

City of Kawartha Lakes

# PS 3280 Asset Retirement Obligation

Accounting Memo and Strategy Paper

# Accounting Memo

## PS 3280 Asset Retirement Obligations

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## 1.0 Executive Summary

This accounting memo is intended to provide a summary and methodology for the actions and considerations taken by The City of Kawartha Lakes (“the City” or “Kawartha”) in adopting accounting standard PS 3280 for Asset Retirement Obligations. The City recognizes the iterative process of adoption of PS 3280 and commits to ongoing improvements of the underlying data and information to regularly revise and update any corresponding detail related to this important initiative. The City has undertaken an approach that focuses on compliance with the standard to start, and would look for efficiencies and process improvement subsequent to the adoption.

The process of adoption was collaborative across the organization. All department managers and key stakeholders who may have held insight and information to guide the process of adoption were consulted along with a thorough contract and legislation scan to ensure that appropriate obligations were considered throughout the process. Upon completion of the appropriate contractual, legislative and legal obligation scan, an initial population of assets with applicable AROs were defined.

The adoption of the standard and recording of AROs resulted in an increase to assets and liabilities on the date of adoption as an ARO liability and corresponding asset of the same amount have been recorded. In the case of AROs associated with buildings where the present value technique was not used, only the ARO asset will be adjusted each period for amortization. In the case of AROs associated with landfills where the present value technique was used, both the ARO liability and the ARO asset will be adjusted each period for accretion and amortization, respectively.

The City decided to apply the prospective application approach to implement the PS 3280 standard. This application does not require restatement of prior periods from the beginning of the fiscal year in which the City first applied the section.

## 2.0 Background

### 2.1 Purpose

The purpose of this memo is to demonstrate the approach taken by The City of Kawartha Lakes (“Kawartha” or “the City”) to adopt the standard PS 3280 Asset Retirement Obligations (“PS 3280”). The new standard PS 3280 is effective for annual financial statements relating to fiscal years beginning on or after April 1, 2022, therefore will be effective from the City’s annual financial statements for the year ending December 31, 2023.

This memo discusses how Kawartha has adopted PS 3280, including the options available, assumptions and conclusions drawn for asset retirement obligations (“ARO”). The City has made policy decisions and interpretations relating to the accounting for AROs under PS 3280.

With regards to PS 3280, this memo contains:

1. Scoping of assets with potential AROs
2. Documentation of key scoping assumptions
3. Methodology of measurement and recognition of identified AROs; and
4. Procedures and journal entries to record AROs

The analysis within this memo is solely based on the current facts and circumstances that exist within the City as of December 2023. To the extent that these facts and circumstances change, the conclusions in this paper may be updated as required.

### 2.2 PS 3280 Asset Retirement Obligations

The standard PS 3280 Asset Retirement Obligations was introduced in 2022 and applies to public sector entities for statements relating to fiscal years beginning on or after April 1, 2022. The main objective being to show liabilities for costs likely to be incurred by an entity on retirement of a tangible capital asset (“TCA”), to establish when and how to recognize this liability and how to disclose this liability in the financial statements.

Common asset retirement obligations include, but are not limited to:

- Decommissioning of dismantling a tangible capital asset that was acquired, constructed or developed;
- Remediation of contamination of a tangible capital asset created by its normal use;
- Post-retirement activities such as monitoring; and
- Constructing other tangible capital assets to perform post-retirement activities.

To identify retirement costs, PS 3280 focuses on legal obligations and obligations created by promissory estoppel that result from an asset’s acquisition, construction, development or normal use. As such, adopting this standard requires in-depth review and analysis of available documentation such as legal contracts as well as inferred obligations.

Other relevant Public Sector Accounting Standards are:

- **PS 3200 Liabilities**  
Costs to retire an asset due to unexpected events that are not subject to an environmental standard are addressed under PS 3200.

