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

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Province of New Brunswick Audit: Observations on Pension Plans

Introduction

3.1 As the accounting for pensions is material to the Province's consolidated financial statements and involves complex accounting issues, we have presented our observations on these topics in a separate chapter of our Report.

Pension Plans - Impacts on the Province

3.2 In prior years market fluctuations and other pension related issues have exposed the Province to volatility in its financial results in the Province's financial statements. For the year ended 31 March 2014 pension expense of $365.4 million was recorded. In addition, complex accounting issues for Shared Risk Pension Plans have been encountered in the past two years. The following paragraphs illustrate these trends, as well as discuss other impacts on the Province associated with the plans.

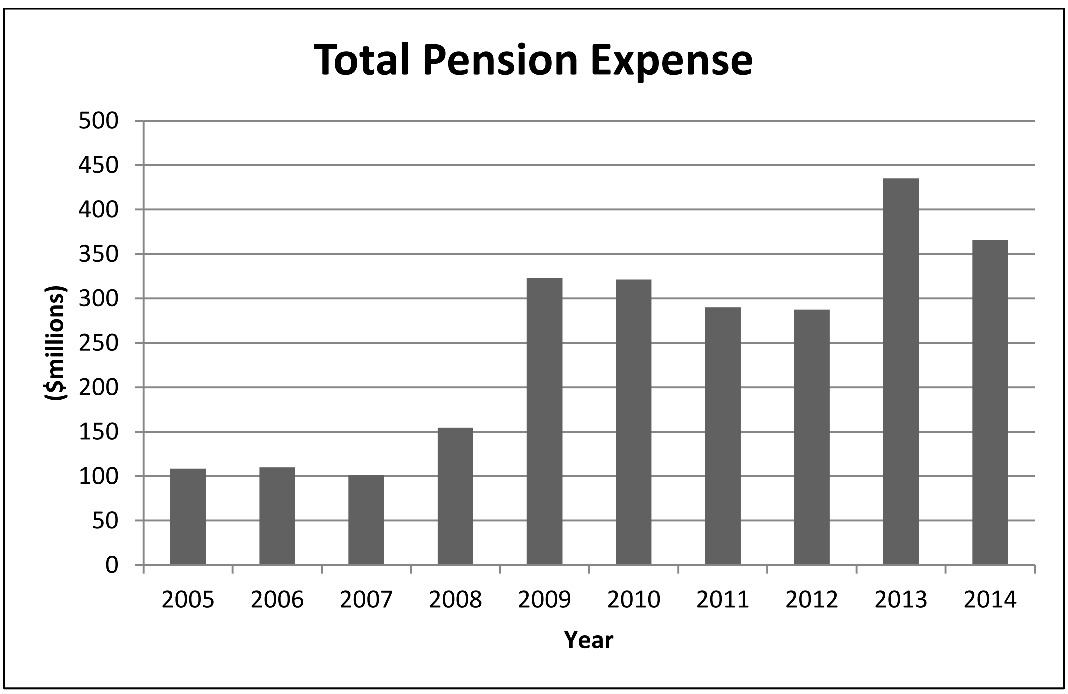
Pension expense growth and volatility

3.3 Exhibit 3.1 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 3.1 - Components of Pension Expense

Components of Pension Expense ($ millions)										
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Employer's share of pension benefits earned	124.1	117.0	126.1	133.8	146.1	131.6	137.4	148.9	177.4	196.0
Net interest expense (revenue)	17.6	30.9	0.4	(9.1)	20.6	118.2	52.9	32.0	62.7	70.4
Plan amendments	-	-	5.9	-	-	-	-	-	-	(11.2)
Amortization of adjustments	(31.8)	(40.3)	(31.2)	30.3	159.7	87.1	99.7	106.5	194.9	132.1
Change in valuation adjustment	(1.5)	2.3	(0.1)	(0.5)	(3.3)	(15.5)	-	-	-	-
NB Power adjustment on shared risk plan conversion	-	-	-	-	-	-	-	-	-	(21.9)
Total pension expense	**108.4**	**109.9**	**101.1**	**154.5**	**323.1**	**321.4**	**290.0**	**287.4**	**435.0**	**365.4**

Exhibit 3.2 - Total Pension Expense



3.4 Exhibits 3.1 and 3.2 highlight the significant increase in the annual pension expense over the ten year period as well as the volatility of the expense. In the year ended 31 March 2005, the pension expense was $108.4 million. By way of contrast, in the year ended 31 March 2014, the pension expense was $365.4 million, an increase of $257.0 million when compared to 2005. The pension expense decreased in 2014 compared to 2013 in part due to a decrease in expense of $56.4 million for the early retirement benefit plan upon comparison with the prior year, as the prior year figures contained a higher expense to account for mortality and discount rate changes. This is offset by a one-time adjustment of $21.9 million to recognize the net pension asset of the New Brunswick Power Corporation at conversion to the Public Service Shared Risk Plan.

3.5 Exhibit 3.3 compares the annual pension expense to the amount of contributions made by the Province to the various pension plans.

Exhibit 3.3 - Pension Expense and Contributions

Pension Expense and Contributions ($ millions)										
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Pension expense	108.4	109.9	101.1	154.5	323.1	321.4	290.0	287.4	435.0	365.4
Employer contributions	223.2	236.4	257.7	272.8	288.6	307.8	313.3	327.0	350.8	216.5
Excess (deficiency) of employer contributions over pension expense	114.8	126.5	156.6	118.3	(34.5)	(13.6)	23.3	39.6	(84.2)	(148.9)

3.6 Exhibit 3.3 shows that for four of the past ten years, the Province's contributions to its various pension plans have been less than the annual pension expense, whereas for six 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 $297.9 million more than the pension expense.

