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Office of the Provincial Controller Division

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

For Discussion Purposes Only

Overview

Issue (background)

- The Province had accounted for the Ontario Teachers' Pension Plan (OTPP) for the prior 14 years since adopting the pension accounting standard (RETIREMENT BENEFITS, Section PS 3250) in 2001/02
- In relation to the 2015-16 Public Accounts for the Province of Ontario, the Auditor General of Ontario (AG) challenged the Province's previous accounting for OTPP and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP)
- The AG disagrees that the surplus in OTPP is a reportable asset to the Province on the basis that:
  - there is no legally enforceable right to unilaterally access the asset
  - no agreement was in place at March 31, 2016 with the Ontario Teachers' Federation (OTF) to reduce future contributions
- The following analysis is specific to OTPP; OTPP's constating documents are different than for other pension plans in Ontario and in other provinces

Reporting in the 2015-16 Public Accounts

- The Province disagrees with the Auditor General's interpretation of Public Sector Accounting Board (PSAB) standards
- The Province believes its share of OTPP's 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 (AG's) interpretation of PSAB standards. Since Management does not agree with the AG's interpretation of PSAB standards as related to 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

- OTPP meets the definition of a jointly sponsored pension plan (JSPP) as defined in the Pension Benefits Act. 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). While not binding upon the sponsors, as the sponsors can change the Funding Management Policy at any time, any changes are required to have the mutual consent of both sponsors. Accordingly, the sponsors can be said to have equal opportunity to benefit from surplus utilization through the negotiation process
- The plan administrator is an independent board of directors that 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 benefit 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 (included in Appendix 1)
- 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 (PSAB standards) and is also a different framework than is used to calculate the net surplus or deficit for funding purposes. Different assumptions are used, for example relating to the discount rate (See Appendix 4)

Primary sources of GAAP

- GENERALLY ACCEPTED ACCOUNTING PRINCIPLES Section PS 1150 states that a reporting entity applies every primary source of generally accepted accounting principles (GAAP) that deals with the transactions and events encountered by that entity
- Section PS 3250 provides clear guidance that a joint defined benefit plan is accounted for using Section PS 3250 and therefore is the primary source of GAAP that must be applied
- Other PSAB standards including the Financial Statements Concepts should be referred to if Section PS 3250 does not provide specific guidance for a circumstance

Question 1 – Classification of a pension asset

For accounting purposes, what type of pension plan is OTPP and how should it be classified under Public Sector Accounting Standards (PSAS)?

Section PS 3250 Applicability to OTPP

- Section PS 3250 paragraph .001 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 (Section PS 3250 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
- Section PS 3250 on its own is sufficient to assess the accounting for OTPP by the Province

Definition of a JDBP

- The Teachers' Pension Act, the Partners' Agreement and the plan text collectively set out the terms surrounding the sharing of control of OTPP between the Province and OTF. The Province of Ontario has an equitable share of the risks and rewards (surpluses and deficits) of OTPP, thus meeting the definition of a Joint Defined Benefit Plan (JDBP) in PSAS

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 (glossary to Section PS 3250).

Conclusion on classification

- The Province has concluded that OTPP meets the definition of a joint defined benefit plan as the Province and Ontario Teachers' Federation are shared sponsors of the plan
- The Teachers' Pension Act, the Partners' Agreement and the plan text for OTPP collectively set out this shared control and equitable sharing of the risks and rewards (surpluses and deficits) of the plan, thus meeting the definition of a joint defined benefit plan in RETIREMENT BENEFITS, Section PS 3250 in PSAS which is a primary source of GAAP

Question 2 – Recognition of a pension asset for a JDBP

As a result of its classification as a joint defined benefit plan, how should the Province of Ontario account for the pension surplus of OTPP in the Public Accounts?

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 Section 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 references "control" over an economic resource in Section PS 1000 and does not address "shared control", which is relevant to the situation of a joint defined benefit plan, in respect of asset recognition. However, the term is included in other PSAB standards, for example relating to government partnerships (Section PS 3060 requires proportionate consolidation which is the recognition of a pro rata share of assets, liabilities, revenues and expenses of the partnership). Section PS 3060 existed prior to the introduction of Section PS 3250 into the PSAB standards, indicating that an asset subject to shared control with another party can be recognized in the financial statements.

