Financial reporting—
Financial status of pensions—an update

12

Main points

This chapter provides an updated summary of the financial status of Government pension plans. Our Office last reported on the financial status of pensions in our 2006 Report – Volume 3.

Over the last five years, Saskatchewan's pension debt grew by almost $2 billion to $6.2 billion at March 31, 2011. Over this period, the cost of the Government's pension promises increased faster than its contributions.

At March 31, 2011, pension debt accounted for 43% of the Government's total debt. Since 2006, the Government reduced its other debt (primarily by increasing the amounts it has set aside as investments in sinking funds).

Governments operate and fund their pension plans based on their own fiscal strategies or laws. Over thirty years ago, Saskatchewan closed its pension plans, whereas other provinces have not yet done so.

The Saskatchewan Government expects future cash flows, needed to fund pension plans, to increase each year over the next ten years and to peak around 2021. This peak is three years later than projected in 2006 when the peak was projected to be in 2018. This later peak shows that projected cash flows can change significantly.

Because of Saskatchewan's strong financial performance over the last five years, it can better afford its pension debt in 2011 than it could in 2006. However, careful financial management is still needed.

Introduction

From March 31, 2006 to March 31, 2011, pension debt has grown from $4.3 billion to $6.2 billion.[1] Determining whether retirement benefit plans should be funded and the amount to be funded in each period is a financial management matter in which legislators, the public, and pensioners are interested.

In our 2006 Report – Volume 3 (Chapter 13), this Office provided a summary of the financial status of pensions. This chapter provides an update. It analyzes the financial status of Saskatchewan's pension plans by looking at:

- future pension payments for funding pension plans
- future affordability of pension promises
- pension payments compared to total revenue

In this chapter, we focus primarily on two of the Government's largest defined benefit pension plans – the Teachers' Superannuation Plan (TSP) and the Public Service Superannuation Plan (PSSP). These plans account for 95% of the Government's total pension debt.[2]

We used the information available for these pension plans for their years ended on or before March 31, 2011.

Future pension payments for funding pension plans

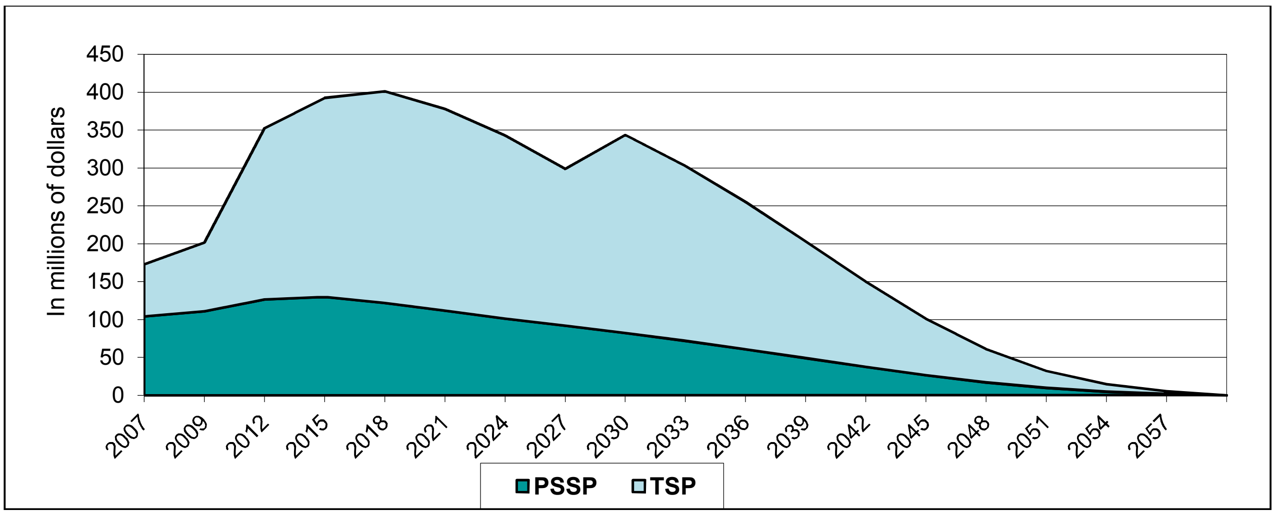
Anticipating future cash needs helps governments to plan for and manage their future borrowing and financing requirements. Periodically, governments estimate pensions' expected cash flows based on actuarial

