Email - November 28 2016 - Re_ Expert Panel - follow up.pdf

From: Patricia O"Malley
To: Uros Karadzic; Martin, Paul (FIN) (Paul.Martin@gnb.ca); Murray Gold (mgold@kmlaw.ca)
Cc: Tam, Nelson (TBS)
Subject: Re: Expert Panel - follow up
Date: November-28-16 5:37:51 PM
Attachments: Expert Panel Report draft outline v1.docx

Hello everyone

Like Uros, I am following up on my assignment from the last meeting. I am attaching a note with some quesstions and a fisrt draft of the report outline. Any comments or suggestions gratefully received.

Standard password.

Cheers!
Tricia

From: Uros Karadzic <uros.karadzic@ca.ey.com>
Sent: November 25, 2016 17:24
To: Patricia O'Malley (plomalley@outlook.com); Martin, Paul (FIN) (Paul.Martin@gnb.ca); Murray Gold (mgold@kmlaw.ca)
Cc: Tam, Nelson (TBS)
Subject: Expert Panel - follow up

Hi All,

As I promised at our last meeting, I am sending some of my preliminary thoughts in the attached. They are high-level and would need to be fleshed out, to the extent the panel feels they are appropriate to be included in our report by the writer.

I will be on vacation next week and out of the country, but I will monitor my email.

Looking forward to seeing everyone again in person on Nov 5.

Uros

Uros Karadzic, FSA, FCIA | Partner | People Advisory Services

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Expert Panel Report draft outline v1.pdf

To: Murray, Uros and Paul

From: Tricia

Subject: Draft outline of report

My first VERY preliminary draft of a possible outline of the report follows: In drafting it, several questions came up I'd like you to think about. I have tried not to follow the same structure as the Position Paper but given the nature of the issue and the kind of analysis it requires, some similarity is inevitable.

Questions (in no particular order):

1. Should the final report include as an appendix all the important information we have reviewed? Also a listing of people we have talked to/received briefings from? FYI, I have not yet had a response from the AG.

2. How much detail do we want to include? There is a lot of info available but the critical facts are pretty straightforward. I'd like to focus the report on what was relevant to our conclusions, whatever they are. If we do that, do we provide additional info in topical appendices for those who are interested? Perhaps we include the background documents by topic with a brief summary of the main point(s) in each document? I found the Position Paper pretty repetitive, especially in the later sections, and I would really like to keep the main body of the report as crisp as we can.

3. Should we address each of the points in the AG's September 26 letter to the DMs? I think my draft outline speaks to the most important ones but some of the other things she says are just plain wrong and I would hate to think that by not taking issue with them we agree with them. Also, if we don't deal with them directly they can still be used to disagree with whatever decision the Province reaches on its future financial reporting. On the other hand, I don't think the letter is a public document so it may not be a problem if we leave some of those item unaddressed.

Expert Panel Report

Draft Outline

Mandate – advice and recommendations to the Province

Issue – recognition and measurement of pension assets arising in jointly sponsored pension plans (Ontario Teachers and OPSEU) in accordance with Canadian public sector accounting standards

1. Relevant standards are Canadian public sector accounting standards set by Public Sector Accounting Board

PS 1150 says that if there is a standard (primary source) that directly covers the topic, no need/requirement to look further

Other sections may be helpful if additional guidance is needed to apply a primary source to specific circumstances

Sections of possible relevance – PS 3060 Government Partnerships, PS 3210 Assets, PS 3320 Contingent Assets

2. Nature of the plans

Classification of plans under PS 3250 – DC or DB. Joint DB is sub-category specifically identified

Key features of OTPP and differences from OPSEUPP

Most important feature of OTPP is equitable sharing of both shortfalls and surpluses. Agreement on sharing required whenever preliminary funding valuation is filed with FSCO. Agreement by good faith negotiation, then mediation then arbitration. But agreement *must* be reached and the shortfall or surplus dealt with/allocated to sponsors.

OPSEUPP clear that any surplus split evenly and each sponsor controls its own surplus

Conclusion – both meet the definition of joint defined benefit plans in PS 3250.

2. Accounting for JSPPs under PS 3250

Normal accounting for DB plans is to reflect on sponsor's balance sheet net deficit or surplus – details of plan assets and liabilities and determination of annual expense provided in notes (include rationale?)

.081 says because risk is limited to its portion of the plan, gov't should account for its *portion* in accordance with stds for DB plans

Therefore step 1 in gov't accounting for joint DB plans is to follow PS 3250 requirements for the plan as a whole, including use of best estimate assumptions followed consistently. PS 3250 permits use of discount rate based on expected rate of return on plan assets

Does not appear to be any disagreement that gov't accounting complies with PS 3250 on plan valuation, although AG questioned discount rate based on comparison with rates used by OTPP for both funding and accounting

[Deal with why OTPP funding and accounting valuations are irrelevant here or later?]