- **PS 3150 Tangible Capital Assets**  
ARO are recognized for assets and as such, the recognition of assets as per PS 3150 is relevant.
- **PS 3260 Liability for Contaminated Sites**  
Costs to remediate contaminated sites due to an unexpected event that is subject to an environmental standard and the direct responsibility of the public sector entity are addressed as part of PS 3250.
- **PS 3300 Contingent Liabilities**  
Uncertainty of existence of an ARO, for example through uncertainty over promissory estoppel or future determination by an external party, is addressed by PS 3300.

## 2.3 City of Kawartha

Typical of cities across Ontario, the City of Kawartha Lakes holds significant tangible capital assets across its operations.

In line with the new standard PS 3280, the City holds assets that have the potential to require costs to retire the asset after at the end of its productive life. In accounting terms, these are the asset retirement obligations. The City holds assets with potential AROs such as, but not limited to, buildings, land, road infrastructure, and water & sewer infrastructure.

## 3.0 Relevant Guidance

### 3.1 PS 3280 Asset Retirement Obligations

There are certain key areas of PS 3280 that are pertinent to Kawartha. These include:

1. AROs can be associated with:
  - a. Fully amortized tangible capital assets (referred to hereon in as Fully Depreciated Assets);
  - b. Tangible capital assets not recorded on the balance sheet (referred to hereon in as Unrecorded Assets);
  - c. Tangible capital assets that are no longer in productive use (referred to hereon in as Assets Not in Productive Use).
2. AROs only arise from legal obligations, and not as a result of general retirement obligations planned for TCA.
3. AROs are required to be reported as other accrued liabilities in the Statement of Financial Position. There is also the requirement for a note disclosure containing details of the ARO.

CPA Canada handbook, PS 3280 Asset Retirement Obligations.

### 3.2 Federal Legislation Review

The City performed a review of federal legislation to identify potential retirement obligations. The following acts were identified:

1. Canadian Environmental Protection Act

This regulation refers to the production and use of asbestos. The City may also consider the use of asbestos in its roads. The Act also has several regulations, which describe how various materials (e.g. PCBs) should be monitored, stored, and used. Many of the Act's associated regulations, however, do refer to waste/by-products that are created, or prohibits use of certain substances, such as microbeads. As a result, this Act may need to be reviewed in greater detail to determine whether it may trigger additional asset retirement activities.

2. Hazardous Materials Information Review Act

This Act creates requirements to disclose situations in which a supplier or an employer files a claim for exemption re: disclosure of hazardous materials in their products. This Act is scoped-in for further analysis to allow the City to consider the requirements in conjunction with its review of the Hazardous Products Act. The City to consider whether it has any hazardous materials as outlined in the ask. If so, consider whether there are any associated retirement obligations.

3. Hazardous Products Act

An Act to prohibit the sale and importation of hazardous products that are intended for use, handling or storage in a workplace. The associated Regulation provides more information regarding the types of substances which are considered to be hazardous. The City to review its current inventory of supplies in case any prohibited materials have been kept on-site. Consider whether the City has any inventory of prohibited hazardous materials.

#### 4. Canada Labour Code

As part of the labour code, this regulation considers the safety aspects of a job from a worker's perspective. This regulation, in conjunction with other regulations, such as those from the Environmental Protection Act may need to be considered to determine if there may be additional safety related fees to be associated with asset retirement obligations. The City is to consider whether there are any safety related fees associated with AROs.

#### 5. Canada Oil and Gas Operations Act

This regulation considers the tasks required to remediate assets related to oil and gas operations which include oil and gas pipelines and wells. This regulation, in conjunction with other regulations, such as those from the Environmental Protection Act may need to be considered to determine if there may be additional costs to be associated with asset retirement obligations.

### 3.3 Provincial Legislation Review

The City performed a review of provincial legislation to identify potential retirement obligations. The following acts were identified:

#### 1. Occupational Health and Safety Act

This act has requirements which may trigger asset retirement obligations, especially as organizations, such as the City is required to create and maintain an asbestos management program/plan to identify asbestos-containing materials in buildings. The City to consider whether there are asbestos-containing materials in buildings.

#### 2. Public Transportation and Highway Improvement Act

The Act refers to various highways and roads the City is/may be responsible for maintaining and repairing. The City to assess whether any existing highways and roads (e.g. tertiary roads) will be closed and retired due to a formal agreement/contract/etc. Routine replacement and maintenance will most likely not fall under the scope of PS 3280.

