# Asset Retirement Obligations — Basis for Conclusions

## Section PS 3280

**FOREWORD**

CPA Canada Public Sector Accounting Handbook Revisions Release No. 46, issued in August 2018, contained a new standard, ASSET RETIREMENT OBLIGATIONS, Section PS 3280.

The primary objective of a Basis for Conclusions document is to set out how the Public Sector Accounting Board (PSAB) reached its conclusions. As well, it sets out significant matters arising from comments received in response to the proposals exposed and indicates how PSAB has dealt with the issues raised.

These documents are intended to assist financial statement users, preparers, auditors and other parties interested in public sector financial reporting in understanding the rationale followed by PSAB when developing standards.

This document has been prepared by staff of PSAB. It does not form part of the CPA Canada Public Sector Accounting (PSA) Handbook nor is it part of public sector generally accepted accounting principles (GAAP). Basis for Conclusions documents also do not include any guidance on the application of the relevant Section or Guideline.

August 2018

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**BACKGROUND**

1. 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 decommissioning of nuclear reactors, removal of asbestos,

retirement of landfills or hospital equipment, such as X-ray or MRI machines. Other obligations to retire tangible capital assets may arise from contracts or court judgments.

2. Before Section PS 3280 was issued, there was no specific guidance addressing the accounting for various types of asset retirement obligations. LIABILITY FOR CONTAMINATED SITES, Section PS 3260, deals with liabilities associated with the contamination of sites. SOLID WASTE CLOSURE AND POST-CLOSURE LIABILITY, Section PS 3270, covers closure and post-closure liabilities associated with a currently operating or closed solid waste landfill site. These two Sections have limited applicability.

3. Without a standard on asset retirement obligations, preparers and auditors must rely on GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150. Although the policies developed are expected to be consistent with FINANCIAL STATEMENT CONCEPTS, Section PS 1000, and LIABILITIES, Section PS 3200, this approach can result in inconsistencies among various public sector entities as to what an asset retirement obligation is, and when and how to recognize and measure the liability.

4. PSAB concluded that developing a standard on asset retirement obligations would improve consistency in accounting for these obligations. It would also provide users with better information about obligations associated with retirement of tangible capital assets. For example, it may enhance their understanding of future revenue requirements to meet future obligations and the full cost of the tangible capital asset.

**PURPOSE AND SCOPE**

5. Section PS 3280 applies to asset retirement obligations associated with tangible capital assets controlled by the public sector entity that are in productive use and no longer in productive use. Only legal obligations, including obligations created by promissory estoppel, are in scope of this standard.

**Controlled by the entity**

6. PSAB concluded, and most respondents to the Statement of Principles and the Exposure Draft agreed, that the scope of the proposed standard should exclude the recognition of asset retirement obligations associated with tangible capital assets not controlled by the entity. This scope limitation is closely linked to the accounting treatment of capitalizing asset retirement costs on the grounds that these costs together with the cost of the related tangible capital asset provide a future economic benefit. Asset retirement costs on their own do not. Therefore, if a public sector entity assumes an asset retirement obligation relating to an asset of others, it is a liability but not an asset retirement obligation for the purposes of this standard.

**Legal obligations**

7. Only legal obligations, including obligations created by promissory estoppel, are in scope of this standard. The majority of the Exposure Draft respondents supported this approach. However, some respondents believed that the scope should include constructive and equitable obligations to maintain consistency with Section PS 3200, Section PS 3260, and the conceptual framework. These respondents considered that limiting the scope to legal obligations removes opportunity to exercise professional judgment and may lead to misleading financial information. Some respondents also asked for useful guidance on constructive and equitable obligations supported by examples.

8. Given the limited scope of this standard, determining when a constructive and equitable obligation exists is very subjective. The scope is limited to obligations associated with tangible capital assets controlled by the entity. It excludes situations involving assumption of responsibility. This limits what could be considered as a constructive and equitable obligation. In addition, PSAB could not see how useful guidance could be developed that would assist public sector entities applying the standard in distinguishing constructive or equitable obligations from management intentions. For example, at what point can it be concluded that sufficient reliance has been placed on the management's decision to retire a tangible capital asset? Consideration was also given to the effects of the lack of useful guidance in this regard. This may create preparer and auditor debates on whether a liability exists and result in unnecessary work.