3.7 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 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.

Pension contributions for the Province's largest plans

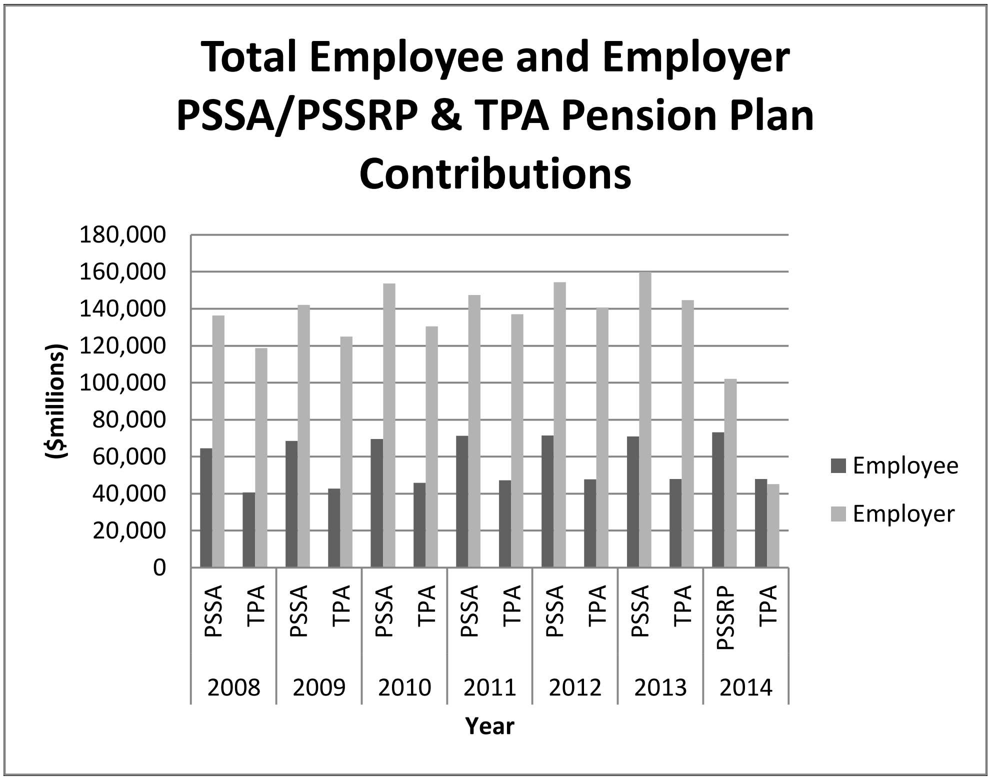
3.8 Further details on pension contributions from 2008 to 2014 for the Province's two largest plans, the Public Service Superannuation Plan (PSSA), now the Public Service Shared Risk Plan (PSSRP) and the Teachers' Pension Plan (TPA) are found in Exhibits 3.4 and 3.5.

Exhibit 3.4 - Pension Contributions for PSSRP/PSSA and TPA Plans

Pension Contributions for PSSRP/PSSA and TPA Plans ($ millions)							
		Employee Contributions	Employer Contributions[1]			Total Employee and Employer Contributions	Ratio of Employer to Employee Contributions
			Normal	Special Payments	Total Employer Contributions		
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
2008	**PSSA**	64.6	80.0	56.4	136.4	201.0	2.11
	TPA	40.6	36.7	81.9	118.6	159.2	2.92
Total 2008-2014	**PSSA**	**489.5**	**624.3**	**371.9**	**996.1**	**1,485.7**	**2.03**
	TPA	**319.9**	**302.6**	**540.4**	**843.0**	**1,162.9**	**2.64**

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

Exhibit 3.5 - Total Employee and Employer (PSSA/PSSRP & TPA) Pension Plan Contributions



The 2014 elimination of special payments to pension plans resulted in an estimated annual cash flow savings of over $150.0 million

3.9 We note that total employer contributions decreased significantly for both the PSSA/PSSRP and TPA plans in fiscal 2014. Employer's contributions for the TPA plan decreased $98.3 million (68% decrease) and employer contributions to the PSSA/PSSRP decreased by $57.9 million (36% decrease). This is a significant change and noteworthy since, in the PSSA/PSSRP's case, this was due to the adoption of a shared risk pension structure while in the case of the TPA plan, no agreement on shared risk had been reached at the time however the Province decided to cease making special payments to the plan. It was determined by the Department of Finance there was no legal requirement to continue these special payments. In both cases, the decision by the Province to stop making special payments to these pension plans was significant. The total cash flow savings to the Province of eliminating special payments to pension plans in fiscal 2014 using an average of the prior six years as a comparison basis was $152.1 million. These savings will compound over time (estimated as billions of dollars of cash flow savings).

3.10 As shown in Exhibit 3.4, TPA employee contributions remained relatively unchanged since last year decreasing less than 1%. PSSRP employee contributions increased by 3% year over year mostly due to an increase in purchase of service contributions of $2.8 million. This resulted in the ratio of employer to employee contributions falling significantly from 3.02 in 2013 to 0.97 in 2014 for the TPA plan and the PSSRP plan ratio falling from 2.26 to 1.40.

