplus utilization. This contrasts with the OTPP Partners' Agreement, which does provide for third party determinations of differences arising between Partners with respect to surplus uses

Pursuant to subsection 14(4) of the CPP Joint Trust Agreement, the Board of Trustees is also permitted to amend the Plan rules and to utilize Plan surpluses so long as there is no resulting increased in contribution rates, there is no creation of, or increase in, an unfunded liability and the proposed amendment is consistent with the Trustees' fiduciary responsibilities. As with the other BC Plans, the Board of Trustees must use a twenty-five year period for the amortization of the Plan surplus.

Unlike the MPP, TPP and PSPP, the CPP Joint Trust Agreement has no transitional provisions that direct the Board of Trustees as to the application of ongoing surpluses during a transitional period.

Ill. SUMMARY AND CONCLUSIONS

A. Ontario Plans

OTPP - The governance arrangements with respect to the OTPP provide that the Partners that sponsor that arrangement, being the Minister of Education and the OTF, may utilize ongoing surpluses as they believe appropriate, subject only to the Ontario Pension Benefits Act, R.S.O. 1990, c.P.8 (the "Ontario PBA"). The Board of Directors of the OTPP, being the OTPP administrator for purposes of the PBA, has no authority with respect to the use of Plan surpluses. The OTPP Partners' Agreement anticipates that the Partners will, on a triennial basis, review the results of a preliminary actuarial valuation and determine whether and how they wish to adjust Plan benefits or contribution rates in view of any existing funding deficiencies or ongoing surpluses. The Partners are obliged to bargain in good faith with each other with respect to the disposition of ongoing surpluses, and may have recourse to mediation and final and binding arbitration should they not reach an agreement on their own. An arbitration panel may apply ongoing surpluses to improve benefits or reduce contributions, subject to the limitations set out in section 92 of the Partners Agreement.

B. BC Plans

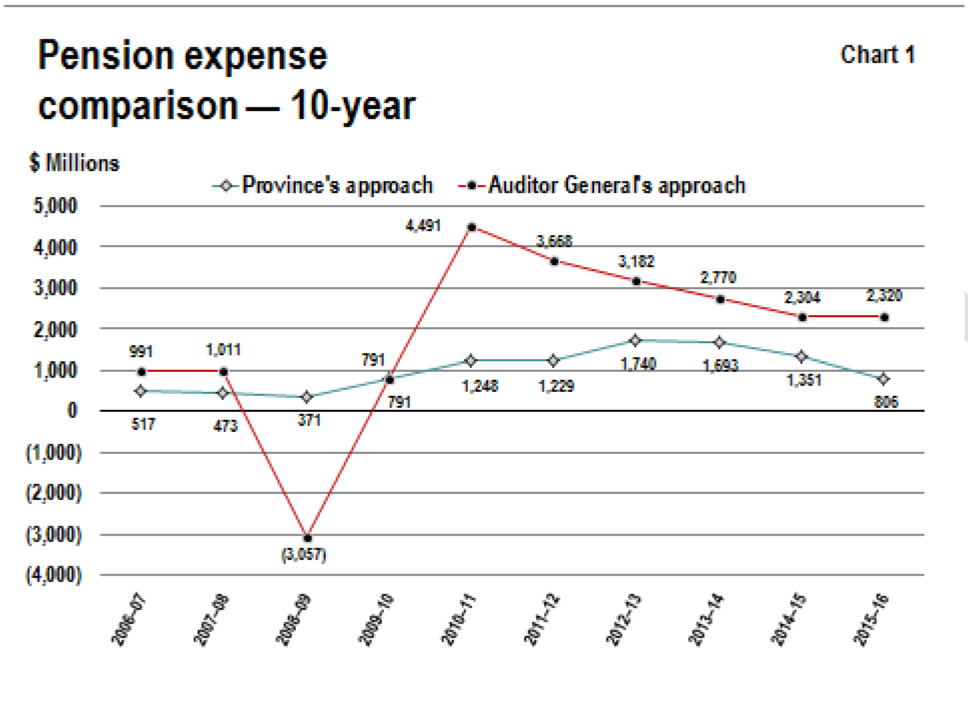
Ongoing Surpluses - All of the BC Plans follow the same pattern with respect to the authority to use ongoing surpluses. In the normal course, the Boards of Trustees of the BC Plans, unlike their Ontario counterparts, are permitted to utilize ongoing surpluses through the amendment of the Plan rules governing contributions and benefits, so long as the amendment of the Plan rules does not result in an increased contribution rate for employees or employers, does not create or increase an unfunded liability in the Plan and is otherwise compliant with applicable legislation and the Trustees' fiduciary obligations.