9. Two respondents suggested that a constructive obligation to retire a bridge may exist on its construction. Infrastructure assets, such as bridges, roads and sewer systems, are normally not permanently removed from service (i.e., retired). Rather, they are maintained and when necessary replaced at the end of their useful lives. Routine replacement is outside the scope of this standard. However, if there is a particular agreement, contract, legislation or other circumstance that obligates the entity to incur asset retirement costs, this Section applies. Further, as obligations to retire an asset arise on acquisition, construction, development or normal use, determining whether a constructive obligation has arisen at that point, without a legal requirement, would be very subjective and may result in inconsistent application.

10. Consequently, to achieve more consistent application of this standard, the Board decided that only existing legal obligations, including legal obligations under the doctrine of promissory estoppel, should be included in its scope. This approach more clearly sets the boundaries of the standard and hence may be better understood, more practical and more consistently applied. If an entity determines that it has an obligation to retire a tangible capital asset, which is not legally enforceable, the entity would apply Section PS 3200. This approach is consistent with that of certain other standard setters.

**Asset retirement obligations associated with landfills**

11. Some respondents to the Statement of Principles encouraged PSAB to broaden the scope of the standard to include all asset retirement obligations. This caused the Board to consider whether asset retirement obligations associated with

solid waste landfill sites, covered under Section PS 3270, should be subject to a separate standard and to a different accounting treatment.

12. PSAB thought these obligations are of the same nature. Further, in both cases the obligations are limited to legal obligations associated with the retirement of tangible capital assets controlled by the public sector entity. The difference in the accounting treatment between Section PS 3270 and this standard is mainly dictated by when these standards were developed and the alternatives for accounting available at that time. 1 Further, the majority of other standard setters reviewed provide one standard on all asset retirement obligations including those associated with landfill sites.

13. Given these arguments, PSAB considered that the consistency in the accounting treatment between closure and post-closure costs of a solid waste landfill and all other asset retirement obligations could be achieved by:
    (a) including closure and post-closure costs within the scope of this standard and withdrawing Section PS 3270; or
    (b) modifying Section PS 3270 to align it with this standard.

14. PSAB concluded that withdrawing Section PS 3270 and including closure and post-closure costs within the scope of this standard would best address the public interest. Having two separate standards covering obligations of the same nature may add to confusion and result in redundancy.

15. In making this conclusion PSAB considered the following main consequences of withdrawing Section PS 3270:
    (a) Obligations may be recognized earlier as the accounting treatment would change from incremental recognition of liability based on usage to recognition on acquisition, construction, development or normal use. The earlier recognition of obligations would result in an earlier increase in net debt.
    (b) The recognized cost of assets would increase because asset retirement costs associated with tangible capital assets in productive use would be added to its carrying amount rather than expensed.
    (c) More professional judgment may have to be used when applying Section PS 3280 as it applies to various types of asset retirement obligations rather than just to landfill sites.
    (d) Some note disclosure would need to be modified to reflect the change in the accounting treatment.

16. PSAB considered these implications and believes that application of consistent accounting principles to similar transactions is important. Recognizing the liability as incurred provides a better reflection of the extent of the entity's liability and will enhance users' understanding regarding the resources required to support future outflows. Principles-based guidance will ensure applicability to a variety of circumstances. Several examples have been included to illustrate the accounting treatment specified in the standard.

17. The Statement of Principles limited the scope to asset retirement obligations associated with tangible capital assets in productive use. PSAB considered that by including closure and post-closure costs within the scope of Section PS 3280 it needed to broaden the scope to accommodate costs associated with closed landfill sites. To do this, the scope was expanded to include asset retirement obligations associated with assets no longer in productive use.

18. To ensure that all critical issues associated with the withdrawal of Section PS 3270 have been considered, PSAB requested that local governments be consulted because this change would affect them the most. The local government stakeholders' comments were considered when writing the Exposure Draft.

19. Overall, the majority of respondents to the local government consultation and the Exposure Draft supported the inclusion of landfill closure and post-closure costs within the standard and the withdrawal of Section PS 3270. However, some respondents raised concerns over the high costs and burden to municipalities, including the extent of the work that will be required and the lack of expertise and financial means in developing estimates to meet the requirements of Section PS 3280.