Funding status of the TPA plan

3.11 The most recent (April 1, 2012) TPA plan actuarial valuation for funding purposes showed an unfunded liability of approximately $595 million or 87.5% funded (2011 = $458 million or 89.8% funded).

At April 1, 2012 the PSSA plan showed an unfunded liability of $1.022 billion or 83.6%

3.12 Specific to the PSSA plan, the April 1, 2012 actuarial valuation for funding purposes showed an unfunded liability of approximately $1.022 billion or 83.6% funded (2011 = $507 million or 90.9% funded).

At January 1, 2014 upon conversion to PSSRP the plan was fully funded at 100.3%

3.13 Upon conversion to the PSSRP plan structure on January 1, 2014 the unfunded liability (for purposes of calculating the funding policy valuation funded status) decreased from the April 1, 2012 value by $1.041 billion as a result of the conversion to the PSSRP structure. The new funding policy valuation as at January, 1, 2014 showed a valuation excess (surplus) of $18.9 million. The funding policy valuation as of January 1, 2014 showed the plan was 100.3% funded.

3.14 This change in funded status compared to April 1, 2012 figures was achieved through significant plan assumption changes for purposes of the funding policy valuation such as:

- removal of automatic indexing and no anticipation of salary increases for purposes of the PSSRP funding policy valuation;
- change in the retirement age assumption due to a change in the retirement age reduction factor. This results in more years with employees working and contributing to the plan and less years receiving pension benefits. Under PSSA plan structure there was no reduction factor to retire upon or after age 60 and if employees

retire earlier than age 60 a 3% reduction factor per year applied. Under the new PSSRP plan structure there is no reduction factor for employees to retire upon or after age 65 and if employees retire earlier than age 65, a 5% reduction factor per year will be applied (for post January 1, 2014 service);

- discount rate change from 6.6% as of April 1, 2012 to 4.75% January 1, 2014 to reflect expected changes in the pension asset mix in order to reduce possible risk exposure and volatility on asset values. As a result, pension asset investment returns are expected to be more stable/lower and derive from a more conservative asset portfolio.

3.15 It should be noted that the funding policy valuation under the PSSRP considers a "termination" value approach. The termination value calculates the amount a member is entitled to if they leave the plan prior to retirement. This obligation is measured based on services accrued at the valuation date and accordingly future salary increases and future indexing of benefits are excluded from this calculation. It is important to note the measurement process differs due to the nature of the valuation. Therefore the PSSRP funding policy valuation cannot be directly compared with the PSSA valuation techniques used in past, but it serves as a reference point to understand the financial impacts of the new PSSRP structure.

At January 1, 2014 the PSSRP 15 year open group funded ratio was 121.5%

3.16 It is also of note that in the PSSRP plan environment there is an important new measurement of the plan's financial performance. The 15 year open group funded ratio is used extensively in the PSSRP funding policy to determine the actions to be taken by the Trustees for future indexing decisions and future changes to contributions or benefits. It is calculated using an asset value that includes the present value of the next 15 years of any excess contributions above the normal cost of the base benefit. As at January 1, 2014 the PSSRP's 15 year open group funded ratio was 121.5%.

3.17 Other shared risk plans' open group funded ratios we found publicly available were the City of Saint John at 114.3% as of January 1, 2014 and the CUPE Employees of N.B. Hospitals, Local 1252 at 114.0% as of July 1, 2012. As the open group funded ratio is part of the required reporting to plan members in a shared risk environment in New Brunswick, we were surprised to note during our audit of the Province that the conversion plan and initial actuarial valuation report (which initially reports the open group funded ratio) was not yet available for the Shared Risk Plan for Certain Bargaining Employees of New Brunswick Hospitals. These documents were later filed with the Superintendent of Pensions on December 31, 2014.

Impact on the Province's employees of recent PSSA plan changes

3.18 As per the Province’s March 31, 2014 consolidated financial statements there are 19,419 active contributors and 14,672 pensioners of the PSSRP/PSSA plan. Details of how PSSA plan changes impact the Province's employees are illustrated in Exhibits 3.6 and 3.7.

3.19 We considered three particular employee scenarios for employees at the beginning of their career, middle of their career and near retirement to illustrate the impacts of the pension plan changes. Exhibit 3.6 shows the results of our analysis. Exhibit 3.7 graphs the information for one of the scenarios in Exhibit 3.6.