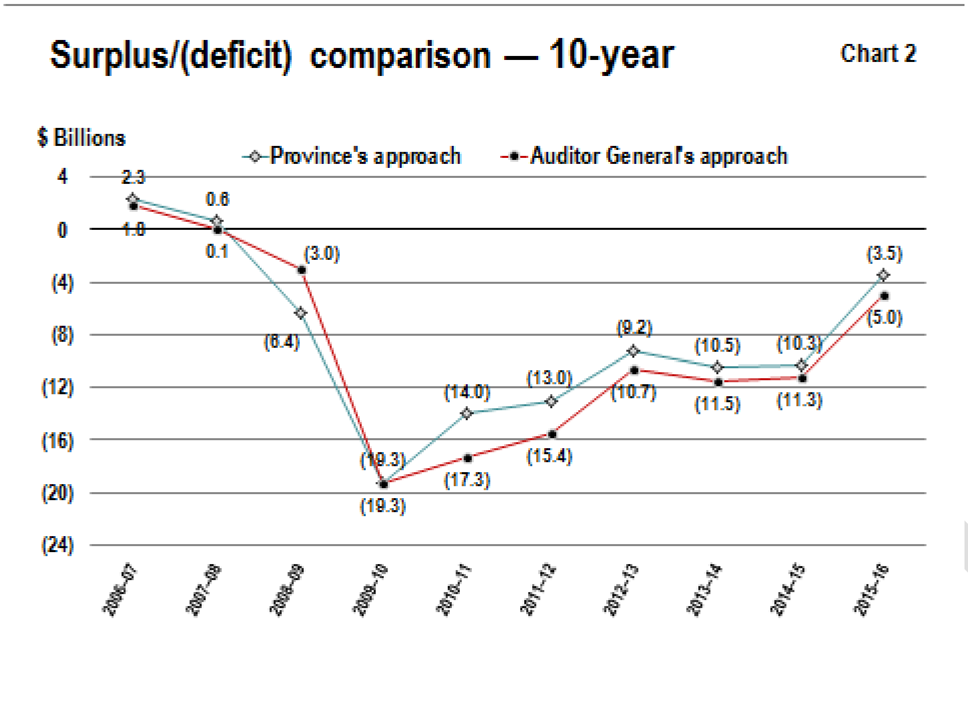
At the same time, each of the BC Plans also permits the Plan Partners to utilize ongoing surpluses by directing the Board of Trustees to amend the Plan rules. The Partners may so direct the Board of Trustees after receiving advice from the Board with respect to the costs of any Plan amendment and the administrative implications of such an amendment, and so long as the proposed amendment is compliant with law and with the Trustees' fiduciary obligations. However, unlike for the OTPP, the BC Plans' constating documents provide neither Partner with a right of recourse to a third party for a final and binding determination concerning surplus utilization.

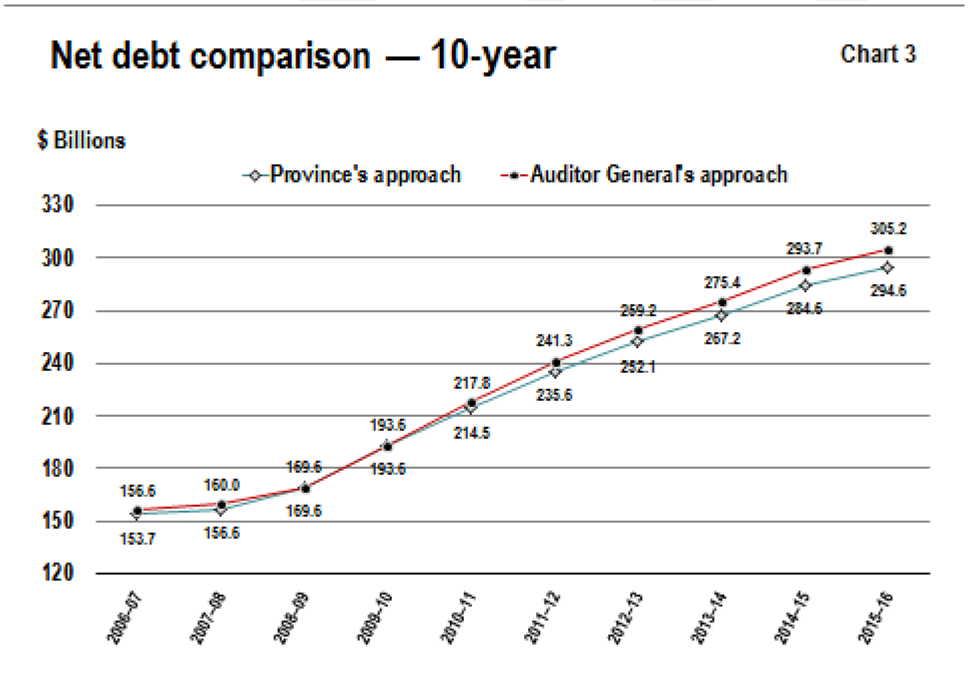
Transitional Period- In addition, three of the four BC Plans we have reviewed (MPP, TPP and, for only two years, the PSPP) contain special rules governing the utilization of ongoing surpluses during a "Transitional Period". In these cases, the Transitional rules require that ongoing surpluses that emerge during the Transitional Period are to be used to restructure the employer contribution obligation and improve benefits. In the cases of the MPP and TPP, the Transitional Periods do not come to an end until all of the intended uses of ongoing surplus during the Transitional Period have been fulfilled. We are not currently aware as to whether the Transitional Periods for the MPP and the TPP remain ongoing, or have terminated. Until such time as the objectives identified for the Transitional Periods are fulfilled, there is no discretion left to either the Partners or the Board of Trustees to utilize ongoing MPP surpluses.

