Town of Whitchurch-Stouffville Council Report Item 8.1

Subject :	**PS 3280 Asset Retirement Obligations – 2023 Adoption**
Staff Report No.	**FI-005-24**
Commission:	**Finance Services Commission**
Date:	**May 15, 2024**

Recommendation:

1) That Council receive Report No. FI-004-24 for information.

1. Purpose:

The purpose of this report is to advise council regarding mandatory changes to the fiscal 2023 financial statements as a result of the new accounting standard PS 3280 Asset Retirement Obligations (AROs).

2. Executive Summary:

According to Public Sector Accounting Standards (PSAS) regulations, the Town is required to adopt PS 3280 Asset Retirement Obligations for the year ended December 31, 2023.

The standard requires an estimation of costs associated with the retirement of tangible capital assets held by the Town that arise specifically from legal obligations. These costs are to be recorded as a liability each year on the financial statements. An amount equal to the liability is to be added to the cost of the corresponding asset and amortized over the useful life, as accretion expense. Thus, the resulting impact will be an increase in liabilities, tangible capital assets, and amortization/accretion expense.

The Town reviewed the capital asset listing and listing of contractual obligations, and per discussion with subject matter experts and review of environmental assessments, all AROs identified were associated with assets that utilized asbestos materials (7 facilities and 3,048.50 metres of concrete sewer pipes).

As a transitional provision, the Town will be applying the modified retrospective application with restatement. For fiscal year 2022, this will involve increase to liabilities ($515,280), increase tangible capital asset balances ($35,340) and corresponding amortization/accretion expense ($35,340), resulting in net reduction and restatement to accumulated surplus of $479,940. Please note that these values provided are preliminary and may be subject to change based on review by the external auditors. For 2023, additional note disclosures will also be required to summarize the impact of the prior year restatement and provide information related to the ARO liability.

3. Background:

Public Sector Accounting Standards (PSAS) has required the adoption of the new standard PS 3280 Asset Retirement Obligations. As this involves a significant change to the financial statements and a complex estimation process, the Finance Services Commission has provided the following report to provide clarity on what the standard requires, the Town’s process for developing the estimate amounts, and ultimately the impact to the 2023 financial statements.

3.1 Asset Retirement Obligation Policy

In response to the new standard, the finance team prepared an internal policy to guide the adoption of the new ARO standard and how to account for the new liabilities. Refer to a copy of the policy attached which includes definitions for key terms, initial approach, recognition, presentation, and responsibilities.

3.2 Application to the Town

This accounting standard applies to all departments, branches, and boards falling within the reporting entity of the Town, including the Whitchurch-Stouffville Public Library and Latcham Art Centre, that possess asset retirement obligations including:

- Assets with legal title held by the Town,
- Assets controlled by the Town, and
- Assets that have not been capitalized or recorded as a tangible capital asset for financial statement purposes.

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 from buildings and other equipment. Other obligations to retire tangible capital assets may arise from contracts or lease arrangements.

3.3 Initial Recognition and Measurement

In summary, the standard requires that a liability be set up for tangible capital assets (TCAs) that have associated legal obligations related to the retirement of the asset.

A liability for an asset retirement obligation must be recognized when all of the following criteria are met (as per PS 3280, paragraph .09)

- 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.

On initial recognition of an ARO liability, the related tangible capital asset must also be increased by the same amount. The cost must then be expensed in a rational, systematic manner over the useful life of the asset, similarly to amortization expense. This is recorded as accretion expense.

For the initial measurement, there are no specific requirements within the standard on how to measure the liability. Since the cash flows required to settle the obligation will be made in the future, a present value technique is often considered the best estimate for the liability, which requires the determination of a discount rate. Refer to section 4.2 below for more information on the measurement basis utilized by the Town. The Town's external auditors have also provided additional documentation for Council's information, see attachment #2 Why Audit Committees should know about AROs.

4. Analysis and Options:

As adoption of PS 3280 is mandatory for fiscal years beginning on or after April 1, 2022, the Town will be required to apply the changes to the upcoming financial statements for the year ending December 31, 2023. Therefore, the items below are provided to highlight the analysis performed and the required impact on the statements as a result of the standard.