20. PSAB agrees that the implementation of Section PS 3280 will take time and resources. For this reason, the transitional provisions provide relief by including an additional transitional provision option. It should also be noted that municipalities are already accounting for closure and post-closure costs using Section PS 3270. Estimating the liability using Section PS 3270 and Section PS 3280 requires some of the same basic assumptions. These provisions should facilitate the implementation of the standard.

21. A few responses to the Exposure Draft revealed some confusion about whether asset retirement obligations associated with landfills need to be recognized immediately or incrementally with use. This confusion may have led to the concern of some respondents about whether the accounting treatment proposed in the Exposure Draft is appropriate for landfills.

22. Section PS 3280 provides recognition principles applicable to all asset retirement obligations, not only those associated with landfills. It states that a liability for an asset retirement obligation can be incurred due to acquisition, construction, development or normal use. The standard does not prescribe the past transaction or event for various circumstances and requires the use of professional judgment. However, examples of specific asset retirement obligations, including those related to landfills, are provided to illustrate the application of the principles and guidance.

23. As indicated in paragraph PS 3280.40, the estimate of the liability for an asset retirement obligation would be based on requirements in existing agreements, contracts, legislation or legally enforceable obligations. In the case of a landfill, the environmental approval establishes the activities required when the site stops accepting waste.

24. When determining the timing of recognition of the various asset retirement obligations associated with a landfill, the entity would consider, for each obligation, whether it is incurred on the landfill's:

(a) acquisition, construction or development; or

(b) normal use.

25. Some asset retirement obligations associated with landfills may be incurred on their construction. For example, the environmental approval may require that a final cover and vegetation be put in place irrespective of landfill site use. Additional obligations will likely be incurred as a result of future operations of the landfill. In some cases, the obligation may be incurred in full when the tangible capital asset is put into production. In other cases, the obligation may be incurred incrementally with use if the events or transactions that create the obligation occur over more than one reporting period. PSAB clarified the guidance on normal use to make these distinctions clear.

26. Another consideration is how the landfill is operated. As indicated in paragraph PS 3280.12, the entire landfill footprint may require approval or each phase may require separate approval. Therefore, only a portion of the landfill may be used at any one time. A respondent to the Exposure Draft noted that the liability should only be recorded as each cell is constructed and used. The intent of the standard is to record only the costs for which a legal obligation exists and where the past transaction or event giving rise to the liability has occurred. The environmental approval needs to be reviewed to understand the entity's obligations specific to the landfill it operates.

**Relationship to Section PS 3260**

27. Section PS 3280 is closely related to Section PS 3260. Both standards deal with certain obligations associated with assets in productive use and those that are no longer in productive use. To clarify the boundaries between these two standards, PSAB:

(a) added a decision tree;

(b) made consequential amendments to Section PS 3260; and

(c) explained the meaning of "normal use".

28. The decision tree explains the following factors that distinguish Section PS 3280 from Section PS 3260:

(a) the cause for the retirement or remediation obligation;

(b) the type of obligation; and

(c) the extent of contamination.

29. Section PS 3280 addresses an asset retirement obligation that results from acquisition, construction, development or normal use of the asset. These obligations are predictable, likely to occur or unavoidable. They exclude costs related to the improper use of a tangible capital asset or those resulting from an unexpected event such as an unexpected contamination. Section PS 3260, on the other hand, includes such costs within its scope. Further, Section PS 3260 requires the existence of contamination to consider if a remediation obligation has been incurred. Asset retirement obligations are not necessarily associated with contamination.

30. A further difference between these two standards is the type of obligation. Section PS 3280 limits the obligations to those that are legally enforceable and associated with tangible capital assets of the entity. Section PS 3260 includes both legal obligations and those voluntarily assumed by the entity.

31. In addition, the existence of contamination that exceeds an environmental standard at the financial reporting date is a necessary condition for recognition of a liability under Section PS 3260. Section PS 3280 does not include such a requirement.

32. To clarify further the boundaries between these two standards, PSAB has made consequential amendments to Section PS 3260. These amendments were necessary to remove examples, which, without further information, could be seen as applying to both standards. For example, both standards deal with certain obligations associated with an asset no longer in productive use. Further information, such as the cause for the retirement or remediation obligation is required to understand which standard to apply.