Step 2 is to determine whether sponsor can benefit from any asset resulting from the valuation or whether valuation allowance required. PS 3250 identifies two ways sponsor can benefit – asset withdrawal or reduction in future contributions. Calculation methodology to determine expected future benefit from reduced contributions is specified. If only one method is required to demonstrate the benefit of the asset, the other need not be considered.

4. Uncertainty in the application of PS 3250

a) expected future benefit methodology for all DB plan assets – period to consider minimum required contributions have been specified. Alternatives include no minimum, use funding specified to net valuation date, use funding specified in any agreement between the sponsors

discuss actuarial valuations which demonstrate the value of the EFB > recognized asset under all possible alternatives so no valuation allowance is required

b) Is unilateral control required to recognize an asset in a joint DB plan?

PS 1000 defines 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.

Past transaction is the existence of the plans and all the related governing documents and agreements; future economic benefits determined in accordance with requirements of PS 3250

Control is discussed in PS 3210 Assets which is effective for f/y on or after 1 April 2017.
.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

In this case, although the control is joint, the gov't can benefit from reduced cash outflows (EFB calculation), it is exposed to the risk of the plan surplus changing. Most importantly, because of the existence of joint control it can deny or regulate the access to those benefits by others due to the stipulation that the Sponsors must agree on the use of any surplus.

The essence of the notion of joint control is that no party sharing control has unilateral control over the decisions that significantly affect the achievement of the goals of the arrangement. Therefore assessing the existence of an asset based on unilateral control when the asset is jointly controlled is inappropriate/inconsistent with the fundamental nature of the arrangement.

c) Supporting technical material

PS 3250 itself does not suggest that the joint nature of control in the case of join DB plans precludes the recognition of an asset resulting from the existence of surplus in the plan. It simply requires the application of the asset ceiling test to the entity's proportionate interest in the surplus.

No additional valuation requirements are imposed by any other PS standards

PS 3060 Government Partnerships was issued in October 1999, predating PS 3250. PS 3060 defines gov't partnerships as contractual arrangements that establish shared control, i.e., no partner can exercise unilateral control and there is an equitable sharing of risks. Decisions require agreement of partners

The gov't accounts for its interest in a government partnership by proportionate consolidation whether the partnership is the ownership of a single asset or when a separate organization holds the assets and liabilities of the partnership. So, the standard *requires* the gov't to recognize an asset for a 50% interest in a capital asset even though it cannot deal with that asset unilaterally

PS 3250 added the discussion of JSPPs to the private sector pension standard it was based on. The language of that addition is clearly based on the language in PS 3060, esp w.r.t equitable sharing of risks, although it has been modified to suit the specific circumstances of pension plans rather than the more general standard relating to all types of partnerships

It could clearly be argued that, in the absence of that addition to PS 3250, it would have been appropriate for the gov't to refer to PS 3060 as important source of guidance given the existence of the Partnership Agreement: "The Minister and the OTF have agreed to establish a partnership for the purpose of designing and administering the Ontario Teachers' Pension Plan and managing the Ontario Teachers' Pension Fund."

No conceptual basis exists for arguing that shared control prevents the recognition of a jointly controlled asset but shared responsibility does not prevent the recognition of a jointly controlled liability. In fact, shared responsibility could be argued to require the recognition of the entire obligation. Either interpretation systematically introduces bias into the financial reporting.

No basis for conclusions to either PS 3060 or PS 3250 exists. In its definition of assets, IFRS also includes a requirement for the asset to be controlled. IFRS 11 Joint Arrangements discusses control as follows. It requires the parties sharing control of the activities of the joint arrangement to have control of the arrangement collectively. That is, as a group, the parties sharing control control the entire arrangement. If a party to a joint arrangement has rights only to the net assets of the joint arrangement, rather than to its individual assets and liabilities, that party accounts for its interest in the joint arrangement as an investment using the equity method. Applying this thinking to OTPP, the Minister and the OTF control the entire pension plan jointly. That joint control gives them rights and obligations only with respect to the net surplus or net deficit of the plan. Consequently it is appropriate for the government to account only for its proportionate interest in either the surplus or deficit, the same accounting that is specified by PS 3250.

PS 3320 Contingent Assets is not applicable. A contingent asset is one whose existence is uncertain. In this case no uncertainty exists regarding the accounting surplus in the joint DB plan. The only possible uncertainty relates to its measurement.

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