Intelligence MEMOS

From: Robert Siddall

To: Canadian Public Finance Officials

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Re: **Accounting Standards Need to Keep Pace with the Evolution of Public Sector Pension Plans**

One of the things I like most about accounting standards is their need to continuously evolve to remain relevant to users of financial information and to accurately reflect the state of affairs of the organization under review.

The need for this accounting evolution is not necessarily driven by the standards themselves, but by the fact that we continue to find new and often more complex ways of doing business.

In these situations, the underlying economic and financial circumstances of a transaction may not have been considered by existing accounting standards. New standards might be needed in these circumstances, such as accounting for financial instruments or bitcoin to pay for obligations or to hold as assets. Alternatively, further guidance might be required to support the application of existing standards to the underlying circumstances of new transactions. The need for these changes usually arises when a greater number of organizations adopt a new way of doing business.

A recent C.D. Howe Institute Commentary provides a good case for the need for public sector pension accounting standards to keep pace with the changing nature of public sector pension plans.

So, what has changed in the area of public pensions that would require consideration of an accounting change?

In the past, most public sector pension plans had defined benefits with one sponsor, who created the plan for a similar group of members. That sponsor determined what benefits were to be provided, and unilaterally determined how these benefits would be paid for.

Today, pension practices are not so simple. In some cases, it is hard to identify the sponsor of a pension plan and how to measure risk inherent in these plans given plan flexibility. Multi-employer pension plans today not only include public sector employers but, in some cases, also include not-for-profit and private sector employers in the plan.

In other cases, what was once the sole responsibility and risk of the sponsor is now shared with others. For example, the government assumes the risks of some plans given that they are the major funder, which leads, as the Commentary puts it, to "moral hazard." In other cases, it is difficult to determine the payout of future benefits as they are contingent on future events that both employers and employees have agreed to.

There have also been changes in how pensions operate that could affect the assumptions of the plan, such as determining the plan's discount rate. These assumptions need to be properly reflected in determining the net assets/net liabilities of the plan.

What was once considered immaterial may now be material. For example, the use of defined contribution accounting for members of a multi-employer defined benefit pension plan may have been an acceptable accounting practice in the past, given that using it was considered immaterial for any one of the employers in the plan. However, the number and circumstances of multi-employer pension plans today, and their impact on employers or the governments that fund these employers' activities, may now be material to their financial operations.

The C.D. Howe Institute Commentary plays an important role by identifying the changing nature of public-sector pension plans in Canada. And it is well timed to the Public Sector Accounting Board's current standards review, which is aimed at better reflecting the changing nature of these plans.

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