33. Majority of respondents to the Exposure Draft found the steps taken by PSAB useful in clarifying the boundaries between Sections PS 3280 and PS 3260. However, two respondents believed that the boundaries could be further clarified by clearly stating, in Section PS 3260, that this standard applies to sites in productive and no longer in productive use. PSAB considers clarity of standards to be important. However, in this case, amending Section PS 3260 may result in unintended consequences. Section PS 3260 covers "certain" obligations related to sites in productive use and no longer in productive use. Without a full review of Section PS 3260, there may be a risk of making consequential amendments that go beyond the scope intended at the time of the approval of this Section. The Board concluded that boundaries between Sections PS 3280 and PS 3260 are clearly defined and that further changes to Section PS 3260 would be beyond the scope of the Asset Retirement Obligations project.

34. Some respondents to the Exposure Draft questioned the inconsistency between the decision tree in Section PS 3280 and that included in Section PS 3260. This distinction was intentional. PSAB considered that the purpose of the decision trees and the nature of the obligations covered under each standard are different. Further, to make the decision tree in Section PS 3280 easy to follow, the Board omitted certain details, included in the Section PS 3260 decision tree, which can be understood from the standard.

35. A few respondents to the Exposure Draft suggested that the decision tree provides examples of its application including how one tangible capital asset could be associated with both: an asset retirement and a remediation obligation. PSAB

believes that this aspect should be clear. The first question in the decision tree asks whether there is a present obligation associated with the asset retirement or remediation. The focus is not on the asset but on the obligation. Therefore, each obligation, whether it relates to remediation or retirement of an asset, is considered separately.

**Obligations outside the scope**

36. Some respondents to the Statement of Principles questioned why certain obligations, such as those associated with waste and by-products, are outside the scope of the standard. As per the definition, asset retirement activities are limited to those that relate to retirement of a tangible capital asset. Costs related to obligations created by waste or by-products produced by a tangible capital asset are outside the scope of Section PS 3280 as such costs are not associated with the retirement of a tangible capital asset but are costs of operations. For example, the use of a nuclear facility may result in radioactive waste requiring clean up. These costs are not associated with the retirement of a tangible capital asset but rather with the cleanup of waste or by-products.

37. One respondent to the Statement of Principles questioned the exclusion of costs related to improper use of a tangible capital asset. These costs have been excluded as they do not relate to either the cost of acquiring, constructing or developing, or the normal use of the tangible capital asset. They are unexpected in nature. For example, a certain amount of contamination may be inherent in the normal operations of a power plant, but a catastrophic accident caused by non-compliance with the company's safety procedures is not. Therefore, the obligation to clean up after a catastrophic accident is outside the scope of this standard. This does not mean that a liability does not exist; it is just not covered within the scope of this standard.

38. Some respondents to the Exposure Draft provided examples of tangible capital assets or circumstances that may not be in scope of this standard. Harbours are one such example. Harbours are generally maintained rather than retired. The environmental obligations associated with harbours can be both expected (e.g., contamination associated with the operations of the harbour) and unexpected (e.g., unexpected leakage from a nearby industry). In certain cases, responsibility for the contamination may be difficult to determine or contamination may not be subject to an environmental standard. Each specific case needs to be considered separately as depending on the circumstances Section PS 3280, Section PS 3260 and/or Section PS 3200 may apply.

**RECOGNITION OF ASSET RETIREMENT OBLIGATIONS**

**Obligations associated with asbestos removal**

39. Section PS 3280 provides that a liability for an asset retirement obligation can be incurred due to the acquisition, construction or development of a tangible capital asset or its normal use. Respondents to the Statement of Principles and the Exposure Draft agreed with these principles. However, a few respondents questioned the prescriptiveness and appropriateness of the recognition guidance surrounding asbestos. Concerns were expressed about the recognition point for liabilities associated with asbestos removal. Some respondents disagreed that a liability for an asset retirement obligation associated with asbestos arises on acquisition, construction or development of a tangible capital asset containing asbestos. In their opinion, there is no liability until the entity decides to renovate or the asbestos is disturbed. This is because existing regulations do not require asbestos to be removed unless the area is disturbed.

