Asset Retirement Obligation Policy

Effective:	April 1, 2022	**Supersedes:**	N/A
Applicable to:	Town departments that possess tangible capital assets	**Authority:**	Treasurer

1.0 Overview

The Town of Whitchurch-Stouffville (the Town) shall account for and report on asset retirement obligations (ARO) in compliance with the Public Sector Accounting Board (PSAB) Handbook, section 3280.

2.0 Policy

The objective of this Policy is to stipulate the accounting treatment for asset retirement obligations so that users of the financial statements can discern information about these assets and their end-of-life obligations. The principal issues in accounting for asset retirement obligations is the recognition and measurement of these obligations.

3.0 Definitions

Accretion expense is the increase in the carrying amount of a liability for asset retirement obligations due to the passage of time.

Asset retirement activities include all activities related to an asset retirement obligation. These may include, but are not limited to:

- decommissioning or dismantling a tangible capital asset that was acquired, constructed, developed, or leased,
- 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.

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

Asset retirement obligation (ARO) is a legal obligation associated with the retirement of a tangible capital asset.

Controlled Asset is an asset that is owned or controlled, directly or indirectly, by the Town.

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.

Tangible Capital Assets (TCA) are non-financial assets having physical substance that:

- Are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance, or repair of other tangible capital assets,
- Have useful economic lives extending beyond an accounting period,
- Are to be used on a continuing basis in the Town's operations, and
- Are not for sale in the ordinary course of operations.

4.0 Application

This policy 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.

The legal obligation, including obligations created by promises made without formal consideration, associated with retirement of tangible capital assets controlled by the Town, will be recognized as a liability, in accordance with PS 3280 Asset Retirement Obligations which the Town 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.

5.0 Approach

To apply PS 3280 to the financial statements, the Town must first identify obligations that are within scope of the standard, determine if the items in scope meet the applicable recognition criteria, and for each item that meets such criteria, estimate the asset retirement costs associated with the obligation.

In the year of adoption, it is critical to identify asset retirement obligations associated with all tangible capital assets controlled by the Town. To ensure completeness of items within scope, Finance staff, with the assistance of department experts, will:

- Review a listing of all tangible capital assets which reconciles to the general ledger and identify all assets with possible retirement obligations,
- Review operating contracts to identify possible asset retirement obligations, and
- Compile a list of key laws and regulations that could impact the Town's assets.

Once asset retirement obligations have been identified as within scope of PS 3280, recognition and measurement criteria will be evaluated to record the obligation in the Town's financial statements. Specific details from PS 3280 regarding recognition and measurement of asset retirement obligations can be found in sections 5.1 and 5.2 of this policy.

5.1 Recognition

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

1) **There is a <u>legal obligation</u> to incur retirement costs in relation to a tangible capital asset,**
    - A legal obligation establishes a clear responsibility to the Town that justifies recognition of a liability. A legal obligation can result from agreements or contracts, legislation of another government, the Town's own legislation, or a promise conveyed to the Town that imposes a reasonable expectation of performance upon the promisor under the doctrine of promissory estoppel.
2) **The <u>past transaction</u> or event giving rise to the liability has occurred,**
    - A liability for an asset retirement obligation can be incurred due to the acquisition, construction or development of a tangible capital asset, or normal use of a tangible capital asset.
3) **It is expected that future economic benefits will be given up, and**
4) **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.**

5.2 Measurement

5.2.1 Initial Measurement

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 the liability would be based on information available at the financial statement date.

The estimate of the 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.

Measurement of a liability for an asset retirement obligation should result in the best estimate of the amount required to retire the tangible capital asset (or component thereof) at the financial statement date. The estimate of the liability requires professional judgment.

Upon initial recognition of a liability for an asset retirement obligation, the Town will recognize an asset retirement cost by increasing the carrying amount of the related tangible capital asset (or a component thereof) by the same amount as the liability.

Where the obligation relates to an asset which is fully amortized, but remains in service, the asset retirement costs increase the cost basis of the asset and are amortized over a revised remaining useful life. Where the obligation relates to an asset which is no longer in service, and not providing economic benefit, or to an item not recorded by the Town as an asset, the obligation is expensed upon recognition.

The capitalization thresholds applicable to the different asset categories will also be applied to the asset retirement obligations to be recognized within each of those asset categories.

5.2.2 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.

Once the related tangible capital asset or component the asset is no longer in productive use, all subsequent changes in the estimate of the asset retirement obligation liability should be recognized as an expense in the period they are incurred.

The liability for an asset retirement obligation will be recognized until it is settled or otherwise extinguished.

5.3 Transitional Provision

In the year of adoption, there are three transitional provision 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. 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.

If an asset retirement obligation exists for a tangible capital asset no longer in productive use, a liability will be recognized with a corresponding adjustment to the opening accumulated surplus/deficit.

Asset retirement costs will be estimated using information and assumptions that are current at the beginning of the fiscal period in which PS 3280 is first applied (January 1, 2023). The amount recognized as asset retirement costs, accumulated accretion and amortization will be measured as of the date the asset retirement obligation was incurred. Comparative information in the financial statements will be restated unless the necessary financial data is not reasonably determinable.

5.4 Presentation and Disclosures

Per PS 3280 Asset Retirement Obligations, the liability for asset retirement obligations will be disclosed. Additional disclosures required in the Town’s financial statements include:

- A general description of the liability and associated tangible capital asset,
- Amortization method used for the asset retirement costs,
- Basis for the estimate of the liability
- A reconciliation of the changes in carrying amount during the period
- How any requirements for financial assurance and funding associated with asset retirement obligations, if legally required, are being met,
- When a reasonable estimate of the amount of an asset retirement obligation cannot be made, that fact and the reasons therefore, and
- The estimated recoveries.

6.0 Responsibilities

Departments are required to:

- Communicate with Finance on retirement obligations, and any changes in asset condition or retirement timelines,
- Inform Finance of any legal or contractual obligations at inception of any such obligation, and
- Assist in the preparation of cost estimates for retirement obligations.
    - Where it is reasonable, this includes providing cost-effective projections of asset retirement obligations by consulting with engineers, technicians and other personnel familiar with the assets and conditional assessments, collecting the relevant information required to minimize service cost, and providing the information to Finance for processing.

Management is responsible for implementing this policy in accordance with the legal obligation of the Federal and Provincial legislation.

Finance is responsible for the development of and adherence to policies for the accounting and reporting of asset retirement obligations in accordance with Public Sector Accounting Board section 3280. This includes:

- Reporting asset retirement obligations in the financial statements of the Town and other statutory financial documents,
- Monitoring the application of this Policy,
- Managing processes within the applicable asset accounting modules and records, and
- Investigating issues and working with asset owners to resolve issues.

7.0 References

- Public Sector Accounting Board, Public Sector Handbook, Section PS 3280 Asset Retirement Obligations
- Dec 5, 2013, Tangible Capital Asset Policies, Town of Whitchurch-Stouffville

8.0 Appendix A: Asset Retirement Obligation Decision Tree

The decision tree below is an illustrative example from PS 3280 Asset Retirement Obligations – Appendix A. It helps to illustrates the boundaries between PS 3280 Asset Retirement Obligations and PS 3260 Liability for Contaminated Sites.