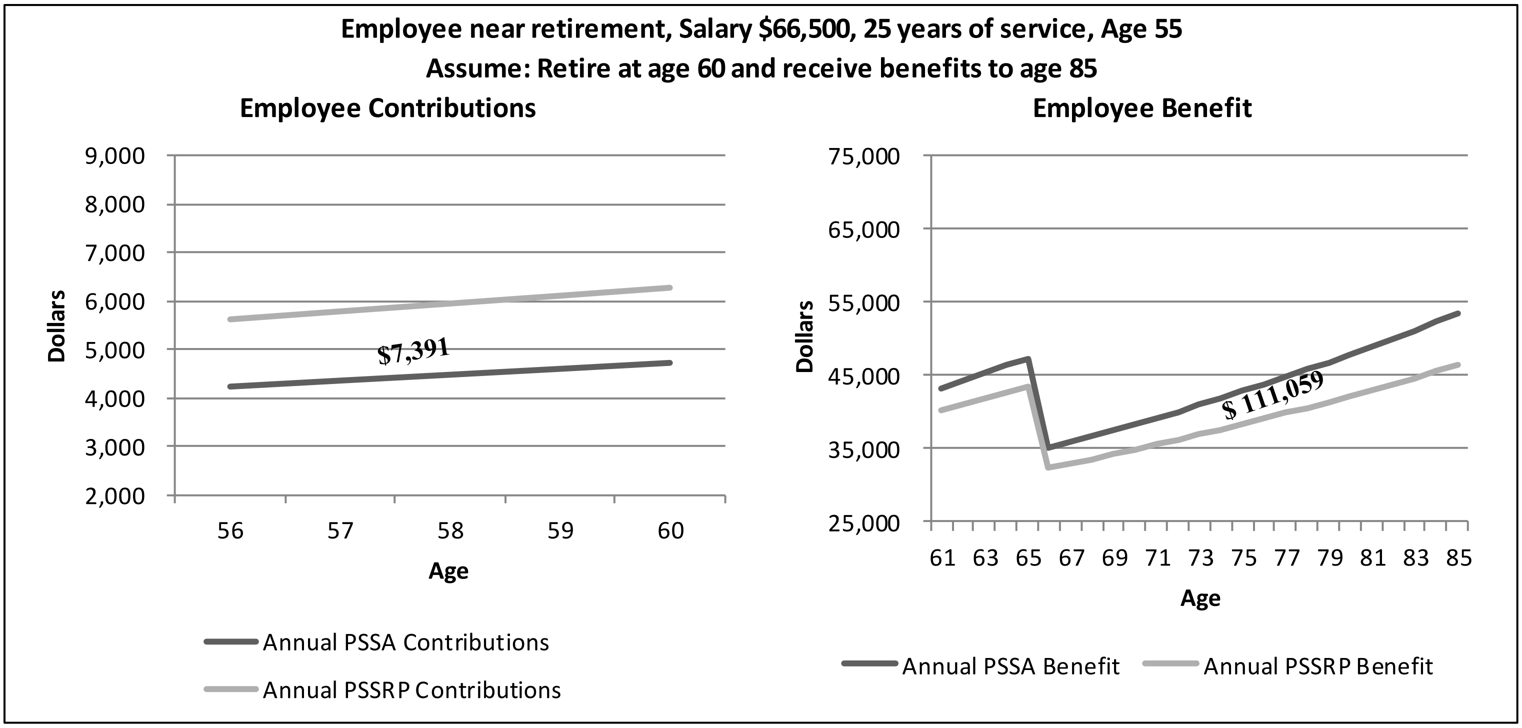
Exhibit 3.6 - Estimate of employee impact of PSSA/PSSRP plan changes

	Years of Service	PSSA (Previous Plan)		PSSRP (New Plan)		Decrease in total benefit accumulated if benefit paid to age 85	Increased contributions required during working life	Total employee impact of pension plan changes if benefit paid to age 85	Present Value of total employee impact to age 85
		Pension Benefit	Bridge Benefit	Pension Benefit	Bridge Benefit				
Employee near retirement salary $66,500, 25 years of service at start of new plan, 55 years old									
Employee Contributions in 2014		4,232		5,631					
Estimated Annual Benefit at Retirement at age 55 (2014)	25	19,377	7,413	19,377	7,413	**42,628**	**-**	**42,628**	**13,165**
Estimated Annual Benefit at Retirement at age 60 (2019)	30	31,352	11,963	29,394	10,886	**111,059**	**7,391**	**118,449**	**43,508**
Estimated Annual Benefit at Retirement at age 65 (2024)	35	41,891	-	40,515	-	**67,040**	**15,855**	**82,895**	**29,674**
Experienced employee salary $66,500, 15 years of service at start of new plan, 45 years old									
Employee Contributions in 2014		4,232		5,631					
Estimated Annual Benefit at Retirement at age 55 (2024)	25	25,434	9,705	20,533	7,318	**278,304**	**15,855**	**294,159**	**75,849**
Estimated Annual Benefit at Retirement at age 60 (2029)	30	41,123	15,691	34,541	11,857	**285,499**	**25,549**	**311,048**	**71,095**
Estimated Annual Benefit at Retirement at age 65 (2034)	35	54,947	-	56,642	-	**99,983**	**36,651**	**136,634**	**34,651**
New employee salary $40,000, 2 years of service at start of new plan, 32 years old									
Employee Contributions in 2014		2,384		3,083					
Estimated Annual Benefit at Retirement at age 55 (2037)	25	19,548	10,526	12,377	5,455	**386,091**	**22,010**	**408,101**	**53,386**
Estimated Annual Benefit at Retirement at age 60 (2042)	30	31,606	17,019	24,346	10,629	**307,271**	**28,899**	**336,170**	**40,095**
Estimated Annual Benefit at Retirement at age 65 (2047)	35	42,231	-	41,794	-	**44,671**	**36,788**	**81,459**	**16,332**

