MNP

Asset Retirement Obligations (ARO)

Understanding the new Accounting Standard

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Introduction

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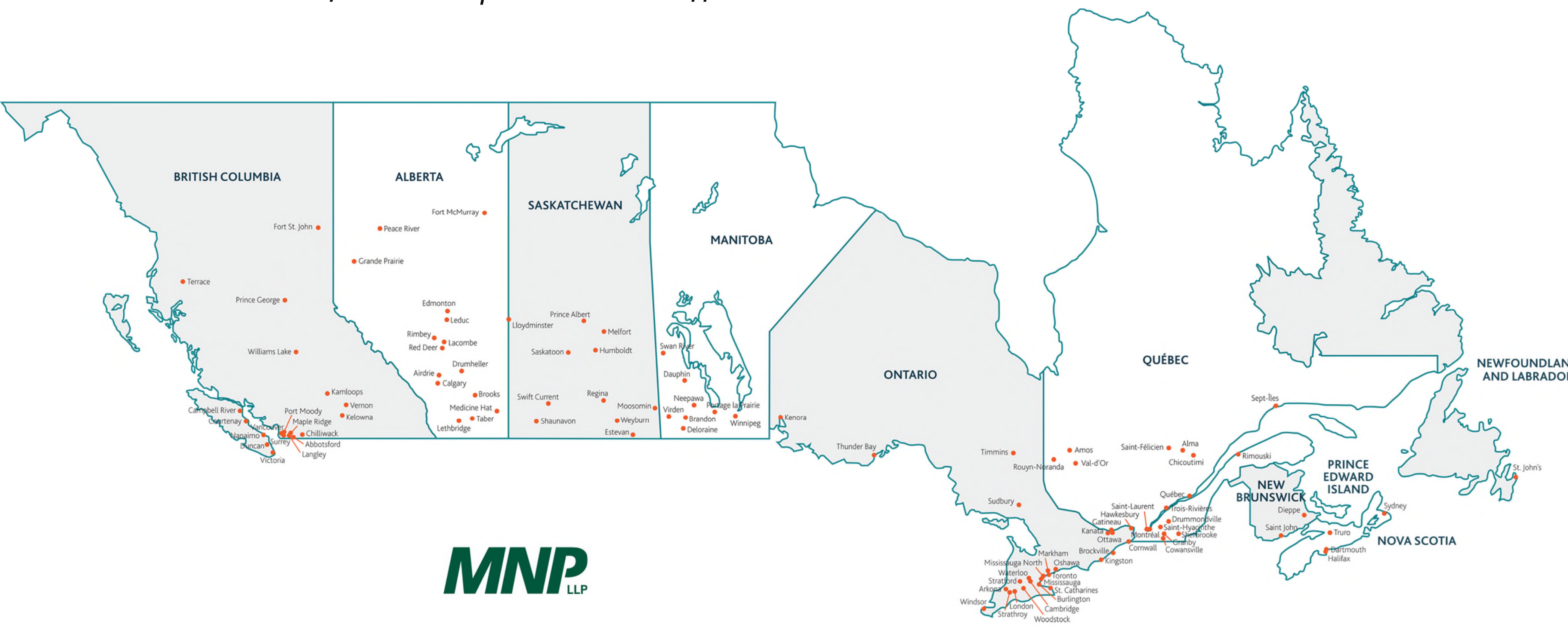

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Agenda

- Setting the Stage
- New Standard – A Deeper Dive
- Financial Reporting Considerations
- Best Practices for Approaching Adoption
- TCA Management

Setting the Stage

Setting The Stage

What is an ARO?

"A legal obligation associated with the retirement of a tangible capital asset (TCA)"

Retirement of a TCA is the permanent removal of a TCA from service and includes sale, abandonment, or disposal.

Covers TCA which are controlled, in and out of productive use, and includes leased assets.

Setting The Stage

What is an ARO?

