Accounting by the Province of the OPSEUPP

1.0 Preamble

This document addresses the accounting for an accrued benefit asset under Canadian Public Sector Accounting Standards (PSAS) by the Province of Ontario in relation to the Ontario Public Sector Employees Union (“OPSEU”) Pension Plan (“OPSEUPP” or the “Plan”).

As at March 31, 2016, OPSEUPP had an accrued asset position for accounting purposes of $521 million.

The details of the accounting valuation for the plan for purposes of reporting by the Province of Ontario as of March 31, 2016 are as follows:

(all figures in $M)	**Total plan**	**50% Share of the plan**
Market related value of assets	17,380	8,690
Value of obligation	15,557	7,778
Surplus (deficit)	1,823	912
Unamortized (gains) losses	(96)	(48)
Adjustment for March 31, 2016	(583)	(291)
Asset (liability) position	1,144	573
Specific Province of Ontario adjustment		(52)
Final Accrued Benefit Asset (liability) position on balance sheet		**521**

2.0 Issue to be considered

1. For accounting purposes, how should OPSEUPP be classified under PSAS?
2. As a result of the classification, how should the Province of Ontario recognize the pension surplus (for accounting purposes) of OPSEUPP in the Public Accounts?
3. How should a pension asset of OPSEUPP be measured in the Public Accounts of the Province of Ontario?

3.0 Conclusions

1. OPSEUPP is a Joint Defined Benefit Plan under PS 3250
2. The Province of Ontario should account for OPSEUPP as a defined benefit plan for its proportionate share of the surplus or obligation that arises under the plan.
3. The Province of Ontario should record its proportionate share of the asset and apply the asset ceiling test under PS 3250. The Province of Ontario believes that the asset is recoverable through the reduction of future contributions and as such, no valuation allowance is necessary.

4.0 Background information

4.1 Overview of OPSEUPP

The Plan is jointly sponsored by the Province of Ontario and the executive of OPSEU. The Plan is managed by OPTrust, a 10-member Board of Trustees, five of whom are appointed by OPSEU and five by the Province of Ontario. The sponsors appoint experienced, professional experts to the OPTrust's Board. More specifically, the Province of Ontario and OPSEU each appoint to the Board of Trustees one experienced member to fill the position of Chair and Vice-Chair, with the roles alternating between Province of Ontario and OPSEU appointees every two years.

OPSEU and the Province of Ontario are equally responsible for ensuring the pension plan has the financial resources to meet its long-term pension obligations. Section 4.6 of the Plan Text notes that the Employer shall pay into the Plan an amount equal to the aggregate amount of all contributions deducted from the members.

The assets of the Plan are held by OPTrust in trust for the beneficiaries of the plan – Ontario public servants who work in the broader public sector (approximately 130,000 members across Ontario). The Province of Ontario does not have unilateral access to the assets of the trust nor does it have the right to unilaterally change contribution amounts, take contribution holidays. Actions of this nature require negotiation and agreement between the two sponsors. While access to the assets of the Trust is not in the Province of Ontario's sole control, it should be noted that the Province of Ontario, as a sponsor of the plan, has established a rate stabilization reserve (RSR) in which surpluses are allocated so that the Province's share of the surplus from the plan is identified and can be used for future decision making on funding and benefit improvements.

Given the historical volatility of the Plan's funding results, the long term risk mitigation decision to date has been to deposit any actuarial gains to the Employer RSR. This reserve has been used to cover the cost of negotiated temporary benefit changes (Factor 80 and Surplus Factor 80), to fund future potential losses, and cover any required amortization payments for prior year losses.

Under the Sponsorship Agreement and the Plan text, the Government has the option to apply their share of the gains to reduce Employer costs (special payments, contribution reductions, contribution holidays, etc.), or deposit the gains to the Employer RSF. There is no provision within the Plan to withdraw the Employer portion of gains.

