Chapter 3
Province of New Brunswick Audit: Observations on Pension Plans

Contents

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Introduction

3.1 Accounting for pensions is material to the Province's consolidated financial statements and involves complex accounting issues. A Glossary of terms is found in Appendix I. This year we encountered significant difficulties in our audit work on pension plans. As such we have presented our observations on these topics in a separate chapter of our Report.

Audit Opinion Qualified Re Pension Accounting

3.2 On September 29, 2015, our Office issued a reservation or a "qualified audit opinion" on the Province's March 31, 2015 consolidated financial statements. Our audit qualification details our concerns regarding how the Province has accounted for its shared risk pension plans. At the time of release of the Province's financial statements, we also published a separate document (found in Appendix II) to explain our accounting concerns. We view this qualification as a very serious matter.

3.3 As described in the audit opinion qualification there is insufficient information to appropriately determine the annual deficit, accumulated deficit, total liabilities and net debt of the Province. This is the first qualified audit opinion on the Province's financial statements in 17 years.

3.4 As of March 31, 2015, four of the Province's pension plans containing more than $14 billion in pension plan assets (unaudited) have been converted to a joint trusteeship form of pension plan. The converted plans are found in Exhibit 3.1.

Exhibit 3.1 – Pension plan conversion dates

Converted Plan Name	Conversion Date
Public Service Shared Risk Pension Plan (the "PSSRP")	January 1, 2014
New Brunswick Teacher's Pension Plan (the "NBTPP")	July 1, 2014
Shared Risk Pension Plan for CUPE Employees of New Brunswick Hospitals (the "H-CUPE")	July 1, 2012
Shared Risk Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals (the "H-CBE").	July 1, 2012

Each pension plan must be assessed on its own merits

3.5 Accounting for shared risk pension plans is a complex process for accounting purposes. The Public Sector Accounting Standard (PS 3250- Retirement Benefits) does not specifically address unique arrangements such as shared risk pension plans. These plans may include both defined benefit and defined contribution elements depending on the plan design. Shared risk pension plans are inherently more complex than traditional pension plan models and present new factors to consider for accounting purposes.

3.6 The Public Sector Accounting Board of CPA Canada has recently formed a task force to study possible changes that may be required to PS 3250. It will likely be a number of years before a revised standard (if any) is published. However, we believe the current standard contains sufficient guidance to permit appropriate accounting analysis and decisions regarding shared risk pension plans.

3.7 We note other provinces and certain municipalities have adopted new pension models. We caution that each pension plan must be assessed on its own merits. Pension plan legislation and specific pension plan provisions may differ between pension plans (and different jurisdictions), and an assessment on a plan by plan basis is required to determine the appropriate accounting treatment of any pension plan conversion.

Departure from Canadian Public Sector Accounting Standards

3.8 Our assessment of the Province's four shared risk plans involved a complex evaluation of the plans' legislation and specific pension plan provisions. Public Sector Accounting Standard 3250 states, "because benefit plans are often complex, careful analysis and professional judgment are needed to determine whether the substance of a particular plan makes it a defined benefit or a defined contribution plan."

3.9 The Province has accounted for the PSSRP, NBTPP, H-CUPE and H-CBE pension plans using defined contribution accounting. Definitions for defined contribution accounting and defined benefit accounting are found in Appendix I.

3.10 We disagree with the Province's choice of defined contribution accounting, as under this method the Province contributes a certain amount in each period and has no responsibilities to make any further contributions. A liability would only be recorded when the amount paid during the period differed from the amount required to be paid.

3.11 Given the structure and substance of these plans, this constitutes a departure from Canadian public sector accounting standards. As a result, the Province's consolidated financial statements for the year ended March 31, 2015 do not reflect the risk inherent in the design of the shared risk pension plans. Examples of plan features that disqualify the use of defined contribution accounting include:

- the employer remains exposed to risk of possible contribution increases that cannot be considered limited or minor;
- the employees' retirement benefits are based on a defined formula; and
- the employer can benefit from plan surpluses through the reversal of past contribution increases.

3.12 Overall, we believe the PSSRP should continue to use defined benefit accounting. Also, we believe using joint defined benefit accounting for the NBTPP, H-CBE and H-CUPE plans would help the Province better portray its remaining exposures to pension plan risk and volatility in its financial statements. In recognition of the mitigation of certain risks, including volatility, we see joint defined benefit accounting as an appropriate middle ground for these plans compared to the defined benefit and defined contribution accounting alternatives.

Unexpected and unsupported change in accounting policy

3.13 After March 31, 2015 the Province informed us it would be retroactively changing its accounting policy for the PSSRP and recording this pension plan using defined contribution accounting in the March 31, 2015 financial statements. Previously, in the March 31, 2014 consolidated financial statements, the PSSRP (including the pre-conversion benefits guaranteed by the Province) was correctly accounted for using defined benefit accounting. The Province has now determined that an accounting treatment similar to a defined contribution plan most closely suits the economic substance of the plan.

3.14 There have been no changes to the PSSRP that warranted a change in accounting policy during this audit year nor has management provided sufficient justification to support a change to defined contribution accounting. Therefore, defined benefit accounting should have continued at March 31, 2015.

Lack of evidence to change defined benefit accounting conclusion for the PSSRP

3.15 Last year the Province chose and supported defined benefit pension plan accounting for the PSSRP based on the following factors:

- level of variability in employer contributions;
- frequency of variability in employer contributions;
- likelihood of variability in employer contributions;
- whether separate accounts are maintained for each employee;
- whether employee benefits earned in the past may be reduced;
- communication to plan members;
- existence of guarantees; and
- presence of constructive or equitable obligations.

3.16 Given the persuasive arguments for defined benefit accounting for the PSSRP, we agreed with the Province's classification of the PSSRP as a defined benefit plan in its March 31, 2014 financial statements. External experts (both the Province's external experts as well as our own) were consulted and agreed with the defined benefit accounting choice. We reconfirmed our accounting conclusion with our experts again for the Province's March 31, 2015 financial statement audit. Conversely, the Province did not obtain expert conclusions and recommendations regarding their accounting decision for the March 31, 2015 financial statements. To date we have not seen adequate evidence to change our opinion that the PSSRP should be accounted for using defined benefit accounting.

Impact of PSSRP change

3.17 The Province's unsupported change in accounting policy from defined benefit to defined contribution accounting for the PSSRP has resulted in:

- the restatement of the opening net pension liability, opening net debt and accumulated deficit of $100.6 million;
- the recognition of a prior year settlement expense of $100.6 million as the plan assets, obligation and unamortized adjustment balance were retroactively removed at the January 1, 2014 plan conversion date; and

- the reversal of a prior year adjustment which included NB Power's pension assets, obligation and unamortized adjustment balances in the Province's pension information.

3.18 It is impossible to determine the changes required to the Province's financial statements as the necessary information has not been provided or calculated. Many numbers are impacted in the Province's financial statements including annual deficit, accumulated deficit, total liabilities and net debt.