Concept of Contingent Asset

- Section PS 3320, provides guidance on the disclosure of contingent assets in a government's financial statements. It characterizes a contingent asset as one where there is uncertainty as to the existence of an asset
- It is the Province's position that the existence of the pension asset is not uncertain – there is an accrued benefit asset calculated in accordance with Section PS 3250 as noted above that is based on past transactions, representing the impact of cumulative contributions and benefit expense
- The Province does however, acknowledge that uncertainty does exist with regards to measurement of the accrued benefit asset and potential impairment thereof

Conclusion on recognition

- 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 3 – Measurement of a pension asset

How should the pension asset of OTPP be measured for purposes of reporting in the Public Accounts of the Province of Ontario?

Guidance in Section PS 3250 on measurement

- Section PS 3250 paragraphs .050 to .059 address how to measure a pension asset
- This is a two-step process
- Firstly the accrued plan obligation (a Credit) and the plan asset (a Debit) are measured in accordance with the standard, and adjusted for any unamortized actuarial gains or losses (a Debit for gains not yet realized, a Credit for losses not yet realized). This measurement results in a retirement benefit liability when it is a net liability (a Credit) amount or an accrued benefit asset (AcBA) when it is a net asset (a Debit) amount

Guidance in Section PS 3250 on measurement (continued)

- When the resulting amount is an asset, the standard requires a second step to test for asset impairment. It should be noted that impairment testing in some form is required for all assets recognized under PSAB standards except those carried at fair value, although the methodology of impairment tests will vary depending on the nature of the asset. The amount that is tested is the “adjusted benefit asset”. When there are net unamortized gains the AcBA is equal to the adjusted benefit asset (AdBA). When there are net unamortized losses the AcBA is reduced by those net unamortized losses to calculate the adjusted benefit asset (AdBA)
- The AcBA is then compared to the expected future benefit (referred to as the asset ceiling test). The objective is to limit a government's accrued benefit asset to the amount it can realize in the future. A government may benefit from an AcBA by either i) withdrawing surplus assets from the plan or ii) by taking a contribution holiday or receiving a refund of contributions (Section PS 3250 paragraph .056)

Government Expectations

- 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 as a minimum, and when there is a surplus. 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
- 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 following slides consider this calculation relative to the Province’s 50% share of OTPP

Considerations re: surplus withdrawal (Part b of the asset ceiling test)

- The Province does expect to realize its expected future benefit 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
- As at March 31, 2016 the Province did not have a signed agreement with OTF regarding withdrawal of the surplus

Considerations re: reduced future contributions (Part a of the asset ceiling test)

- While Section PS 3250 states that legal enforceability is required to report an expected benefit 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 expects to 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/reductions. 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, or when there is a surplus. The surplus “zone” for OTPP impacts how the pension surplus may be utilized by the Province summarized in Appendix 3
- In addition, the Income Tax Act (ITA) imposes limits on the level of contributions that may be made to a pension plan that has “excess surplus” (as defined by the ITA).
- 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

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

- There is very limited guidance in PSAB standards 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. The key scenarios considered and results are summarized in Appendix 5.
- 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 and the results of the actuarial valuations performed as part of the pension asset ceiling test, 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 (both in terms of selection of rate under PSAS and in Ontario's case, management's best estimate of the long-term 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 (see Appendix 4)
- The choice of rate used by the Province (long-term rate of return on plan assets) is consistent with the rate used by other Provinces in Canada for their pension plans (see Appendix 6)
- PSAS acknowledges that the objective of funding and accounting are different (Section PS 3250 paragraphs .008 to .010). Because of the different objectives, the discount rates used will also be different

Accounting for JDBP by other Provinces

- Provinces such as British Columbia, New Brunswick, Manitoba and Nova Scotia do not report assets for their provincial sponsored pension plans or alternatively provide a valuation allowance to reduce the value of a pension asset balance to nil
- The different accounting treatment in the Province of Ontario (for OTPP) reflects the difference circumstances in these other provinces with regards to expected future benefits related to pension surpluses

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 and assumptions
- 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 relating to OTPP that would have otherwise been reported on the Province's books as at March 31, 2016
- Refer to Appendix 2 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 for OTPP compared with following the Province's interpretation of the PSAS