The Funding Policy, Board-Approved Policy, dated July 17, 2014

OPTrust provides the following regarding the use of Plan Surpluses:

OPTrust recognizes that decisions on the use of surplus are reserved to the Sponsors. However, in the interests of providing information to the Sponsors, OPTrust has recommended a number of principles for the Sponsors to consider when determining how to use surplus that arises from time to time, designed to minimize the risk to future Plan funding. They are as follows, in order:

1. Use surplus to pay for any past unfunded liability that has not been fully amortized through previous valuations.

2. Restore benefits previously lost due to prior deficits.

3. Restore stabilization reserves to recommended levels to protect against future adverse actuarial and investment experience.

4. If the current employee and employer contribution rates are above the normal rate specified in OPTrust Management studies, use surplus to return contributions back to the normal rate.

5. If surplus is still available, consider temporary contribution reductions as the most predictable way to reduce the surplus in the Plan.

6. When considering Plan improvements, establish a preference for temporary benefit improvements over permanent Plan changes since temporary improvements will be prepaid from existing surplus and are less likely to have an impact on future contribution rates.

7. When considering permanent Plan improvements, recommend those that better rationalize the overall Plan design, such as provisions that present an undue hardship or level of unfairness to Plan members.

Member and Employer Rate Stabilization Reserves

The Sponsors of the OPSEUPP have established two stabilization reserves to deal with actuarial gains when they arise. The Employer and Member Stabilization Reserves are the remaining employer's and members' share of the net actuarial gain. These stabilization reserves are intended to be used as a buffer against any future actuarial losses that may arise.

Gains (and losses) are shared equally by Plan members, subject to the following:
(i) 50% of the gain or such other amount as may be collectively bargained shall be used for the benefit of employers, to be applied against any special payments required to be made by any employers and thereafter to reduce employers' normal costs [SA, s. 56 (c) (i)]; and
(ii) 50% of the gain or such other amount as may be collectively bargained shall be used for the benefit of Plan members [SA, s. 56 (c) (ii)].

Excerpts from Plan Text on Withdrawal of Surplus

Section 18.2 of the Plan Text notes that, if the Plan is wound up in whole or in part, the assets in the Fund shall first be allocated for the provision of benefits in accordance with terms of the Plan, the Pension Benefits Act, the Income Tax Act (Canada) and any other applicable legislation or agreement between the sponsors.

Section 18.3 also notes that if after provision for benefits payable to or in respect of members of the wind up, in whole or in part, of the plan, assets remain in the Fund or the part of the Fund affected by a partial windup, such assets shall be applied as determined by OPSEU subject to the Pension Benefits Act and the Income Tax Act (Canada) for the exclusive benefit of the members and former members, their beneficiaries and dependents.

4.2 Accounting for OPSEUPP by the Province of Ontario

The Province of Ontario's Public Accounts as of March 31, 2016 includes an accrued pension asset of $521M that represents the employer's share of the OPSEUPP surplus position based on the accounting actuarial valuation for the plan. This situation has arisen because, to this point in time, the Province of Ontario's share of the total contributions to the Plan plus the actual investment returns on the Plan's assets have exceeded the Province of Ontario's share of the accumulated retirement benefit expense.

The Province of Ontario recognizes 50% of the accrued benefit asset on its consolidated statement of financial position, which represents the Province of Ontario's Share of the Pension Plan.

5.0 Question 1 – Classification of the OPSEUPP

5.1 Relevant Guidance on Classification

PS 3250 has specific application guidance to Joint Defined Benefit Plans:

Joint defined benefit plans

.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.

.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.

5.2 Conclusion on classification

Application of PS 3250 to Joint Defined Benefit Plans
A joint defined benefit plan is a unique retirement benefit plan where the sponsors have shared control over the plan. 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. This is the case for OPSEUPP where the Province and OPSEU are joint sponsors. This classification has been applied consistently by the Province for OPSEUPP for over the last 10 years. Paragraph .081 of PS 3250 clearly states that a government should account for its portion of the Plan in accordance with the standards for defined benefit plans. As a result, the Province of Ontario accounts for its proportionate share of the Plan and has historically recorded its share as 50% of the Plan.

