Asset Retirement Obligation Policy

Intent

This policy stipulates the processes by which asset retirement obligations (AROs) will be recognized, measured, updated, and integrated into existing processes, and the related roles and responsibilities, so that users of the financial information can discern information about these assets, and their end-of-life obligations. The policy specifically addresses how to identify an ARO, when and how to recognize the liability, and how to measure a liability for the asset retirement obligation.

Scope

This policy applies to all departments, units, branches, boards, and agencies that are within the reporting entity of Minto, and possess asset retirement obligations related to the following assets:

1. Assets with legal title held by Minto
2. Assets controlled by Minto
3. Assets reported in any entities that are consolidated with the Town for financial statement purposes
4. Assets that have not been capitalized or recorded as tangible capital assets for financial statement purposes (unrecorded tangible capital assets)

The scope of applicability (decision tree) is attached to this policy as Appendix A

Definitions

Accretion Expense: The increase in the carrying amount of a liability for asset retirement obligations due to the passage of time.

Asset Management: The coordinated activity of an organization to realize value from assets.

Asset Retirement Activities: All activities related to an asset retirement obligation including (but not limited to):

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

Asset retirement cost: The estimated cost required to retire a tangible capital asset, i.e. to meet the asset retirement obligations.

Asset Retirement Obligation: A legal obligation associated with the retirement of a tangible capital asset.

Controlled asset: An asset that is owned or controlled, directly or indirectly.

Legal Obligation: A clear duty or responsibility to another party that justifies recognition of a liability.

A legal obligation can result from:

- Agreements or contracts;
- Legislation, including legislation of another government; and, or
- A promise conveyed to a third party that imposes a reasonable expectation of performance upon the promisor.

Productive Use: Tangible capital assets 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.

Professional Judgment: A reasonable estimate of the liability would require professional judgment based on the available information at year-end and could be supplemented by experience, third party quotes and, in some cases, reports of independent experts.

Recovery: An Asset Retirement Obligation recovery can occur when Minto is able to recover asset retirement costs from a third party.

Retirement of a Tangible Capital Asset: The permanent removal of a tangible capital asset from service. This term encompasses sale, abandonment, or disposal in some other manner but does not include temporary idling of the asset.

Tangible Capital Assets: Non-financial assets having physical substance that:

a) 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 Municipal tangible capital assets;
b) Have useful economic lives extending beyond one accounting period;
c) Are to be used on a continuing basis in municipality's operations; and
d) Are not for sale in the ordinary course of operations.

Threshold Amount: The minimum estimated cost of an individual asset retirement obligation to be recognized as a liability. The threshold is applicable to each type of asset retirement obligation (i.e., asbestos, lead, etc.) and not to the aggregate of each type of asset retirement obligation associated with an individual asset.

Unrecorded Assets: Tangible capital assets with no recorded value or nominal value. Assets with no recorded value may arise from not meeting capitalization thresholds at the time of acquisition, construction, or development. Assets recorded at nominal value could be the result of no reasonable estimate of value at time of capitalization. In addition, assets used under an operating lease agreement, would be considered unrecorded assets. These assets should be assessed for asset retirement obligations.

Policy Statement

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 the abatement of asbestos and decommissioning wells. 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 Minto, will be recognized as liability in accordance with the Public Sector Accounting Board (PSAB) Handbook, section 3280.

Minto will be adopting PS3280 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.

Procedural Information

Recognition

A liability should be recognized when all the following criteria are met as at the financial reporting date:

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

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

Directly attributable costs will 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.

Upon initial recognition of a liability for an asset retirement obligation, Minto 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. In the case of a fully amortized asset an extension to the estimated useful life is required. Where the obligation relates to an asset which is no longer in service, and not providing economic benefit, Minto will establish a liability with a corresponding adjustment to accretion expense in the year of adoption. Where the obligation relates to an asset not recorded by Minto, the asset retirement costs are established as a liability with an offset to accretion expense in the year of adoption.