4.1 Analysis Performed

The Town underwent the detailed exercise of reviewing the tangible capital asset register to determine which assets would be in scope for further analysis. The assets were split out by department and these lists were discussed with the appropriate subject matter experts (department managers and other staff as applicable) to gain an understanding of any potential items associated with retirement obligations. Several thorough discussions were held to ensure that a complete understanding was obtained. In addition to reviewing the TCA list, a listing of all contractual obligations was obtained and reviewed in detail to ensure that any legal obligations associated with asset retirement at the end of a lease were identified as well.

Based on these discussions, it was determined that the assets associated with retirement obligations included buildings and concrete sewer pipes that contained asbestos materials. Ontario was the first Canadian province to ban the use of friable asbestos (March 1986, O. Reg. 654/85). Of the many non-friable materials, only drywall joint compound has been banned in Canada. In practice, non-friable asbestos ceased being used in most materials by manufacturers as a result of asbestos concerns circa 1990.

The presence of asbestos at these sites was confirmed through the Hazardous Building Materials Assessments performed by Pinchin Ltd. The abatement of asbestos is expected to be at the end of the useful life of each building.

The following assets were identified for ARO measurement:

- Lemonville Community Centre
- Senior Centre (6240 Main Street)
- Stouffville Arena
- Ballantrae Community Centre
- Latcham Hall
- Parks Depot
- Whitchurch-Stouffville Museum
- Concrete Sewer Pipes
    - The Town identified 3,048.50 metres of sewer pipe made with asbestos cement. These were identified through a CCTV scan of all stretches of sewer performed by Braywood Services Inc.

4.2 Impact to Financial Statement Values

In the year of adoption, there are three transitional provision options to implement the new standard: retroactive, modified retroactive, or prospective application.

The Town will use the modified retroactive application to transition to PS 3280 Asset Retirement Obligations for the financial statements of the year ended December 31, 2023. The Town contracted BDO to perform the calculations and measurement of the associated ARO based on the identified assets above and environmental assessments for the properties performed by Pinchin Ltd and Braywood Services Inc. As part of the modified retroactive approach, the Town utilized a present value technique to discount the future cash flows based on assumptions as at January 1, 2023. The discount rate was determined as the weighted average interest rate on long-term liabilities, per 2022 financial statement Note #7.

As such, the following will be recognized in the financial statements:

- A liability for any existing asset retirement obligations, adjusted for accumulated accretion to date,
- An asset retirement cost capitalized as an increase to the carrying amount of the related tangible capital asset,
- Accumulated amortization on the capitalized cost, and
- An adjustment to the opening balance of the accumulated surplus/deficit.

i. *Impact on 2022 Values*

As a result of the restatement, the following adjustments are required:

- Increase liabilities for asset retirement obligation = $515,280

- Increase TCA for amortization/accretion expense (recorded under each category) = $35,340
- Restate accumulated surplus (net reduction of $479,940) = $351,047,406

ii. *Impact on 2023 Values*

The current year values impacted by the AROs include the following, in summary:

- Asset retirement obligation liability = $536,767
- Accretion expense (recorded under each category) = $21,487

Please note that the values provided for 2022 and 2023 are preliminary and are thus subject to change during the review by the external auditors.

4.3 Impact to the Notes to the Financial Statements

The notes also form an integral part of the financial statements, and this PS standard requires additional note disclosures. Two additional notes to the financial statements will be required in 2023 – one for the asset retirement obligation, and one for the restatement of 2022 values.

5. Financial Implications:

There are no financial implications arising from this report. The 2023 budget anticipated the additional audit and consulting fees related to the adoption of this new standard. Any future budget impacts will be taken into consideration.

6. Alignment with Strategic Plan:

1. Good Governance
   Provide Good Governance

2. Organizational Effectiveness
   To Elevate our Organizational Effectiveness

7. Attachments:

1. Asset Retirement Obligation Policy
2. Why Audit Committees should know about AROs

8. Related Reports:

None

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