Asset Retirement Activities:

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

Setting The Stage

Why Report AROs?

Better decision making

- True cost of an asset
- Planning for future expenditures and required revenues

Encourages better asset management

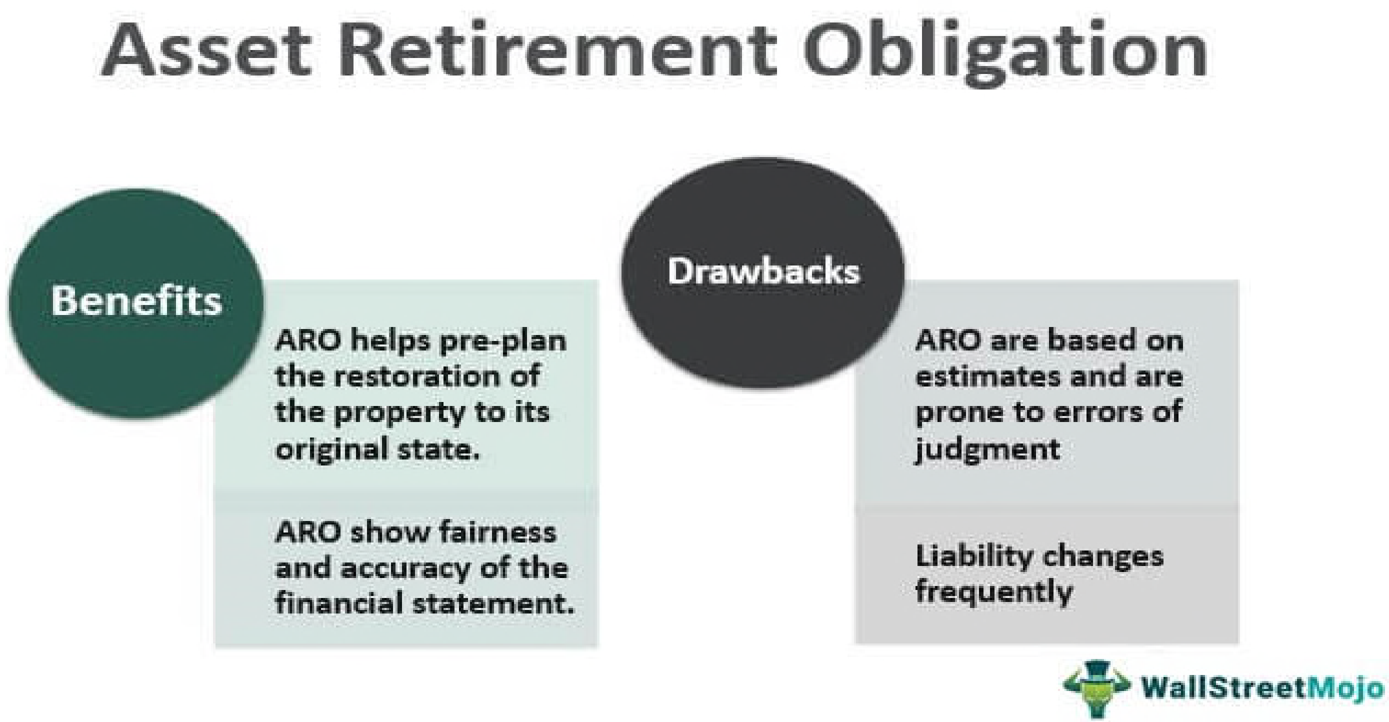
Transparency to members

Consistency with non-government entities

- IAS 16 and IAS 37
- ASPE 3110

Setting the Stage

Why Report AROs?