40. Asbestos is regulated in all jurisdictions in Canada. Those regulations require the entity to handle and dispose of the asbestos in a prescribed manner when it is disturbed. Although the timing of the removal may be sometime in the future, a legal obligation to perform asset retirement activities still exists. The ability to postpone the asbestos removal does not relieve the entity of the obligation. The asbestos will eventually need to be removed and disposed of because the tangible capital asset containing asbestos has a finite life. Even if the tangible capital asset containing asbestos were sold, the price would reflect the obligation to retire it. The approach taken in Section PS 3280, regarding asset retirement obligations associated with asbestos, is consistent with that taken by the U.S. Financial Accounting Standards Board.

41. Some respondents to the Exposure Draft also thought that it is necessary to consider whether, in the case of asset retirement obligations associated with asbestos, it is expected that future economic benefits will be given up and whether a reasonable estimate of the amount involved can be made. They considered that, in some cases, the entity may not expect to give up future economic benefits, such as when an entity does not have foreseeable plans to renovate or demolish the building or when an entity has taken actions to keep the asbestos safe. A few respondents also thought that an entity may not be able to make a reasonable estimate of the obligation to retire asbestos as it may not be known when asbestos will be disturbed.

42. PSAB considered that determining whether economic benefits will be given up will require applying professional judgment considering the specific circumstances. However, because of the nature of the obligations covered by Section PS 3280, it is generally expected that future economic benefits will be given up. This is because all asset retirement obligations, including those related to asbestos removal, are expected and legally enforceable. Other parties could compel the entity to fulfil the obligation, leaving the entity with little or no discretion to avoid it.

43. Uncertainty about the timing of settlement of the asset retirement obligation does not remove that obligation from the scope of this standard, but will affect the measurement of the liability. This may require the use of professional judgment and be supplemented by experience, third-party quotes and, in some cases, reports of independent experts. Uncertainties affecting the measurement of a liability for an asset retirement obligation are disclosed in accordance with MEASUREMENT UNCERTAINTY, Section PS 2130.

## RECOGNITION AND ALLOCATION OF ASSET RETIREMENT COSTS

### Accounting for the debit balance

44. Upon initial recognition of a liability for an asset retirement obligation associated with tangible capital asset in productive use, Section PS 3280 requires an entity to 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. Although the majority of respondents to the Statement of Principles agreed with this approach, some were concerned that it allows for smoothing of expenses and results in capitalization of costs that have no future value.

45. Given the respondents' arguments, PSAB has reconsidered how to account for asset retirement obligations associated with tangible capital assets in productive use. Five alternative approaches to capitalization, some of which were put forward by respondents, were reviewed by considering their impact on accountability and decision making, consistency with the PSA Handbook, consistency with other standard setters and consensus:
    (a) Recognize asset retirement costs as deferred outflows of resources.
    (b) Present asset retirement obligations net of the related capitalized asset retirement cost.
    (c) Recognize all asset retirement costs as an expense.
    (d) Recognize asset retirement costs incrementally as a liability and an expense over the useful life of the related tangible capital asset.
    (e) Capitalize asset retirement costs directly attributable to acquisition, construction or development, and expense those related to normal use.

46. PSAB believes that the deferred outflow of resources approach would not fit the current conceptual framework. Recognizing the asset retirement obligation net of the related capitalized asset retirement cost would result in a lack of transparency. The expense approach may result in a lack of consensus and is not supported by the work of other standard setters. The incremental recognition of liability is a viable approach supported by the work of the U.S. Federal Accounting Standards Advisory Board and consistent with the approach taken in Section PS 3270. However, this approach would result in an understatement of liability as liability is recognized incrementally based on use rather than as incurred.

47. Capitalizing asset retirement costs directly attributable to acquisition, construction or development, and expensing those related to normal use was considered a viable option. This alternative is consistent with the definition of cost in TANGIBLE CAPITAL ASSETS, Section PS 3150. It supports the notion that asset retirement costs directly attributable to acquisition, construction or development are no different from other costs that have or will be incurred to prepare the tangible capital asset for its intended use. Further, expensing costs directly attributable to normal use is consistent with the accounting treatment in Section PS 3270. This alternative also mitigates the risk of overvaluing assets and distorting their true service value, a concern raised by respondents. However, although this approach provides many benefits, PSAB was concerned that it would result in debates over the types of costs qualifying for capitalization versus needing to be expensed. The Board also believes this option would add complexity, may not be practical and may result in inconsistency with the guidance of some of the other standard setters.