[1] The Government sponsors the following closed defined benefit plans: Teachers' Superannuation Plan, Public Service Superannuation Plan, Saskatchewan Transportation Company Employees' Superannuation Plan, Anti-TB League Employees Superannuation Plan, and Members of the Legislative Assembly Superannuation Fund. Also the Government sponsors the following open defined benefit plans: Judges of the Provincial Court Superannuation Plan, Pension Plan for the Non-Teaching Employees of the Saskatoon School Division No. 13, Saskatchewan Pension Annuity Fund. Finally, the Government contributes to the Saskatchewan Healthcare Employees' Pension Plan (a joint opened defined benefit plan). Furthermore, it sponsors several closed defined benefit plan of its government business enterprises. The two main plans are: Power Corporation Superannuation Plan, Saskatchewan Telecommunications Pension Plan. At March 31, 2011, its government business enterprise plans has a combined pension debt of $81.1 million. (*Public Accounts 2010-11 – Volume 1.* pp. 89 - 92).
[2] *Public Accounts 2010-11-Volume 1.* pp. 89-92.

calculations and assumptions concerning inflation, mortality rates, wage rates, and investment returns.

In this section, we used projected future pension payments (cash flows) because projected pension debt (liability) was not available for both the TSP and PSSP. The following graphs shows the Government's projected future cash flows in nominal dollars for TSP and PSSP. Amounts are reflected in nominal dollars because PSSP did not project its cash flows in constant dollars (i.e., today's dollars).

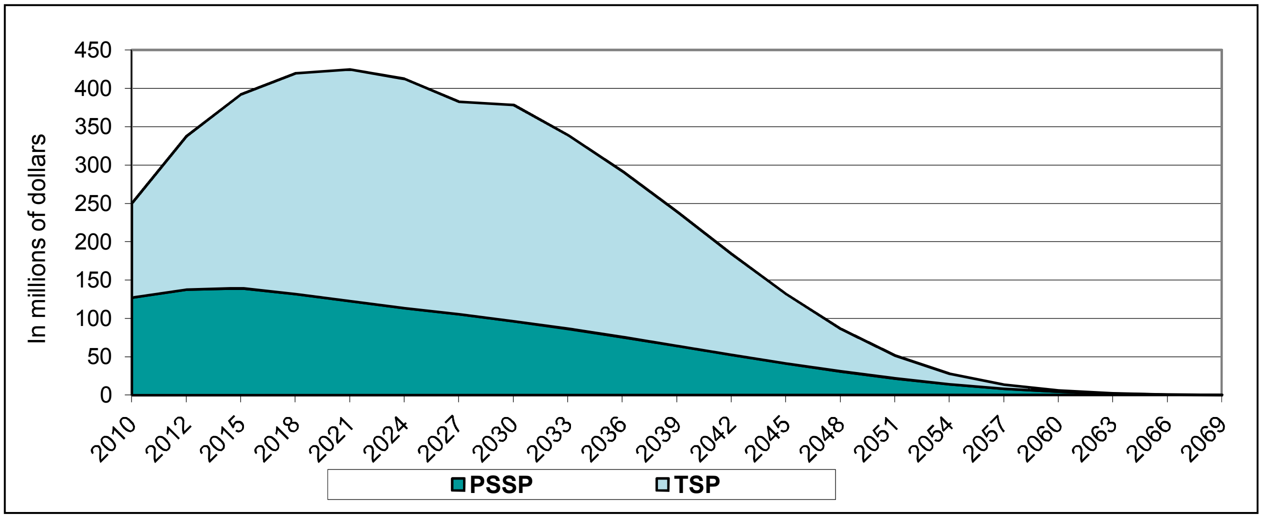
Graph 1—2006 PSSP & 2005 TSP projected net pension payments (funding) from 2007 to 2060 (in nominal dollars)



Source: from PSSP Actuarial Valuation Report at March 31, 2006 and TSP Financial Projections Report at June 30, 2005.

