

Council Policy No.:	CP204-xxx
Council Policy Name:	Asset Retirement Obligation
Date Approved by Council:	June 25, 2024, CR2024-013
Date revision approved by Council:	
Related SOP, Management Directive, Council Policy, Forms	

### Policy Statement and Rationale:

The Corporation of the City of Kawartha Lakes shall account for and report on asset retirement obligations (ARO) in accordance with the Public Sector Account Standards (PSAS) Handbook, section 3280 effecting January 1<sup>st</sup>, 2023 for the inclusion in the consolidated financial statements as at December 31<sup>st</sup>, 2023. This standard must be applied to public sector entities that prepare financial statements in accordance with PSAS including all Canadian municipalities.

The purpose of this Policy is to provide guidance and a framework to preparers and users of financial reports concerning treatment for end-of-life obligations for assets.

### Policy

#### Recognition

A liability should be recognized when, as at the financial reporting date:

- there is a legal obligation to incur retirement costs in relation to a tangible capital asset;
- the past transaction or event giving rise to the liability has occurred;
- it is expected that future economic benefits will be given up; and
- a reasonable estimate of the amount can be made.

A liability for an asset retirement obligation cannot be recognized unless all of the criteria above are satisfied.

The estimate of the liability would be based on requirements in existing agreements, contracts, legislation or legally enforceable obligations, and technology expected to be used in asset retirement activities.

The estimate of a liability should include costs directly attributable to asset retirement activities. Costs would include post-retirement operation, maintenance and monitoring that are an integral part of the retirement of the tangible capital asset.

Directly attributable costs would include, but are not limited to, payroll and benefits, equipment and facilities, materials, legal and other professional fees, and overhead costs directly attributable to the asset retirement activity.

### **Scope:**

The Policy applies to all departments, boards, committees and agencies falling within the reporting entity of the Corporation of the City of Kawartha Lakes that possess asset retirement obligations.

ARO includes, but is not limited to:

- The removal and remediation of contaminants, such as asbestos and lead, within building or construction materials (e.g. roads, flooring, roofs).
- Restoration of leased property to its former condition at the end of the lease
- Removal of underground storage tanks used to store gas or oil
- Costs to retire landfills (previously PSAS 3270, now included in PSAS 3280)

Prior to the introduction of PS 3280 there was no guidance on the retirement of long-life assets.

The City is now required to recognize obligations previously out of scope

Exclusions from ARO include costs associated with the following:

- Remediation of contaminated sites (Refer to PSAS 3260 Liability for Contaminated Sites).
- Improper use of a tangible capital asset.
- Preparing a tangible capital asset for an alternative
- The occurrence of an unexpected event such as an unexpected contamination.

Legal obligation can arise through:

- Agreement or contract.
- A government's own legislation.
- Legislation of another government.
- The Doctrine of Promissory Estoppel where a promise, without consideration, to a third party is reasonable expectation of performance by the promisor.

Existing laws and regulations require public sector entities to take specific actions to retire certain tangible capital assets at the end of their useful lives. This includes activities such as removal of asbestos, retirement of landfills. Other obligations to retire tangible capital assets may arise from contracts or court judgments, or lease arrangements.

The legal obligation, including obligations created by promises made without formal consideration, associated with retirement of tangible capital assets controlled by the City, will be recognized as liability in the books of the City of Kawartha Lakes, in accordance with PS3280 which the City will be adopting starting January 1, 2023.

Asset retirement obligations result from acquisition, construction, development or normal use of the asset. These obligations are predictable, likely to occur and unavoidable. Asset retirement obligations are separate and distinct from contaminated site liabilities. The liability for contaminated sites is normally resulting from unexpected contamination exceeding the environmental standards. Asset retirement obligations are not necessarily associated with contamination.

### **Definitions:**

**Accretion expense** is the gradual and incremental growth of assets that increase the carrying amount of a liability for asset retirement obligations due to the passage of time.

**Amortization** is the allocation of the cost of a tangible capital asset (TCA) as an expense over its useful life. Also known as depreciation.

**Asset retirement activities** are activities related to an asset's retirement obligation including decommissioning/dismantling of an asset and post retirement monitoring costs.

**Asset retirement cost** is the estimated amount required to retire a tangible capital asset.

**Asset retirement obligation** is a legal obligation associated with the retirement of a tangible capital asset.

**Capitalization Thresholds** is the value above which tangible capital assets are capitalized and reported in the financial statements.

**Carrying amount** is the net book value of a tangible capital asset, for example cost less accumulated depreciation.

**External auditor** is a firm of accountants that provide an independent opinion on the financial statements for the City.

**In-scope assets** are those assets that meet the definition for asset retirement obligation.

**Retirement of a tangible capital asset** is the permanent removal of a tangible capital asset from service. This term encompasses sale, abandonment or disposal in some other manner but not its temporary idling.