**See paragraph 3.20 and 3.21 for assumptions used in these calculations*

**See paragraph 3.21 for an explanation of bridge benefits*

Exhibit 3.7 - Estimate of employee impact of PSSA/PSSRP plan changes



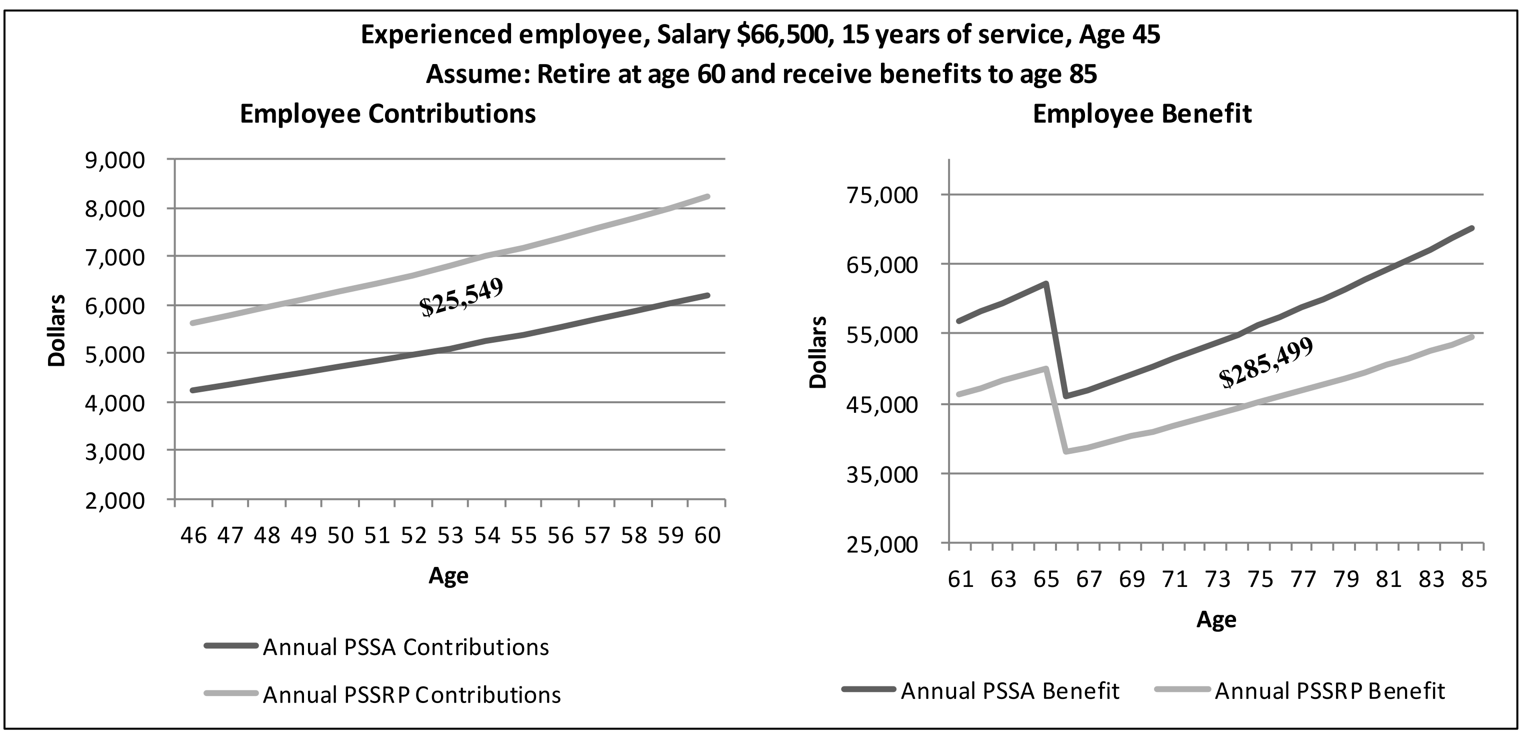


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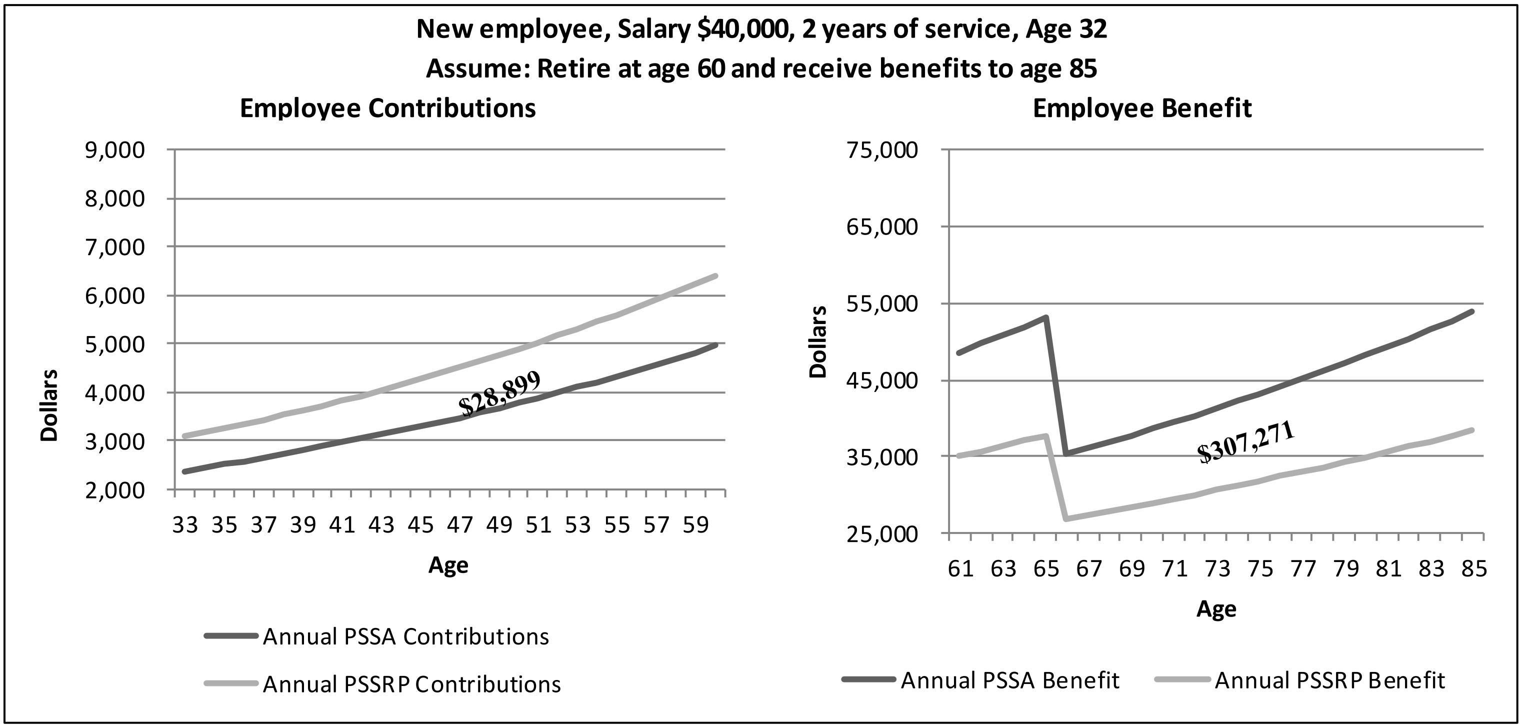
Exhibit 3.7 - Estimate of employee impact of PSSA/PSSRP plan changes (continued)



**See paragraph 3.20 and 3.21 for assumptions used in these calculations*

Significant assumptions

3.20 The following assumptions are used in calculating employee pension contribution amounts and pension benefits presented in Exhibits 3.6 and 3.7. These assumptions are used by the plan's actuary and include:

- From the funding valuation, annual salaries and yearly maximum pensionable earnings both are increased annually at rates of 2.75% until the age of retirement.
- From the funding valuation, inflation increases at an annual rate of 2.25% starting in 2014. Inflation under the PSSRP is calculated at 85.3% of inflation resulting in an effective inflation rate of 1.92%
- From the accounting valuation, a discount rate of 6.35% representing management's best estimate of future returns was used to calculate present values.

3.21 To provide consistency across employee scenarios in Exhibits 3.6 and 3.7, additional assumptions were made as follows:

- An annual salary of $40,000 is representative for a new employee.
- Annual salaries of $66,500 for the experienced employees are consistent with the average salary for active members of $65,523 as at April 1, 2013 which is used in the recent actuarial funding valuation.
- There is no interruption of employee service between January 1, 2014 and the retirement date.
- Employees live until the age of 85.
- Benefit amounts up to age 85 do not include any adjustments for amounts received by beneficiaries.
- The PSSRP calls for equal employee and employer contributions after 15 years. We have not made any adjustments to employee contribution rates as these rates are unknown at this time.
- We have assumed there to be no changes in benefits or contributions. However, as per the funding policy the PSSRP provides for potential reductions and increases in base benefits as well as temporary increases and decreases in employee contributions.