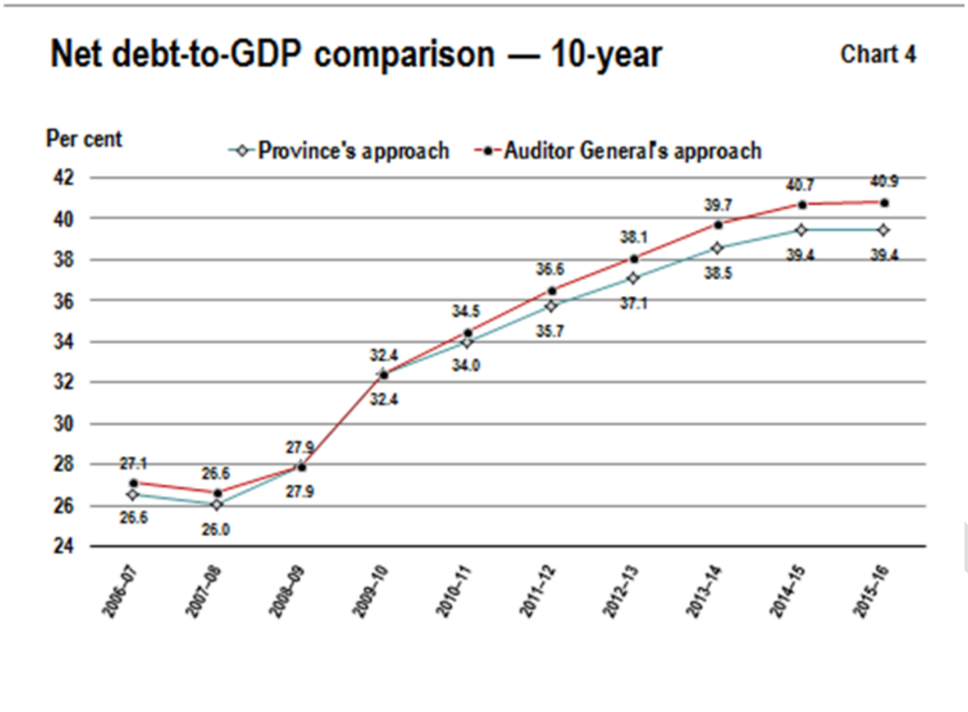
We trust that these comments have been of assistance to you. Should you have any questions in regard to them, please do not hesitate to contact the undersigned.

Appendix D - Comparison of key measurements of the Province over the prior 10 years following the Auditor General's approach to pension accounting compared with following the Province's interpretation of the PSAS.




Surplus/(deficit) comparison — 10-year
Chart 2
$ Billions
Province's approach
Auditor General's approach
4
0
(4)
(8)
(12)
(16)
(20)
(24)
2.3
1.8
0.6
0.1
(3.0)
(6.4)
(19.3)
(19.3)
(14.0)
(17.3)
(13.0)
(15.4)
(9.2)
(10.7)
(10.5)
(11.5)
(10.3)
(11.3)
(3.5)
(5.0)
2006–07
2007–08
2008–09
2009–10
2010–11
2011–12
2012–13
2013–14
2014–15
2015–16


Net debt comparison — 10-year
Chart 3
$ Billions
Province's approach
Auditor General's approach
330
300
270
240
210
180
150
120
156.6
153.7
160.0
156.6
169.6
169.6
193.6
193.6
217.8
214.5
241.3
235.6
259.2
252.1
275.4
267.2
293.7
284.6
305.2
294.6
2006–07
2007–08
2008–09
2009–10
2010–11
2011–12
2012–13
2013–14
2014–15
2015–16


Net debt-to-GDP comparison — 10-year
Chart 4
Per cent
Province's approach
Auditor General's approach
42
40
38
36
34
32
30
28
26
24
27.1
26.6
26.6
26.0
27.9
27.9
32.4
32.4
34.5
34.0
36.6
35.7
38.1
37.1
39.7
38.5
40.7
39.4
40.9
39.4
2006–07
2007–08
2008–09
2009–10
2010–11
2011–12
2012–13
2013–14
2014–15
2015–16

Appendix E – Guidance in the various constating documents for OTPP relating to use of the surplus and the sharing of responsibilities

