PSAB Updates and Asset Retirement Obligations

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September 2017

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Public Sector Accounting Standards Update

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Overview of Current Changes to the Public Sector Accounting Standards - New Standards and Application Date

Topic	Effective Date years commencing on or after
Introduction to PSAS	January 1, 2017
Related party disclosures (PS 2200)	April 1, 2017
Inter-entity transactions (PS 3420)	April 1, 2017
Assets (PS 3210) Contingent assets (PS 3320) Contractual rights (PS 3380)	April 1, 2017 April 1, 2017 April 1, 2017
Restructuring transactions (PS 3430)	April 1, 2018
Financial instruments (PS 3450)* Foreign Currency Translation (PS 2601)* Financial Statement Presentation (PS 1201)* Portfolio Investments (PS 3041)* (*must be adopted together)	April 1, 2019 For entities who previously applied Part V of CICA Handbook, Accounting - April 1, 2012

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Public Sector Accounting Standard Changes
Introduction to Public Sector Accounting Standards

- **Provide guidance as to the basis of accounting to be used by partnerships effective for years commencing on or after January 1, 2017**
  - Government business partnerships with only public sector partners to use Part I (IFRS) of the CPA Canada Accounting Handbook
  - Non-business government partnerships with only public sector partners to use either Public Sector Accounting Standards or Part I (IFRS)
  - Partnerships with one or more private sector partners to use standards determined by the partners

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Public Sector Accounting Standard Changes
Introduction to Public Sector Accounting Standards (Cont'd)

- Government components to apply Public Sector Accounting Standards effective years commencing on or after January 1, 2017
- Includes specific definitions for all types of government organizations, and partnerships, including definitions for public sector entity and government component

Public Sector Accounting Standard Changes
Related Party Disclosures – PS 2200

- Two new handbook sections have been issued – one on disclosure and the other on measurement. The measurement section is entitled Inter-Entity Transactions
- The definition of related party includes control and relates to both entities and individuals
- From the perspective of the entity that is reporting, parties related to it typically include those:
  a) entities that control it, share control of it or it controls;
  b) entities that are subject to common control;

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Public Sector Accounting Standard Changes
Related Party Disclosures – PS 2200 (cont'd)

c) entities that it shares control of with other commonly controlled entities;
d) entities that are subject to shared control by other commonly controlled entities;
e) entities that it shares control of with other entities;
f) entities that are subject to shared control by other commonly controlled entities and other entities;
g) individuals who are members of key management personnel or close family members of those individuals; and
h) entities controlled by, or under shared control of, a member of key management personnel or a close family member of that individual

Public Sector Accounting Standard Changes
Related Party Disclosures PS 2200 (cont'd)

- Disclosure of information about the transaction and the underlying relationship is required when they occur at a value different from what would have been recorded if they were not related
- Only transactions occurring that have a material effect on the entity reporting
- Disclose nature and extent and can include contributed goods and services at no cost
- Effective for years commencing on or after April 1, 2017

Public Sector Accounting Standard Changes
Related Party Disclosures PS 2200 (cont’d)

- **Disclosures include:**
  a) adequate information about the nature of the relationship with related parties involved in related party transactions;
  b) the types of related party transactions that have been recognized;
  c) the amounts of the transactions recognized classified by financial statement category;
  d) the basis of measurement used;
  e) the amount of outstanding balances and the terms and conditions attached to them;
  f) contractual obligations with related parties, separate from other contractual obligations;

Public Sector Accounting Standard Changes
Related Party Disclosures PS 2200 (cont'd)

g) contingent liabilities involving related parties, separate from other contingent liabilities; and

h) the types of related party transactions that have occurred for which no amount has been recognized.