Source: [Asset Retirement Obligation - What Is It, Accounting (wallstreetmojo.com)]

Setting the Stage

More Information about AROs

From a Google Search of "PS 3280":

- [2020 06 PSAS 3280 Asset Retirement Obligations - FINAL (mnp.ca)]
- [Perspectives on PS3280 Asset Retirement Obligations (kpmg.com)]
- [Section PS 3280 - Asset Retirement Obligations | BDO Canada]
- [PSAB Asset Retirement Obligation Standard - Resources (mfoa.on.ca)]

Setting the Stage

Difference from Other Standards

Landfills – old PS 3270

	New Section PS 3280	Old Section PS 3270
Liability	Recognized as incurred – earlier recognition	Recognized incrementally as landfill is used – later recognition
Total liability (estimated total expenditure)	Generally the same	
Assets	Asset retirement obligations are capitalized – increase the carrying amount of the related asset	N/A
Net debt	Both methods impact net debt PS 3280 = earlier increase in net debt	
Total expenses (over time)	Generally the same	
Annual expenses	Differences in annual expenses are due to differences in methodology used in recognizing the liability	

Source: PSAB In Brief: How Asset Retirement Obligations, Section PS 3280 applies to asset retirement obligations associated with landfills

Setting the Stage

Difference from Other Standards

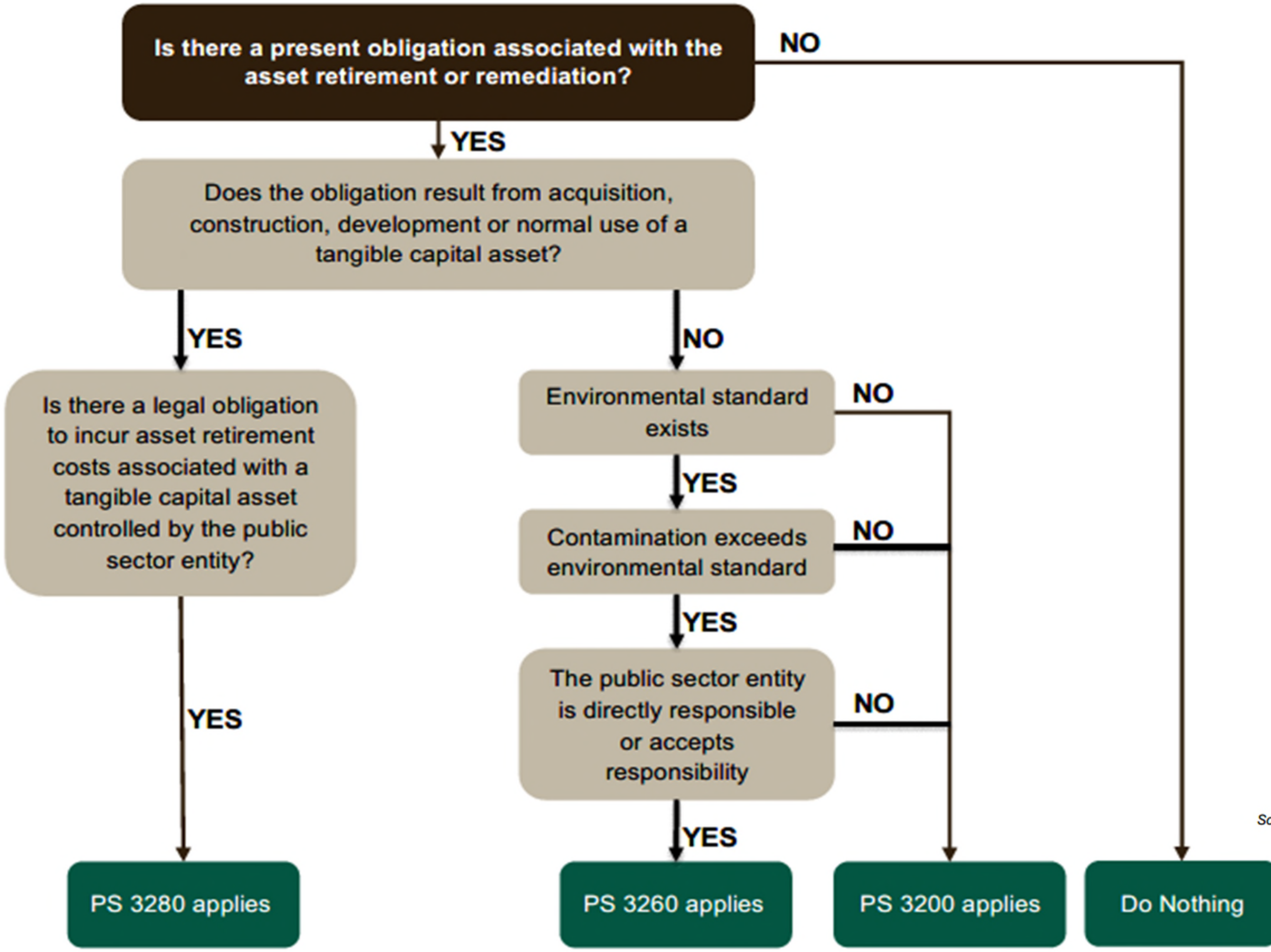
Contaminated Sites – PS 3260

PS 3280	PS 3260
Cause for the retirement or remediation obligation	
• Acquisition, construction, development, normal use. • Not necessarily associated with contamination.	• Unexpected event*, improper use. • Contamination needs to exist.
Type of Obligation	
• Legal obligation related to tangible capital asset of the entity.	• Legal, constructive, and equitable obligations (direct responsibility and assumed).
Extent of contamination	
• Does not need to exceed the environmental standard.	• Must exceed the environmental standard.

** e.g., Normal use at a fueling station could create an asset retirement obligation, however a fuel spill elsewhere could create a contaminated site.*

Source: PSAB In Brief: Asset Retirement Obligations and Liability for Contaminated Sites – determining which standard should be applied