APPENDICES

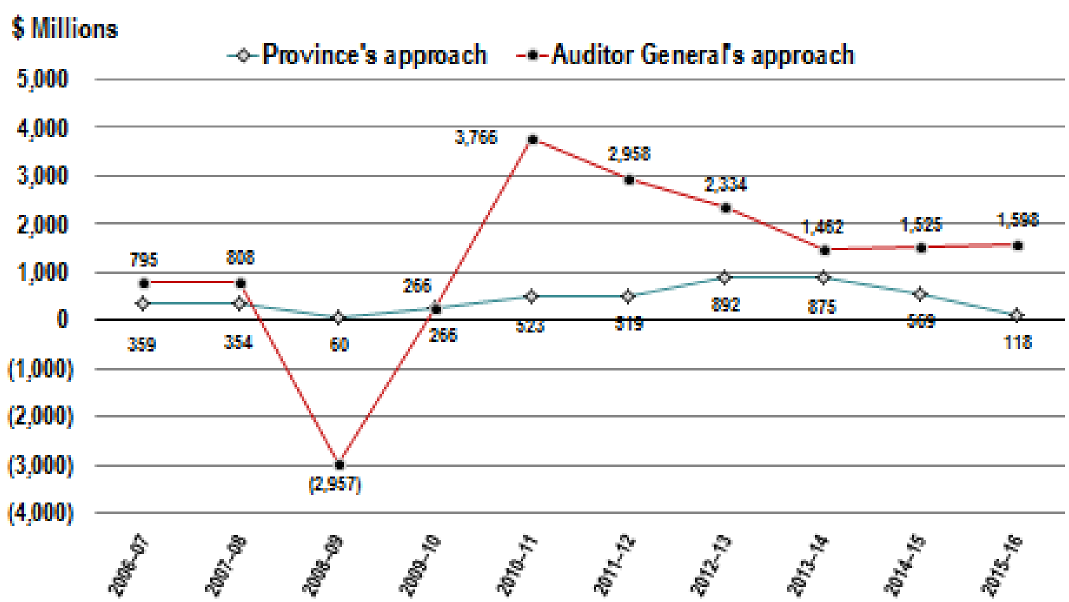
Appendix 1:
History of Surplus Utilization for OTPP

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 special payments	$0
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	$9.3 Billion	

Appendix 2:Comparison of key measurements of the Province over the prior 10 years

OTPP expense comparison — 10-year

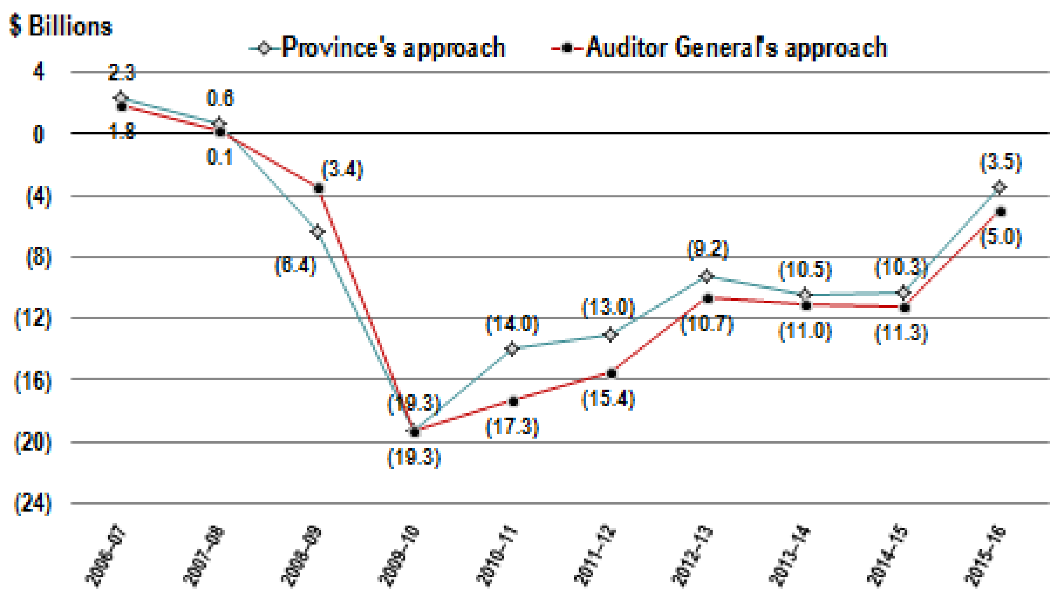
Chart 1



Appendix 2: Comparison of key measurements of the Province over the prior 10 years