In 2006, the Government expected future cash flows for TSP and PSSP to increase each year until 2014 and peak around 2018 for a combined cash outflow of about $401 million (see Graph 1).

Graph 2—2009 PSSP & TSP projected net pension payments (funding) from 2010 to 2069 (in nominal dollars)



Source: PSSP Actuarial Valuation Report at December 31, 2008 with extrapolation to March 31, 2009 (prepared May 1, 2009) and TSP Financial Projections Report at June 30, 2009 (prepared December 2009)

The 2009 cash flow projection for the PSSP and TSP were the most last available at the time of this study. The 2009 cash flow projections show that the Government expected future cash flows for these plans to increase each year over the next ten years and to peak around 2021 for total combined cash outflow of $425 million (see Graph 2).

Five years ago, when we compared the 2001 cash flow projection[3] to the 2006 cash flow projection, we found that cash flows were most likely to grow faster than anticipated in 2001.[4]

When we compared the 2006 cash flow projection (graph 1) to the most recent cash flow projection (graph 2), we found that the pension cash flow projections were higher than previously anticipated, but would take longer to peak.

Projections, by their nature, do not take into consideration any future changes in actuarial assumptions and estimates, which could result in significant changes to the projections. As a result, projected cash flows can change significantly because of future changes in underlying

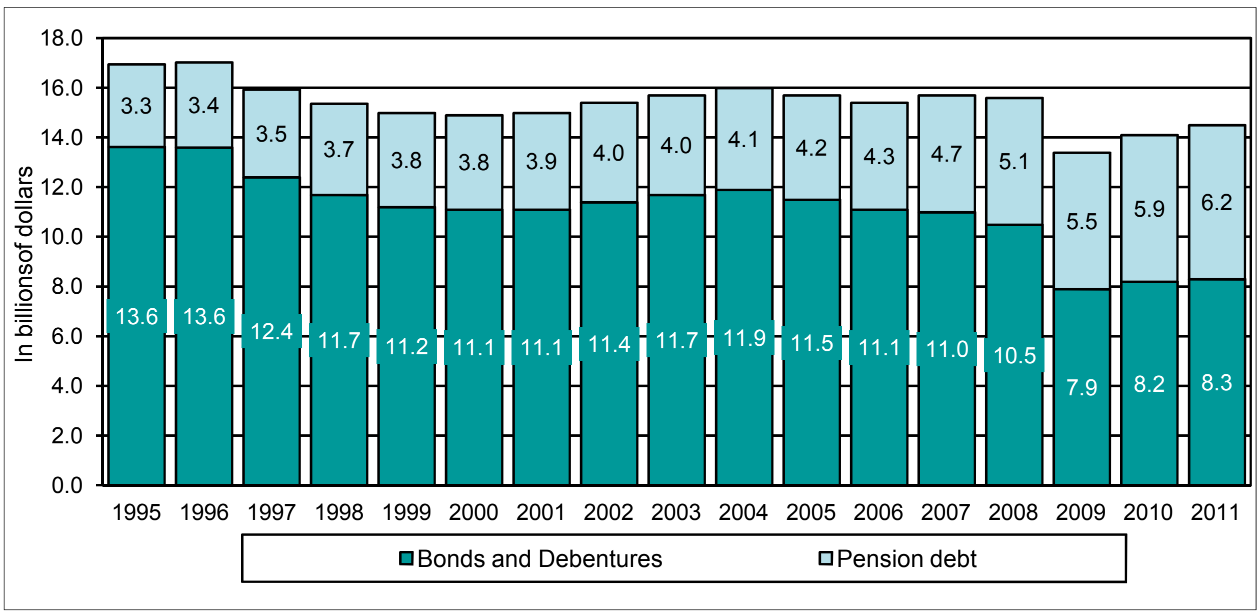
[3] Saskatchewan Finance. (March 2011). *Report on addressing unfunded pension liabilities.* Regina: Author. [This document can be obtained from Standing Committee on Public Accounts as tabled document 12/24].
[4] 2006 Report – Volume 3 (Chapter 13).

assumptions and estimates (e.g., employees are retiring later than previously anticipated).