#### 3. Aggregate Resources Act

Part VI of the act provides for progressive rehabilitation and final rehabilitation on the site. The City to consider whether the City excavates any of the following: gravel, sand, clay, earth, shale, stone, limestone, dolostone, sandstone, marble, granite or other materials.

#### 4. Resource Recovery and Circular Economy Act

Section 30 states that hazardous and special products (HSP) must be collected by the producer and processed by an HSP processor which could trigger an ARO.

#### 5. Drainage Act

This act refers to two types of liabilities (injuring and outlet) which may trigger an ARO. Outlet liabilities are most likely addressed during the initial stages of a TCA (e.g. during construction of drainage assets) and may not be associated with ongoing liabilities. The City is advised to consider whether outlet liabilities are associated with asset retirement activities.

#### 6. Environmental Protection Act

This regulation refers to the production and use of asbestos and other hazardous materials. The City may also consider the use of asbestos in its roads and buildings. Many of the Act's associated regulations, however, do refer to waste/by-products that are created, or prohibits use of certain substances. As a result, this Act may need to be reviewed in greater detail to determine whether it may trigger additional asset retirement activities.

#### 7. Lakes and Rivers Improvement Act

This act refers to processes, which must be followed prior to altering a dam. This act may be applicable for the City, especially if permanent removals of dams are considered.

#### 8. Mining Act

This Regulation provides rehabilitation requirements for mine sites that should be considered by the City to determine if it may trigger and ARO.

### 3.4 Municipal Legislation Review

As a result of the review of by-laws to identify AROs that was conducted by the City's legal team, no AROs were identified. The potential of AROs coming from by-laws is assessed as very low. No items were scoped in as it related to contractual obligations from by-laws.

### 3.5 Lease Obligation Review

Leases were reviewed by the City's legal team for properties that had a tangible capital asset leasehold improvement associated with them. This was done to identify future lease termination obligations that might meet the reporting criteria in PS3280 Asset Retirement Obligations. Following the review of the City's leases, it was determined that there are no existing ARO obligations as a result of any stated lease terms.



## 4.0 Scoping

Phase 1 of the adoption of PS 3280 involves the identification and recognition of AROs relating to assets held by Kawartha. The City has performed various scoping activities. These included reviewing asset listings, holding discussions with asset managers and experts, and performing in-depth analysis over the inclusion/exclusion of assets to ensure a complete list of assets with AROs was compiled.

### 4.1 Identification of TCA

AROs are tied to TCAs that may incur retirement costs. All assets, whether recorded or not recorded for accounting purposes, must be considered in the assessment of determining AROs.

#### **Assets in Productive Use**

Assets still in productive use without a date of remediation as per the asset register were included in the assessment. This includes any assets under lease.

#### **Fully Depreciated Assets**

Assets that have a net book value of zero and are fully depreciated were included in the assessment of AROs, as they may still in productive use. These fully depreciated assets remain part of the asset register.

#### **Assets Not in Productive Use**

The City has gone through the process of identifying assets that are no longer in productive use for the purpose of determining whether an obligation exists with the associated assets. The City regularly reviews a listing of assets and determine whether assets are no longer in productive which are to be disposed of. This process highlights to management those assets which are no longer in productive use and therefore would not meet the criteria required to recognize an ARO.

#### **Unrecorded Assets**

The City regularly reviews the asset listings in collaboration with operational teams to identify unrecorded assets. Assets that are not recorded that are in use by the City would be in scope of the ARO analysis. The City has confirmed that there are no unrecorded assets. The TCA register continues to record assets with \$0 net book values. This addresses the concern that fully amortized assets are not recorded within the TCA register.

### 4.2 Identification of ARO

As per section .09 of PS 3280, an ARO should be recognized only when all 4 of the criteria below are satisfied:

- a) *There is a legal obligation to incur retirement costs in relation to a tangible capital asset;*
- b) *The past transaction or event giving rise to the liability has occurred;*
- c) *It is expected that future economic benefits will be given up; and*
- d) *A reasonable estimate of the amount can be made.*

The process flow below shows the steps Kawartha has taken in assessing whether an ARO exists for each asset.

