Accounting by the Province of Ontario for the Ontario Teachers' Pension Plan

**Preamble**

Analysis is specific to OTPP

Constating documents are different than for other pension plans in Ontario and in other provinces

**Issue being considered**

The Province followed the same accounting for OTPP for the prior 14 years during which the pension accounting standard (Section PS 3250) was the same.

In relation to the 2015-16 public accounts for the Province of Ontario, the OAG disagreed with the Province's accounting for OTPP and OPSEUPP

The OAG disagrees that the surplus in OTPP is a reportable asset to the Province on the basis that:

- there is no legally enforceable right to the asset
- no agreement is in place at March 31, 2016 with the Ontario Teachers' Federation (OTF) to reduce future contributions

**Reporting in the 2015-16 Public Accounts**

The Province disagrees with the AG's interpretation of PSAB standards.

The Province believes their share of the plan accounting surplus should be recognized as an asset. The Province expects to benefit from the reported pension assets through reduced contributions and has performed the requested pension asset ceiling test to confirm that the Province's estimated asset value is not impaired.

For purposes of the 2015/16 Public Accounts, the Province regulated the accounting treatment for pension assets for the jointly sponsored pension plans (OTPP and OPSEUPP) to reflect the Auditor General's interpretation of PSAB. Since Management does not agree with the AG's interpretation of PSAB as related to the jointly sponsored pension plans, the regulation was necessary to achieve the AG's accounting treatment and to allow management to sign off on the Statement of Responsibility.

**Overview of OTPP**

A jointly sponsored pension plan (JSPP) as defined in the Pension Benefits Act. The OTPP meets this definition. The sponsors are the Province of Ontario and the OTF.

The sponsors are jointly responsible for decision making, share in contributions, and collectively address any plan funding surplus/deficit (at least every 3 years)

The plan administrator is an independent board of directors and follows the direction of the co-sponsors on all key decisions, which includes plan structure, level of plan benefits, contribution rates, funding levels and contingency reserves and changes to the plan documents.

**Prior accounting for OTPP by the Province**

Since 2001-2002, the Province has recorded its portion (50%) of the pension asset of OTPP in accordance with Section PS 3250

With regards to expected future benefit of the surplus, the Province would not expect to withdraw any surplus, but through reduced future contributions

The Province and OTF have a history of equally sharing the benefits of surplus utilization as demonstrated from the time OTPP became a JSPP to the date the Funding Management Policy in 2003 was established (include in appendix only)

**Question 1 – Recognition of a pension asset**

First we address why the surplus of OTPP is an asset to the Province

**Applicability of Section PS 3250 to OTPP**

The purpose and scope of Section PS 3250 is included in paragraph .001 which states "This Section establishes standards on how to account for and report obligations for employee retirement benefits in government financial statements".

Obligations for retirement benefits result from a promise by a government to provide these benefits to employees because of retirement in return for their services (paragraph .03).

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.

**Definition of JDBP**

A joint defined benefit plan (JDBP) 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 (glossary to Section PS 3250).

**Primary sources of GAAP**

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.

PS 3250 provides clear guidance that a JDBP is accounted for using PS 3250 and therefore is the primary source of GAAP that must be applied.

Other standards in PSAS including the Financial Statements Concepts should be referred to if PS 3250 does not provide specific guidance for a circumstance.

**Concept of shared control and asset recognition**

Section PS 3250 requires the government to account for its portion (as there is shared control) of a JDBP following the accounting requirements for a defined benefit plan within PS 3250; no distinction is made as to whether the plan is in a surplus or deficit position. In a JDBP the risks and rewards of a plan are equitably shared, so the Province's portion of the plan includes its share of any asset as well as its share of any liability

The Financial Statement Concepts definition of an asset includes "control" over an economic resource. Despite the conceptual framework not directly addressing "Shared control" it is included in other standards in PSAS, for example relating to government partnerships (Section PS 3060) which existed prior to PS 3250

**Conclusion on recognition**

Section PS 3250 on its own is sufficient to assess the accounting for OTPP by the Province

OTPP is appropriately classified as a JDBP under Section PS 3250

Section PS 3250 requires recognition by the Province of 50% of the plan assets of OTPP

Unilateral control is not necessary for asset recognition ( as also seen with government partnerships); shared control is appropriate for a JDBP

Uncertainty relating to OTPP's pension surplus relates to measurement, not uncertainty regarding expected future benefits for the Province

**Question 2 – Measurement of a pension asset**

Second we address how to measure the pension asset of OTPP in the Province's financial statements

**Guidance in Section PS 3250 on measurement**

An overview of the pension accounting for a defined benefit plan (and therefore a JDBP) in Section PS 3250 includes:

An accrued benefit asset should be presented on a government's statement of financial position net of any valuation allowance for any excess of the adjusted benefit asset over the expected future benefit (paragraph .050)

An accrued benefit asset 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) (Glossary).