- Under both PSSA and PSSRP, if an employee is eligible for early retirement, a bridge benefit is paid in addition to their lifetime pension. The bridge benefit ceases to be paid when the employee reaches age 65 and is eligible for Canada Pension Plan benefits, or at their death, whichever is earlier. These bridge benefits have been shown separately in amounts presented in Exhibit 3.6 for information and included in employee impact totals.

3.22 In addition it should be noted the information in Exhibits 3.6 and 3.7 is difficult to calculate with exact accuracy. The PSSRP actuary produces 2000 economic scenarios in his testing for each of the next 20 years, based on a number of assumptions that may or may not occur; however, only one scenario of those 2000 tested will occur. It should also be noted current economic modelling only exists over the next 20 years, and in some cases estimates were necessary to extend beyond 20 years for purposes of calculating information for Exhibits 3.6 and 3.7. While certain complex assumptions are required in order to calculate this information, and assumptions may change as actual results are known, we believe there is value to presenting the estimates in Exhibits 3.6. and 3.7.

PSSRP pension plan changes have significant impacts on public servants

3.23 From review of the information in Exhibits 3.6 and 3.7, it is clear as a result of the plan changes, employees will pay more in contributions; receive lower benefits, work longer or a combination of all three of these outcomes. The amount of benefits expected to be earned at January 1, 2014 in the PSSA plan compared to the PSSRP plan in our example in Exhibit 3.6 for the relatively new employee retiring at 55 is a lifetime reduction in expected pension benefits of approximately $300,000 on a non-discounted basis.

3.24 In particular the pension plan changes are impacting the new and middle career employees the most, with employees near retirement being less affected by plan changes. The implementation of these plan changes allows those with the longest time to plan for retirement to react to their changed circumstances for retirement planning purposes.

3.25 Key factors decreasing employee future benefits under the new PSSRP include:

- a change from a best five year salary plan to an enhanced career average salary plan;
- a change from no retirement reduction factor at 60 to no retirement reduction factor now at 65; and
- an increase in the reduction factor calculation from 3% to 5%.