48. PSAB concluded that capitalization of asset retirement costs associated with tangible capital assets in productive use is the most suitable alternative for the following reasons:
    (a) Asset retirement costs are necessary and integral to owning and operating a tangible capital asset.
    (b) Asset retirement costs are not a separate asset because there is no specific and separate future economic benefit that results from them.
    (c) Capitalization provides useful information for accountability and decision making.
    (d) Capitalization is consistent with the approach of the International Public Sector Accounting Standards Board, the Accounting Standards Board, International Accounting Standards Board and the U.S. Financial Accounting Standards Board.
    (e) Capitalization has been supported by the majority of respondents.

49. An asset retirement obligation may arise for a tangible capital asset no longer in productive use. For example, a new legislation created after the tangible asset has been removed from service, may now require its disposal in a prescribed manner and specific post-retirement activities. Given that there is no longer any period of future benefit associated with the asset retirement costs, PSAB concluded that these costs would be expensed.

### Impairment

50. Some respondents to the Statement of Principles and the Exposure Draft raised concerns that the capitalization of an asset retirement obligation may present issues with the impairment assessment. The concern is that the existing impairment guidance in Section PS 3150 does not consider capitalization of asset retirement costs, which may lead to potential overstatement of assets. Respondents are suggesting that this issue be addressed by prioritizing the Impairment of Non-financial Assets project or through an amendment to Section PS 3150.

51. PSAB agrees with respondents that separate guidance on impairment outside of this standard would be best suited to address the impairment issue.

### Allocation of asset retirement costs

52. The Statement of Principles proposed that the asset retirement obligations be accounted for at the individual component level regardless of how the tangible capital asset is accounted for. This approach was thought to best reflect the annual costs of these obligations as "back loading" of costs to future periods could result. Although the majority of respondents to the Statement of Principles agreed with this proposal, several believed this treatment may be difficult for entities to apply in practice when they do not componentize their assets. Respondents also believed this approach would lead to inconsistency in accounting between the underlying asset and the retirement obligation associated with it. They suggested a choice of allocating the asset retirement costs at either the network or the component level.

53. PSAB considers amortizing the retirement obligations over the useful life of the component, rather than the network, is more conceptually sound and produces better cost information. However, the Board agrees that this approach may lead to practical issues and inconsistency with Section PS 3150, where paragraph PS 3150.12 allows a choice in accounting for tangible capital assets on a network or component basis. The Board believes that the allocation policy should be determined by the usefulness of the resulting information to the public sector entity compared to the cost of collecting and maintaining it. Consequently, the Board agrees that a choice in allocating the retirement costs at either the network or the component level should be allowed. Given that asset retirement costs are not separate assets, their allocation would be consistent with that used for the related tangible capital asset. Section PS 3150 provides further guidance regarding accounting and allocation of cost of a tangible capital asset.

54. The Exposure Draft provided guidance on what is meant by allocating the asset retirement cost to expense in a rational and systematic manner. It stated that a rational and systematic manner could include amortization over the remaining useful life of the tangible capital asset (or a component thereof) or some other appropriate period depending on the use of the related asset. A respondent to the Exposure Draft noted that the use of a tangible capital asset should be considered in determining its useful life. PSAB agreed and removed the redundant wording.

55. Section PS 3280 permits different methods of accounting for the asset retirement costs in cases where the obligation is incurred over the life of the tangible capital asset. For example, if an entity incurs additional asset retirement obligations each year, the entity could recognize the obligation, capitalize the asset retirement cost and amortize it over the remaining useful life of the tangible capital asset. This method increases the amount of the amortization expense each year. Under an alternative method, the entity could capitalize and then expense the asset retirement cost incurred each year, which would record the expense related to the tangible capital asset on a straight-line basis.

**Fully amortized, non-depreciable and unrecognized tangible capital assets**

56. Respondents to the Statement of Principles asked PSAB to clarify the treatment of asset retirement costs associated with fully amortized, non-depreciable and unrecorded tangible capital assets.

57. An asset retirement obligation may exist in connection with a fully amortized tangible capital asset that is still in productive use. PSAB considered three accounting options to account for these costs:

(a) Increase the tangible capital asset by the amount of the asset retirement cost and amortize the cost over the remaining useful life of the tangible capital asset.