6.0 Question 2 – Recognition of surplus

6.1 Standards in the PSA Handbook

The following standards were considered relevant when determining whether an asset can be recognized in the Public Accounts:

.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]

.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 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. 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.

6.2 Analysis

PS 3250.50 requires that 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. This comparison between the adjusted benefit asset and the expected future benefit informs whether a valuation allowance is required and if so, how much of a valuation allowance should be recorded.

PS 3250.52 contemplates that there are two ways in which a government can benefit from an accrued benefit asset. 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. As such, an expected future benefit would include the ability to either withdraw plan assets from the Plan or reduce future contributions.

PS3250.52 also goes on to consider that an accrued benefit asset may become impaired when there is a Plan surplus that the government is not entitled to benefit from fully. The paragraphs in the standard that follow determine how a government would go about considering the extent of any impairment, which would give rise to a valuation allowance. In order to make this determination, the government is required to consider the "expected future benefit", which would effectively create a ceiling for the asset. Here the guidance diverges between benefit expected to be realized through future reductions in contributions and those to be realized through withdrawal of surplus.

Specifically with respect to withdrawal of surplus, PS 3250.59 is very clear that expected future benefit can only be asserted where the Province of Ontario has a current legally enforceable right to withdraw assets from the Plan. This guidance was considered as to whether it should be applied to cases where the expected future benefit related to the Pension Asset is expected to be realized through reduced contributions; however it was concluded that the guidance does not apply in this situation. While PS 3250.59 does introduce the concept of a legally enforceable right, 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.

OPSEUPP has established a rate stabilization reserve for each Plan Sponsor, one for the Government and one for the employees. The Funding Management Policy and the Sponsorship Agreement establishes that actuarial gains must be shared equally amongst the Sponsors. Now that the initial transferred unfunded liability of the Plan has been eliminated, as actuarial gains are generated, the Government has the ability to use its 50% share of the gain to reduce contributions.

6.3 Conclusion

The Province of Ontario should account for OPSEUPP as a joint defined benefit plan, which means applying PS 3250 defined benefit accounting for its share of the Plan. As the Plan is in an asset position, the Province of Ontario should reflect its proportion of the asset (50%) subject to any valuation allowance.

7.0 Question 3 – Measurement of a pension asset

7.1 Standards in the PSA Handbook

The following standards are relevant to determining how the Pension Asset should be measured

.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 3250.50 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

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

Section PS 3250 paragraphs .053 to .058 lay out a mathematical calculation that determines the value of 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 Section PS3250 paragraph .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". 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 Section PS 3250, specifically that the amount of an asset is limited to the "expected future benefit" as defined in Section 3250 paragraph .56.

Therefore in accordance with Section PS 3250 paragraph .56 the Province of Ontario 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.

7.3 Considerations re: withdrawal of the surplus (Section PS 3250 paragraph .056 (b))

In relation to the ability of a government to benefit from a surplus through the withdrawal of the surplus, Section 3250 paragraph .059 indicates "The expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal."

For OPSEUPP, the Funding Policy does not contemplate surplus withdrawal and so for the purposes of this analysis, it is assumed that any surplus withdrawal would have to be negotiated between the sponsors. Only at the time of wind-up and if there were remaining assets would negotiations be required to determine how the surplus would be used for the benefit of the members.

There are no provisions in the OPSEU Plan text to permit the withdrawal of a surplus. PS 3250.59 indicates that the expected future benefit includes amounts to which a government has a legally enforceable right of withdrawal. As there is no certainty that the Province will be able to access an OPSEUPP surplus through withdrawal, the Province cannot rely on withdrawal of surplus to support the measurement of the OPSEUPP accrued benefit asset.

7.4 Considerations re: reduced future contributions (Section PS 3250 paragraph .056 (a))

Section PS 3250 paragraph .056(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.