3.19 Exhibit 3.2 presents details regarding further information required to determine the impact of this accounting departure on the Province's deficit. In summary, as the Province did not request a valuation for accounting purposes from their actuaries and perform the necessary calculations, the impact cannot be determined.

Exhibit 3.2 – Information required to determine impact of accounting departure

Converted Plan Name	Information required
PSSRP	• Actuarial valuation for accounting purposes at March 31, 2015 to measure the Province's obligation/liability for the plan. • Prepare accounting calculations and determine pension balances and entries required under defined benefit accounting.
NBTPP	• Audit of plan assets as at July 1, 2014 (plan conversion date). • Actuarial valuation for accounting purposes at March 31, 2015 to measure the Province's obligation/liability for the plan. • Prepare accounting calculations and determine pension balances and entries required under joint defined benefit accounting.
H-CUPE	• Actuarial valuation for accounting purposes at March 31, 2015 (with comparative figures at March 31, 2014 and April 1, 2013) to measure the Province's obligation/liability for the plan. • Prepare accounting calculations and determine pension balances at March 31, 2015 (with comparative balances at March 31, 2014 and April 1, 2013) and entries required under joint defined benefit accounting.
H-CBE	• Actuarial valuation for accounting purposes at March 31, 2015 (with comparative figures at March 31, 2014 and April 1, 2013) to measure the Province's obligation/liability for the plan. • Prepare accounting calculations and determine pension balances at March 31, 2015 (with comparative balances at March 31, 2014 and April 1, 2013) and entries required under joint defined benefit accounting.

Management would need to prepare best estimates for assumptions, which would include its best estimate of the obligations, mortality rates, discount rates, indexation, annual wage and salary increase assumptions, etc.

Accounting for the NBTPP as a joint defined benefit plan

3.20 The NBTPP converted to a new pension structure on July 1, 2014. The previous structure was accounted for by the Province using defined benefit accounting. The NBTPP has now been accounted for by the Province using defined contribution accounting. Given factors such as:

- the employer remains exposed to possible contribution increases that cannot be considered limited or minor;
- employees' retirement benefits are based on a defined formula; and
- the employer can benefit from plan surpluses through the reversal of past contribution increases;

there is persuasive evidence that this plan should have been accounted for using joint defined benefit accounting.

3.21 A reservation was also included in the audit opinion for the Province's March 31, 2015 consolidated financial statements regarding the lack of an audit performed on NBTPP asset balances as at July 1, 2014 (the plan conversion date). It was important an audit be performed at this date to verify the asset value transferred to the new plan and then confirm the accuracy of the plan settlement details. Without an audit to verify the asset balance transferred to the new plan, we cannot verify details of the settlement calculation. It is also important that an audit be performed to ensure the asset balance transferred to the NBTPP Board of Trustees and asset performance measurements for the new plan are accurate.

Accounting for the H-CUPE and H-CBE Shared Risk Plans

3.22 During fiscal 2012-13, the H-CUPE pension plan and the H-CBE pension plan converted to a Shared Risk Pension Plan model.

3.23 Prior to conversion to shared risk plans, both H-CUPE and H-CBE pension plans had been reported in the Province's consolidated financial statements as defined contribution pension plans. Upon conversion, the Province's position was that the shared risk plans should continue to be accounted for as defined contribution plans given the risks inherent in the plans are largely borne by the employees. As the contributions on the part of the Province are defined and limited with minimal variability expected from one year to the next, defined contribution accounting was accepted at that time, due to the small size of these plans compared to the PSSRP and NBTPP, and given that a contribution liability of $66.9 million was recorded for the shortfall of employer contributions. When this liability was reversed/extinguished by the Province as part of the March 31, 2015 financial statement audit, the pension accounting for H-CUPE and H-CBE became a significant audit concern.

3.24 As the remaining contribution liability has now been eliminated, there is persuasive evidence that joint defined benefit accounting should also be used for the H-CUPE, and the H-CBE plans:

- the employer remains exposed (as no employer contributions liability is now recorded) to possible contribution increases that cannot be considered limited or minor;
- employees' retirement benefits are based on a defined formula; and

- the employer can benefit from plan surpluses through the reversal of past contribution increases.

Pension Expense and Pension Contributions

3.25 Exhibit 3.3 provides details of the Province's total pension expense for the past ten years. For purposes of illustrating the potential volatility of this figure, a longer-term approach of ten years has been provided.

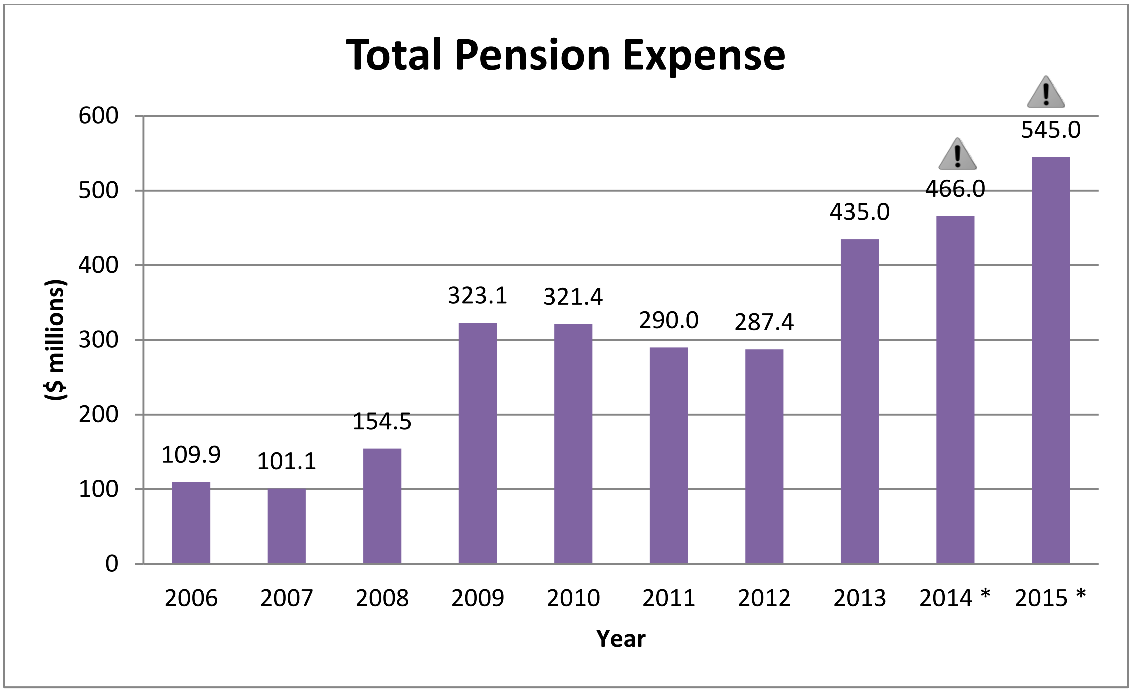
Exhibit 3.3 - Components of Pension Expense

