Intelligence MEMOS

From: William B. P. Robson

To: Canadians worried about government debt – especially the unseen amounts

Date: March 5, 2018

Re: **New accounting may reveal government pension liabilities**

Good decisions require good information. Improving the information legislators and voters get about government finances is an ongoing task. Establishing public-sector accounting standards in the 1980s was a key step, and their gradual adoption federally, provincially and municipally has moved us forward. As the C.D. Howe Institute's fiscal accountability reports have documented, adherence to the standards is incomplete, but Canadians have more consistent, meaningful information about public sector finances than they once did.

Even as we push governments to adhere to the existing standards, we still need to improve those standards. A major gap has opened between private- and public-sector accounting for deferred employee compensation, notably pensions. Reflecting future obligations in today's statements of financial position is tricky – because of uncertainty about the appropriate value to assign to them in the present, and because pressure to tell a happy story tempts sponsors to shade that value downward.

Once upon a time, sponsors of pension plans heavily discounted future payments, typically arguing that assets invested to cover those obligations would earn high returns. They also deferred recognition of (usually adverse) differences between their (optimistic) assumptions and (disappointing) experience – amortizing those differences over many years, which delayed and diluted their impact on annual results.

Deeper thought about the nature of pension promises, and bitter experience – think of the recent Sears debacle, where lax rules left a plan underfunded and its beneficiaries out of luck – has changed private-sector practice. Nowadays, responsible sponsors discount future payments at rates that reflect the bond-like character of the pension promise, and show changes in pension-related assets and liabilities immediately.

Public-sector accounting standards, by contrast, still let governments discount future payments for pensions and other post-retirement benefits using assumed returns on assets – even when their plans hold inadequate assets, sometimes none at all, to earn those assumed returns. As for timing of recognition, governments still delay and dilute the impact of differences between past projections and updated ones.

Post-retirement benefits of government employees are relatively rich and unconditional. The liabilities and annual costs they publish are typically big. But the differences between what they publish, and what market-based discount rates and immediate recognition would reveal are also big. For the federal government alone, fair-value accounting would show an unfunded pension liability almost $100 billion larger, and annual employment costs $9 billion higher, than last year's published figures.

Change may be coming. The Public Sector Accounting Board consulted on potential changes to timing of recognition last year, and is currently consulting on potential changes to discount rates. Government representatives are likely arguing for the status quo – and if changes occur, some governments may resist implementing them. But continuing failures of US state and local pension plans – whose understated liabilities and "smoothed" changes are a scandal – will remind us that hiding a problem usually makes it worse, and heighten the pressure for change.

Canadians may soon know more about their governments' finances. We will see that governments have made – are still making – more expensive promises than we knew. The sooner we see that, and the faster governments make themselves as financially healthy as they already claim they are, the better off Canadians – as taxpayers, as beneficiaries of government programs, and as informed voters – will be.

William B.P. Robson is President and CEO of the C.D. Howe Institute, and is a member of the Public Sector Accounting Board's Employment Benefits Advisory Group.

To send a comment or leave feedback, email us at blog@cdhowe.org.