- **Items of a similar nature should be disclosed in aggregate**

Public Sector Accounting Standard Changes
Inter-Entity Transactions PS 3420

- **Transactions amongst components of the Government Reporting Entity**
- **Transactions at carrying amount unless**
  - normal course (use exchange amount)
  - fair value consideration (use exchange amount)
  - no or nominal amount (use carrying amount by provider and carrying amount or fair value by recipient)
  - cost allocation (use exchange amount)
- **Unallocated cost recognition is optional but if costs are allocated, revenue and expense should be at gross amounts**
- **Effective for years commencing on or after April 1, 2017**

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Public Sector Accounting Standard Changes – Assets PS 3210

- Guidance on key aspects of the definition of assets
  - They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows
  - The public sector entity can control the economic resource and access to the future economic benefits
  - The transaction or event giving rise to the public sector entity's control has already occurred

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Public Sector Accounting Standard Changes – Assets PS 3210 (cont’d)

- An entity controls the economic resource and access to future economic benefits when it:
  - Can benefit from the economic resource through its capacity to provide goods and services, to provide future cash inflows or to reduce cash outflows;
  - Can deny or regulate access to those benefits by others; and
  - Is exposed to the risks associated with the economic resource.
- Information about major categories of assets that are not recognized should be disclosed
- Effective years commencing on or after April 1, 2017

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Public Sector Accounting Standard Changes
Restructurings PS 3430

- Establishes standards for recognizing and measuring assets and liabilities transferred in a restructuring
- Assets and liabilities to be measured at their carrying amount
- A restructuring transaction in the public sector differs from an acquisition as they generally include either no or nominal payment
- A restructuring transaction differs from a government transfer as the recipient would be required to assume the related program or operating responsibility
- Effective for years commencing on or after April 1, 2018

Public Sector Accounting Standard Changes Financial Instruments / Foreign Currency / Financial Statement Presentation

- **Financial Instruments / Foreign Currency Translation / Financial Statement Presentation**
  - Must be applied at the same time
  - Financial Statement Presentation changes related to the statement of remeasurement gains and losses to be presented in a separate statement
- **Effective Date**
  - Effective for years commencing on or after April 1, 2019, extended from April 1, 2016 last year, for all other organizations including municipal governments
- **Early adoption is permitted**

Public Sector Accounting Standard Changes
Financial Instruments PS 3450

- Measurement/Recognition Principles
  - New Section PS 3450 Financial Instruments
  - Investments in equities that are traded in an active market are measured at fair value, with changes recognized in operations
  - All other financial instruments are carried at cost or amortized cost
  - Option to record any financial instrument at fair value – Irrevocable election on initial recognition
  - Any investments where managing and reporting performance for a group of financial assets, financial liabilities, or both on a fair value basis

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Public Sector Accounting Standard Changes
Financial Instruments PS 3450 (cont'd)

- Measurement/Recognition Principles – derivatives
  - Derivatives continue to be measured at fair value
  - Hedge accounting is not permitted
  - Contracts must be reviewed for embedded derivatives
  - Option to value full contract with embedded derivative at fair value rather than separately account for the derivative features

Public Sector Accounting Standard Changes
Financial Instruments PS 3450 (cont'd)

- Transaction costs
  - Capitalize transaction costs for instruments carried at cost or amortized cost
  - Expense transaction costs for instruments carried at fair value
- Effective Interest method
  - Interest should be measured using the effective interest method
- Timing of recognition
  - Purchase and sale of investments should be recorded using the trade-date; not the settlement date

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Public Sector Accounting Standard Change
Financial Statement Presentation PS 1201

- Statement of Remeasurement Gains and Losses
  - Exchange gains/losses yet to be settled
  - Fair value remeasurements on investments and derivatives

Public Sector Accounting Standard Change
Financial Instruments – Financial Statement Presentation (cont'd)

Statement of Remeasurement Gains and Losses

For the year ended December 31	20X1	20X0
Accumulated remeasurement gains and losses at beginning of year	$ xx	$ xx
Unrealized gains (losses) attributable to:		
Derivatives	xx	xx
Portfolio investments	xx	xx
Foreign exchange	xx	xx
Amounts reclassified to the statement of operations:		
Derivatives	xx	xx
Portfolio investments	xx	xx
Foreign exchange	xx	xx
Net remeasurement gains and losses for the year	xx	xx
Accumulated remeasurement gains and losses at the end of the year	$ xx	$ xx