Components of Pension Expense ($ millions)										
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014*** Restated	**2015***
Employer's share of pension benefits earned	117.0	126.1	133.8	146.1	131.6	137.4	148.9	177.4	199.9	258.2
Net interest expense (revenue)	30.9	0.4	(9.1)	20.6	118.2	52.9	32.0	62.7	61.9	18.5
Plan amendments	-	5.9	-	-	-	-	-	-	-	(5.5)
Curtailment costs	-	-	-	-	-	-	-	-	-	0.1
Amortization of adjustments	(40.3)	(31.2)	30.3	159.7	87.1	99.7	106.5	194.9	104.2	44.0
Change in valuation adjustment	2.3	(0.1)	(0.5)	(3.3)	(15.5)	-	-	-	-	-
Plan settlements ***(recorded in year as a result of conversion to new pension plan structure)***	-	-	-	-	-	-	-	-	100.0	229.7
Total pension expense	**109.9**	**101.1**	**154.5**	**323.1**	**321.4**	**290.0**	**287.4**	**435.0**	**466.0**	**545.0**

** Note the pension expense for 2014 (restated) and 2015 would have been significantly different if the shared risk/targeted benefit pension plans were properly accounted for in accordance with Canadian Public Sector Accounting Standards.*

The audit opinion for the Province of New Brunswick's March 31, 2015 financial statements expressed reservations which may impact expenses, liabilities, annual and cumulative deficit as well as Net Debt. Readers are cautioned the above information may not be appropriate for their purposes. The numbers impacted by the reservations have been shaded above.

Exhibit 3.4 - Total Pension Expense



** Note the pension expense for 2014 (restated) and 2015 and would have been significantly different if the shared risk/targeted benefit pension plans were properly accounted for in accordance with Canadian Public Sector Accounting Standards.*

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Pension expense volatility

3.26 Exhibits 3.3 and 3.4 highlight the significant increase in the annual pension expense over the ten-year period as well as the volatility in expense. In the year ended March 31, 2006, the pension expense was $109.9 million. By way of contrast, in the year ended March 31, 2015, the pension expense was $545.0 million, an increase of $435.1 million when compared to 2006.

Plan settlement pension expenses

3.27 The pension expense for the year ended March 31, 2015 was $545.0 million, which included a one time plan settlement expense of $229.7 million because of the Province's decision to account for the NBTPP using defined contribution accounting.

3.28 Pension plan expense as reported in the consolidated financial statements for the year ended March 31, 2014 was $365.4 million. The restated pension plan expense for the year ended March 31, 2014 was $466 million because of the Province's decision to account for the PSSRP as a defined contribution plan (previously correctly accounted for as a defined benefit plan). This decision involved retroactively recording a 2014 plan settlement expense for the PSSRP of approximately $100 million.

Details of the Province's pension balance

3.29 Exhibit 3.5 provides the history of the Province's pension balance for all pension plans reported in the consolidated financial statements for accounting purposes as well as the important components involved in the pension balance calculation over the past ten years. It is important to note that the pension balance is different than pension expense. In Exhibit 3.5, the pension balance for accounting purposes is the amount that appears on the statement of financial position (or balance sheet) of the Province.

Exhibit 3.5 - Components of the Pension Balance for Accounting Purposes

Components of the Pension Balance for Accounting Purposes
($ millions)

	2006	2007	2008	2009	2010	2011	2012	2013	2014* Restated	2015*
Estimated accrued benefit obligations	7,324.5	7,865.5	8,289.3	8,642.5	8,570.2	8,895.7	9,318.3	10,146.6	5,766.6	989.1
Value of plan assets	7,449.3	8,030.5	8,024.1	6,512.4	7,703.1	8,387.0	8,674.7	9,293.9	5,293.1	473.0
Pension position before accounting adjustments	(124.8)	(165.0)	265.2	2,130.1	867.1	508.7	643.6	852.7	473.5	516.1
Accounting adjustments	155.0	38.6	(509.9)	(2,340.3)	(1,063.7)	(728.6)	(903.1)	(1,002.2)	(373.5)	(136.4)
Pension balance for accounting purposes	30.2	(126.4)	(244.7)	(210.2)	(196.6)	(219.9)	(259.5)	(149.5)	100.0	379.7

** Note the pension balance for accounting purposes for 2014 (restated) and 2015 would have been significantly different if the shared risk/targeted benefit pension plans were properly accounted for in accordance with Canadian Public Sector Accounting Standards.*

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3.30 Under defined benefit pension accounting the pension balance for accounting purposes is calculated by comparing the estimated market value of plan assets to the actuarial estimate of accrued benefit obligations owing to present and future pensioners. From this difference an adjustment is made for accounting purposes. The purpose of the accounting adjustment is to reduce year to year pension expense volatility by allowing actual results achieved on plan assumptions to be reported over time and not all in one year. As a result of the Province's accounting policy to record the PSSRP and NBTPP using defined contribution accounting, the pension assets and related obligations were removed from the Province' consolidated financial statements.

3.31 As well the prior year unamortized expense adjustments for the PSSRP and NBTPP (which had been deferred and not previously expensed) were entirely reversed and expensed upon adoption of defined contribution accounting for the PSSRP and NBTPP.

3.32 The magnitude of this change to defined contribution accounting is further illustrated when considering the size of the balances removed as part of the pension accounting conversion. Using the March 31, 2014 figures (as all of the figures for March 31, 2015 cannot be calculated) the Province effectively removed in 2015:

- $11.5 billion in pension liabilities;
- $11.0 billion in pension assets; and
- unamortized accounting adjustments of $759.3 million

as part of the change to defined contribution accounting.

3.33 It should be noted the volatility of the plans would be expected to be reduced over the long term with the introduction of the new shared risk/targeted benefit model, however, the exposure to volatility and risk has not been eliminated.

3.34 Overall, we believe using joint defined benefit accounting for the NBTPP, H-CBE and H-CUPE plans would help the Province better portray its remaining exposures to pension plan risk and volatility in its financial statements. In recognition of the mitigation of certain risks, including volatility, we see joint defined benefit accounting as an appropriate middle ground for these plans compared to the defined benefit and defined contribution accounting alternatives. With respect to the PSSRP, as the Province's obligation related to pre-conversion benefits expire, over time, we believe joint defined benefit accounting would be also appropriate for this plan.

Pension contribution volatility

3.35 Exhibit 3.6 compares the annual pension expense to the amount of contributions made by the Province to the various pension plans.