Exhibit A: Scope of Applicability



Source: CPA Handbook PS 3280 Appendix A

New Standard – A Deeper Dive

New Standard – A Deeper Dive

The Standard – PS 3280

PS 3280 provides guidance for the accounting of AROs. The standard consists of:

1. For obligations to retire TCAs that are predictable and unavoidable. This requires:
    i. Entities have a legal obligation to permanently remove a tangible capital asset from service (i.e., retire); and
    ii. Control the tangible capital asset that needs to be retired.
2. Guidance on when an ARO is recognized
3. Guidance on what variables to consider when initially measuring an ARO
4. Guidance on subsequent measurement and measurement uncertainty.
5. Disclosure guidance pertaining to AROs.
6. Guidance on transitional provisions.

New Standard – A Deeper Dive

The Standard – PS 3280

What costs PS 3280 does not cover:

- TCAs and their replacement and maintenance;
- Contaminated sites (PS 3260);
- Improper use of a TCA;
- Activities to prepare a TCA for an alternative use;
- Resulting from unexpected events;
- Obligations created by waste or by-products produced by TCA (such as sewage waste); and,
- The plan to sell or otherwise dispose of a TCA.
- ARO type costs for TCA which are not controlled (PS 3200 if a liability)

New Standard – A Deeper Dive

Recognition Criteria

In accordance with PS 2380.09, an ARO is recognized when all four are met:

- There is a legal obligation to incur retirement costs in relation to a TCA;
- 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.

New Standard – A Deeper Dive

Recognition Criteria – Legal Obligation

PS 3280.10 specifies that a legal obligation establishes a clear duty or responsibility to another party that justifies recognition of a liability.

A legal obligation related to PS 3280 may result from:

- ✓ Agreements or contracts;
- ✓ Legislation of another government;
- ✓ A government's own legislation; or,
- ✓ A promise conveyed to a third party that imposes a reasonable expectation of performance upon the promisor under the doctrine of promissory estoppel.