Pension Benefits Act (PBA) and the regulations (PBR)
While they do address surplus withdrawals, the PBA and PBR do not otherwise mandate any particular use of ongoing surplus that may arise in a pension plan, e.g. for benefit improvements or contribution holidays. One must therefore look to the Teachers' Act, and to the Partners' Agreement and FMP in order to determine how ongoing surplus is dealt with under the OTPP.
Teachers' Pension Act (TPA)
Paragraph 10(1)3 of the Teachers' Act provides that the Minister of Education and the executive of the OTF may enter into an agreement (i.e., the Partners' Agreement) that provides for certain matters, including: "3. The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the Minister, the employers who contribute under the plan and the active plan members". This is a fundamental legislative pronouncement that the Province and the members of the plan are meant to "share" both upside (surplus) and downside (deficit) under the plan. Although it is not an express statement of 50/50 sharing, it would presumably inform the expectations of the Sponsors regarding how any surpluses are to be utilized. Pursuant to Section 10 of the TPA, the Minister of Education and the OTF (collectively the Sponsors) have entered into an agreement for the management of the Plan (Partners' Agreement), to which is appended a Funding Management Policy (FMP) that is deemed to form part of the Partners' Agreement. The FMP provides a framework for the funding of the Plan and how deficits and surpluses will be addressed. The Partners can deviate from the FMP by agreement.
Partners' Agreement
The Partners' Agreement is between the Province of Ontario and the OTF and sets out the formal relationship between the partners in sponsoring the OTPP. Paragraph 8 of the Partnership Agreement states that the partners will be responsible for designing the Plan structure, setting the benefits of the Plan, developing new policy, deciding what the contribution rate will be, what the funding levels, margins and contingency reserves will be, how to make changes to the Plan and other Plan documents, deciding whether or not to file a valuation more frequently than required by the Pension Benefits Act, appointing the OTTP Board, and defining the role of the Board. By contrast, section 19 of the Partners Agreement sets out the responsibilities of the OTPP Board, and does not confer any authority on the OTPP Board to change benefits or contribution rates that are provided under the OTPP. This means that the OTPP Board has no authority to use ongoing surpluses either to improve benefits or reduce contributions. Only the Sponsors to the OTPP have the authority to utilize ongoing surpluses. The process governing the use of ongoing surpluses by the Sponsors is set out in the Partners' Agreement. It anticipates that the OTPP Board will prepare an actuarial valuation of the OTPP every

three years (section 73). Paragraph 74 requires negotiation in good faith regarding changes to the Plan that flow from a valuation that is be filed with the regulators. Paragraph 75 of the Partners' Agreement requires the Sponsors to advise the Board of OTPP of what changes affecting benefits and contribution rates they are proposing so that the Board can provide cost estimates and comments on the administrative impact of the changes to both partners as soon as possible. Section 77 of the Partners' Agreement anticipates that the Sponsors may appoint a mediator to assist them and sections 84 and 86 of the Partners' Agreement provide for the appointment of a Board of Arbitration to make a final and binding order with respect to the utilization of an ongoing surplus disclosed by the actuarial valuation. A Board of Arbitration is empowered to change contribution rates and/or benefits under the Plan, or to keep an amount of surplus in reserve, but is subject to certain limits that are set out in section 92. If the Sponsors cannot agree on the changes required to the Plan, a mediator is appointed to assist the Sponsors in coming up with an agreement. The mediator is responsible for submitting a report to the Sponsors on his or her views on the positions of the partners and provide a recommendation to the Sponsors. If the Sponsors do not accept the mediator's report, the arbitration process will begin and an arbitration board will be appointed. The board will consist of 3 people, with each partner selecting one representative and two appointees will select the final member who is an umpire. Paragraph 94 of the Partners' Agreement indicates that the report created by the arbitration board will be implemented. Paragraph 92 sets some parameters for the arbitration, including part (c), which sets out that the parameters that the award of the arbitration will provide that the contributions from the Minister and employers be equal to those of the members. We note that the mediation/arbitration process would not be triggered unless there is an actuarial valuation to be filed with the regulators that requires the Sponsors to agree on how any surplus or deficit is to be addressed. If a valuation is prepared in a year when no filing is required (filings generally only being required every three years), and the Sponsors do not agree to file the valuation, then the Sponsors do not necessarily have to address funding and benefit issues and therefore no negotiations may occur. In addition to the clauses identified above, the Partners' Agreement has an appendix called the Funding Management Policy which sets out the Sponsors' responsibilities in making funding decisions and surplus allocation regarding the Plan.
Funding Management Policy (FMP)
The FMP is an appendix to the Partners' Agreement that speaks to how the Plan should be funded and

how surpluses should be utilized by both parties. The protocol for the use of a surplus under the OTPP is detailed in the FMP adopted by the Ontario Government and OTF as sponsors of the OTPP.
The FMP sets out a complex series of considerations surrounding funding management and the use of any excess of assets over liabilities. The FMP sets out a number of “funding zones”, depending on the level of funding in the Plan. The following three are most relevant to addressing surpluses:

i) Restoration zone (Article 3 of the FMP) allows for a surplus to be utilized to “restore” foregone indexation and then to either increase benefits to the “run-rate benefit” level (i.e., the long-term target level) or to lower contributions (or a combination of these two options) (Section 3.06(e)).

ii) Temporary improvement zone (Article 4 of the FMP) is the zone where contributions can be temporarily reduced, a surplus distribution can be made on a temporary basis and/or benefits can be temporarily improved (as long as it does not create a long term cost) (Section 4.05).

iii) Permanent improvement zone is where the Plan is essentially fully funded and has the funding security desired to support permanent changes. Article V (Permanent Improvements) of the FMP provides for permanent actions that can be taken when Plan assets exceed current liabilities by more than 10% of current liabilities. In this regard Section 5.05 provides for actions that can be taken in respect of the amount that assets exceed current liabilities. Such actions can include changes to current benefits, current contributions, or both.