Exhibit 3.6 – Pension Expense and Contributions

Pension Expense and Contributions ($ millions)										
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014 ***	**2015 ***
Pension expense	109.9	101.1	154.5	323.1	321.4	290.0	287.4	435.0	466.0	545.0
Employer contributions	236.4	257.7	272.8	288.6	307.8	313.3	327.0	350.8	216.5	265.3
Excess (deficiency) of employer contributions over pension expense	126.5	156.6	118.3	(34.5)	(13.6)	23.3	39.6	(84.2)	(249.5)	(279.7)

** Note the pension expense for 2014 (restated) and 2015 would have been significantly different if the shared risk/targeted benefit pension plans were properly accounted for in accordance with Canadian Public sector accounting standards.*

The audit opinion for the Province of New Brunswick's March 31, 2015 financial statements expressed reservations which may impact expenses, liabilities, annual and cumulative deficit as well as Net Debt. Readers are cautioned the above information may not be appropriate for their purposes. The numbers impacted by the reservations have been shaded above.

3.36 Exhibit 3.6 shows that for half of the past ten years, the Province's contributions to its various pension plans have been less than the annual pension expense, whereas half of the past ten years the amount of employer contributions exceeded the amount of the pension expense. Over the past ten years, the Province has contributed $197.2 million less than the pension expense.

3.37 The year to year differences are largely due to the legislated and actuarial funding requirements of the plans being different than the measurement of pension expense as required by Canadian Public Sector Accounting Standards. Funding requirements are intended to ensure there will be sufficient funds in the plans to pay pension benefits while the pension expense is intended to measure the net cost of pension benefits earned by employees during the year.

3.38 The significant increase in the deficiency of employer contributions compared to pension expense in fiscal years 2014 ($ 249.5 million) and 2015 ($279.7 million) relate to one time "plan settlement" expenses for the PSSRP of $100.6 million and NBTPP of $229.7 million as a result of the Province's decision to apply defined contribution accounting.

Pension contributions for the Province's two largest plans

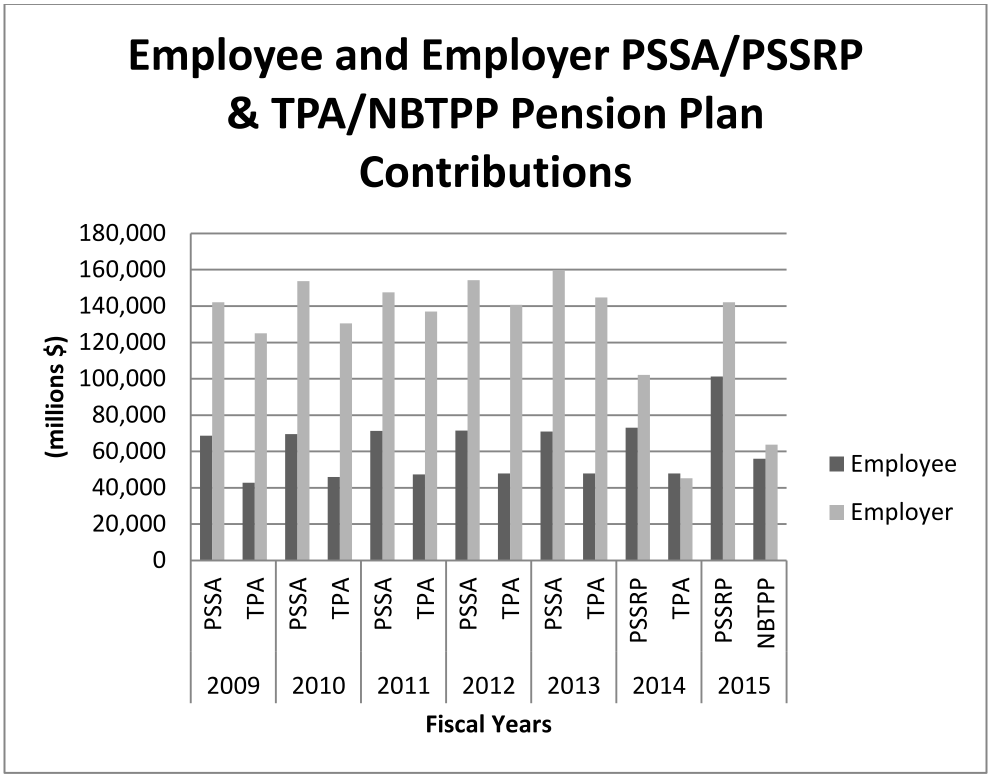
3.39 Further details on pension contributions from 2009 to 2015 for the Province's two largest plans, the Public Service Superannuation Plan (PSSA), now the PSSRP and the Teacher's Pension Plan (TPA), now the NBTPP are found in Exhibit 3.7 and Exhibit 3.8.

Exhibit 3.7 – Pension Contributions for the PSSRP/PSSA and NBTPP/TPA Plans

Pension Contributions for PSSRP/PSSA and NBTPP/TPA Plans ($ millions)							
Fiscal Year	Plan	Employee Contributions	Employer Contributions[1]			Total Employee and Employer Contributions	Ratio of Employer to Employee Contributions
			Normal	Special Payments	Total Employer Contributions		
2015	PSSRP	101.2	142.1	-	***142.1***	243.3	1.40
	NBTPP	56.0	63.8	-	***63.8***	119.8	1.14
2014	PSSRP	73.1	102.1	-	***102.1***	175.3	1.40
	TPA	47.7	46.5	-	***46.5***	94.2	0.97
2013	PSSA	70.9	92.1	67.9	160.0	230.9	2.26
	TPA	47.9	46.1	98.6	144.8	192.6	3.02
2012	PSSA	71.5	89.4	64.9	154.3	225.8	2.16
	TPA	47.8	46.4	94.4	140.7	188.6	2.94
2011	PSSA	71.2	84.3	63.2	147.5	218.7	2.07
	TPA	47.3	45.1	91.9	137.0	184.3	2.90
2010	PSSA	69.6	92.8	61.0	153.7	223.3	2.21
	TPA	45.9	41.9	88.6	130.5	176.4	2.84
2009	PSSA	68.6	83.6	58.5	142.1	210.7	2.07
	TPA	42.7	39.9	85.0	124.9	167.6	2.93
Total 2009-2015	**PSSRP**	**526.1**	**686.4**	**315.5**	**1,001.9**	**1,528.0**	**1.90**
	TPP	**335.3**	**329.7**	**458.5**	**788.2**	**1,123.5**	**2.35**

[1] *PSSRP/PSSA Employer contributions include contributions from the Province, Crown Corporations and other participants.*

Exhibit 3.8 – Employee and Employer (PSSRP/PSSA & NBTPP/TPA)



3.40 We noted in Exhibit 3.7, the total employer contributions increased for both the PSSRP $40.0 million (39.2%) and the NBTPP/TPA $17.3 million (37.2%) plans in fiscal 2015 compared to fiscal 2014. Significant changes were made to the employer's contribution rates which resulted in higher employer contributions compared to the prior year. It is important to note that no special payments were made for the PSSRP/PSSA or the NBTPP/TPA in fiscal 2015 or 2014.