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.

Subsequent Measurement

The asset retirement costs will be allocated to accretion expense in a rational and systematic manner 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.

Recoveries

A recovery related to an asset retirement obligation should be recognized when all three of the following criteria are met:

1. The recovery can be appropriately measured;
2. A reasonable estimate of the amount can be made; and
3. It is expected that future economic benefits will be obtained.

A recovery should not be netted against the liability. A contingent recovery should be disclosed in accordance with PS3320 Contingent Assets.

Presentation and Disclosure

The liability for asset retirement obligations will be disclosed in the financial statements.

Legislative and Administrative Authorities

Public Sector Accounting Board, Public Sector Handbook and Section PS 3280 Asset Retirement Obligations.

Roles and Responsibilities

Council Responsibilities

Approving this policy and reviewing and monitoring its implementation and reporting in the annual audited financial statements.

Finance Responsibilities

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 responsibility for:

- Maintaining an inventory of all asset retirement obligations and determining their proper accounting treatment under the terms of this policy;
- Consulting with other departments and experts to determine the existence and estimated cost of asset retirement obligations;
- Reporting asset retirement obligations in the financial statements and other statutory financial documents;
- Managing processes related to Tangible Capital Assets including maintaining complete current and accurate information and records;
- Periodically reviewing legislation and agreements, and updating the ARO process as required, and

- Monitoring the application and compliance of this policy.

Public Works, Planning and Building

- Providing cost-effective projections of asset retirement obligations, by consulting with engineers, technicians, and other personnel familiar with the assets and conditional assessments; and
- Collecting the relevant information required to minimize service costs and providing the information to the Finance Department for processing.

All Department Responsibilities

- Communicating with Finance Department on retirement obligations, and any changes in asset condition or retirement timelines;
- Assisting in the identification and preparation of cost estimates for retirement obligations; and
- Inform Finance of any legal or contractual obligations at inception of any such obligation.

Transitional Approach

Minto has opted to transition to PS 3280 using the following method:

Prospective Approach

Under the prospective approach, Minto will apply PS 3280 as of the year of adoption without considering previous years. Any asset retirement obligation that already exists will be adjusted for any changes resulting from adoption of PS 3280. The Prospective Approach involves recognition of an asset and liability equal to the present value of the expected outflows, amortization of the asset over its remaining useful life, and accretion of the liability over the life of the asset. Where the present value calculation is used, current rates and assumptions are appropriate. For any asset that is no longer in productive use, Minto will record an expense in the year of adoption. The prospective approach does not require any adjustment to the opening deficit / surplus.

Discount and Inflation Rates

PS 3280 notes that a present value calculation is often the best available technique with which to estimate an asset retirement liability when the cash flows required to settle or otherwise extinguish the liability are expected to occur over extended future periods. However, there is no requirement for a public sector entity to use a present value technique, or to apply discounting consistently across all assets.

In situations where there is significant uncertainty about the timing of the cash flows Minto may opt to not inflate and discount back the cash flows. Professional judgment will be required in assessing the appropriateness of inflation and discounting.

Minto has opted to use the following discount and inflation rate at transition. Please note that rates and the methodology for selecting rates can change over time.

Discount Rate: 4.25% which is equal to the Bank of Canada’s overnight rate in January 2023.

Other acceptable discount rates could include an effective borrowing rate if the obligation will be funded through debt, an investment rate if the obligation will be funded through internal resources or Government of Canada Bond Yields (Zero-Coupon or Marketable).

Inflation Rate: 4.28% which is equal to this historical average of the Non-Residential Construction Price Index for the Toronto Region for Infrastructure and Buildings and 4.2% which is equal to the CPI index for April 2023 for machinery and equipment.

Associated Policies

- Strategic Asset Management Policy 3.3

Appendix A: Decision Tree – Scope of Applicability