The ability to reduce contributions or increase benefits through the temporary or permanent improvement zone are subject to ensuring that the requirements of 3.06 in the restoration zone are met. Article VIII of the FMP sets out that the parties must agree to any changes arising out of FMP decisions. For filing valuations, if the Sponsors are unable to agree the mediation process set out in the Partners’ Agreement, the arbitration process outlined in the Partners’ Agreement will be followed. For valuations that are not filed, either party can decide not to negotiate.

The Plan is currently in the Restoration Zone. Contributions to the OTPP currently include a 1.1% special contribution on all earnings and that the Restoration Contribution Reduction under Section 3.06(e) would if agreed to by both Sponsors, permit this special contribution to be eliminated. This special contribution is scheduled to end in 2026.

If the Plan gets to either the temporary improvement zone or the permanent improvement zone, section 4.06 and subsection 5.05(b) of the FMP provides that a benefit improvement can only occur if the Sponsors (the Ontario government and the OTF) have entered into a written agreement governing the manner in which the contribution by the government and other employers may be adjusted to offset any surplus distribution or benefit improvement (temporary or permanent) to be granted.

Section 8.01 of the FMP provides the following:

Section 8.01 Unless the Sponsors mutually agree to the contrary, they shall follow the procedures described in paragraphs 74 to 100 when determining the plan changes arising from Section 3.07.

The Partners' Agreement and the FMP contain no general arbitration clause governing all disputes relating to the agreement, although Section 14 of the Partners; Agreement provides for the possibility of voluntary arbitration. There has been no instance where the arbitration provisions have been invoked by the parties since the FMP was established. OTPP's internal legal counsel, has indicated that the arbitration provisions in the FMP would be expected to apply to disputes relating to the utilization of surplus under each of these provisions.

Where a matter has been submitted to arbitration, case law has established that the agreement between the parties that is being arbitrated is the fundamental source of subject matters that come within the arbitration board's jurisdiction. The parties are free to design their own procedures, including setting the scope of the arbitration board's jurisdiction and specifying the potential outcomes of the arbitration (subject to certain default appeal rights and mandatory grounds to set aside an award under the Arbitration Act). The arbitration board is empowered to make binding decisions because of the arbitration agreement, including any limitations on that authority. Canadian courts have traditionally granted deference to arbitration awards.

Arbitration provisions are generally procedural in nature and therefore do not provide a strong foundation upon which to base parties' reasonable expectations about their substantive rights under an agreement. To resolve a dispute, the arbitration board would engage in an exercise in interpretation of the operative substantive provisions of the relevant governing documents, including any applicable statutory provisions. However, as noted above, under section 92 of the Partners' Agreement, the arbitral award must meet certain mandatory conditions. Among other things, the arbitral award is required to provide that the contributions of the Minister and those employers who are required to contribute are equal to the contributions of members (section 92(c) of the Partners' Agreement). The arbitration board does not have discretion to ignore this mandatory provision, although the provision would need to be given effect within the context of the relevant documents and applicable statutes, interpreted as a whole, and other relevant factors, such as past conduct of the parties. As part of the arbitration board's interpretation exercise of the relevant governing documents, in the event of ambiguity in the written terms of the documents, evidence of the parties' post-agreement practices can be admitted as an aid to interpreting the agreement. Past practices may illustrate the parties' intentions at the time of the agreement. These considerations of past practices would be in conjunction with any explicit mandatory considerations set out in the governing document, e.g. prevailing economic conditions and the overall state of the provincial economy under section 91 of the Partners' Agreement. The past practices which the arbitrator may consider would include those described above: the long history of 50/50 member/employer contributions to the plan, and the equal sharing of surpluses prior to 2003 (from 2003 onwards the plan was mostly in deficit, with surpluses used to restore foregone escalated adjustments for members).

Appendix F – Pension liability (asset) and expense reported by the Province of Ontario for OTPP over the prior 14 years

Ontario Teachers' Pension Plan (excluding Retirement Compensation Plan)

$ Millions Fiscal Year	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
50% Pension Liability (Asset) Reflecing Accounting Policy for Joint Plans						
Accrued benefit obligation, closing balance	27,544	32,185	33,660	35,505	37,045	40,186
Less: pension fund assets (market related values), closing balance	(34,390)	(36,215)	(37,929)	(39,579)	(41,396)	(44,347)
Unamortized experience gains (losses)	6,066	2,750	2,646	2,112	2,028	1,493
Adjustment for different year ends	421	436	449	472	497	523
Other Unamortized Amounts (initial unfunded liability, difference in contributions, etc.)	642	507	383	256	135	20
Pension liability (Asset) at March 31 Reported before any valuation	**282**	**(336)**	**(791)**	**(1,233)**	**(1,691)**	**(2,126)**
Valuation Allowance	**-**	**-**	**-**	**-**	**-**	**-**
Pension Liability (Asset) after valuation Allowance	**282**	**(336)**	**(791)**	**(1,233)**	**(1,691)**	**(2,126)**
50% Pension Expenditure Reflecing Accounting Policy for Joint Plans						
Current period benefit cost	650	770	848	868	878	955
Amortization of experience gains	(568)	(235)	(247)	(222)	(233)	(234)
Pension interest expenditure	(353)	(374)	(250)	(272)	(261)	(281)
Cost of plan amendment	-	2,260	-	-	-	-
Less: recognition of unamortized experience gains	-	(2,260)	-	-	-	-
Amortization of Other amounts	(134)	(131)	(130)	(132)	(134)	(135)
Pension expense before valuation	**(405)**	**29**	**221**	**241**	**250**	**305**
Expense increase (reduction) in valuation Allowance						
Pension Expense after valuation Allowance	**(405)**	**29**	**221**	**241**	**250**	**305**