The City obtained all available contracts, legal agreements, lease agreements and legislation to analyze for evidence of retirement obligations in line with these criteria for its assets. Asbestos and hazardous materials were highlighted as an ARO that will likely be present for the City.

Specific consideration was given to the doctrine of promissory estoppel, whereby Kawartha has conveyed a promise to a third party that imposes a reasonable expectation of performance.

## AROs in Assets in Productive Use

Assets identified, through the method described in section 4.1, in productive use were included in the assessment.

### Assumptions

An initial review of the tangible capital asset listing as at December 31, 2021 was reviewed and major accounting classes were assessed and assigned a likelihood of the potential of ARO.

Tangible Capital Assets as at December 31, 2021*			
Major Accounting Class	NBV (in 000's)	# of Assets	Potential of ARO
Building & Improvements	105,418	912	High
Land & Improvements	30,907	769	Possible
Road Infrastructure	139,612	20,813	Possible
Vehicle & Equipment	30,855	573	Low
Water & Sewer	133,376	12,013	Possible
<b>Total Net Book Value</b>	<b>440,168</b>	<b>35,080</b>	

\*The Net Book Value (NBVs) were obtained from the Audited Financial Statements for the fiscal year 2021 with the # of assets obtained from the Master TCA listing dated Dec 31, 2021.

## AROs in Fully Depreciated Assets

### Guidance from the Standard

PS 3280.30:

*An asset retirement obligation may exist in connection with a fully amortized tangible capital asset that is still in productive use. For example, a public sector entity may control a fully amortized school containing asbestos. Although the tangible capital asset is fully amortized, its cost basis exists and the liability for an asset retirement obligation related to the initial acquisition, construction or development of the tangible capital asset would increase the cost basis of that asset. The costs would be amortized over the revised estimate of the remaining useful life.*

## Impact of Section 30

Considerations exist with respect to assessing when the entity plans to remediate the tangible capital asset or when the tangible capital asset will no longer be in use. This includes considering whether the City will continue to use the asset past the useful life. Further analysis will have to be performed to re-assess the remaining useful life of the asset.

## Assessment and Conclusion

The City will identify AROs on assets that are still in productive use but have been fully amortized. The TCA register continues to record assets with zero dollar net book values.

Any ARO associated with these assets will result in an increase to the cost base of the asset. Kawartha will re-assess the estimated date of the incurrence of the retirement expense and amortize the increased cost base over the remainder of the estimated time period to retire or remediate the asset. For ease of calculation, the increase to an asset's cost base as a result of recognizing the cost of an ARO, may be accounted for as a sub-asset of the existing tangible capital asset.

When assets are fully amortized but still in productive use, an assumption was made to estimate the expected year when the asset will be remediated, as required by the PSAS standard. For buildings it was assumed the retirement dates on average would be 10 years from now. Estimations were based on discussions with the asset experts and the fact that many buildings are very long-lived assets that are still in use.

## **AROs in Assets Not in Productive Use**

### Guidance from the Standard

*PS 3280.32:*

*An asset retirement obligation may arise for a tangible capital asset no longer in productive use. For example, a new legislation created after the tangible asset has been removed from service may now require its disposal in a prescribed manner and specific post-retirement activities. Given that there is no longer any period of future benefit associated with the asset retirement costs, these costs would be expensed.*

### Assessment and Conclusion

On an ongoing basis, the City will expense any asset retirement costs for associated assets that are no longer in productive use. This is aligned with the guidance provided above where PS 3280.32 allows public sectors to expense the costs on the basis that there is no longer a future benefit associated with the asset retirement costs.

