

1.0 Policy Statement and Purpose

Consistent with PS 3280 – Asset Retirement Obligation introduced by the Public Sector Accounting Board (“PSAB”), accounting for Asset Retirement Obligations (“ARO”) is effective January 1, 2023 for The Municipality of Chatham-Kent (“the Municipality”).

The purpose of this policy is to outline the principles and procedures for the recognition and measurement of Asset Retirement Obligations (“ARO”) associated with tangible capital assets (“TCA”) within the Municipality. This policy ensures compliance with PS 3280 and the Municipal Act s. 294.1, which requires that municipalities prepare financial statements in accordance with the standards of the PSAB.

2.0 Operating Principles

2.1 Recognition

A TCA is considered within the scope of this policy if it meets the following criteria:

- The asset is a TCA.
- The Municipality controls the asset, including leased TCAs.
- A legal or contractual obligation exists for the Municipality to perform retirement activities for the TCA.
- The asset is in productive use or not in productive use.

A liability must be recognized when all the criteria below are present as at the financial reporting date:

- There is a legal obligation to incur retirement costs related to a TCA.
- The past transaction or event resulting in this obligation has already occurred.
- It is expected that the Municipality will have to give up future economic benefits.
- A reasonable estimate of the amount can be made.

2.2 Legal Obligation

A legal obligation establishes a clear duty or responsibility to another party that the Municipality must fulfill. An Obligation can result from:

- Agreements or contracts;
- Legislation of another government;
- Government’s own legislation; and
- A promise made to another party that could be legally enforced.

2.3 Exclusions

Certain retirement and disposal activities not directly attributable to fulfilling required, and predictable costs are excluded from the cost of the ARO. These exclusions:

- **Acquisition:** Original costs to acquire, construct or develop the related TCA.
- **Replacement:** Costs relating to routine replacement of TCAs. For example, infrastructure such as roads and bridges are typically subject to maintenance rather than permanent removal from service due to a legal requirement.

- **Maintenance:** Costs relating to routine maintenance of TCAs. These costs shall be expensed as incurred.
- **Remediation of contamination:** Remediation of contamination that is not a predictable result of the normal use of the TCAs, such as contamination from accidents or spills. Contamination that is beyond the threshold set by environmental regulations is accounted for separately and not within the scope of this policy.
- **Catastrophic events:** Costs resulting from catastrophic events such as flooding or fires.
- **Repurposing:** Costs relating to the preparation of a TCA for an alternate use.
- **Clean-up and by-products:** Costs related to clean-up of waste or by-products produced by the TCA's normal use. These costs represent routine operations and are not associated with the retirement of the asset.
- **Improper use:** Costs caused by improper use of an asset.
- **Sale or disposal:** Costs to prepare a TCA for sale or disposal that arises from the plan to sell or dispose of the TCA rather than a legal or contractual requirement.

2.4 Measurement

The estimate of the ARO must include all costs directly attributable to required retirement activities as best estimated at the financial reporting date. This estimate should include:

- Materials and equipment
- Payroll and benefits
- Directly attributable overhead costs
- Legal and professional fees
- Post-retirement operation, maintenance, and monitoring required to fulfil the ARO
- Cost of new TCAs acquired solely for asset retirement activities. For example, as part of retiring a landfill, new water monitoring wells might be constructed.

Sources of cost information to estimate the ARO may include:

- Third party proposals and quotes for the required activities
- External quotes and market data on costs of similar activities
- Historical costing information on similar activities completed by the Municipality

When the cash flows and timing required to fulfil the retirement obligation can be reasonably estimated, a present value technique shall be used to account for the obligation. The liability is discounted to its present value upon initial recognition and adjusted yearly for accretion expense.

When there is uncertainty about the amount or timing of cash flows to settle the ARO, the present value technique may not be used. Uncertainties about timing and amount to settle an ARO does not remove the obligation but will affect its measurement. Any such uncertainty must be identified and disclosed in the notes to the financial statements.

The ARO asset must be amortized in a systematic manner over the useful life of the TCA it relates to. The amortization of ARO assets for the Municipality should be done in a manner consistent with the Municipality's treatment of the TCA it relates to.

2.5 Re-measurement

The estimate of the ARO should be based on the best available information on the financial reporting date.

Over time, as new information becomes available, estimates used to calculate the ARO are likely to change. Estimates (including the amount and timing of retirement costs and, if applicable, the

discount rate used) must be reviewed every fiscal year and appropriately reflected in the financial statements.

Examples of new information that will impact the estimate include:

- Revisions to the useful life of the TCA
- New information on the cost of the ARO activities
- Changes in expectations of market inputs, such as discount and inflation rates
- New, more cost-effective technologies
- Changes to the legal requirements

Accretion due to passage of time must be accounted for first, prior to applying any changes in estimates. Any change in estimate should be applied prospectively as a revision to the ARO liability, with a corresponding adjustment to the TCA asset if it is in a recognized TCA in productive use.

When a TCA is no longer in productive use, all subsequent changes in the estimate of the related ARO liability should be recognized as an expense in the fiscal year it is incurred.

The liability for an ARO continues to be recognized until it is settled or otherwise extinguished.

On retirement of a TCA:

- Asset retirement costs should be deducted from the ARO liability as the related cash flows are incurred.
- If the actual cash flows are higher than the ARO liability recognized by the Municipality, the excess cash flows should be expensed in the period incurred.
- If the actual cash flows are less than the ARO liability recognized by the Municipality, the excess liability should be offset by a prior year recovery.

Any changes to the ARO asset due to changes in estimate must be applied prospectively in the period of the change without any revision to amortization previously booked. The revised ARO asset is amortized over the remaining useful life of the related TCA.

2.6 Recoveries

If a portion of the asset retirement costs are recoverable by the Municipality from another party, the recovery must be accounted for. The amount recovered will be accounted for as revenue in the fiscal year it is received.

A recovery related to ARO should be recognized when:

- the recovery can be appropriately measured;
- a reasonable estimate of the amount can be made; and
- it is expected that future economic benefits will be obtained.

A recovery shall not be netted against the liability.

The sale of an asset on retirement may qualify as a recovery if the criteria above for a recovery are met, however a plan to sell an asset in the future would not be sufficient to confirm that future economic benefits will be received or result in a reasonable measurement of the recovery.

3.0 Glossary of Terms

Asset Retirement Obligation (ARO)

A legal obligation associated with the retirement of a tangible capital asset (TCA). ARO activities may include decommissioning or dismantling of TCAs, remediation of TCA contamination, post-retirement activities, and constructing other TCAs to perform post-retirement activities. Examples of AROs include, but are not limited to:

- Asbestos
- Lead
- Landfill
- Closure and post-closure care, etc.

Tangible Capital Asset (TCA)

A physical asset held for service delivery and administrative purposes within the Municipality