3.41 The $40.0 million increase in PSSRP ($17.3 million increase for NBTPP) employer contributions compared to the prior year results in part relates to an increase in employer contribution rates. Exhibit 3.9 below provides detail on the employer contribution rate changes for the PSSRP and the NBTPP.

Exhibit 3.9 – Employer Pension Contribution Rates

Pension Plan	Employer Rates	
	Prior to New Plan	After New Plan
PSSRP[1]	8.932% up to YMPE[3]	12.5%
	11.55% in excess of YMPE	
NBTPP[2]	7.3% up to YMPE plus special payments determined by an actuary	11.5% up to YMPE
	9% in excess of YMPE plus special payments determined by an actuary	13.2% in excess of YMPE

[1]PSSRP employer contribution rates changed April 1, 2014
[2]NBTPP employer contribution rates changed July 1, 2014
[3]YMPE – Yearly Maximum Pensionable Earnings

3.42 Employee contributions also increased for both the PSSRP and the NBTPP/TPA as shown in Exhibits 3.7 and 3.8. In 2015, PSSRP employee contributions increased 38.4% and NBTPP/TPA employee contributions increased 17.4%. However, the ratio of employer to employee contributions for the PSSRP remained consistent year over year at 1.40.

3.43 The ratio of employer to employee contributions for the NBTPP/TPA increased from 0.97 in 2014 to 1.14 in 2015. Despite the increase in the NBTPP/TPA ratio from the prior year, the 2015 ratio is significantly lower than the total ratio for 2009 to 2015 of 2.35.

Pension Assets Rates of Return

3.44 The net interest component of the pension expense depends primarily on the rate of return earned on pension fund assets. These returns are volatile, as illustrated in Exhibit 3.10 which reports the rates of return for the New Brunswick Investment Management Corporation’s (NBIMC) pension funds under management since it was established in 1996 and diversified away from government bonds. The NBIMC serves as trustee and investment manager for the Provincial Court Judges’ pension fund, and the investment manager for the PSSRP and NBTPP.

Exhibit 3.10 - NBIMC Rates of Return: Pension funds under management

NBIMC Rates of Return			
Year	**Percentage**	**Year**	**Percentage**
2015	14.05	2006	15.87
2014	13.56	2005	8.51
2013	9.08	2004	25.27
2012	5.00	2003	(6.95)
2011	10.42	2002	3.45
2010	19.94	2001	(5.25)
2009	(18.34)	2000	20.57
2008	0.79	1999	(0.62)
2007	8.68	1998	18.68
		1997	10.14
19 year annualized return			**7.50%**

3.45 The returns earned by the NBIMC on pension funds under management have ranged from a high of 25.27% in the year ended 31 March 2004 to a low of (18.34) % in the year ended 31 March 2009. Over the past 19 fiscal years the annualized rate of return has been 7.50% for pension funds under management.

Funding status of the Province's largest pension plans

3.46 A funding policy valuation is required annually under subsection 100.61(1) of the New Brunswick *Pension Benefits Act* ("PBA") and subsections 14(5) to 14(7) of Regulation 2012-75 for the PSSRP, the H-CUPE and H-CBE shared risk pension plans. The *Teacher's Pension Plan Act* 17(1) states *"The administrator shall ensure that a funding valuation of the plan is performed by, and an actuarial valuation report respecting the plan is prepared by, an actuary (a) before July 1, 2014, and (b) subsequently at least once every three years."* An overview of the funding status of significant provincial pension plans is found in Exhibit 3.11.

Exhibit 3.11 - Funding Status of Significant Provincial Pension Plans

Funding Status of Significant Provincial Pension Plans								
	PSSRP		NBTPP		H-CUPE		H-CBE	
	$	% funded	$	% funded	$	% funded	$	% funded
Funding Status prior to Conversions[5]	1.0 billion deficit	83.6	595.0 million deficit	87.5	199.8 million deficit	67.9	246.7 million deficit	82.2
Funding Status After Conversions[6]	18.9 million surplus	100.3	8.5 million surplus	100.2	254.5 million deficit	64.7	42 million deficit	96.4
Most Recent Actuarial Funding Valuations[6]	290.0 million surplus[1]	104.6	8.5 million surplus[2]	100.2	161.0 million deficit[3]	80.8	250.5 million surplus[4]	117.7
Indexation applied January 1, 2015	1.43%		1.43%		1.43%		1.43%	

Date of most recent actuarial funding valuation
[1]PSSRP: January 1, 2015
[2]NBTPP: January 1, 2014
[3]H-CUPE: December 31, 2014
[4]H-CBE: December 31, 2014
[5]Refer to paragraph 3.47
[6]Refer to paragraph 3.48

3.47 The calculation of the funding status prior to conversion considers a “going-concern basis” approach. This value is determined by comparing the actuarial value of the assets to the actuarial liabilities. The actuarial liabilities are based on the benefits earned up to the valuation date assuming the plans would continue indefinitely.

3.48 The funding status after conversion calculation considers a “termination” value approach. The termination value calculates that amount a member is entitled to if the member leaves the plan prior to retirement. This obligation is measured based on services accrued at the valuation date and future salary increases and future indexing of benefits are excluded from this calculation.

3.49 It is important to note the measurement process differs before and after conversion due to the nature of the valuation. Therefore, the funding policy valuation cannot be directly compared with the valuation techniques used before conversion, but it serves as a reference point to understand the financial impacts of the new pension plan structures.

Exhibit 3.12 - 15 Year Open Group Funded Ratio

15 Year Open Group Funded Ratio	
PSSRP	123.7 %
H-CUPE	122.0 %
H-CBE	145.2 %

3.50 The 15-Year Open Group Funded Ratio is presented in Exhibit 3.12. In simple terms, the 15 year open group funded ratio compares the fair market value of the pension plan's assets, plus the present value of contributions over the next 15 years, to the pension plan's liabilities.[1] This is a very important ratio as it is used extensively under the funding policy to determine the actions to be undertaken by the Trustees under the funding policy deficit recovery plan and the funding policy excess utilization plan.

Status of risk management goals

3.51 Exhibits 3.13 and 3.14 detail the achievement of certain risk management goals of the Province's largest pension plans.