3.26 Also impacting employees is an increase in the contribution rates from 5.8% of earnings up to the Yearly Maximum Pensionable Earnings (YMPE) and 7.5% of earnings that exceed the YMPE, to 7.5% of earnings up to the YMPE and 10.7% of earnings that exceed the YMPE.

3.27 We noted that for employees with significant years of service the impact of the pension plan changes was reduced as the Province provided a guarantee that benefits earned prior to January 1, 2014 will never be reduced.

3.28 Information in Exhibit 3.6 has been presented on a discounted and non-discounted basis. Information presented on a discounted basis is shown as of January 1, 2014 using the 6.35% discount rate as per the January 1, 2014 accounting valuation. Given that information reported on annual employee pension benefits statements is presented on a non-discounted basis, we have also reported the non-discounted values, in Exhibit 3.6 as this would best reflect employee expectations of accrued pension benefits.

Pension Assets Rates of Return

3.29 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 3.8 which reports the rates of return for the New Brunswick Investment Management Corporation (NBIMC) since it was established in 1996 and diversified away from government bonds. The NBIMC manages the trust funds for the Province's larger pension plans including the PSSA (now PSSRP) plan, the TPA plan and the Provincial Court Judges' pension (Judges') plans.

Exhibit 3.8 - NBIMC Rates of Return

NBIMC Rates of Return			
Year	**Percentage**	**Year**	**Percentage**
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	(5.23)
2009	(18.34)	2000	20.57
2008	0.79	1999	(0.62)
2007	8.68	1998	18.68
2006	15.87	1997	10.14
18 year annualized return			**7.15**

3.30 The returns earned by the NBIMC 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 18 fiscal years the annualized rate of return of the NBIMC has been 7.15%, which is above the 4.75% required for the PSSRP plan and above the 6.60% rate of return for the TPA plan currently required for funding purposes by the Province's independent actuary.

3.31 The rate of return for accounting purposes assumed by the Province on the significant plans in the 2013-14 consolidated financial statements was 6.35% and 6.50%. The accounting required for the Province's pension plans remains subject to estimates and the consolidated financial statements continue to remain exposed to volatility from many factors, including investment returns. Although NBIMC's rates of return have been volatile as shown in Exhibit 3.8, there has been reduced volatility experienced in the last four years.

Pension Accounting

3.32 Exhibit 3.9 provides the history of the Province's pension balance for accounting purposes and the important components involved in the calculation over the past ten years.

Exhibit 3.9 - Components of the Pension Balance for Accounting Purposes

Components of the Pension Balance for Accounting Purposes ($ millions)										
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Estimated accrued benefit obligations	6,719.6	7,324.5	7,865.5	8,289.3	8,642.5	8,570.2	8,895.7	9,318.3	10,146.6	12,343.8
Value of plan assets	6,521.7	7,449.3	8,030.5	8,024.1	6,512.4	7,703.1	8,387.0	8,674.7	9,293.9	11,529.7
Pension position before accounting adjustments	197.9	(124.8)	(165.0)	265.2	2,130.1	867.1	508.7	643.6	852.7	814.1
Accounting adjustments	(41.2)	155.0	38.6	(509.9)	(2,340.3)	(1,063.7)	(728.6)	(903.1)	(1,002.2)	(814.7)
Pension balance for accounting purposes	156.7	30.2	(126.4)	(244.7)	(210.2)	(196.6)	(219.9)	(259.5)	(149.5)	(.6)

3.33 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. Exhibit 3.9 provides the details of these components of the pension balance.

3.34 Exhibit 3.9 shows that the Province's pension position before accounting adjustments improved in the year ended 31 March 2014 from $852.7 million to $814.1 million in 2014. The value of the estimated pension obligations before accounting adjustments exceeded the value of plan assets for the past eight years.

Accounting deferrals and adjustments are permitted under Public Sector Accounting Standards

3.35 The accounting adjustment row in Exhibit 3.9 is a critical part of pension accounting because it assumes a long term view, that the pension plan will be in existence over the long term and there will be volatility from year to year. Therefore, accounting standards permit for the smoothing of this volatility. Such adjustments for accounting purposes are allowed to be deferred and amortized into operating results in future years. Because the accounting adjustments are due to experience deferrals, the pension balance is in a negative liability position (presented in the Province's consolidated financial statements as a net pension liability) of $0.6 million at 31 March 2014.

3.36 As at 31 March 2014 the balance of accumulated experience adjustments (losses) for accounting purposes that were deferred and required to be amortized in future years totalled $814.7 million. Such deferral balances from experience adjustments are common in public sector pension accounting. While the cause of the experience adjustments results primarily from deviations to the assumed rate of return, it is a general indication that assumptions used in pension calculations did not match actual events. This accounting adjustment balance is also an indicator of the magnitude of the amount that must be recognized as an expense over future years.

Accounting for the Province's Shared Risk Pension Plans

3.37 As stated earlier in this chapter, during fiscal 2013-2014 New Brunswick's largest provincial pension plan converted to a Shared Risk Pension Plan model. This section will discuss the accounting considerations regarding this significant change. As background, we note that during fiscal 2012-2013 two pension plans converted to the new Shared Risk Pension Plan model: the pension plan for CUPE Employees of New Brunswick Hospitals (H-CUPE) and the pension plan for Certain Bargaining Employees of New Brunswick Hospitals (H-CBE). More information about the conversion of these specific plans can be found in our 2013 Report.