Ontario Teachers' Pension Plan (excluding Retirement Compensation Plan)

$ Millions Fiscal Year	2006-07	2007-08	2008-09	2009-10	2010-11
50% Pension Liability (Asset) Reflecing Accounting Policy for Joint Plans					
Accrued benefit obligation, closing balance	41,560	44,178	46,011	48,304	49,559
Less: pension fund assets (market related values), closing balance	(47,425)	(52,459)	(53,479)	(54,556)	(57,123)
Unamortized experience gains (losses)	2,888	4,560	2,617	277	772
Adjustment for different year ends	529	650	687	764	774
Other Unamortized Amounts (initial unfunded liability, difference in contributions, etc.)	(114)	54	136	206	220
Pension liability (Asset) at March 31 Reported before any valuation	**(2,562)**	**(3,016)**	**(4,027)**	**(5,005)**	**(5,799)**
Valuation Allowance	**-**	**-**	**-**	**-**	**-**
Pension Liability (Asset) after valuation Allowance	**(2,562)**	**(3,016)**	**(4,027)**	**(5,005)**	**(5,799)**
50% Pension Expenditure Reflecing Accounting Policy for Joint Plans					
Current period benefit cost	998	1,051	1,118	1,175	1,217
Amortization of experience gains	(235)	(355)	(557)	(458)	(294)
Pension interest expenditure	(258)	(381)	(536)	(481)	(397)
Cost of plan amendment	-	-	-	-	-
Less: recognition of unamortized experience gains	-	-	-	-	-
Amortization of Other amounts	(146)	38	34	30	(4)
Pension expense before valuation	**359**	**354**	**60**	**266**	**523**
Expense increase (reduction) in valuation Allowance					
Pension Expense after valuation Allowance	**359**	**354**	**60**	**266**	**523**

Ontario Teachers' Pension Plan (excluding Retirement Compensation Plan)					
$ Millions					
Fiscal Year	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
50% Pension Liability (Asset) Reflecing Accounting Policy for Joint Plans					
Accrued benefit obligation, closing balance	51,847	52,977	54,762	56,901	58,184
Less: pension fund assets (market related values), closing balance	(57,843)	(59,932)	(65,434)	(71,538)	(78,499)
Unamortized experience gains (losses)	(1,648)	(1,237)	1,851	4,816	9,001
Adjustment for different year ends	799	826	853	882	895
Other Unamortized Amounts (initial unfunded liability, difference in contributions, etc.)	222	242	257	273	272
Pension liability (Asset) at March 31 Reported before any valuation	**(6,623)**	**(7,124)**	**(7,711)**	**(8,667)**	**(10,147)**
Valuation Allowance	**-**	**-**	**-**	**-**	**10,147**
Pension Liability (Asset) after valuation Allowance	**(6,623)**	**(7,124)**	**(7,711)**	**(8,667)**	**-**
50% Pension Expenditure Reflecing Accounting Policy for Joint Plans					
Current period benefit cost	1,283	1,396	1,327	1,462	1,451
Amortization of experience gains	(245)	(91)	35	(156)	(362)
Pension interest expenditure	(495)	(387)	(457)	(707)	(939)
Cost of plan amendment	-	-	-	-	-
Less: recognition of unamortized experience gains	-	-	-	-	-
Amortization of Other amounts	(24)	(26)	(30)	(31)	(33)
Pension expense before valuation	**519**	**892**	**875**	**569**	**118**
Expense increase (reduction) in valuation Allowance					**1,480**
Pension Expense after valuation Allowance	**519**	**892**	**875**	**569**	**1,598**

Appendix G - Comparison of the discount rates used by Provincial pension plans across Canada relative to the discount rate used by OTPP [Tables are to be updated]

Review of Discount Rates Across Jurisdictions

- In the inter-jurisdictional review of all funded provincial sponsored or joint sponsored plans which also have stand-alone plan financial statements:
  - the Ontario Teachers' Pension Plan (OTPP) is the only plan were the discount rate used in the plan's financial statements is more than 50 basis points below the discount rate used by the province.
  - OTPP stand-alone financial statements use the market rate of Provincial bonds.
- All other plans' financial statements (i.e. 23 plans across jurisdictions) use the long-term rate of return as the discount. The discount rate used by the plans' are lower than 50 basis points or less than the provinces' discount rate or at times higher than the provincial rate.

