

Intelligence MEMOS



From: Bill Robson and Alexandre Laurin
To: Concerned Ontarians
Date: October 17, 2016
Re: **MEMO TO ONTARIO TAXPAYERS - AUDITOR GENERAL'S OBJECTIONS
TO ONTARIO'S PENSION ACCOUNTING ARE THE TIP OF A FISCAL ICEBERG**

The release of Ontario's public accounts for the 2015/16 fiscal year in early October featured an unusual tussle between the government and the provincial Auditor General (AG). The AG's unwillingness to approve Ontario's treatment of public sector pensions in its consolidated financial statements prompted the government to issue unaudited statements – an unprecedented move. While Ontario released audited statements shortly afterwards, with a qualified opinion from the AG, issues at stake in this dispute are larger – and more problematic for Ontario taxpayers – than they look.

The dispute over the public accounts centres on the government's treatment of the Ontario Teachers Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP) in its financial statements. The province has been netting pension assets against pension liabilities related to these plans, reducing the reported provincial debt and improving its annual results, lately reducing the provincial deficit. The provincial AG, Bonnie Lysyk, [objects to that treatment](#).

The main issue highlighted in [Ms. Lysyk's statement on the dispute](#) is that the province has no certain access to any funding surplus that may arise in these pension plans, which are jointly-governed risk-sharing plans. For taxpayers to benefit from a surplus, the partners governing these plans would have to agree to reduce government contributions. The fact that OTPP is using some of its recorded surplus to [partially restore inflation increases](#) for accruing benefits supports the AG's interpretation.

Ms. Lysyk has argued for a valuation allowance annihilating the effect of these surpluses on the balance sheet. And in the documents it has now released, the province did include an allowance related to these plans – increasing the province's reported debt by \$10.7 billion, and worsening its annual deficit from \$3.5 to \$5.0 billion. If the province were to restate previous years' results similarly, it would satisfy Ms. Lysyk's objections. But problems with Ontario's pension accounting are much bigger than this.

The AG's statement does not mention it explicitly, but the province gets these positive pension-related values by understating the value of its pension promises. Private-sector sponsors of defined-benefit pension plans must value their liabilities by discounting future payments at rates reflecting the debt-like nature of these obligations: the yields on bonds of appropriate credit quality. However, Ontario, like governments elsewhere, discounts future pension promises using generous assumed rates of return on assets. This practice understates [public-sector pension benefits](#) and the [costs of employee compensation](#).

Ontario discounts OTPP and OPSEUPP liabilities at 6.25 percent for its financial statements. While not as high as the discount rate used by bankrupt Detroit, it is far above Ontario Savings Bonds – [currently 2.2 percent](#). And – a particular sticking point for the AG – it is above the rates the plans themselves use – 4.8 and 5.55 percent. Using a more appropriate discount rate would show not pension surpluses, but deficits – and likely big ones.

Ms. Lysyk has brought part of the problem with Ontario's pension accounting to light. But taxpayers in Ontario, like their fellows elsewhere in Canada, are still exposed to risks much larger than their governments admit.

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