In the event of a surplus, OPTrust recommends to the Sponsors certain principles be followed when determining how to use the surplus. The recommendation from OPTrust is to allocate actuarial gains to any unfunded liabilities or restore cuts to benefits due to prior deficits, before moving into the rate stabilization reserves, reducing contributions, and then restoring benefits. Appendix A provides a history of the allocation of actuarial gains (losses) from January 1, 1993 to December 31, 2014. As such, there are two significant indicators that lead the Province to believe that future contributions can be reduced, which are:

1. The Province has its own RSR that can be utilized to reduce future contributions. The Sponsorship Agreement outlines the priorities for the Government's RSR utilization. Within the parameters of the Sponsorship Agreement there is "some" autonomy for the Government on how it allocates its RSR funds.
2. The Funding Principles of the plan put an emphasis on eliminating unfunded liabilities and reducing current contributions, before enhancing benefits. Any unfunded liabilities (UL) in a plan require past service special contributions to be made over a number of years to eliminate the UL. If a significant portion of the UL is eliminated, the special contributions that are being paid over the amortization period would be reduced upon filing of the applicable valuation with the regulator.

In determining the expected future benefit of the asset, the Government has looked at 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. Typically for defined benefit plans minimum contributions include those that are required by the pension regulator to be made for funding. However, minimum contributions regardless of any surplus, may be required by plan text, legislation or other agreements with employees. For OPSEUPP a key element of judgment is determining what contributions are required by the current plan arrangements "regardless of any surplus". The constating agreements for OTPP require that the parties negotiate every 3 years as a minimum, and when there is a funding surplus.

7.5 Conclusion on measurement

The OPSEUPP is in a surplus position for accounting purposes and therefore it is appropriate to recognize an accrued benefit asset on the Province of Ontario's consolidated statement of financial position. The measurement of that accrued benefit asset is subject to the asset ceiling test. The Province of Ontario performed as asset ceiling test on OPSEUPP and it was determined that no valuation allowance was necessary. The expected future benefit from the asset is the amount of contributions that could be reduced in the future from this surplus. As each of the Plan Sponsors have their own stabilization reserves, and the Funding Policy promotes contribution reduction ahead of benefit improvement, the expected future benefit exceeds the net plan asset, which means there is no basis to require the recording of a valuation allowance.

8.0 Additional Considerations noted by the Pension Asset Expert Advisory Panel

The Pension Asset Expert Advisory Panel's report noted some additional considerations in relation to the accounting for OPSEUPP. The following sections are exerts from the Advisory Panel's report.

8.1 Determination of relevant accounting guidance and assessing accounting policies applied to pension plans

The Pension Asset Expert Advisory Panel in their report also noted a government may also refer to accounting guidance in other GAAP frameworks as long as those frameworks are consistent with PSAS standards and PS 1000. PS 1150 identifies the Canadian Accounting Standards Board (AcSB), International Accounting Standards Board (IASB), and International Public Sector Accounting Standards Board (IPSASB) amongst others, as important sources to consult on matters not covered by primary sources of GAAP and for assistance in applying a primary source of GAAP to specific circumstances [based on PS 1150.19]. The Panel observed that the IPSASB has a mandate to set accounting standards for the Public Sector internationally. Standards set by IPSASB (International Public Sector Accounting Standards or IPSAS) are applied in a number of jurisdictions globally and the current Chair of PSAB is a voting member of IPSASB.

PS 1000 states that the objectives of government financial statements are a significant factor in the selection of accounting policies used in government financial reporting [based on PS 1000.13]. The objectives of government financial statements are set out in PS 1100, *Financial Statement Objectives* (PS

1100) and are therefore a relevant source of guidance when determining appropriate accounting policies.

Consistent with the requirements of PS 1150, the Panel therefore contemplated not only the guidance found in PS 3250, the primary source of GAAP relating to the recognition and measurement issues addressed in this report, but also the concepts in PS 1000, the objectives of financial statements in PS 1100 and relevant guidance issued by other standard setters to ensure its analysis was complete and robust. The Panel was particularly guided by the following principles and objectives:

- **Financial statements are prepared to provide useful information**

Financial reporting is not an end in itself. Its purpose is to communicate useful information to users of general purpose financial statements (GPFSs). Governments are accountable to those that provide them with resources, and to those that depend on them to use those resources to deliver services during the reporting period and over the longer term [based on PS 1000.15].