Surplus/(deficit) comparison — 10-year

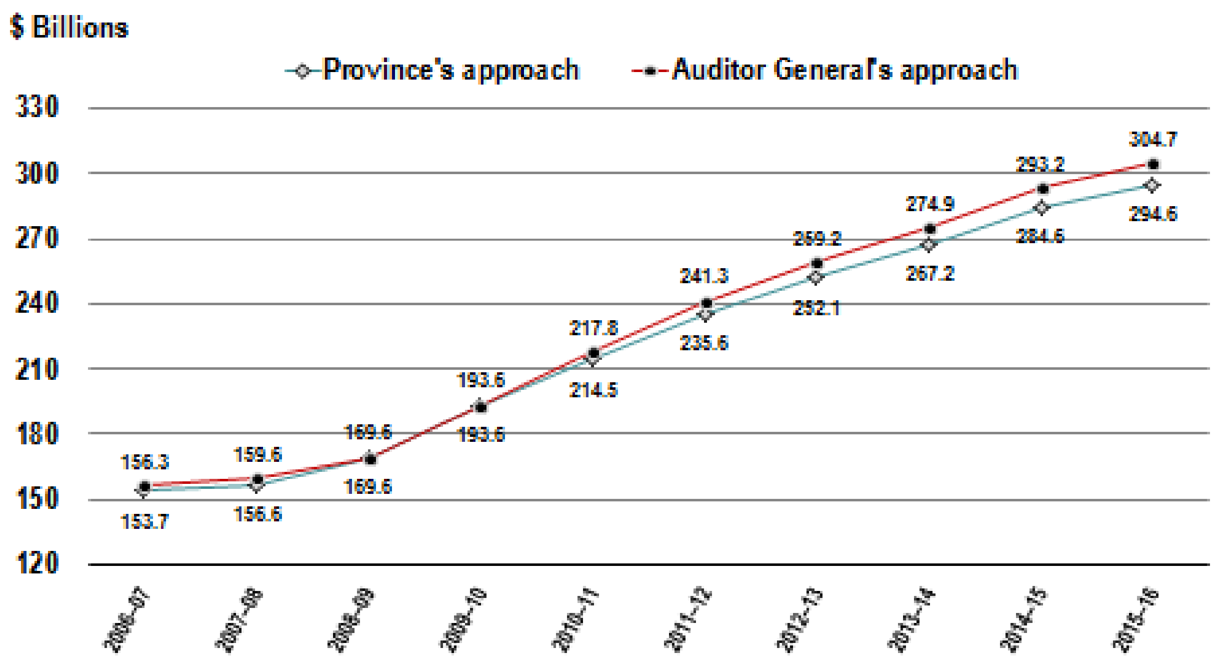
Chart 2



Appendix 2: Comparison of key measurements of the Province over the prior 10 years

Net debt comparison — 10-year

Chart 3



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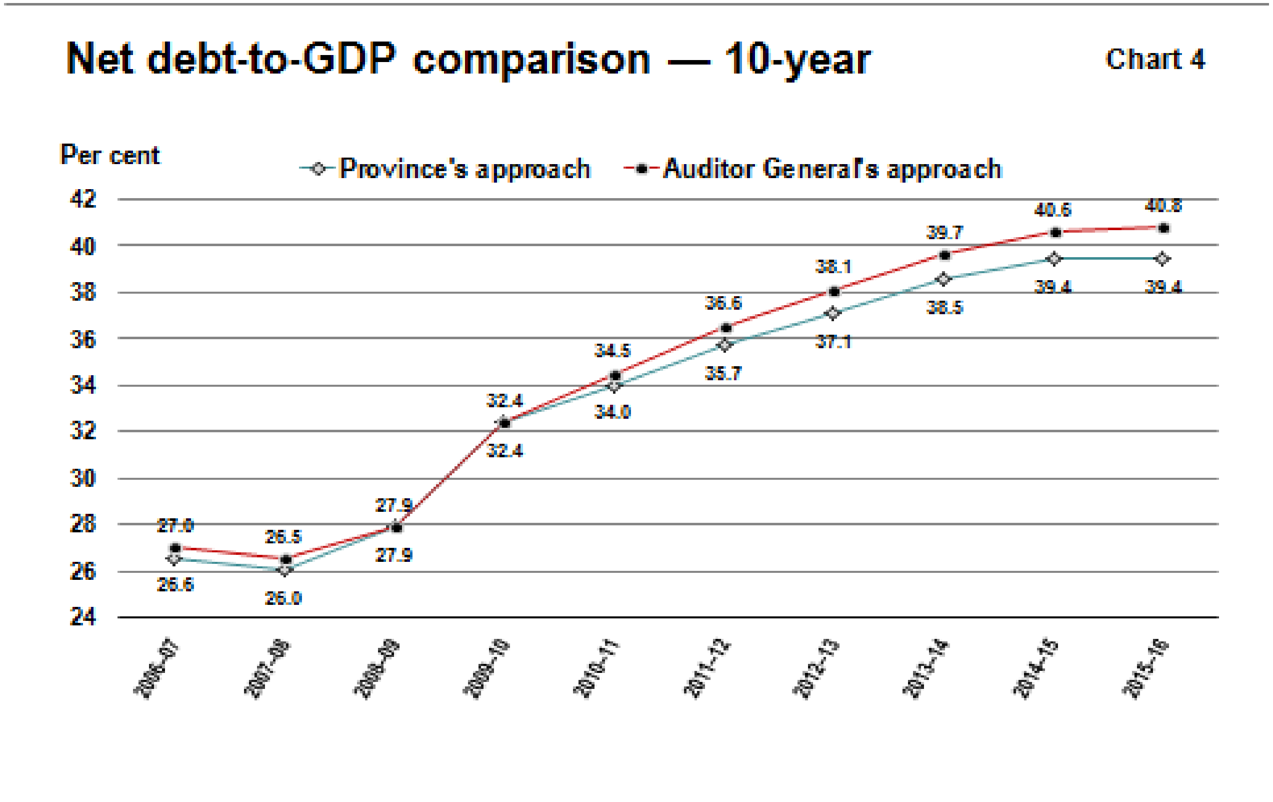