Future affordability of pension promises

Looking at the trends of a government's debt, including pension debt, provides insight into how much will be left for future generations of citizens to pay or finance. A government's total debt includes amounts due to members of pension plans (pension debt) and bondholders (bonds and debentures) less amounts set aside as investments in sinking funds. For example, the total debt shown in Graph 3 for March 31, 20011 is comprised of $5.1 billion of public debt, $3.2 billion of government business enterprise specific debt and $6.2 billion of pension debt. These amounts agree with the Summary Financial Statements.

Graph 3—The Government's total debt fiscal years ended March 31 from 1995 to 2011



Source: Audited Saskatchewan Summary Financial Statements. Total debt is net of sinking funds.

Graph 3 shows that in the last five years pension debt relative to the Government's total debt has increased by 15% from 28% in 2006 to 43% in 2011. Saskatchewan uses a "pay-as-you-go" strategy to fund PSSP and pays contributions to TSP based on a formula set out in law. Because the costs of these pension plans have increased faster than its contributions, the pension debt has grown.

Based on TSP's audited financial statements, TSP's pension debt at June 30, 2011 was about $4.5 billion. Based on PSSP's audited financial statements its debt at March 31, 2011 was $1.9 billion.

In 2009, the Government projected TSP's pension debt (liability) to peak in 2013/2014 at about $4.3 billion.[5] Projected PSSP debt was not available at the time of this study; projected PSSP cash flows peak in 2015. TSP's debt at June 30, 2011 was higher than the 2009 projected debt. As previously noted, projections can change significantly.

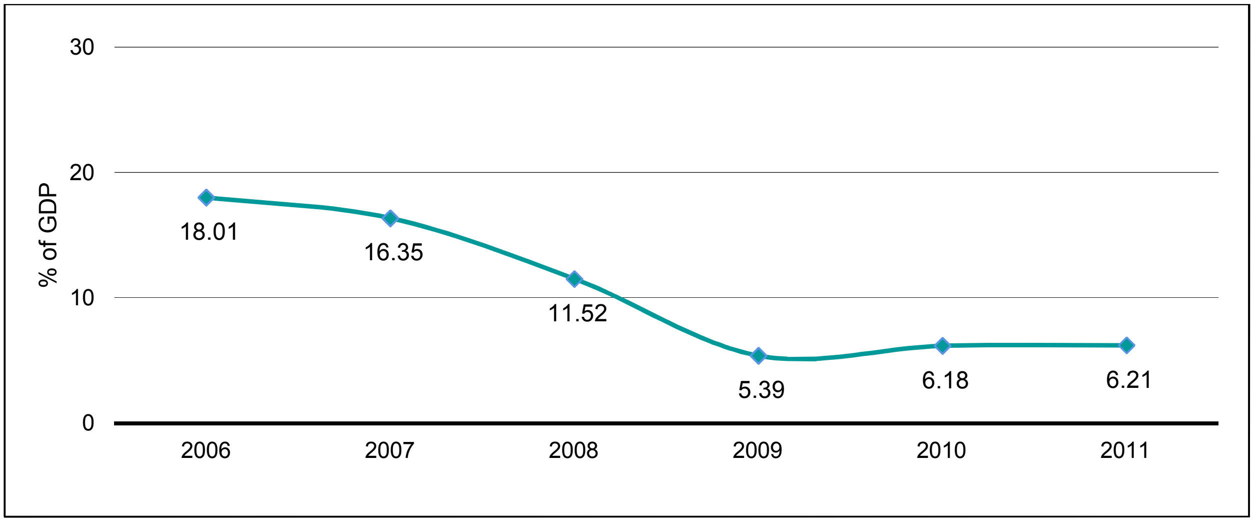
Also, Graph 3 shows that during the same period the Government's total debt has declined $0.9 billion from $15.4 billion in 2006 to $14.5 billion in 2011 (see **Chapter 10 – Public financial reporting–the need to change** for further discussion of Government debt).