## AROs in Unrecorded Assets

### Guidance from the Standard

PS 3280.31:

*An asset retirement obligation may arise in connection with a tangible capital asset that is not recognized. In this case, the asset retirement cost would be expensed as there is no cost basis of the underlying asset to which the asset retirement costs can be attached. This is consistent with the principle that asset retirement costs are not a separate asset because there is no specific and separate future economic benefit that results from them.*

### Assessment and Conclusion

During the scoping and identification of assets with AROs, the City did not identified assets still in use but not recorded in the accounting records. On an ongoing basis, for those assets that are unrecorded but have AROs, the City will recognize the liability and expense the asset retirement cost on the basis that there is no cost value of the underlying asset to which the asset retirement costs can be attached. This is consistent with PS 3280.31 where the asset retirement cost should not be treated as a separate asset.

### 4.3 Preliminary Identification of AROs

Based on the analysis set out in 4.2 Identification of ARO, each asset in scope was assessed as to whether it could give rise to an ARO. The resulting table shows that there are 352 likely ARO's identified and 6,307 assets with potential AROs.

Preliminary # of Assets with Potential AROs				
Major Accounting Class	Likely	Potentially	Major Equipment Class Included	Potential Types of AROs
Buildings & Improvements	151	17	Buildings	Asbestos Assets categorized as "possible" include buildings that reside on a landfill
Land & Improvements	118		Land, Parking lots	Asbestos in parking lots Landfill sites
Road Infrastructure		6,290	Bridges – Concrete, Bridges - Wood, Culverts – Concrete, Roads (Base, Gravel, HCB, LCB), Sidewalks (Asphalt, Concrete, Cpavers)	Asbestos in roads, bridges, culverts, and sidewalks Creosote in bridges
Water & Sewer	83		Buildings – Architectural (25), Buildings – Architectural (40), Buildings – Concrete	Asbestos
<b>Total</b>	<b>352</b>	<b>6,307</b>		

*\*\*Note: The assets currently identified as "Potentially" will need to be moved to "Yes" or "No" upon final measurement and recognition. These assets are maintained as "Potentially" status to determine whether further information is required from department managers.*

## 4.4 AROs in Tangible Capital Assets

The Canadian manufacturing of most asbestos-containing materials ended in 1979, and asbestos use was phased out during the 1980's. In 1987, the World Health Organization's (WHO) International Agency for Research and Cancer declared that asbestos was a human carcinogen. However, stockpiles existed, and asbestos products were found built into buildings up into the early 1990's.

Effective December 30, 2018, the export of asbestos and asbestos-containing products became prohibited in Canada under the Asbestos Prohibition. These regulations prohibit the import, sale, and use of asbestos as well as the manufacturing, import, sale, and use of asbestos-containing products, with a limited number of exclusions.

Although asbestos was not fully prohibited until 2018, large concentrations of asbestos are virtually non-existent in post-1990 builds due to the following: manufacturing in Canada was no longer occurring, making asbestos material harder to obtain, and the WHO declaring asbestos as a carcinogen.

The population of TCAs was assessed in depth to determine which assets and categories of assets contain AROs following the preliminary assessment of AROs as discussed in section 4.3 above. Based on the completion of hazardous material assessments completed by engineering firm Cambium Consulting and Engineering, and through consultations with asset managers at the City who reviewed the assessments for the purposed of implementing the standard, it was determined that no AROs exist in the Land & Improvements, Road Infrastructure and Vehicles & Equipment categories. Therefore, all assets in these categories have been scoped out.

Following a review of assessments completed on TCAs including buildings, the City was able to confirm which assets contained AROs with the remaining population of assets being scoped out of ARO consideration.

Buildings made only of wood materials such as wooden sheds, barns, etc., were assessed to not be included in measurement since being made of wood material would be unlikely to trigger an ARO and/or contain hazardous materials.

### Assessment and Conclusion

While Canadian manufacturing of most asbestos-containing materials ended in 1979, the City recognizes that the use of asbestos-containing materials may have continued for a period of time after 1979 and has therefore used the year 2000 to complete the initial scoping of buildings. Further scoping and the recording of AROs was then determined by hazardous material reports and assessments. The City also recognizes that there is a risk that buildings constructed after the year 2000 may contain asbestos, however the risk is low and not significant.

## 4.5 Final Conclusion on Scoping

After applying the assumptions from above, there are a total of 83 tangible capital assets in scope for ARO measurement. The table below shows a summary of the tangible capital assets in-scope for ARO measurement by asset category.