New Standard – A Deeper Dive

Recognition Criteria – Legal Obligation

Where to look:

- ✓ Federal legislation applicable on-reserve
  - i.e. Environmental standards, labour code, Indian Act, etc.
- ✓ Provincial legislation applicable on-reserve
  - i.e. Provincial legislation typically is not considered to have jurisdiction on-reserve, but there are instances where Provincial legislation does apply or is accepted/adopted which creates precedent for potential legal obligations
- ✓ Provincial legislation applicable when decommissioned assets are required to be removed from the reserve
  - Hazardous waste and transportation regulations federally and provincially may differ creating a difference in legal obligation if an item needs to be moved, with similar consideration for things such as recycling fees for electronics, used oil, and tires, etc.

New Standard – A Deeper Dive

Recognition Criteria – Legal Obligation

Where to look:

- ✓ Nation's own legislation such as land codes or land management acts, constitutions, property tax codes/acts, FALs, etc.
- ✓ Agreements, permits, or contracts with ISC for construction or operating of assets
- ✓ Agreements or contracts with other funders, leases for property, housing rental agreements, etc.
- ✓ A "promissory estoppel" may be a result of public acknowledgment of an intention to do something, specifically with a BCR, media releases, reports at Assembly, etc.

New Standard – A Deeper Dive

Recognition Criteria – Past Transaction or Event

Past transaction or event	Example	Explanation
Acquisition	Public sector entity acquires a building containing asbestos. Regulations require that asbestos be removed in a prescribed manner.	The obligation is incurred on acquisition of the building as existing regulations require the entity to handle and dispose of the asbestos in a prescribed manner when it is disturbed. The ability to postpone the asbestos removal does not relieve the entity of the obligation.
Normal use (incurred when asset is put into production)	Public sector entity opens a waste water treatment plant. Environmental approval requires closure activities to be performed irrespective of volume of waste accepted.	The obligation is incurred in full when the entity starts accepting waste because it is linked to the normal use of the water treatment plant, but not to the volume of waste accepted.
Normal use (incurred incrementally with use)	Public sector entity opens a sewage lagoon. Environmental approval requires post-closure activities that are directly linked to the volume of waste accepted.	The obligation is incurred incrementally with use of the sewage lagoon because it is linked to the normal use of the sewage lagoon and the volume of waste accepted.

Source: PSAB In Brief: A plain and simple overview of Asset Retirement Obligations, Section PS 3280

New Standard – A Deeper Dive

Recognition Criteria – Reasonable Estimate

PS 3280.23

Existence uncertainty

In some circumstances, a public sector entity may have doubts as to the existence of an asset retirement obligation. For example, a public sector entity may be uncertain whether it has incurred an obligation through the operation of the doctrine of promissory estoppel. The existence of any liability in such cases is contingent on a future determination by a court, a regulator or some other competent authority, or a future determination by the entity that it would be held liable. In these circumstances, CONTINGENT LIABILITIES, Section PS 3300, provides additional guidance. If a liability for an asset retirement obligation is recognized, this Section would be applied.

Identification of what needs to be decided for the uncertainty to be realized needs to be evidenced.

New Standard – A Deeper Dive

Recognition Criteria – Reasonable Estimate

PS 3280.23

An acceptable standard to follow is that an ARO should be identified and recorded if ‘a reasonable effort could be made by a knowledgeable person’ to attain sufficient information to make an assessment and related estimate. If information could be attained but has not, then it could impact an auditor’s opinion.

Consult PS 3300 *Contingent Liabilities* if existence uncertainty does exist.