The objectives of financial reporting by governments are, therefore, to provide information about the government that is useful for accountability and for decision-making purposes. Among other things, users of the GPFSs of governments need information to validate assessments of the resources currently available to support present activities, meet liabilities and contractual obligations, and for future expenditures to support service delivery activities. Users also need to understand to what extent there are restrictions or conditions attached to the use of such resources [based on PS 1000.21; PS 1100.20].

- **What qualities make financial statement information useful?**

The most important qualities that make information useful to users are relevance and faithful representation. For it to be useful, the information must be relevant to the decisions made by users and for assessing accountability. That is, the information has the potential to make a difference to those decisions and assessments [based on PS 1000.26].

Accounting uses the term “faithful representation” to mean that the information provides an authentic or realistic portrayal of the economic phenomena it says it portrays. For this to be the case, the transactions and other events reflected in the financial statements must be accounted for, presented and described in accordance with their substance and economic reality [based on PS 1000.29].

Thus, when a potential accounting treatment is being evaluated, it is assessed in large part by considering whether it will produce information that is relevant and provides a realistic picture of the government. This requires financial statements that show clearly the government’s assets and liabilities, income and expenses.

An important component of faithful representation is neutrality. Information is neutral when it is free from bias that would lead users towards making decisions that are influenced by the way the information is measured or presented. Financial statements that do not include everything necessary for faithful representation of transactions and events affecting the government would be incomplete and, therefore, potentially biased [based on PS 1000.29].

Neutral information faithfully represents the economic and other phenomena that it purports to represent. However, to require information included in GPFSs to be neutral does not mean that the information is without purpose or that it will not influence behaviour. By definition, relevant information is capable of influencing users' assessments and decisions.

- **What does "conservatism" mean and how should it be applied?**

PS 1000 of the CPA Canada Public Sector Accounting Handbook describes conservatism this way:

Conservatism
The application of conservatism in making judgments under conditions of uncertainty affects the neutrality of financial statements in an acceptable manner. When uncertainty exists, estimates of a conservative nature attempt to ensure that assets, revenues and gains are not overstated and, conversely, that liabilities, expenses and losses are not understated. Conservatism does not, however, encompass the deliberate understatement of assets and revenues or the deliberate overstatement of liabilities and expenses.

A similar discussion of the same concept, labelled "prudence", was included in the pre-2010 conceptual framework of the IASB. In finalizing the 2010 version of its Framework, the confusion caused by the ambiguity of that discussion prompted the IASB to remove any reference to prudence and to describe in other ways the desirable characteristics of good quality financial reporting. However, after much comment and debate, in its most recent Exposure Draft (ED) of changes to its conceptual framework, the IASB proposed re-introducing an explicit reference to "prudence". The Basis for Conclusions to that ED provides the following rationale for that proposal:

> The IASB noted that prudence is a term used by different people to mean different things. In particular:
>
> (a) some use it to refer to a need to be cautious when making judgements under conditions of uncertainty, but without needing to be more cautious in judgements relating to gains and assets than for those relating to losses and liabilities ('cautious prudence').
>
> (b) others use it to refer to a need for asymmetry: losses are recognised at an earlier stage than gains are ('asymmetric prudence'). There is a range of views on how to achieve such asymmetry, and to what extent. For example, some advocate a concept of prudence that would:
>
> > (i) require more persuasive evidence to support the recognition of gains (or assets) than of losses (or liabilities); or
> >
> > (ii) require the selection of measurement bases that include losses at an earlier stage than gains.
>
> The IASB considers that prudence (defined as the exercise of caution when making judgements under conditions of uncertainty) can help achieve neutrality in applying accounting policies.

> Thus, cautious prudence is a factor in giving a faithful representation of assets, liabilities, equity, income and expenses.
>
> Some argue that asymmetric prudence is a necessary characteristic of useful financial information. The IASB disagrees with this view.