(b) Adjust the opening balance of the tangible capital asset and the related accumulated amortization.

(c) Re-estimate the useful life of the tangible capital asset and treat the adjustment as a correction of an error as described in ACCOUNTING CHANGES, Section PS 2120.

58. PSAB considered option (a) to be most appropriate. It is consistent with the principle that the asset retirement costs, in conjunction with the cost of the tangible capital asset, form the full cost of the asset. This option is also consistent with the accounting for a change in estimate as described in Section PS 2120. It is also more transparent than option (b) and generally more appropriate than option (c). Option (c) would only apply if the entity determines that the correction is a result of an error rather than a change in estimate.

59. An asset retirement obligation may exist in connection with an unrecognized tangible capital asset that is still in productive use. PSAB believes that these costs would be expensed, as there is no cost basis to which the asset retirement costs could be attached. This treatment is consistent with the principle that asset retirement costs are not a separate asset because there is no specific and separate future economic benefit that results from them. However, some respondents to the Exposure Draft did not agree with this treatment. Some considered that this is inconsistent with the treatment of asset retirement obligations associated with fully amortized tangible capital assets. In both cases, the underlying asset may be in productive use and therefore, it would be counterintuitive to treat these situations differently. The main reason for the difference in the accounting treatment is not whether an asset has service potential but the fact that asset retirement costs, on their own, do not provide service potential. These costs are not separate assets but rather integral costs to owning and operating a tangible capital asset.

60. A few respondents to the Exposure Draft asked for examples of when asset retirement obligations may exist in connection with an unrecognized tangible capital asset. PSAB could not identify examples of this situation. However, in general, this situation may occur when the asset retirement obligation relates to an asset that was not recognized because of one of the following reasons:

(a) the underlying asset cannot be measured;

(b) the PSA Handbook prohibits its recognition (see paragraph PS 1000.57); or

(c) the entity meets the criteria for a small organization (see CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph PS 4230.03).

61. PSAB was asked to provide guidance on asset retirement obligations associated with non-depreciable tangible capital assets. The Board could not identify examples of this situation. The possible examples considered were of asset retirement obligations related to a non-depreciable tangible capital asset but associated with a separate depreciable asset. For instance, improvements may be required to use land for storage purposes. In this case, the asset retirement obligation would be associated with the improvements rather than with the land. Given that useful examples were not identified, specific guidance on this topic has not been provided. The general principles on recognition and allocation of asset retirement obligations would be applied.

**Expensing asset retirement costs**

62. A few respondents to the Exposure Draft from the not-for-profit sector noted that their organizations have an objective to achieve a balanced budget each year and that expensing asset retirement obligations associated with tangible capital assets no longer in productive use would cause volatility in the statement of operations. Some respondents from this sector were also concerned that this treatment results in a situation where the tangible capital asset would be unfunded. This could be the case when the entity expenses the asset retirement costs without being able to match it with the related funding from the government.

63. PSAB acknowledges that implementation of this new standard may result in some challenges for the not-for-profit sector. However, the issues surrounding balanced budget and funding are not only limited to the effects of this standard. PSAB is consulting with the not-for-profit community to improve its understanding of this sector's specific needs. The consultation's findings may have broader implications requiring consideration outside of the scope of this project.

**MEASUREMENT**

64. Most respondents to the Statement of Principles and the Exposure Draft agreed with the non-prescriptive measurement guidance. However, some respondents indicated that PSAB should outline different valuation techniques commonly expected to be used by entities measuring an asset retirement obligation and the nature of the circumstances that would be best suited to those different valuation techniques. A few respondents also encouraged the Board to provide prescriptive guidance on the discount rate or factors useful in its determination. They considered that lack of such guidance may lead to an opportunity for manipulation of the financial statements and detract from their comparability.

65. PSAB provided non-prescriptive measurement guidance because of the flexibility it provides. For asset retirement obligations, the objective is to measure the obligation at each reporting date until the obligation is fulfilled. This is done by applying a discount rate to the best estimate of the amount required to retire a tangible capital asset. By not prescribing the discount rate, the standard allows the entity to choose a rate that best reflects the risks specific to the liability for an asset retirement obligation for that particular entity. However, to assist in applying present value techniques, the Board provided some principles, such as no double counting of risk or the use of consistent assumptions. The PSA Handbook may benefit from general guidance on measurement; however, this standard is not the best place for such guidance.