[1] H-CBE Pension Plan Newsletter, Winter 2015

Exhibit 3.13- Shared Risk Management Goals under the Pension Benefits Act (PBA) and Results

Risk Management Goal	Goal under PBA	PSSRP (Results as at 1 January 2015)	H-CBE (Results as at 31 December 2014)	H-CUPE* (Results as at 31 December 2014)
Primary Risk Management Goal There is at least a 97.5% probability that base benefits will not be reduced over the 20 years following the valuation.	97.5%	98.55% Passed	99.15% Passed	99.85% Passed
Secondary Goal 1 [Regulation7(3)(a)] Expected contingent indexing of base benefits of active members for service before the conversion date shall, on average over the next 20 – year period, exceed 75% of the increase in the Consumer Price Index; Or Expected contingent indexing of base benefits of retirees and deferred vested members of service rendered before the conversion date shall, on average over the next 20- year period, exceed 75% of the escalated adjustments specified in the pension plan immediately before it was converted to a shared risk plan (i.e. Full CPI subject to a maximum increase of 5.0% or 6.0% per year depending on the date of retirement.)	75.0% of the assumed increase in CPI	85.9% of the assumed increased in CPI Passed	83.7% of the assumed increase in CPI Passed	93.9% of the assumed increase in CPI Passed
Secondary Goal 2 [Regulation7(3)(b)] The amount of ancillary benefits (other than contingent indexing) that are expected to be provided shall, on average over the next 20 – year period, exceed 75% of the value of the ancillary benefits specified in the plan text.	75% of the value of ancillary benefits will be provided	Above 97.8% Passed	At or above 99.15% Passed	At or above 99.85% Passed

**H-CUPE (with Facilicorp NB Transfer)*

Exhibit 3.14 - Risk Management Goal under TPPA and Results

Risk Management Goal	Minimum requirement under TPPA	Results for NBTPP (Results as at 1 January 2014)
Risk Management Goal **[Paragraph 11(1) of TPPA]** There is at least a 97.5% probability that the past base benefits at the end of each year will not be reduced over a 20- year period.	97.5%	98.3% Passed

Conclusion - Summary of Significant Findings

3.52 Our observations, recommendations and departmental responses to our significant findings regarding pension plans are presented in the following pages.

3.53	Unsupported change in pension accounting policy

The Office of the Comptroller (OOC)/Department of Finance retroactively changed the Province's accounting policy for the PSSRP (including the pre-conversion benefits guaranteed by the Province) from defined benefit accounting to defined contribution accounting. However, there have been no changes to this plan during this audit year nor has management provided sufficient justification to support the reasons for this change.

The OOC/Department of Finance did not accurately assess the accounting classification of the NBTPP. Given:

- the employer remains exposed to possible contribution increases that cannot be considered limited or minor;
- employees' retirement benefits are based on a defined formula;
- the employer can benefit from plan surpluses through the reversal of past contribution increases;
- the absence of a pre-conversion benefit guarantee; and
- there is persuasive evidence that this plan should have been accounted for using joint defined benefit accounting.

The OOC/Department of Finance did not accurately assess the accounting classification of the H-CBE and H-CUPE plans. The accounting for H-CUPE and H-CBE became a significant accounting concern during our March 31, 2015 audit as the Province reversed/extinguished the previously recorded contribution liability for a shortfall in employer pension contributions.

As the remaining contribution liability has now been eliminated, there is persuasive evidence that joint defined benefit accounting should now be used for the H-CUPE, and the H-CBE plans:

- the employer remains exposed (as no employer contributions liability is now recorded) to possible contribution increases that cannot be considered limited or minor;
- employees' retirement benefits are based on a defined formula;
- the employer can benefit from plan surpluses through the reversal of past contribution increases; and
- the absence of a pre-conversion benefit guarantee.

Further, the OOC/Department of Finance did not determine the impact of these accounting changes on the Province's consolidated financial statements, so it is not possible to determine what the deficit, accumulated deficit, total liabilities and net debt of the Province would have been had these pension accounting changes not occurred.

Recommendations

We recommend the OOC and Department of Finance record the PSSRP using defined benefit plan accounting and the NBTPP, H-CUPE and H-CBE be recorded using joint defined benefit accounting in accordance with Canadian public sector accounting standards.

We recommend the OOC/Department of Finance restate the Province's March 31, 2015 consolidated financial statements to present correct pension accounting for the PSSRP, NBTPP, H-CUPE and H-CBE.

We recommend the OOC/Department of Finance obtain actuarial valuations for accounting purposes for the Province's shared risk/targeted benefit plans, as well as other necessary information, so that the impact of not implementing defined benefit accounting for the PSSRP and joint defined benefit accounting for the NBTPP, H-CUPE and H-CBE can be determined.

Comments from Management

The Office of the Comptroller has determined that based on the substance of these plans, defined contribution accounting is the appropriate accounting treatment in accordance with Canadian public sector accounting standards.

The Office of the Comptroller has determined that based on the substance of these plans, defined contribution accounting is the appropriate accounting treatment in accordance with Canadian public sector accounting standards. We will continue to account for these plans using defined contribution accounting until changes in the accounting standards or pension plans prompt a review of this position.

Canadian public sector accounting standards do not require this information for defined contribution accounting. Therefore, the Office of the Comptroller does not intend to commit public resources to obtain this information.

3.54	Late accounting decisions

Subsequent to March 31, 2015 the Province informed our office of its decision to account for the PSSRP and the NBTPP using defined contribution accounting. As a result, there were delays in issuing the Province's financial statements and our audit report due to complex accounting matters that required significant time and analysis.

In the prior year, we provided the Office of the Comptroller a recommendation to engage appropriate pension accounting resources to evaluate and select accounting options for the Teacher's Pension Plan conversion and that this work should be completed no later than December 2014.

Recommendation	Comments from Management
We recommend the Office of the Comptroller/ Department of Finance complete its annual review and assessment of pension classification and make significant pension accounting decisions well in advance of year end. For the March 31, 2016 audit we recommend this work be completed no later than January 31, 2016.	*The OOC does not envision any changes in the pension accounting classification for the March 2016 audit.*

3.55	Accounting/ documentation concerns with estimates

During our audit of pension plans, we compared the assumptions proposed by the Actuarial Valuation Committee to the actuarial valuation reports prepared by the Province's external actuary.

Certain assumptions used in the actuarial valuations for accounting purposes were on the higher end of an acceptable range. These included certain discount and inflation rates. There was no supporting rationale documented to note why these values would be the best choice within the range.

Recommendation	Comments from Management
We recommend the Department of Finance ensure the Actuarial Valuation Committee prepare and maintain evidence to justify and support assumptions used for the Province's actuarial valuations for accounting purposes including documenting rationale to support choices within acceptable ranges.	*The Actuarial Valuation Committee will maintain evidence to support assumptions used by the actuaries.*

3.56	**Insufficient Audit Evidence for the NBTPP Assets at Conversion Date**

We were unable to obtain sufficient appropriate audit evidence to support the value of the NBTPP assets of $4.9 billion at conversion (July 1, 2014) and related calculated values as presented in the consolidated financial statements (plan asset actuarial gains, new items in unamortized adjustments, plan settlement of unamortized adjustments, amortization of unamortized adjustments, plan settlement expense and amortization adjustment expense). We have therefore qualified our March 31, 2015 audit opinion on the Province's financial statements for this circumstance.