In the ED and its subsequent consideration of comments received, the IASB has concluded that only “cautious prudence” is consistent with neutrality, and therefore with faithful representation of financial information. In its 2014 update of its conceptual framework, IPSASB removed explicit references to “prudence”, explaining that “the need to exercise caution in dealing with uncertainty” was implicit in the discussion of neutrality. PSAB’s 2015 consultation paper on *Conceptual Framework Fundamentals and the Reporting Model* is consistent with the conclusions of both the IASB and IPSASB:

> Conservatism is removed as an explicit concept but would still play a role in cases of estimation when there is uncertainty and there is a choice between equally possible amounts. In such cases, conservatism would require that there be no deliberate understatement of liabilities or overstatement of assets.

This view of applying a “cautious” conservatism in respect of estimation uncertainty rather than as a rationale for asymmetric recognition or measurement of assets or liabilities is consistent with the current definition of conservatism in PS 1000, and represents the latest thinking of standard setters in a number of jurisdictions, including Canada.

Part of the rationale for standard setters’ rejection of asymmetric conservatism, or prudence, is the recognition that conservatism applied in one period inevitably results in its opposite in subsequent periods. Conservatively understated assets/revenue or overstated liabilities/expenses in one period will result in overstated income in a future period when actual experience is more favourable than the conservative estimate. Thus, asymmetric conservatism/prudence means that both financial position and financial performance are mispresented in multiple periods. Moreover, as they cannot determine the degree of conservatism applied in a set of financial statements, users’ ability to make comparisons between governments and over time is impaired.

Views of the Pension Asset Expert Advisory Panel

The Panel considered the guidance in PS 3250 and how it applies to the recognition and measurement of the Ontario Provincial Government’s share of the Plans when they are in a net pension asset position for accounting purposes. In its analysis the Panel considered whether the contractual arrangements and other circumstances regarding the accounting surplus in the Plans met the definition of an asset and whether the resulting accounting meets the financial statement objectives of PSAS.

The Panel's analysis is presented in the following sections on Recognition Issues and Measurement Issues.

8.2 Application of defined benefit accounting to joint defined benefit plans

The Pension Asset Expert Advisory Panel in their report noted PS 3250.81 states "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".

The Panel discussed two possible interpretations of how this guidance is to be applied to JDBPs:

- Interpretation A – Divide the plan between the sponsors' respective portions; the government applies all the guidance on defined benefit plans in PS 3250 only to its portion;
- Interpretation B – The government applies the defined benefit plan guidance in PS 3250 to the plan as a whole; the government then recognizes only its portion of the plan in its financial statements.

This is an important interpretation in assessing both the asset recognition guidance in PSAS and the perspective through which the guidance on defined benefit plans in PS 3250 is applied.

For example, under interpretation A, dividing the plan first would entail measuring plan assets at the government's share, determining the accrued benefit obligation at the government's share and then determining whether any valuation allowance is required for any net pension asset that arises. Both the Ontario Provincial Government and Auditor General seem to implicitly adopt this view in their analyses.

Conversely, under interpretation B, the plan assets and accrued benefit obligation amounts for the whole plan are measured in accordance with PS 3250. The valuation allowance guidance is applied to any net pension asset that arises on the plan as a whole. The government then calculates its portion of the net pension asset, net of any valuation allowance, in determining the amount of asset to recognize in the Public Accounts. The contractual arrangements, including the rights of the Sponsors jointly or individually, would be considered in determining the government's portion of the JDBP.

In its analysis, the Panel noted that the contractual arrangements between the Sponsors result in joint control over the plan as a whole and not unilateral control by each sponsor over its share of the plan. (In the case of OPSEUPP it is noted that each Sponsor has unilateral control over how it utilizes its RSF, but this does not equate to unilateral control and decision-making over a portion of the entire plan.) A determination of the assets and the obligations of a defined benefit plan can be made only with reference to the plan as a whole.