66. One respondent to the Exposure Draft also raised concern over the inconsistency of the discount rate guidance among the various PSA standards as well as the standards being developed. PSAB is establishing a methodology for developing discount rate guidance to be used in future standard development.

67. One respondent to the Statement of Principles and one to the Exposure Draft had some reservations about the merits of annual measurement revisions. As liability for an asset retirement obligation is generally long term in nature, the measurement of the amount is likely to change as new information becomes available. Reflecting these changes is an essential step in providing the best estimate of the amount of liability.

**RECOVERIES**

68. Section PS 3280 provides that where a liability for an asset retirement obligation may be mitigated by a claim against a third party, the amount of the recovery is a separate asset, not an offset to the measurement of the liability. A few respondents to the Statement of Principles and the Exposure Draft considered that recoveries should be taken into consideration when determining the best estimate of the net expenditures required to complete the retirement. PSAB disagrees with this position because in the case of asset retirement obligations typically two different counterparties are involved and there is no legal right of offset. In addition, separate risks are associated with each the obligation and the recovery. The same logic applies to recoveries associated with liabilities for remediation of contaminated sites. To address this matter, the Board made a consequential amendment to Section PS 3260.

69. A respondent to the Exposure Draft, who agreed with the treatment of recoveries in Section PS 3280 and the consequential amendments to Section PS 3260, thinks that PSAB needs to ensure a consistent approach to recovery guidance across all of its standards. The Board agrees that the guidance on recoveries in the PSA Handbook needs to be reviewed. As this matter affects a number of PSA standards, applying to various situations, the appropriateness of the recovery guidance in those Sections needs to be addressed outside of the scope of this project.

**PRESENTATION AND DISCLOSURE**

70. There was an overall support for the disclosure requirements. A few respondents to the Statement of Principles and a respondent to the Exposure Draft found the requirement in paragraph PS 3280.63(d) too onerous. This requirement

states that an entity needs to disclose a reconciliation of the beginning and ending aggregate carrying amount of the liability. PSAB continues to support this disclosure requirement given that it provides useful information about changes in the liability balance between reporting periods.

71. Several respondents to the Exposure Draft considered that the standard should provide guidance with regard to the level of detail required in the disclosure requirements. They suggested that guidance similar to that included in paragraph PS 3260.66 be included. PSAB agreed and amended the guidance accordingly.

72. PSAB also:

(a) clarified that cases where an entity may not be able to make a reasonable estimate of the amount of the liability are expected to be extremely rare; and

(b) enhanced disclosure requirements to capture relevant disclosures from Section PS 3270, which has been withdrawn.

**TRANSITIONAL PROVISIONS**

73. The new standard applies to fiscal periods beginning on or after April 1, 2021. When an accounting standard is adopted for the first time, the PSA Handbook provides a choice of prospective or retroactive application. However, to ease transition, PSAB also included a third transitional provision option – a modified retroactive application. This option, unlike the retroactive application, does not require the use of historical assumptions and discount rates to estimate the asset retirement obligation. Instead, the entity would base the assumptions and discount rate on information that is current at the beginning of the fiscal year in which this standard is first applied. Its application is clarified in paragraphs PS 3280.69-.71 and illustrated in Appendix B. Whichever transitional provision option is selected, it must be applied consistently to all asset retirement obligations.

74. Two respondents to the Exposure Draft were not clear how to apply this standard prospectively and highlighted that the prospective application may be subject to interpretation. To ensure that all asset retirement obligations outstanding as of the transition date are reflected and to clarify the intended treatment, PSAB provided additional guidance on prospective transitional provisions.

**OTHER MATTERS**

75. Respondents to the Statement of Principles and the Exposure Draft asked PSAB to enhance the standard by including further useful examples applicable to all public sector entities or modifying those considered inappropriate. Respondents also provided other suggestions aimed at clarifying the guidance. The Board considered all these recommendations and amended the guidance where these suggestions improved its clarity.

# Footnotes

1. Tangible capital assets were not defined when Section PS 3270 was issued.