<b>Category</b>	<b>Number of TCAs in-scope for ARO</b>
Buildings and Improvements	51
Water & Sewer – Buildings (Architectural)	8
Water & Sewer – Buildings (Concrete)	6
Landfill Sites	18

## 5.0 Measurement

Phase 2 of the adoption of PS 3280 involves preparing and planning the measurement methodologies to apply for the various AROs identified in 4.0 Scoping. In this phase, the City has performed various activities such as collecting asset information and data, identifying and filling gaps in the collected information and data, determining appropriate measurement methodologies for identified AROs, and collecting support and evidence for the ARO methodologies.

### 5.1 Initial Measurement

Only costs that are directly attributable to asset retirement activities will be included in estimation of the ARO liability.

Directly attributable costs are those that are related to the nature and extent of the asset retirement obligation in accordance with the agreement, contract, legislation or a legally enforceable obligation establishing the ARO liability.

As per PS 3280.34, directly attributable costs may include items such as payroll and benefits, equipment and facilities, materials, legal and other professional fees, and overhead costs directly attributable to the asset retirement activity.

Conversely, costs related to obligations created by waste or by-products produced by a tangible capital asset are costs of operations and are not directly attributable to asset retirement obligations. These costs would not be included in the estimation of the ARO liability.

### 5.2 Measurement Methodologies

Various measurement methodologies were developed and applied for the different categories of TCAs in-scope for ARO measurement.

#### **Buildings, Building Improvements, and Water Sewer**

ARO measurement was performed for buildings, buildings improvements and water sewer facilities that are in-scope for AROs. The City utilized pricing information from previous remediation work, previously completed assessments from Consulting and Engineering firm Cambium (that outlined the quantities or hazardous materials in buildings) and discussions with asset managers and experts (such as Cambium), to determine the costs that were then applied to buildings in scope for ARO measurement to estimate the ARO liability.

#### **Landfills**

ARO measurement was performed for landfills that are in-scope for AROs. The City utilized a comprehensive assessment of landfills prepared by Urban & Environmental Management Inc. which determined the estimated closure and post closure costs for each of the City's landfills. These costs were then included in the ARO assessment and valuation to determine the estimate of the ARO liability.

## 5.4 Application of Time Value of Money

The present value technique of ARO measurement factors in the time value of money through the application of a discounted cash flow calculation. As per PS 3280.47, a discount rate reflects the time value of money and the risks specific to the liability for asset retirement obligations, for which future cash flow estimates have not been adjusted. The assumptions applied in the cash flows and the discount rate should be internally consistent. The discount rate will be used in the discounted cash flow calculation to determine the present value of the ARO liability at each year-end reporting date.

The present value technique was only used for landfill sites and was not applied to AROs relating to buildings. This was based on a policy decision as the impact of electing to use the present value technique would not be significant for AROs relating to buildings; however, would have a substantial impact on AROs relating to landfills as the values applying the present value technique and not applying it were vastly different.

## 5.5 Estimated ARO Liability

The total liability as at December 31, 2023 is \$30,701,594 (\$27,506,051 relating to Landfills and \$3,195,543 relating to Buildings & Water Sewer). The tangible capital asset as at December 31, 2023 is \$30,109,487 with accumulated amortization of \$657,534, showing a net asset value of \$29,451,954. The impact on the accumulated surplus/deficit in adoption year is \$1,249,640.

Please see the “Valuations” excel workbook for the detailed computations.

## 5.6 Transitional Provisions

The standard outlines three transitional provisions that are available for all entities implementing PS 3280.

When analyzing the various provisions, consideration was made as to the impact to the financial statements, the impact on budget and the overall cost versus benefit of adherence to the requirements of each of the transitional provisions.

The City decided to apply the prospective application approach to implement the PS 3280 standard. This application does not require restatement of prior periods from the beginning of the fiscal year in which the City first applied the section.

Based on the above provisions considered, the decision was made based on the following criteria:

- Effort/cost of implementation
- Benefit of prior year information restated vs. cost of providing the information

Kawartha has selected the prospective application as the best option for the transitional provision for ARO.