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Public Sector Accounting Standard Changes
Foreign Currency PS 2601

- PS 2601
  - Current rate would be used
  - Gains/losses yet to be settled (i.e. remeasurement gains and losses) presented in a separate statement

Introduction to PSAB's Asset Retirement Obligations Exposure Draft

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Basics of the Exposure Draft- Timeline

- **Exposure draft was open for comment until June 15, 2017. Formal accounting standard to follow.**
- **Adoption date**
  - Applies to fiscal years beginning on or after April 1, 2022
  - Earlier adoption is permitted
  - Understand the transitional rules and choices

Basics of the Exposure Draft- Timeline

June 2014

- Statement of Principles approved

December 2016

March 2017

- PSAB's Exposure Draft

Today

April 2022

- First Public Reporting for AROs

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Purpose and Scope of Standard

- **Establishes standards on how to account for and report a liability for asset retirement obligations:**
  - Defines which activities are included in a liability for retirement of a tangible capital asset
  - Establishes when to recognize and how to measure a liability for an asset retirement obligation

Purpose and Scope of Standard

- Provides the related financial statement presentation and disclosure requirements
- Applies to legal obligations, including an obligation created by promissory estoppel, associated with the retirement of a tangible capital asset that result from its acquisition, construction, development or normal use

Asset Retirement Activities

- *"Includes 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 or developed;*
  - *decontamination created by the normal use of the tangible capital asset;*
  - *post-retirement activities such as monitoring; and*
  - *constructing other tangible capital assets in order to perform postretirement activities."*

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Scope of Standard

- **The standard defines scope to include :**
  - Retirement obligations associated with tangible capital assets controlled by a public sector entity (assumption of responsibility not a requirement)
  - Legal obligations, including an obligation created by promissory estoppel
  - Includes solid waste landfill closure and post-closure liability (has resulted in the proposed amendment to withdraw Section PS 3270)
  - Asset retirement obligations associated with tangible capital assets that are in productive use and those that are no longer in productive use

Scope of Standard

- **Primary changes from the Statement of Principles:**
  - Scope includes solid waste landfill closure and post-closure liability.
  - Asset retirement obligations associated with tangible capital assets that are in productive use <u>and those that are no longer in productive use</u>.

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Scope of Standard

- **The standard EXCLUDES:**
  - Routine replacement
  - Improper use
  - Unexpected event
  - Alternative use
  - Waste and by-products
  - Costs that arise solely from a plan to sell

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Potential Impact of Including Solid Waste Landfill Closure And Post-closure Liability

- Obligations would be recognized earlier as the accounting treatment changes from incremental recognition of liability based on usage to recognition on acquisition, construction, development or normal use. Results in an earlier increase in net debt.
- 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.

Potential Impact of Including Solid Waste Landfill Closure And Post-closure Liability

- More professional judgment may have to be used when applying the proposed standard as it applies to various types of asset retirement obligations rather than just to landfill sites.
- Note disclosure requirements to reflect the change in the accounting treatment.

Comparison of Scope of ARO and PS 3260

ARO	PS 3260
• **Asset retirement obligations not related to contamination** associated with entity's Tangible Capital Asset (TCA) in productive or no longer in productive use (e.g. dismantling of a TCA). • **Expected contamination** related to a TCA controlled by the entity in productive or no longer in productive use.	• **Expected or unexpected** contamination where the entity **accepts responsibility** (underlying asset not controlled by the entity or no legal requirement to perform decontamination). • **Unexpected contamination** related to a TCA controlled by the entity in productive or no longer in productive use.