SFS net debt as a percentage of provincial GDP

Net debt as a percentage of provincial gross domestic product (GDP) measures the level of financial demands placed on the economy by a government's spending and revenue-raising practices. Comparing the Government's net debt to the state of the economy (i.e., GDP) provides insight into the degree to which a government can maintain existing service commitments and meet its existing financial obligations without increasing debt or taxes.

[5] TSP Financial Projections Report at June 30, 2009 (prepared December 2009).

Graph 4—SFS net debt as a percentage of the Saskatchewan's gross domestic product – from March 31, 2006 to March 31, 2011



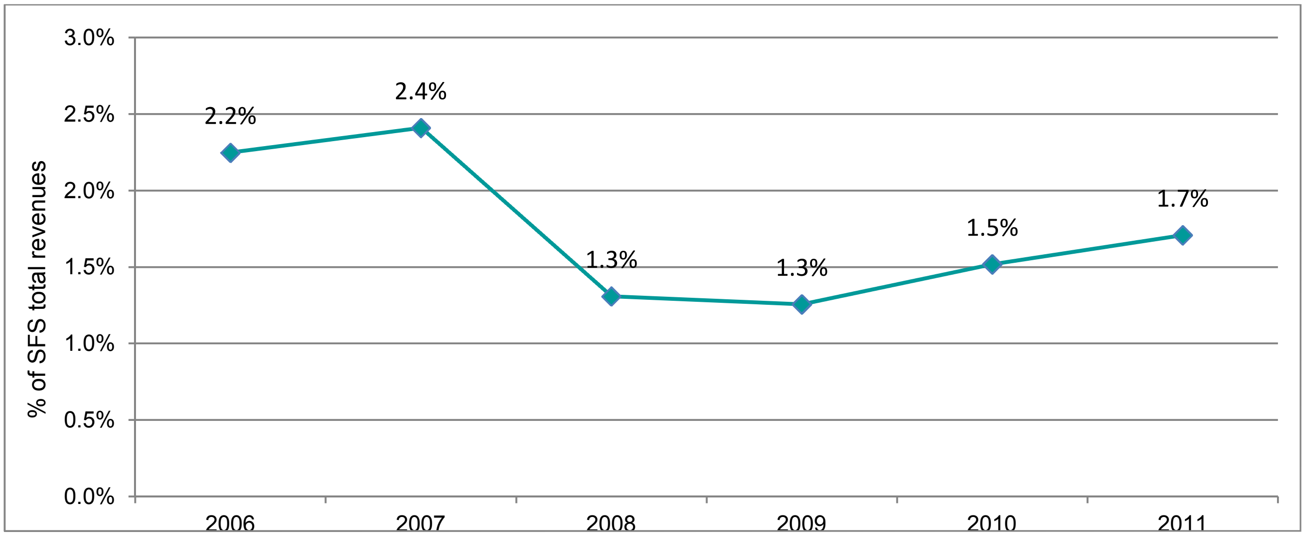
Source: Saskatchewan Public Accounts 2010-11 Volume 1, p.37.
SFS - Summary Financial Statements

A growing economy helps governments to maintain their programs and reduce debt. Graph 4 shows that since 2006 the Government's net debt as a percentage of gross domestic product (GDP) has decreased from 18.01% in 2006 to 6.21% in 2011. This decrease suggests that the Government is better able to afford its debt (including its pension debt) in 2011 than in 2006.