It is important an audit be performed at this date to verify the asset value transferred to the new plan and confirm the accuracy of the plan settlement calculation details. It is also important that an audit be performed to ensure the asset balance transferred (and now under the oversight of the NBTPP Board of Trustees) as well as asset performance measurements for the new NBTPP plan are accurate.

The plan asset value is a significant number and the Province should have ensured the plan asset values were audited upon conversion, however, there was no request of the pension fund's auditor to conduct an audit at the conversion date.

Recommendation	Comments from Management
We recommend the Department of Finance obtain audited asset values for the NBTPP as at July 1, 2014 and also at the conversion date for any future pension plan conversions or settlements.	*Audits of the asset values for the NBTPP were performed at March 31, 2014 and December 31, 2014. Going forward, asset values will be audited annually as at December 31. Audits of the contributions to the plan and benefit payments from the plan were performed at March 31, 2014 and December 31, 2014. Going forward, these audits will be performed annually as at December 31. We will consider this recommendation with respect to any future pension plan conversions.*

3.57	Pension Plan Financial Statements

During our audit of pension plans, it was noted the trustees of the PSSRP and the NBTPP obtained audited pension fund financial statements instead of audited pension plan financial statements. Pension plan financial statements include the pension liability on the financial statements whereas pension fund financial statements do not. The inclusion of the liability on the plan's audited financial statements is important as it not only shows pension plan members and decision makers the full financial position of the plan but also provides audit verification of the pension plan liability.

In addition, if the liability is not recorded in the Province's financial statements, due to use of defined contribution accounting, our office will not continue to perform annual audit procedures on this liability balance. Considering the current financial reporting for the PSSRP and NBTPP excludes the liability, no annual audit procedures would then be performed on this significant balance.

Recommendation

We recommend the Board of Trustees of the NBTPP and the PSSRP request audited annual pension plan financial statements be obtained for the NBTPP and PSSRP plans upcoming fiscal year ends and that these plan financial statements be published in the pension plans' annual report to members.

Comments from NBTPP

The NBTPP Board of Trustees has carefully considered the issue of whether to prepare pension plan financial statements.

Of particular concern for the Board was the lack of explicit guidance as to the appropriate accounting for target benefit pension plan liabilities under the current accounting framework contained in Part IV --- Accounting Standards for Pension Plans of the Canadian Professional Accountants Handbook.

The Board of Trustees is responsible for ensuring that an actuarial valuation is prepared triennially in accordance with the PBA and the TPPA and filed with the Superintendent of Pensions. In years in which the actuarial valuation is not required, a cost certificate is required to be filed with respect to the Funding Policy. In addition, the contribution and benefit decisions that the Board is responsible for are based solely on the actuarial valuation prepared with respect to the Funding Policy.

We understand, from our discussions with our external auditor, that the appropriate accounting for target benefit plans such as the NBTPP is currently being examined by the Public Sector Accounting Board and that they expect to issue an Invitation to Comment to the public in the second quarter of 2016. We look forward to the accounting profession dealing with this lack of accounting guidance. In the meantime, the Board will be guided by our legislated reporting requirements and our duty to provide information to plan members. We have already decided to publish all audited pension fund financial statements and all actuarial valuations when available on our plan website and to highlight these valuations in our semi-annual plan newsletters.

Comments from PSSRP

The PSSRP Board of Trustees has considered your recommendation to prepare audited pension plan financial statements. Currently the audited pension fund statements and the funding obligation, as determined by the plan actuary, are provided to plan members in the annual report.

The Board of Trustees are concerned of the lack of explicit guidance as to the appropriate accounting for target benefit pension plan liabilities. We understand that the Public Sector Accounting Standards Board is currently examining the issue. We look forward to the accounting profession providing accounting guidance in this regard.

Nevertheless, the Board of Trustees have referred your recommendation to the Audit Committee for further examination and a recommendation to the Board.

3.58	Retirement Compensation Arrangement Concerns
Each year the Income Tax Act (ITA) establishes a maximum pension benefit limit (based on employment income) that can be earned under a registered pension plan. For the 2014 calendar year this employment income limit was $154,250 for the Public Service Shared Risk Plan (PSSRP). Certain employees' annual earnings in the public service exceed this amount. Pension contributions in relation to income earned above this limit cannot be retained in the PSSRP as it is a registered pension plan subject to the ITA limit. Therefore, a Retirement Compensation Arrangement (RCA) fund was created to accept employer and employee contributions in excess of the ITA limits. The RCA is part of the Province's Supplementary Retirement Fund (SERP). The RCA fund was created after December 31, 2014. Contributions that should have gone to the RCA fund during the 2014 calendar year were deposited into the PSSRP. This resulted in a receivable from the PSSRP to the RCA fund for $6.3 million at December 31, 2014 which remained at March 31, 2015. Contributions above the ITA limit should not have been deposited into the PSSRP and should have been deposited into the RCA fund. It was noted that the RCA fund's application was completed in the 2015 calendar year.	

Recommendation	Comments from Management
We recommend the Departments of Finance and Human Resources ensure the pension plans administered by the Province have filed the required documents with the Canada Revenue Agency on a timely basis and that pension contributions are deposited with the correct party.	*As a result of the complexities surrounding the establishment of a Registered Compensation Arrangement (RCA), the process took longer than originally planned. As the RCA was established earlier this year, the required contributions will be deposited with the correct party in 2015.*

3.59	Lack of Rigor in Review of Pension Calculations
During our audit, we noted a lack of documented evidence that another individual who has sufficient knowledge of the Province's pension plans performed a detailed review of these schedules and related note disclosure to ensure this information was correct. An example where further review was warranted was the NB Power pension adjustment (initially included in error with the pension restatement). This error was identified by our Office and subsequently adjusted.	

Recommendation	Comments from Management
Given the complex nature of pension accounting, we recommend the Department of Finance and the Office of the Comptroller have another person (other than the preparer) with sufficient pension knowledge perform a detailed review of the Province's pension schedules and related note disclosure to ensure this information is correct.	*It is the policy of the Office of the Comptroller that all calculations, accounting entries and note disclosures be reviewed by a person other than the preparer. This policy was followed, the review was documented and the reviewer has sufficient knowledge with respect to pension accounting.*

Appendix I – Glossary of Terms

Defined Benefit (DB) pension plan: This method requires the Province to calculate and record a liability for future payments to current and future retirees. It is a less risky structure for the employee, but more risky for the Province. It is structured to provide members with predetermined income benefits at retirement. The Province contributes towards the pension and in addition offers more security to members as the pension promise is based on benefits to be paid during retirement. The Province would step in financially if the investments dramatically crash in order to ensure that members receive their retirement income benefits.

Defined Contribution (DC) pension plan: This method results in the Province not calculating or recording a liability for future payments to current or future retirees. The Province only records its yearly contributions to the plans. It is more risky for the employee, with no risk for the Province. It is structured to provide members with retirement income, but is only meant "to help individuals accumulate retirement savings during their active career"[2]. This means the Province still contributes towards the pension, but does not guarantee a return nor does it guarantee income benefits to be paid at retirement.