A government may benefit from an accrued benefit asset either by withdrawing surplus assets or by taking a contribution holiday or receiving a refund of contributions (paragraph .052).

To determine the extent to which an accrued benefit asset may be impaired, the government first determines the adjusted benefit asset which is the accrued benefit asset less net unamortized actuarial losses (paragraph .053).

The adjusted benefit asset is then compared to the expected future benefit. The objective is to limit a government's accrued benefit asset to the amount it can realize in the future (paragraphs .054 and .055).

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 (referred to as the asset ceiling test - paragraph .056).

**Guidance on measurement as applicable to OTPP**

The Province expects future benefits from OTPP's plan surplus to be realized through reduced future contributions, not withdrawals. 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'.

Expectations of benefitting from the surplus are based on:

1. The Teachers' Pension Act requires equal contributions from the Province and from plan members of OTPP;

2. The history of surplus utilization for OTPP demonstrates sharing of the financial benefit between sponsors;
3. No sponsor of OTPP can unilaterally utilize the plan's surplus; and
4. If the sponsors of OTPP cannot agree on how to utilize the pension surplus, the matter can be submitted to arbitration.

The Province considers that the uncertainties around how and when to utilize the surplus do not result in an inability or lack of entitlement to utilize the surplus

**Calculating the limit on the carrying amount of an accrued benefit asset (asset ceiling test)**

Calculation of the asset ceiling test involves professional judgement. As a reminder Section PS 3250 indicates the expected future benefit to be recorded by the government is the sum of:

a. The present value of its expected future accrual for service for the current number of active employees less the present value of minimum contributions the government is required to make regardless of any surplus; plus
b. The amount of the plan surplus that can be withdrawn in accordance with the existing plan and any laws and regulations.

The next slides will consider this calculation relative to the Province's 50% share of OTPP

**Through withdrawal of the surplus (Part b of the asset ceiling test)**

The Province does not consider there to be expected future benefit available through withdrawal of any plan surplus.

Section PS 3250 specifies that an amount for withdrawal of surplus is only included when a government has a legally enforceable right of withdrawal.

In accordance with the Funding Management Policy for OTPP, the parties must negotiate in order for a withdrawal of the surplus to happen, therefore the Province does not have a signed agreement with OTF regarding the withdrawal of the surplus.

**Through reducing future contributions (Part a of the asset ceiling test)**

While Section PS 3250 states that legal enforceability is required to include an amount for a withdrawal of the plan surplus it does not include a similar requirement in respect of the ability to benefit through future contribution reductions. The Province has an expectation that they will benefit fully from the asset by exercising their current rights under the plan arrangements to negotiate the use of surpluses in the form of contribution holidays.

The present value of its expected future accrual for service is typically calculated based on the Province's share (50% for OTPP) of the current service cost reported in the most recent actuarial valuation taken into perpetuity

There is very limited guidance in PSAS on determining the present value of minimum contributions the government is required to make regardless of any surplus; professional judgement is required. The Province engaged consultants to calculate this value for OTPP considering different assumptions on future minimum contributions. Considered was the contractual obligation under the Partners' Agreement that the Province and OTF negotiate and set both the benefits and the contributions every three years. The key scenarios considered include

- TBD.(Pauline)

For purposes of OTPP in the 2015-16 public accounts, 11 years was used by the Province reflecting management's best estimate of the number of future years for which current minimum contributions are to be made until the Income Tax Act limits are reached

Based on the Province's best estimate calculation of the expected future benefit, no valuation allowance was deemed necessary in relation to the pension asset of OTPP at March 31, 2016

**Other guidance in PSAS on measurement**

Section PS 2130 provides guidance on dealing with measurement uncertainty

Measurement uncertainty in pension plan accounting exists for example in the estimation of the valuation allowance and in the determination of the discount rate (which is often management's best estimate of the rate of return on plan assets)

Historical rates of return on plan assets have supported the past discount rates used by the Province in relation to OTPP

**Comparability of Ontario's accounting for JDBPs to other Provinces**

Provinces such as British Columbia and New Brunswick do not report assets for their provincial joint sponsored pension plans or alternatively provide a valuation allowance to reduce the pension asset balance to nil

The difference in accounting versus the Province of Ontario (for OTPP) results from these other provinces not having any access to the pension surpluses unlike in Ontario

**Conclusion on measurement**

The Province's position is that the attributes of the JDBP arrangements for OTPP entitle the Province to access its portion of the plan surplus through the right to negotiate its use of the Province's benefit through future reduced contributions

Significant professional judgement and estimation is involved in determining the valuation allowance under Section PS 3250; the Province has applied reasonable estimates

Based on the result of modelling performed in relation to the asset ceiling test, the Province concluded that no valuation allowance was necessary to the pension asset that would have otherwise be reported on the Province's books as at March 31, 2016.