To apply the guidance on the Limit on the Carrying amount of an Accrued Benefit Asset (the "Asset Ceiling Test") to the government's share of the plan, while applying the guidance on determining the accrued benefit obligation and the measurement of plan assets to the plan as a whole, would not be a consistent approach. This is because the Asset Ceiling Test includes amounts for future accruals for service that are calculated on a whole plan basis consistent with the measurement of the accrued benefit obligation.

As PSAB did not provide explicit guidance on the application of the Asset Ceiling Test to a Joint Sponsor's portion of a pension plan, it is reasonable to apply the Asset Ceiling Test in the same manner as other guidance in PS 3250 on the measurement of plan assets and accrued benefit obligation; that is to apply the guidance in the standard prior to determining the government's portion of the plan. The main difference between a single sponsor plan and a joint defined benefit plan is that for the latter, control is shared and a sponsor has only a portion of the positive or negative risks. It would be logical and consistent with the objectives of financial reporting to calculate the net pension asset or net pension liability in the same manner as for single sponsor plan – on a whole plan basis – before accounting for the shared control distinction by determining the government's portion of that net pension asset or net pension liability.

The Panel also noted that defined benefit plan accounting in financial statements reflects the plan's accounting surplus or deficit. The plan's assets and obligations are those of the separate entity - the plan - not those of the sponsor. The sponsor is responsible for, or entitled to, only its share of the net result of the plan. This accounting is similar to an "equity method" of accounting which would reflect the sponsor's interest in the net assets (or net liability) of a plan. Therefore, it is also conceptually consistent with the treatment of certain other arrangements subject to shared control (e.g., Government Business Partnerships in PS 3060), to calculate the net assets or liabilities in the plan before determining what portion of those net assets or liabilities the sponsor recognizes.

Application to OTPP and OPSEUPP

In respect of OTPP, the Partner's Agreement and the Plan Text provide that the entitlement to gains or surplus under the plan (rewards) and the liability for deficiencies in the pension fund (risks) are shared between employers and active members, consistent with the *Teachers' Pension Act*. These have historically been shared on a 50/50 basis when considered over the long term.

The OPSEUPP plan indicates that any funding surplus is allocated between the employers and members on a 50/50 basis. Each sponsor can then use its allocated portion as it unilaterally determines. This means that members and employers can use their portion of the funding surplus at different times, as historically has been the case. For accounting purposes, the net pension asset is determined based on the full plan using "best estimate" assumptions. While the RSFs are based on funding surplus, each Sponsors' share of net pension asset is affected by the relative position of their RSF as compared to the other Sponsor's RSF. For example, to the extent that Sponsor A has taken a benefit by utilizing their RSF and Sponsor B has not, Sponsor A's share of the net pension asset would be reduced accordingly.

Views of the Pension Asset Expert Advisory Panel

The Panel believes it is appropriate to apply all aspects of the guidance for accounting for defined benefit plans in PS 3250 to a JDBP prior to determining the government's portion of that plan for recognition in the financial statements. This results in financial reporting for a JDBP that aligns most closely with the concepts of defined benefit accounting in PS 3250 and with the economic substance of joint defined benefit plan arrangements.

The Panel recommends that the Ontario Provincial Government monitor the use of its rate stabilization reserve in determining its share of the net pension asset of OPSUEPP, as this could fluctuate over time.

8.3 Contingent asset considerations

The Pension Asset Expert Advisory Panel in their report noted a net pension asset is not an uncertain economic resource. While uncertainty exists about the measurement of a net pension asset, there is no uncertainty about whether the plan exists, and therefore about the existence of any estimated net pension asset. PS 3320 notes that "The mere fact that an estimate of an amount is involved (measurement uncertainty) does not, in and of itself, constitute the type of uncertainty that characterizes a contingent asset". The extent of the economic resource becomes clear as measurement uncertainty is resolved, not as future events occur or fail to occur. For clarity, while actuarial assumptions may be revised as more information becomes available in respect of the cost of the services provided by employees, this is a resolution of the measurement uncertainty inherent in the estimation of services provided. No future events are needed to clarify whether the service was provided by the employees or whether the plan assets were contributed. Similarly, there are no future events that require third party consent, such as regulatory approvals, nor are there any governance level changes, such as amendments to sponsor surplus/liability sharing provisions, that are required before the plan sponsors can jointly benefit from any surplus assets in the plan.