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Boundaries Between ARO and PS 3260

	ARO	Contaminated Sites
The 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
The type of obligation	• Legal (related to TCA of the entity)	• Legal and assumed responsibility
The extent of contamination	• Contamination does not have to exceed the environmental standard	• Contamination must exceed the environmental standard

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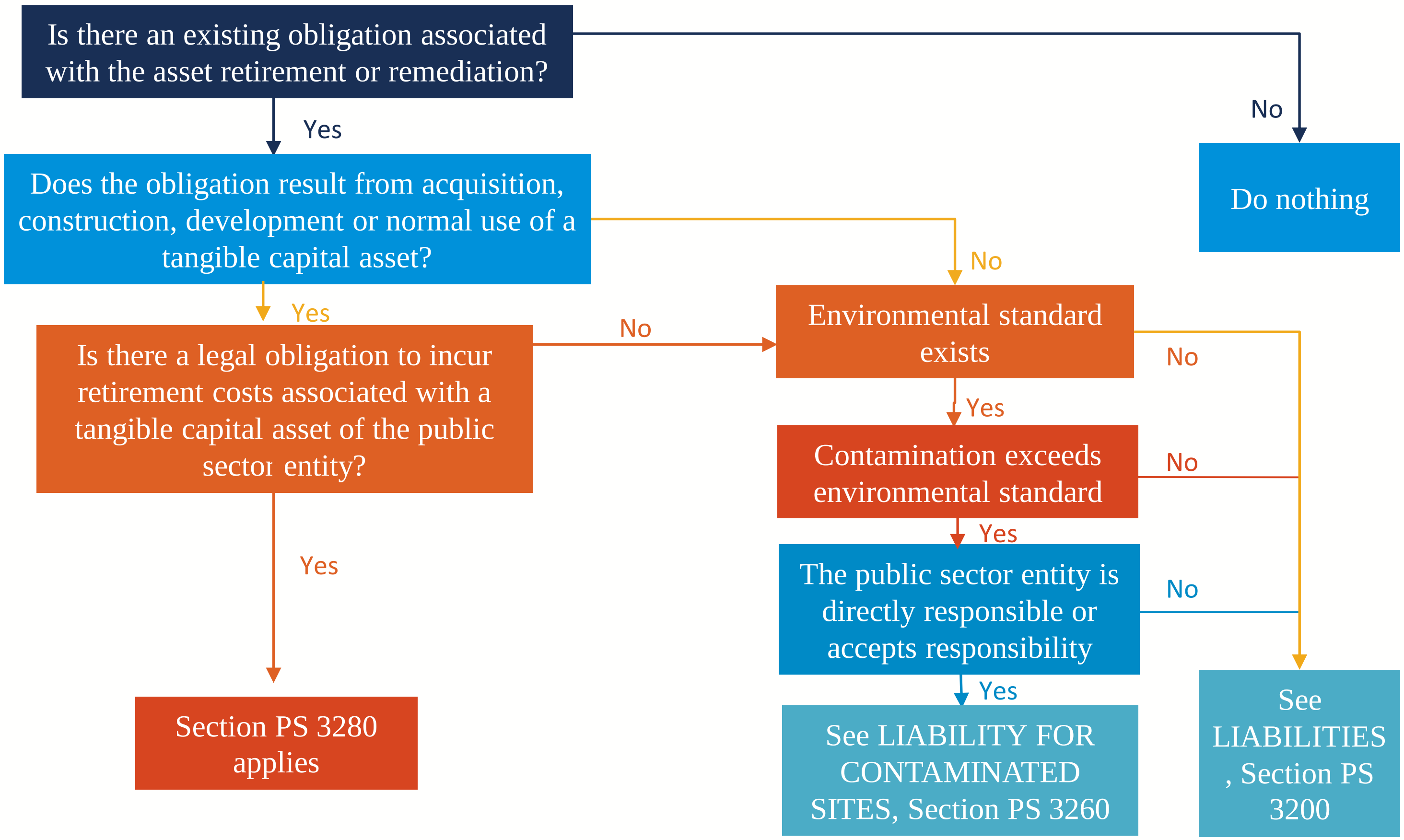
Decision Tree –Scope of Applicability



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Recognition/Allocation

- A liability for an asset retirement obligation can be incurred due to:
  - the acquisition, construction or development of a tangible capital asset; or
  - normal use of a tangible capital asset.