New Standard – A Deeper Dive

Possible TCAs with an ARO

- Buildings and structures
  - Asbestos removal and other hazardous material (i.e. lead paint)
- Wastewater holding tanks and disposal fields
  - Water and wastewater lines, especially concrete asbestos or lead pipes
- Underground storage tanks
- Solid waste landfills
- Wells (water, oil, gas)
- Reforestation of land subject to a timber lease

New Standard – A Deeper Dive

Possible TCAs with an ARO

- Information technology hardware and communication infrastructure (protection of privacy legislation)
- Vehicles or equipment, including specific components
- Solar or wind energy generating equipment
- Hazardous materials such as batteries, refrigerant chemicals, radioactive material
- Recycling fees not paid up-front – electronics, tire, used oil, etc.
- Leases resulting from land codes (some leases require the land to be returned back to the way it was at the start of the lease) (legal obligation when on land can be complicated being on-reserve given impact of Indian Act and land being held by the Crown)

New Standard – A Deeper Dive

Measurement

PS 3280.33

Measurement of a liability for an asset retirement obligation should result in the best estimate of the amount required to retire a tangible capital asset (or a component thereof) at the financial statement date. [APRIL 2022]

Considerations	
Which costs to include?	Includes costs that are: • Directly attributable to asset retirement activities (for example, payroll, materials, and overhead costs). • Based on requirements in existing agreements, contracts, legislation, and/or legally enforceable obligations.
Estimation technique	A present value technique is often the best available technique to estimate the liability, as asset retirement obligations tend to be long term in nature.
Discount rate	The 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.

New Standard – A Deeper Dive

Measurement - Estimates

As per PS 3280.58, "uncertainty about the timing and amount of the settlement of the asset retirement obligation does not remove that obligation but will affect the measurement of the liability" therefore uncertainty and the use of estimates does not negate the reporting of a liability.

Considerations about estimate:

- Source of information - from a third party or internally prepared
- Timing - how old is the information being used for the estimate, how often is it updated
- Evaluation – information can be verified, replicated, comparable to other information, reasonableness

New Standard – A Deeper Dive

Measurement - Discounting

- Discounting adjusts estimates for time
  - Changing value of money (present value of future costs)
  - Changing costs (inflation)

- Discount rates considerations:
  - Risk for the liability – may be borrowing rate, cost of capital, opportunity cost rate
  - Needs to be consistently applied
  - If no discounting, provide justification

New Standard – A Deeper Dive

Measurement - Recoveries

PS 3280.60-62 identifies the potential of recording a recovery as an asset (*note – cannot be netted*) but only if the Nation controls the asset as required by PS 3210.

If there is no control but indications and support for a contingent asset as per PS 3320, then note disclosure may be appropriate.

ISC position – No ARO related to on-reserve assets as they do not own assets (recipient eligibility for funding); may provide funding for liabilities but no obligation to do so until funding agreement signed.

Canada has a fiduciary duty due to the control over reserve lands – however, there is no clear indication that this duty negates legal obligations resulting from contracts/agreements or other Canadian legislation

Financial Reporting Considerations

Financial Reporting Considerations

Adoption Options

- Retroactive application – restate as if recorded correctly from time of obligation event (purchase asset, legislation changes, etc.) using historical assumptions and rates
- Modified Retroactive application – restate as if recorded correctly however using current assumptions and rates

Retroactive application creates more comparable financial statements between the current year and the prior year, may require more effort to determine numbers

- Prospective application – record obligation and TCA as of April 1, 2022

Prospective application results in significant variances from current year to prior year, but may be simpler and efficient to report numbers

Financial Reporting Considerations

Tangible Capital Assets (“TCA”)

- Initial recognition/measurement of an ARO results in larger TCA cost.
  - Better reflects true cost of the asset
  - Each year after there is more amortization expense

- Adoption of ARO process an opportunity to revisit amortization rates to determine appropriate
  - Are amortization rates reflective of actual ‘useful lives’ of the TCA?
  - Impact of AROs for TCAs still being used but are fully amortized (note, still need to record)

Financial Reporting Considerations

Financial Statement Note Disclosures

Should include:

- ✓ What the ARO is and the associated TCA
- ✓ The amortization method used for the asset retirement costs
- ✓ All variables used for any estimates for the cost, discounting, etc.
- ✓ Reconciliation of beginning and ending liability showing changes due to:
  - Liability added in the current year
  - Amount spent on past liability in the current year
  - Change resulting from passage of time (accretion expense from discounting)
  - Revisions in estimated cash flows
- ✓ If legally required, how ARO liabilities are being funded and balance of funds
- ✓ Where estimate cannot be made, explain why
- ✓ Estimated recovery assets, if any

Best Practices for Approaching Adoption

Best Practices for Approaching Adoption

Sources of Information

Where to start:

- TCA listing
- ACRS report
- Project managers
- Public works team members
- Operating agreements
- Lease contracts
- Nation own legislation (Land Code/Act, FAL, etc.)