As such, PS 3320 is not a relevant source of guidance in considering whether the Ontario Provincial Government can recognize an asset in respect of a net pension asset in a JDBP plan.

Views of the Pension Asset Expert Advisory Panel

The net pension asset meets the definition of an economic resource because it exists and future benefit is available to the Sponsors in accordance with the Plan documents. There is no uncertainty regarding the existence or potential benefit of the net pension asset.

8.4 Calculation of the present value of expected future accruals for service for the current number of active employees

The Pension Asset Expert Advisory Panel in their report noted that Section PS 3250 paragraph .058 includes guidance that indicates, in addition to the expected future accruals for service, the expected administrative and investment expenses to be paid out of the plan can be included in the calculation, if they are not already taken into account in the expected return on assets rate.

Views of the Pension Asset Expert Advisory Panel

The guidance on expected future accruals for service is relatively straightforward to apply to OTPP and OPSEUPP. The Panel suggests that the Ontario Provincial Government might consider to what extent the expenses paid out of the plans should be included in the determination of the future economic benefit.

8.5 Accounting for Pension Plans by other Provinces

The Pension Asset Expert Advisory Panel in their report noted some other jurisdictions in Canada disclose that they do not recognize a net pension asset for certain JDBPs. The Panel has not examined these other plans as part of its mandate and cannot comment on the appropriate accounting for other plans. The Panel observes that the facts and circumstances of any plan should be carefully considered in determining whether a net pension asset can be realized. For example, the Consolidated Summary Financial Statements of the Province of British Columbia for the year ended March 31, 2015 discloses "The province has no claim on accrued asset amounts. If the individual pension boards decide to reduce or suspend employer contributions for a period of time, the province may record an asset. Therefore, the recorded value of the net assets is nil until such time such a decision is made." This indicates that the plan arrangements regarding the determination of contribution levels may differ fundamentally from those of OTPP and OPSEUPP as described above.

OTPP and OPSEUPP are dissimilar to certain other plans, such as some target benefit pension plans in New Brunswick, where the government's contribution rates are subject to a pre-determined narrow fixed range as set out in the plan's governing documents. The ability for the government to take contribution reductions is therefore limited.

Appendix A- History of Allocation of Actuarial Gains (Losses) (in millions)

OPSEUPP may have actuarial gains or losses each year because the actual events during the year ("experience") do not exactly match the long-term assumptions previously made. Actuarial gains or losses on plan assets occur because the actual investment returns were higher or lower than anticipated. Gains or losses on actuarial liabilities can occur because long-term assumptions (e.g., mortality, salary increases, termination, retirement and economic) differed from actual experience. These gains or losses are amortized under PSAS. Changes in the unfunded actuarial liability may also be amortized where due to changes in actuarial assumptions or methods.

Under the OPSEUPP Sponsorship Agreement, no agreement or amendment to the Plan shall provide for or permit any payment of surplus out of the Fund to the Province of Ontario, or any employer participating in the Plan. For greater certainty, the use of actuarial gains to offset Employer Contributions and any going concern unfunded liability or solvency deficiency does not constitute the payment of surplus out of the Fund.

In its history, the OPSEU Pension Plan has not reported excess surplus as per section 147.2(2) of the Income Tax Act.

The Employer and Member Stabilization Funds are the remaining employer's and members' share of the net actuarial gain. These funds are to be used as a buffer against any future actuarial losses that may arise.

As per the Sponsorship Agreement, the Government's share of gains was not recognized until the Transferred Initial Unfunded Liability had been fully liquidated as of December 31, 2001. As a result, the Government's gains were recognized in the years: 2001, 2007, 2013, 2014 and 2015. The gains for 2015 were not allocated and remain as an experience gain to be carried forward to the next funding valuation. The December 31, 2014 RSR for each Sponsor has accumulated interest at the valuation discount rate of 5.85%.