**Standards/PSAS** refers to the Public Sector Accounting Standards.

## **Responsibilities**

The roles and responsibilities of implementing and maintaining this standard involve multiple stakeholders across the City. The range of duties and responsibilities would include the following:

### **Finance**

- Lead the initial implementation and annual maintenance of ARO project
- Development of and adherence to the policies for accounting treatment
- Monitor compliance on the application of this Policy
- Investigate and provide resolutions for issues requiring clarification to other stakeholders
- Obtain clarity and/or opinion from legal counsel for matters such as contractual obligations, terms and conditions, ARO regulations and legislations
- Act as the liaison between external auditors and the other departments
- Appraise Council of requirements of the standard and the impact on the City
- Report asset retired obligations in the financial statements of the City and other statutory financial documents

### **Departments**

- Monitor current and pending legislations for ARO implication to determine the impact on the City's assets
- Provide Finance annually with the accurate and relevant information related to asset retirement obligations
- Inform Finance of any potential obligation(s) that might be associated with an asset
- Communicate changes in asset conditions and retirement timelines to Finance
- Assist in the compilation of cost estimates for retirement obligations
- Coordinate and communicate with consultants

### **Corporate Management**

- Ensure implementation and annual compliance with PSAS requirements
- Ensure the preparation and presentation of the annual financial statements of the City can meet the financial obligations under ARO
- Funding Responsibility – as part of the long range financial plan ensure the City can meet its financial obligations under ARO

### **Measurement**

#### **Initial Measurement**

Professional judgement and the use of estimates are integral in determining ARO in year of adoption as well as in subsequent years. Estimates are based on the best information available at that point in time. PSAS indicates that:

- Costs should only include those that are related to the asset retirement obligation in accordance with the legally enforceable obligation.
- Third party judgement and subsequent matter experts may be required to determine the best estimate of an ARO.

#### **Inclusion of third party and consultants**

The City must assess the level of expertise required for ARO evaluation and determine if resources are available internally before sourcing external consultants.

If the decision is made to contract a consultant for an ARO project, the process will be conducted in accordance with the Procurement Policy.

#### **Accounting Treatment**

The following table summarizes the required treatment for ARO in various circumstances.

<b>Circumstance</b>	<b>Treatment under PSAS 3280</b>
TCA is still in productive use but is fully amortized (example would be a fully amortized building containing asbestos)	ARO is added to existing cost base and is amortized over the asset's revised remaining useful life
TCA is no longer in productive use	ARO is expensed immediately
ARO relates to an asset not previously capitalized	ARO is expensed immediately

### **Subsequent Measurement**

The asset retirement costs will be allocated to accretion expense in a rational and systemic manner (straight-line method) over the useful life of the tangible capital asset or a component of the asset.

On an annual basis, the existing asset retirement obligations will be assessed for any changes in expected cost, term to retirement, or any other changes that may impact the estimated obligation. In addition, any new obligations identified will also be assessed.

### **TRANSITIONAL PROVISION**

#### **Transitional Options**

PSAS 3280 provides users the option to use one (1) of the following transition methods:

- **Prospective application** – For the purposes of prospective application the following are noted under this method: entity would recognize:
  - valuation and accounting for ARO are at adoption date.
  - An assumption of no prior ARO asset or liability prior to adoption of standard.
  - No requirement to restate prior years or to adjust Accumulated Surplus
  
- **Retroactive application with restatement of prior periods** – The new accounting policy is applied to events and transactions from the date of origin of such items. The financial statements for each prior period presented for

comparative purposes are restated to reflect the new policy. The balance of the accumulated surplus / deficit at the beginning of the earliest period presented is restated to reflect the cumulative effect of the change on periods prior to that date.

- a) **Modified Retroactive application** - This option allows an entity to use the assumptions and discount rate for ARO at adoption date. ARO is also recognized at the beginning of the comparative year.

The City will use the **Prospective Application Method** as of January 1, 2023.

**ARO Liability.** An estimate is made of the future date at which ARO liability will be payable for each asset class.

**Presentation and Disclosure**

The liability for asset retirement obligations will be disclosed in the annual financial statements. The City’s disclosure will include, but not limited to:

- a) *general description of the liability for an asset retirement obligation and the associated tangible capital asset (or a component thereof).*
- b) *the amortization method used for the asset retirement costs.*
- c) *the basis for the estimate of the liability, including the estimated total undiscounted expenditures, the time period over which the undiscounted expenditures are to be incurred, the estimated timing of settlement of these expenditures and the discount rate used.*

**Revision History:**

Proposed Date of Review:

<b>Revision</b>	<b>Date</b>	<b>Description of Changes</b>	<b>Requested By</b>
0.0	[Date]	Initial Release	

## Schedule "A"

### Asset Decision Tree – Scope of Applicability