3.38 As part of the PSSA conversion process in fiscal 2013-2014 a number of changes were made to the previous PSSA pension plan including increasing the retirement age, introducing stronger reductions for early retirement, removing guaranteed indexing (now capped at 5%), introducing conditional indexing and establishing contributions at a higher level all to create a high probability that plan goals (sustainable, affordable, secure and transparent pensions) will be met. However, one of the key differences in this plan conversion compared to the prior year conversion of plans was that the Province had guaranteed that the benefits earned to the conversion date (January 1, 2014) by plan members would never be decreased.

Accounting for the Province's Shared Risk Pension Plans

3.39 The conversion to the Shared Risk Pension Plan model was a complex process for accounting purposes as the Public Sector Accounting Standard on pensions (*PS 3250 - Retirement Benefits*) does not fully address unique arrangements such as shared risk pension plans. PS 3250 does indicate that in some circumstances a benefit plan may include defined benefit and defined contribution elements, and 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."

Persuasive arguments for multiple accounting options

3.40 After reviewing the details of the shared risk pension plan arrangements and reviewing the accounting standards, we determined persuasive arguments could be made for both defined benefit and joint defined benefit accounting treatment based on the present accounting standards. It is important to note that this accounting classification is significant, as a joint defined benefit plan accounting treatment generally involves recording the employer share of the obligation and cost on the financial statements, whereas a defined benefit plan generally involves recording the entire plan obligation and cost in the financial statements. The PSSRP plan had been reported in the Province's past consolidated financial statements as a defined benefit pension plan prior to its conversion to a PSSRP structure.

3.41 Our assessment involved a complex evaluation of the plans' legislation and plan provisions. We caution that 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. Each pension plan must be assessed on its own merits. A high degree of professional judgment was exercised in the accounting model determination.

3.42 A significant question in the accounting analysis pertained to which party bears the risk in the pension arrangement: the employer or employee. A number of factors were considered in analyzing this question such as:

- level of variability in employer contribution;
- 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.

Province advocates defined benefit pension plan accounting

3.43 After considering all of these factors the Province's position was that the PSSRP plan should be accounted for as a defined benefit plan.

3.44 Highlighted in our audit work pertaining to this accounting decision were the following factors:

- the guarantee issued to members by the Province that there would be no reduction in benefits earned prior to January 1, 2014;
- the level of potential variability in employer contributions; and
- potentially large dollar impacts (and increased risk exposure) to the Province given the large size of this plan.

3.45 While factors existed to possibly consider a defined contribution accounting classification, they were not sufficiently persuasive. We agree with the overall plan classification as a defined benefit plan

Economic substance of the plans pre and post conversion

3.46 However, in our review of the plan details and structure it appeared as though a different defined benefit plan classification may be appropriate if the PSSRP was considered on a pre and post conversion basis. On a pre-conversion basis, the benefits earned are guaranteed by the Province and this leads more clearly to a defined benefit accounting conclusion. On a post-conversion basis the economic substance of the plan has changed somewhat as the benefits are not guaranteed post-conversion. Therefore, on a conceptual level, there is an argument for considering there are two plans, each deserving of their own consideration and classification.

Joint defined benefit plan possibility for post-conversion service

3.47 It is possible that upon further review it may be determined that the PSSRP has more similarities to a joint defined benefit plan as the plan matures. In a joint defined benefit plan the risks are shared between the government and the plan participants on an equitable (but not necessarily even or identical) basis and the funding contributions are shared mutually between the government and the plan members. In future, as more non-guaranteed post-conversion service is rendered the government will likely retain less residual risks and the risks will become more evenly shared post conversion. Joint defined benefit accounting may then be a more appropriate basis to record the post-conversion services, costs and obligations.

3.48 Under joint defined benefit plan accounting the Province would only record the portion of the liability, cost etc. that relates to the portion of the costs and risks the employer (the Province) assumes (possibly 50% or some other appropriate percentage). This would likely, over time, cause a significantly different result in the Province's audited financial statements as more of this post-conversion service accumulates in large amounts.

3.49 We believe this matter should be studied further. In the near future the majority of the plan liability is derived from pre-conversion service. There is little post-conversion liability until more significant employee service time has elapsed under the post-conversion plan. However, as time passes the amount of post-conversion service will grow, and if the plan classification were to change to joint defined benefit, a significant adjustment may result for accounting purposes.

Defined benefit accounting accepted for PSSRP

3.50 However, for the year ended 31 March 2014, the Province's view is that the appropriate classification of the PSSRP, given the guarantee arrangement and other factors, is as a defined benefit plan. We agreed with this conclusion at this time given the limited amount of post-conversion service, but recommended this decision be reviewed to investigate this accounting alternative in future.

Future accounting standards changes may impact accounting decision

3.51 It is important to note accounting standards are evolving and there have been changes in pension accounting standards internationally. In addition, pension accounting standards in Canada may also change to better reflect the emerging structures of new pension plan models. We will continue to monitor accounting standards as they evolve, and our conclusion on the appropriate accounting treatment for the PSSRP, H-CUPE and H-CBE plans may change in future depending on the changes in accounting standards.

3.52 Given the Province's announced intention to convert more pension plans to shared risk pension plans we believe the question of appropriate accounting treatment will continue to be an important issue in future audits.