1

Plan's discount rate is lower than the provincial rate by more than 50 bps

	Provincial Nominal Discount Rate	Basis of Provincial Nominal Discount Rate	Plan's Nominal Discount Rate	Basis of Plan's Nominal Discount Rate
Ontario				
Ontario Teachers' Pension Plan (OTPP)	6.25%	LT return on plan assets	3.25%	Market rate of Provincial Bonds

2

Plan's discount rate is lower by 50 bps or less (or higher than the provincial rate)

	Provincial Nominal Discount Rate	Basis of Provincial Nominal Discount Rate	Plan's Nominal Discount Rate	Basis of Plan's Nominal Discount Rate
Ontario				
Ontario Public Service Employees Union Pension Plan (OPSEUPP)	6.25%	LT return on plan assets	5.75%	LT return on plan assets
Healthcare of Ontario Pension Plan (HOOPP)	5.75%	LT return on plan assets	5.65%	LT return on plan assets plus margin
Colleges of Applied Arts and Technology Pension Plan (CAATPP)	6.00%	LT return on plan assets	5.70%	LT return on plan assets
Ontario Public Service Pension Plan (PSPP)	6.00%	LT return on plan assets	5.95%	LT return on plan assets
Alberta				
Teachers' Post-1992 Pension Plan	7.00%	LT return on plan assets	7.25%	LT return on plan assets
Universities Academic Pension Plan	6.10%	LT return on plan assets	6.25%	LT return on plan assets

3

Plan's discount rate is higher than the provincial rate (or lower by 50 bps or less) (cont'd)

	Provincial Nominal Discount Rate	Basis of Provincial Nominal Discount Rate	Plan's Nominal Discount Rate	Basis of Plan's Nominal Discount Rate
Alberta (cont'd)				
Local Authorities Pension Plan	5.80%	LT return on plan assets	5.80%	LT return on plan assets
Public Service Pension Plan	6.20%	LT return on plan assets	6.20%	LT return on plan assets
Management Employees Pension Plan	6.40%	LT return on plan assets	6.40%	LT return on plan assets
Provincial Judges and Master in Chambers Pension Plan	5.75%	LT return on plan assets	5.80%	LT return on plan assets
Supplementary Retirement Plan for Public Service Managers	6.20%	LT return on plan assets	6.20%	LT return on plan assets
Special Forces Pension Plan	6.30%	LT return on plan assets	6.30%	LT return on plan assets

4

Plan's discount rate is higher than the provincial rate (or lower by 50 bps or less) (cont'd)

	Provincial Nominal Discount Rate	Basis of Provincial Nominal Discount Rate	Plan's Nominal Discount Rate	Basis of Plan's Nominal Discount Rate
Saskatchewan				
Saskatchewan Healthcare Employees' Pension Plan (SHEPP)	6.80%	LT return on plan assets	6.80%	LT return on plan assets
British Columbia				
Public Service Pension Plan	6.50%	LT return on plan assets	6.50%	LT return on plan assets
Municipal Pension Plan	6.50%	LT return on plan assets	6.50%	LT return on plan assets
Teachers' Pension Plan	6.50%	LT return on plan assets	6.50%	LT return on plan assets
College Pension Plan	6.50%	LT return on plan assets	6.50%	LT return on plan assets

5

Plan's discount rate is higher than the provincial rate (or lower by 50 bps or less) (cont'd)

	Provincial Nominal Discount Rate	Basis of Provincial Nominal Discount Rate	Plan's Nominal Discount Rate	Basis of Plan's Nominal Discount Rate
Quebec				
Commission administrative des regimes de retraite et d'assurances	6.50%	LT return on plan assets less inflation	6.40%	LT return on plan assets less inflation
Newfoundland				
Memorial University of Newfoundland Pension Plan	6.30%	LT return on plan assets	6.30%	LT return on plan assets
Nova Scotia				
Nova Scotia Public Service Superannuation Plan (PSSP)	6.75%	LT return on plan assets	6.35%	LT return on plan assets
Nova Scotia Teachers' Pension Plan (TPP)	6.75%	LT return on plan assets	6.40%	LT return on plan assets

6

Plan's discount rate is higher than the provincial rate (or lower by 50 bps or less) (cont'd)

	Provincial Nominal Discount Rate	Basis of Provincial Nominal Discount Rate	Plan's Nominal Discount Rate	Basis of Plan's Nominal Discount Rate
Manitoba				
Civil Service Superannuation Plan	6.00%	LT return on plan assets	6.00%	LT return on plan assets plus inflation
Teachers Pension Plan	6.50%	LT return on plan assets	6.25%	LT return on plan assets

7

Appendix G – History of Surplus Utilization for OTPP

The history of OTPP surplus utilization from the time the OTPP became a jointly sponsored pension plans to the date that the FMP was established (in March 2003) demonstrates a past practice of the Sponsors equally sharing (in the aggregate) the benefits of surplus utilization:

Valuation Date	Surplus/(Deficit)	OTF	Ontario Government	Surplus Remaining
1990	$(7.8 billion) unfunded liability	Increased contributions by 1% to 8.9%	Agreed to make a series of special payments to eliminate the unfunded liability and match increased contributions	Special payments considered an asset bringing the plan to a $0 surplus
1993	$1.5 billion	$325 million to offset social contract days	Eliminated special payments for $1.2 billion saving	$0
1996	$0.7 billion	$0.6 billion for benefit improvements and RCA contributions	N/A	$0.1 billion
1998	$6.8 billion	$2.2 billion for benefit improvements	$4.6 billion to reduce the value of remaining special payments	$0
1999	$3.5 billion	N/A	$3.5 billion to reduce the value of remaining	$0

			special payments	
2001	$6.8 billion	$6.2 billion for benefit improvements	N/A	$0.6 billion
2002	$1.9 billion	Sponsors agreed not to make any changes to benefits or contributions		$1.9 billion
Total		$9.3 Billion		

Although surplus utilization prior to 2003 may not have been 50/50 each time, from 1990 to 2002 the aggregate value obtained by each of the Sponsors was equal. In certain instances where the Province received a disproportionate share of the financial benefits from surplus utilization, a commitment was made to the OTF that they would receive future surplus available for utilization. In 1998, $6.8 billion in surplus was utilized to cause a $2.2 billion benefit improvement and to provide the Province with a $4.6 billion reduction in the value of special payments owed by the Province. As part of this negotiation, the OTF and the Province agreed to allow future surplus to be utilized to eliminate the Province's remaining special payments (which resulted in $3.5 billion surplus being utilized in 1999 to reduce the value of the Province's remaining special payments) and a commitment was made for the next $6.2 billion in surplus to be available to OTF for benefit improvements (such surplus being utilized for benefit improvements in 2001).

Appendix H – Summary of different valuation methodologies for pension valuations

The following table summarizes the main similarities and differences in assumptions and methodologies used for i) OTPP's funding valuation, ii) the financial statements of OTPP, prepared under CPA Canada Handbook – Accounting Part IV and iii) actuarial valuation of the Province's share of OTPP prepared for the province under Public Sector Accounting Standards.

Assumption/ methodology	Funding valuation (Going concern basis)	Accounting Part IV – (OTPP Financial statements)	Accounting PSAS – (Province Financial statements)
Purpose	To inform plan sponsors of the amount that needs to be contributed each year to adequately fund benefits	Financial statements [of pension plans] provide information about the pension plan including net assets available for benefits and pension obligations.	Measure and report the obligation for employee retirement benefits and to attribute the costs of those benefits to the periods in which the related services are rendered.
Actuarial cost method	*[To confirm – not clear from the valuation report]*	Projected benefit method prorated on services	
Asset valuation	The actuary should select an asset valuation method that is consistent with the circumstances of the work. The value of assets may be, subject to specific requirements for different types of valuation, any of: • Their market value; • Their market value adjusted to moderate volatility in investment returns; • The present value of their cash flows after the calculation date; and • Their value assuming a constant rate of return to maturity in the case of illiquid assets with fixed redemption values [To confirm the approach taken in OTPP funding valuation]	Fair value for all plan assets. Fair value is determined in accordance with IFRS 13, *Fair value measurement*.	Market -related values, which are defined as either market values or amounts adjusted to market values over a period not to exceed five years, applied consistently. The Province uses adjusted market values for some classes of assets in certain plans.
Discount rate	Best estimate less Margins for adverse deviations and expenses where appropriate.	In measuring a pension obligation amount, the defined benefit obligation amount determined by the	Not specified. However two methods are specifically acknowledged – a)

	For funded plans, the best estimate may be either the expected investment return on the assets of the pension plan at the calculation date and the expected investment policy after that date, OR Reflect the yields on fixed income investments, considering the expected future benefit payments of the pension plan and the circumstances of the work To confirm the approach taken in OTPP funding valuation]	plan's sponsor may be (but is not required to be) used. Part IV notes that guidance on determining the defined benefit obligation can be found in EMPLOYEE FUTURE BENEFITS, Section 3462, in Part II of the Handbook, and in IAS 19 Employee Benefits in Part I of the Handbook. Part I (IAS 19) requires the use of government bonds when no deep market for high quality corporate bonds exists. Per their financial statements OTPP uses a discount rate based on bonds issued by the Province of Ontario.	discount rates determined by reference to plan asset earnings and b) discount rates determined by reference to the government's cost of borrowing.[11] The Province of Ontario uses a discount rate for OTPP determined by reference to plan asset earnings.
Underlying population data	All valuation methodologies should use consistent underlying data of the population covered by the plan		
Inflation rate	All valuation methodologies should treat inflation in a consistent manner and use a consistent inflation assumption (best estimate). [To confirm this is actually the case – does the Province rely on the OTPP's Board's judgement or make their own estimates?]		
Demographic assumptions	All valuation methodologies should use a consistent demographic assumptions (best estimate) in similar ways [To confirm this is actually the case – does the Province rely on the OTPP's Board's judgement or make their own estimates?]		
Other economic assumptions	All valuation methodologies should use a consistent other economic assumptions (best estimate) in similar ways [To confirm this is actually the case – does the Province rely on the OTPP's Board's judgement or make their own estimates?]		

[11] The Public Sector Accounting Board has formed an Employment Benefits Task Force to examine a number of aspects of the existing Public Sector Accounting Standard dealing with retirement benefits, including consideration of the discount rate. To date there have been no due process documents and no indication as to the direction of the PSAB in respect to discount rates.