Municipality of West Elgin

Policy #AD 3.6

Asset Retirement Obligation Policy

Effective Date: **April 25, 2024**

Review Date:

1. Purpose

The purpose of this policy is to stipulate the accounting treatment for Asset Retirement Obligations ("ARO") so that users of the financial statements can see information about these assets and their end-of-life obligations. The principal issues in accounting for asset retirement obligations are the recognition and measurement of these obligations.

2. Objective

The objective of this policy is to ensure the liabilities and costs associated with the asset retirement obligations are properly, consistently, and accurately identified, accounted for, and disclosed in the Municipality of West Elgin's financial statements. This policy specifically addresses:

- how to identify asset retirement obligations
- when and how to recognize a liability for asset retirement obligation
- how to measure a liability for asset retirement obligation

3. Terms and 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;
- remediating the contamination of a tangible capital asset created by its normal use;
- post-retirement activities such as monitoring; or
- constructing other tangible capital assets to perform post-retirement activities.

Asset retirement cost is the estimated amount required to meet the asset retirement obligations.

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

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 acquired, constructed, or developed and:

- are held for use in the production or supply of goods and services;
- have useful lives extending beyond one fiscal year;
- are intended to be used on a continuing basis; and
- are not intended for resale in the ordinary course of operations.

Tangible capital assets include such diverse items as roads, buildings, vehicles, equipment, land, water and sewer systems, computer hardware and software (either purchased or developed internally), bridges, leasehold improvements, and capital assets acquired by capital lease or through donation.

4. Scope

All municipal employees who manage municipal assets shall fall within the scope of this policy and must adhere to the policy.

Municipal assets include:

- assets with legal title held by the municipality,
- assets controlled by the municipality, 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, closing landfills or discontinuing the use of in-ground fuel tanks. Other obligations to retire tangible capital assets may arise from contracts, 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 municipality will be recognized as liability in the financial records of the municipality, in accordance with Public Sector Accounting Board (PSAB) Handbook, Section 3280, which the municipality adopted for years beginning on or after April 1, 2022.

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 normally results from unexpected contamination exceeding the environmental standards. Asset retirement obligations are not necessarily associated with contamination.

5. Roles and Responsibilities

Department directors and staff are required to:

- Communicate with the Treasury department on retirement obligations and any changes in asset condition or retirement timelines.
- Assist in the preparation of cost estimates for retirement obligations by providing projections of asset retirement obligations; by consulting with engineers, technicians, and other personnel familiar with the assets and conditional assessments; by collecting the relevant information required to minimize service cost; and by providing the information to the finance department in a timely manner.
- Inform the Treasury department of any legal or contractual obligations at inception of any such obligation.
- The Treasury department is responsible for the development of and adherence to policies for the accounting and reporting of asset retirement obligations in accordance with PSAB Handbook, Section 3280. This includes responsibility for:
  - Proper accounting within the municipality’s accounting software.
  - Reporting asset retirement obligations in the financial statements of the municipality and other statutory financial documents.
  - Investigating issues and working with asset managers to resolve issues.
  - Monitoring the application of this policy.

The GIS/Asset Management and Treasurer are responsible for managing processes within the municipality’s asset management software and documenting assets with identified asset retirement obligations.

1.0 Policy Statement

1.1 The municipality shall account for and report on asset retirement obligations in compliance with the PSAB Handbook, Section 3280.

2.0 Application

2.1 The scope of applicability for asset retirement obligations under this policy is outlined in Appendix A.

2.2 Common examples of asset retirement obligations include:

- Asbestos and Lead – Older buildings purchased or constructed by the municipality may contain asbestos and/or lead materials (like paint, tiles, pipes, etc.) requiring a future cost to remediate upon retiring the building.
- Leasehold Improvements in Buildings – Lease agreements may require leasehold improvements to be removed upon termination. If the probability of the occurrence can be assessed greater than 70%, then it must be recorded.
- Petroleum Storage Tanks – Petroleum management regulations prescribe requirements for out of service storage tank systems and decommissioning of storage tanks.
- Wells – Well construction regulations prescribe decommissioning requirements for drinking water wells and monitoring wells.

- Other – Mercury, medical equipment, landfills, gravel pit and quarry remediation, and other regulated materials may fall under this policy.
- Solid waste landfill closure and post closure liabilities (replacing PSAB Handbook, Section 3270)

3.0 Recognition

3.1 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 costs can be made. A liability for an asset retirement obligation cannot be recognized unless all the criteria above are satisfied.

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

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

3.4 The estimate of a liability should include directly attributable costs, including but 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.

3.5 Upon initial recognition of a liability for an asset retirement obligation, the municipality 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 no longer in service and is not providing economic benefit, or to an item not recorded by the municipality as an asset, the obligation is expensed upon recognition.

3.6 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.

4.0 Subsequent Measurement

4.1 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.

4.2 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.

5.0 Presentation and Disclosure

5.1 The liability for asset retirement obligations will be disclosed in the municipality's financial statements.

6.0 Review of Policy / Procedure

6.1 The Treasurer is responsible for ensuring this policy is reviewed at least once per council term to ensure it is in compliance with any legislative changes.

Appendix A – Scope of Applicability

Figure: Decision Tree – Scope of Applicability