Appendix 3: Surplus Zones

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.

Appendix 4: OTPP funding vs. accounting discount rates and actual performance

Ontario Teacher's Pension Plan			
Rate Comparison			
	OTPP Annual Performance	OTPP Filed Discount Rate *	Province Economic Assumption for Nominal Return
2005	17.2%	6.48%	7.00%
2006	13.2%		7.00%
2007	4.5%		6.75%
2008	-18.0%	5.65%	6.75%
2009	13.0%	5.00%	6.75%
2010	14.3%		6.75%
2011	11.2%	5.40%	6.75%
2012	13.0%	5.30%	6.75%
2013	10.9%		6.75%
2014	11.8%	4.95%	6.75%
2015	13.0%	4.85%	6.50%
2016	n/a	n/a	6.25%

"OTPP filed discount rate" relates to that used in OTPP's financial statements prepared using Part IV and that the "Province Economic Assumption for Nominal Return" relates to that used in the Province's financial statements prepared using PSAB in relation to the OTPP plan.

Appendix 5: Summary of Ceiling Test Results (Various Scenarios)

Model Assumptions	Expected Future Benefit or Asset Ceiling ($ Billions)	Results
1. There is no minimum employer contribution under the plan/legislation that is required if a surplus is present.	$44.6	There is no reduction in the expected future benefit (EFB) as at March 31, 2016.
2. The employer minimum contribution considers the most recent funding valuation dated January 1, 2015 for the period of the current funding report. Contribution requirements are $1.7B per year for 2015, 2016 and 2017.	$41.2	The minimum contribution requirement applies to the current period of the funding report and until a new report is completed. EFB is reduced for 2 years by $1.7B at March 31, 2016.
3. The employer minimum contribution considers the most recent funding valuation dated January 1, 2015 for the period of contribution requirement (i.e. 11 years through 2026) not just for the period of the current funding report.	$29.3	Uses a period to 2026 (11 year period) based on the funding report special contribution requirement. The EFB at March 31, 2016 is reduced by $15.3B.
4. The surplus is never used until the time it reaches the Income Tax Act (ITA) threshold. Once attained, the excess surplus is used at 50% for employees and 50% for the Province to reduce contributions in the following years.	$23.2	The ITA surplus limit is reached at the end of 2025, leading to forced contribution reductions from 2026. EFB is reduced by $21.4B at March 31, 2016
5. Every year, 50% of current year surplus is applied to improve member benefits and the remaining 50% of the current year surplus is retained and continues to accrue. Once the ITA threshold is attained, the excess surplus is used 50%-50% to reduce contributions by employees and the Province.	$12.9	The ITA surplus limit is reached at the end of 2041 leading to forced contribution reductions from 2042. EFB is reduced by minimum $31.7B at March 31, 2016.

Appendix 6: Discount rates used by other Senior Canadian Governments and Pension Plans

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Government

Ontario – LT ROR	6.25
Alberta – LT ROR	6.5
Saskatchewan – LT ROR	6.5
BC – LT ROR	6.5
Quebec LT ROR	6.5
NFLD – LT ROR	6.3
NS – LT ROR	7.75
MB – LT ROR	6.25

Plan - Funding

OTPP	4.85%
AB – Post 1992 PP	6
SK – SHEPP	NA
BC – PSPP	6.5
QC - CARRA	5.8
NFLD – MUPP	5.8
NS - NSTPP	6.25
MB - MTPP	6

Plan F/S

OTPP – MR of Prov. Bonds	*3.25*
AB TPP – LT ROR	7.0
SK – LT ROR	6.5
BC – LT ROR	6.5
QC – LT ROR	6.4
NFLD – LT ROR	5.8
NS – LT ROR	6.25
MB – LT ROR	6