Executive Summary

Introduction

The Panel was appointed to provide advice and recommendations to the Ontario government on the application of public sector accounting standards to Ontario's jointly sponsored pension plans. The need for this advice arose as a result of a difference of professional opinion between the government's professional accounting staff and the Office of the Auditor General (OAG).

The Panel has specifically considered whether the government should include an asset in its financial statements representing its share of the surplus in two pension plans – Ontario Teachers' Pension Plan (OTPP) and Ontario Public Sector Employees' Union Pension Plan (OPSEUPP). This is an important question because including or excluding the asset affects the picture the Public Accounts provide of the government's financial position at the year end and how it has managed its resources over the year (the annual surplus or deficit).

The Panel received and reviewed background information, including the governing documents of the plans and related agreements. It received analyses from both the government and the OAG, setting out their respective understanding of the facts and their conclusions. The Panel met with both the government's professional accounting staff and the Auditor General and her Public Accounts staff responsible for the pension issue to ensure we fully understood their thinking. The Panel then performed its own independent analysis of the documents and of the legal, actuarial and accounting issues using the expertise and experience of its members related to those issues.

The full report sets out in detail the Panel's analysis and the reasons for its conclusions. This summary gives the overall conclusions and the main considerations that influenced the Panel's thinking.

Panel conclusions and considerations

Both OTPP and OPSEUPP are jointly sponsored defined benefit plans. In these plans, the risks and rewards are shared between an Employee Sponsor – in these cases, the Ontario Teachers Federation or OPSEU – and an Employer Sponsor – the government. In accordance with the terms of the Plans, the Sponsors must agree on all decisions about the important features of the plan, including valuation assumptions, how shortfalls (deficits) are to be made up and how the benefits of overfunding (surpluses) are to be shared.

The Panel's analysis concludes that an asset exists for the government in both OTPP and OPSEUPP because:

- the accounting surplus in the plan has a future economic benefit – the surpluses in the plans can be used by reducing the contributions the government is required to make to the plans, freeing cash that would otherwise be required to make contributions to be used for other purposes.

- the government controls access to that accounting surplus – the government shares control of the surplus with the Employee Sponsors. In OTPP, the Sponsors must agree on how the surplus will be used. If they don't agree, the process to be followed to reach a decision is set out in the plan. The only condition is that the surplus must be shared "equitably," or fairly. Historically, surpluses have been shared approximately 50/50 over time, though not necessarily in each period. In OPSEUPP, funding surpluses are allocated 50/50, and each sponsor is free to use its allocation for benefit improvements or contribution reductions as it sees fit. This indicates 50/50 sharing of surpluses is the principle.
- the accounting surplus exists as the result of past transactions and events – service rendered by the employees, contributions made by both the employees and employer, and investment earnings.

The public sector pension accounting standard notes that the sponsors could benefit from a surplus by taking assets out of the Plans as well as by reducing their contributions. The standard includes several specific conditions for a sponsor to recognize an asset based on withdrawal. The Panel concluded that these conditions are not relevant to assessing the ability of a sponsor to reduce contributions because:

- The legal requirements for taking assets out of a plan and those for reducing contributions are very different. Removing assets requires permission to do so in the terms of the plan, agreement with plan members or approval of the joint sponsor, as well as approval of the Financial Services Commission of Ontario. In contrast, the joint plan sponsors are free to decide on their own level of required contributions as long as they comply with the terms of the plan and with the Pension Benefits Act. All that is required is for the joint sponsors to agree. No external approvals are needed. The Panel concluded that the accounting answer should reflect the significant differences between the legal regimes that apply to contribution reductions and asset withdrawals.
- In the case, of OPSEUPP, the terms of the plan explicitly prohibit asset withdrawals. However, they also explicitly provide that contribution reductions are not asset withdrawals. The terms of the OTPP are not as explicit when it comes to asset withdrawals. However, the Sponsors have agreed on a policy to guide the use of surpluses in the plan – once previous reductions in pension benefits have been restored, the next priority is to reduce contributions for both members and the government. Thus, the government does not currently have an intention or ability to benefit by taking assets out of the Plans.

The Panel also concluded there is no accounting standards requirement for any agreement to be in place specifying when and by how much contributions will be reduced for the government to record an asset beyond the agreements already in place (i.e., legislation and the various plan documents). The public sector accounting standards are clear that the benefits from the surplus need only be expected. In these cases, benefits can reasonably be expected based on the law, the terms of the Plans and the policies and past actions of the joint Sponsors in fulfilling their responsibilities to act fairly. Given all the uncertainties and estimates required in accounting for pensions, virtually nothing can be considered certain.

Because of those estimation uncertainties, like accounting for all other assets, the public sector pension accounting standard requires the government to consider whether the benefits it expects will be enough to recover the entire amount of the surplus asset. The standard provides specific guidance on how to measure the expected benefit of the asset based on reduced contributions. No contribution requirements are fixed because they must be renegotiated regularly. Following the guidance in the standard shows that the government will be able to benefit by the entire amount of the asset.

Stepping back

It is reasonable to expect that the plan Sponsors will be able to benefit from lower contribution levels in the future, if the plans have surplus assets. While the government (or teachers/OPSEU members) may not expect to receive refund cheques, it is reasonable for them to expect that fewer contributions will need to be made if there are surplus assets in the plans. On the other hand, all parties would expect that benefits will be reduced or additional contributions will need to be made should deficits emerge.

Established mechanisms exist to put these expectations into practice. History shows examples of plan sponsors benefiting from surpluses in these plans. Expecting that the joint sponsors will benefit from the surplus assets in the future is also reasonable. In fact, it would be unreasonable, absent any changes, to assume otherwise.

Given that the government can be expected to benefit from surplus assets, those assets have real economic value. It would be misleading not to recognize its share of them in the Public Accounts.

Panel advice

The Government should record an asset in the Public Accounts for its share of the surplus reported in the accounting valuations of OTPP and OPSEUPP. The estimated future benefit of the recorded asset should continue to be evaluated following the requirements of the public sector pension accounting standard each year.