Joint Defined Benefit (JDB) pension plan: A joint defined benefit plan is one in which the Province does not have full control over the retirement benefit plan. Control is shared between the Province and another plan sponsor. Sharing of control does not necessarily mean that all parties have the same level of control; one party may have more control than another. In such an arrangement there is an equitable relationship between the funding by the parties, the extent of control each party is able to exercise over the plan and the risks and benefits that accrue to the parties from the plan.[3]

[2] https://hoopp.com/Left-Rail-Page.aspx?pageid=189&LangType=1033

[3] 2006 Report of the Auditor General of New Brunswick, Volume I, Chapter 2, paragraph 2.116

Appendix II – CLEAN AUDIT OPINIONS ARE IMPORTANT

Auditor General's comments regarding audit opinion on 31 March 2015 financial statement of the Province of New Brunswick

October 1, 2015

Under section 11 of the Auditor General Act, I am legislated to audit the financial statements of the Province of New Brunswick (the "Province") and to express my opinion as to the fair presentation of the financial statements.

Professional audit standards establish when it is appropriate for me to express an "unqualified opinion" also referred to as a clean opinion. Alternatively, professional standards establish when a "qualified opinion" or in other words, a reservation is warranted for inclusion in the opinion. In the auditing profession, a qualified audit opinion is a rare occurrence in the public sector. It indicates to the users of the financial statements that some of the information is misleading or not auditable.

After many meetings and discussions with the Department of Finance and the Office of the Comptroller, on 29 September 2015 I signed the audit opinion on the Province's 31 March 2015 financial statements. On this date, I issued a reservation or a "qualified audit opinion" on the financial statements in regards to the Province's accounting for Shared Risk Pension Plans.

This is first qualified audit opinion on the Province's financial statements in 17 years.

This document has been prepared to clearly explain the significance of issuing a qualified audit opinion. Further details will be contained in my next annual report to the Legislative Assembly, expected to be tabled in December 2015.

Kim MacPherson

Kim MacPherson, CPA CA
Auditor General of New Brunswick

Appendix II – CLEAN AUDIT OPINIONS ARE IMPORTANT *(continued)*

1. What is a qualified audit opinion?
2. Why should taxpayers be concerned?
3. In general terms, what's the problem?
4. In more technical terms, what is the problem?
5. Has there been a qualified audit for the Province of New Brunswick before?

1. What is a qualified audit opinion?

A qualified audit opinion is a rare occurrence in the public sector. It indicates to the readers of the financial statements some of the information presented is either misleading or not auditable. When auditors issue a qualified opinion, they are communicating they have a major concern with:

- The availability of sufficient and appropriate evidence; or
- The entity's compliance with accounting standards (GAAP).

An auditor may issue a qualified audit opinion when parts (but not all) of the financial statements are inaccurate or lack support.

2. Why should taxpayers be concerned?

This is more than a disagreement among accountants. When the Auditor General, who is independent from government, disagrees with the Department of Finance and those responsible for preparing the financial statements, it brings into question the credibility of the numbers. In this case, the Province's financial statements do not properly account for the four Shared Risk Pension Plans. These four plans contain more than $14 billion in pension plan assets at 31 March 2015. The financial statements do not reflect the risk inherent in the design of a Shared Risk Pension Plan.

In the Auditor General's opinion, this means that readers of the financial statements, such as the public, elected officials and credit rating agencies, cannot fully assess the fiscal situation using the Province's financial statements for the year end of 31 March 2015.

The deficit reflected of $388.6 million would be different had the four plans been accounted for properly, however this difference cannot be determined as sufficient information was not provided by the Province.

Furthermore, when the Auditor General qualifies an audit report for accounting standards compliance, she must continue to qualify it each and every year after until changes are reflected that satisfy the Auditor General.

3. In general terms, what's the problem?

Last fiscal year, the **Defined Benefit (DB) pension plan accounting** was the accounting method used to account for the Public Service Shared Risk Pension Plan (PSSRP). This was agreed on by the Province, Auditor General and external experts.

Appendix II – CLEAN AUDIT OPINIONS ARE IMPORTANT *(continued)*

This year, nothing changed in the pension plans, but the Province changed its accounting to ***Defined Contribution (DC) pension plan accounting.*** This change, however, was not supported by external experts or the Auditor General and the Province did not provide sufficient support to justify the change.

The result of changing from **Defined Benefit (DB) accounting** to ***Defined Contribution (DC) accounting*** means the Province no longer records future pension payments as a liability in the books. For PSSRP, it erases over $4.7 billion in pension assets, which are typically offset by $5.1 billion in liability relating to future pension payments.

4. In more technical terms, what is the problem?

Essentially, the issue relates to the difference between a ***Defined Benefit (DB) pension plan*** and a ***Defined Contribution (DC) pension plan*.** Public Sector Accounting Standard on pensions (PS 3250 **-** Retirement Benefits) does not fully address unique arrangements such as shared risk pension plans. PS 3250 also states that "because benefit plans are often complex, careful analysis and professional judgment are needed to determine whether the substance of particular plan makes it a defined benefit or a defined contribution plan."

As of March 31, 2015, four of the Province’s pension plans have been converted to a joint trusteeship form of pension plan.

Converted Plan Name	Conversion Date
Public Service Shared Risk Pension Plan (the “PSSRP”)	**January 1, 2014**
New Brunswick Teacher’s Pension Plan (the “NBTPP”)	**July 1, 2014**
Shared Risk Pension Plan for CUPE Employees of New Brunswick Hospitals (the “H-CUPE”)	**July 1, 2012**
Shared Risk Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals (the “H-CBE”)	**July 1, 2012**

The Province has accounted for the four plans using defined contribution accounting.

In the March 31, 2014 consolidated financial statements, the PSSRP, was correctly accounted for using defined benefit accounting. There have been no changes to this plan during this audit year nor has management provided sufficient justification to support a change to defined contribution accounting. Therefore, defined benefit accounting should have continued at March 31, 2015.

For the NBTPP, the H-CUPE, and the H-CBE, given the absence of pre-conversion benefits guarantees, as in the PSSRP, these three plans should have used joint defined benefit accounting.

In addition, joint defined benefit accounting should be used for the H-CUPE, and the H-CBE because the past contribution liability of $66.9 million established upon conversion of these plans (for a past shortfall in employer contributions) has now been extinguished.

5. Has there been a qualified audit for the Province of New Brunswick before?

Yes, a qualified audit opinion has been issued for the Province before, but it is a rare occurrence. The last time an Auditor General of New Brunswick had a reservation on the Province's audited financial statements was 17 years ago in 1998. In that year, there were two concerns regarding:

- The carrying value of the investment in New Brunswick Power Corporation, and
- The method of recognizing revenue received from Canada relating to the implementation of the Harmonized Sales Tax (HST).