Pension payments compared to total revenue

Comparing pension payments to total revenue shows a government's flexibility to respond to rising commitments (i.e., increased pension payments). Changes in this indicator may affect a government's ability to incur increasing pension payments while continuing to provide other essential government services.

Graph 5—TSP & PSSP pension payments as a percentage of SFS total revenues



Source: Payments derived from components of the pension expense in the Government's summary financial statements as of March 31. SFS revenue is "total revenue" from audited Summary Financial Statements (SFS)–statement of operations.

Graph 5 shows Saskatchewan's combined pension payments for TSP and PSSP as a percentage of its total revenues (SFS revenues). From 2006 to 2011, pension payments as a percentage of SFS revenues decreased 0.5% from 2.2% to 1.7%. This decrease occurred primarily because since 2006 the Government's revenues increased faster than pension payments. Although, the Government is in better financial position to afford its pension promises in 2011 than in 2006, pension payments are increasing and are not anticipated to peak until 2021.

Summary

Even though, over the last five years, the Government's pension debt increased by $1.5 billion, total debt was reduced by almost a billion dollars. To date, the strategy has been not to fund pension debt.

During this same five years, the growth in the economy as reflected by growth in the provincial GDP and a strong resource sector helped the Government lower its net debt as percentage of GDP by 11.8%. This suggests that the Government has a greater ability to meet its existing pension commitments today than it did five years ago.

However, the Government must exercise caution. Pension debt remains significant at $6.2 billion at March 31, 2011 and accounts for 43% of the Government's total debt. Projected cash flows show that cash flows are now anticipated to grow faster than previously planned. Pension debt is projected to peak within the next ten years. Projections can change significantly.

In future years, under its current funding strategy, the Government will likely need to spend more of its money for paying past pension promises. The Government must continue to use pensions' projected cash flows to assess the impact on the Government's overall cash flow, borrowing needs, and pension funding strategy.

Glossary

Constant dollars – removes the effect of inflation to show the expected future cash flows in today's dollars.

Closed plan – is a pension plan that does not allow new members to join; existing members continue to receive the promised pension benefits.

Defined benefit pension plan – a pension plan that specifies the amount of pension that members of the plan receive on retirement or the method of determining the pension.

Defined contribution plan – a pension plan in which the contributions are fixed. The member's pension is based on the accumulated contributions (i.e., total contributions made by the employee and employer over the member's career) and the investment earnings on these contributions.

General debt – public debt net of loans to Crown corporations for government business enterprise specific debt.

Government business enterprises – are self-sufficient Crown corporations that have the financial and operating authority to sell goods and services to individuals and non-governmental organizations as their principal activity. Examples include SaskPower, SaskEnergy, SaskTel, and the Liquor and Gaming Authority.

Government business enterprise specific debt – debt issued by the GRF specifically on behalf of a government business enterprise where the government expects to realize the receivable from the government business enterprise and settle the external debt simultaneously.

Investments in sinking funds – monies set aside (typically in investments) for the repayment of debt.

Net Debt – a measure of a government's financial position that is, calculated as the difference between financial assets and liabilities. Net debt provides a measure of the future revenues required to pay for past transactions and events. If the total financial assets exceed the total liabilities, it is called net assets.

Nominal dollars – is the value of the actual cash flows that are expected to be in the future, taking into account factors such as inflation.

Pension debt – the amount by which the pension obligation (promise) exceeds the assets of the pension plan. This amount is called "pension liabilities" in Saskatchewan's Summary Financial Statements- Summary Statement of Financial Position.

Summary Financial Statements (SFS) – is a report of the financial results of all organizations that the Government uses to provide goods and services to the public. Summary financial statements combine the financial activity of all government organizations including ministries, Crown corporations, agencies, boards, and commissions, etc.

Total debt – is the aggregate of gross general debt, gross government business enterprise specific debt and pension debt liabilities less investments in sinking funds.

Sinking fund – are funds set aside for the repayment of debt.

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