Best Practices for Approaching Adoption

Common Legal Obligation Findings

Wastewater infrastructure including lagoons – does not appear to be any clear legal obligation yet from federal legislation or ISC contracts

- Decommissioning does occur but usually part of a plan to replace with a new asset

Water treatment plants, sewage pumping stations, water wells, underground water and wastewater lines, underground storage tanks – no clear legal obligation identified from federal legislation

However, if any of the above are found to be leaking than a contaminated site exists.

Best Practices for Approaching Adoption

Landfills

As per *Indian Reserve Waste Disposal Regulations* which supplement the *Indian Act*, waste sites can only be allowed on reserve lands if 'permitted' by the Minister.

To search for potential permits:

Indian Lands Registry / Registre des terres indiennes (aadnc-aandc.gc.ca)

Registry box to be "ILRS", Purpose box "Disposal Site", find First Nation, click + beside each box to have criteria added to search

To search for contaminated sites:

Search by Keyword (tbs-sct.gc.ca)

Best Practices for Approaching Adoption

Landfills

Permitted sites:

- Decommissioning plans and costs the responsibility of the permit holder, therefore ARO exists
- ISC provides funding via specific programs, must be applied for (may be contingent asset)
- Costs typically include covering (material typically clay which may have to be transported from a distance), replanting and landscaping, fence and structure removal, and monitoring
- Permit does not allow for "hazardous waste materials" to be put in the landfill, therefore asbestos, petroleum, chemical, biomedical, creosote treated materials, etc. that are not considered household items may need to be transferred to another landfill/facility

Best Practices for Approaching Adoption

Landfills

Non-Permitted sites:

- Likely indicates no asset exists (can compare to TCA listing for development costs) and if no asset, then no ARO.
- Landfill or dump sites being used by the Nation would be ‘contaminated sites’
- Existence of hazardous waste materials supports a contaminated site
- Assessed using PS 3260 guidance

Best Practices for Approaching Adoption

Asbestos

- Federal and Provincial legislation requires protection of individuals working with materials containing asbestos.
  - Legal obligation created with the passing of the relevant legislation – first regulations in housing 1980 with move to complete ban in housing and buildings in early 1990's (complete ban on all coatings for other building materials not until 2018)
  - Costs include isolation of the impacted area, PPE for workers, disposal to appropriate site.
  - Housing and buildings – inspections and inventory of asbestos sites or estimate of costs based on age of buildings

Best Practices for Approaching Adoption

Access Support

- ISC may fund projects related to adopting ARO:
  - Asbestos inventory creation
  - Support for implementation of process to identify and report ARO
  - Asset management systems

TCA Management

TCA Management

Why Asset Management

- Maximize the life-cycle of assets
- Mitigate health and safety risks
- Assets meet codes and standards
- Ensure programs are delivered in a cost effective and environmentally sound manner
- Planning for the unexpected and being able to adapt and react
- Predict and plan the replacement of existing infrastructure
- Reduce asset life-cycle costs

TCA Management

How to Do It

Similar to ACRS reports process but for all assets (not just ISC funded).

1. Review TCA policies (thresholds, amortization rates)
2. Develop inventories of all TCAs
3. Determine asset conditions
4. Develop asset management plans
   - Consider maintenance and replacement costs and timelines
5. IT systems
   - Selection of appropriate software, populating information, keeping it up-to-date

Questions?

Thank You

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