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Recognition/Allocation

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

Recognition/Allocation

- **Recognition and allocation guidelines:**
  - Capitalize asset retirement obligation and allocate the cost in a rational and systematic manner.
  - Capitalize vs. expense:
    - Capitalize asset retirement obligations associated with fully amortized tangible capital assets.
    - Expense asset retirement obligations associated with unrecognized tangible capital assets.
    - Expense asset retirement obligations associated with tangible capital assets no longer in productive use *(new guidance in exposure draft)*

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Recognition/Allocation

- **Recognition and allocation guidelines:**
  - Allocation:
    - A choice of allocating the ARO cost at the component or network level.
    - Allocation of ARO cost to be consistent with the amortization policy of the underlying tangible capital asset.

Recognition/Allocation

- Key changes from the Statement of Principles:
  - Public sector entities have a choice of allocating the ARO cost at the component or network level. The SOP previously required that this be allocated only at the component level.
  - Allocation of ARO cost must be consistent with the amortization policy of the underlying tangible capital asset.
  - New guidance provided with respect to the treatment of asset retirement obligations associated with fully amortized tangible capital assets, unrecognized tangible capital assets, and tangible capital assets no longer in productive use.

Measurement

- The estimate of a liability should include costs directly attributable to asset retirement activities. Costs would include post-retirement operations, maintenance and monitoring that are an integral part of the retirement of the tangible capital asset. Includes costs of tangible capital assets acquired as part of asset retirement activities to the extent those assets have no alternative use.

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Measurement

- Directly attributable costs would 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.

- Costs include only those related to the nature and extent of the asset retirement obligation in accordance with the agreement, contract, legislation or a legally enforceable obligation establishing the liability

Measurement

- 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. A present value technique is often the best method with which to estimate the liability

- **Recognize period to period changes in liability:**
  - due to timing, amount of original estimate, discount rate – capitalize
  - due to passage of time – expense
  - if underlying asset is retired – expense

Recoveries

- **Recovery guidelines:**
  - A recovery should not be netted against the liability. It should be recognized as a separate asset when it meets the recognition criteria
  - ED adds a principle relating to contingent recoveries that was not previously addressed in the SOP.

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Presentation and Disclosure

- Presentation and Disclosure guidelines:
  - Description of the liability and associated tangible capital asset
    - Amortization method used
    - Basis for the estimate of the liability
    - Reconciliation of the changes in carrying amount during the period

  - ED adds:
    - How funding and assurance provisions are met
    - Estimated recoveries

Transitional Elements

- Transitional guidelines:
  - ED adds:
    - Extended transition date to 2022; and
    - Three transitional provision options
      1. Prospective
      2. Retroactive
      3. Modified retroactive application

Preparing to Implement
Asset Retirement Obligations

Identifying Assets in Scope

- **Review active and inactive TCA's to identify those with retirement obligations. Consider:**
  - Retirement obligations associated with tangible capital assets controlled by a public sector entity (including both those which are in productive use and those that are no longer in productive use)
  - Legal obligations
  - Solid waste landfills

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Identifying Assets in Scope

- Reconcile this inventory with the site inventory for contaminated sites
- Engage functions outside of finance (particularly public works and engineering)
- Consider implications of transitional options for assets in scope

Assessing in Scope Sites

- **Evaluate the inventory of assets in scope against the proposed recognition criteria:**
  - 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 amount can be made.

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Measurement

- **For identified in-scope assets meeting the recognition criteria:**
  - Develop a best estimate of the liability for an asset retirement obligation to retire the tangible capital asset.
  - Benchmarks for an appropriate discount rate when applying a present value technique
  - Define those costs directly attributable to asset retirement activities.
  - Documentation critical to auditability

Accounting Policy Matters

- **Consider key accounting policy selections that will impact adoption of the standard**
  - Choice of allocating the ARO cost at the component or network level.
  - Transitional options
  - Consistency with other policies and procedures (such as amortization; contaminated sites)

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Thank you

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