KPMG

Perspectives on PS 3280 Asset Retirement Obligations

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Introduction

PS 3280 Asset Retirement Obligations is a complex accounting standard which requires the application of professional judgement and will result in significant changes to the financial statements of public sector entities. Asset retirement obligations are an estimate which will need to be derived from available information and will require public sector entities to make judgments and assumptions leveraging available data and the insights of their team members.

This guide provides KPMG's perspective on key implementation issues and technical interpretations of the guidance in PS 3280. It provides insights into challenges public sector entities are likely to face as they implement PS 3280 for the first time and establish a process for the review of the obligation at each financial reporting date. This guide aims to help management and other stakeholders by providing a guide to key matters arising from implementation of the standard.

Overview of PS 3280

Definitions

- Asset retirement activities include all activities related to an asset retirement obligation.
- An asset retirement obligation is a legal obligation associated with the retirement of a tangible capital asset.

Recognition

- An asset retirement obligation is recognized when 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.
- The asset retirement obligation is recognized as a liability with an increase to the carrying amount of the related tangible capital asset in the same amount as the liability.
- The asset retirement cost is allocated to expense in a rational and systematic manner over the useful life of the tangible capital asset.
- The asset retirement cost is added to the cost base of a fully amortized tangible capital asset and amortized over the revised estimate of the remaining useful life.
- The asset retirement cost is expensed for an unrecognized tangible capital asset or a tangible capital asset no longer in productive use.

Measurement

- The estimate of a liability should include costs directly attributable to asset retirement activities.
- In periods subsequent to initial measurement, revisions to either the timing, amount of the original estimate of the undiscounted cash flows or discount rate are recognized as part of the tangible capital asset. The passage of time is recognized as accretion expense.

Recoveries

- A recovery related to asset retirement obligations 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 should not be netted against the liability.

Transitional provisions

- PS 3280 applies to fiscal years beginning on or after April 1, 2022.
- PS 3280 can be applied using retroactive application, modified retroactive application or prospective application.

Timing of recognition of retirement obligations

When should asset retirement obligations be recognized for assets under construction – when the construction is complete, when the asset is put into use, or as the asset is being constructed?

KPMG's perspective

PS 3280 notes that 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. There is no further specific guidance on the precise timing of recognition.

Public sector entities will need to determine what activity creates the obligation and record the obligation when that activity occurs. For example, consider the scenario where a hazardous material is used as insulation in a building under construction and a provincial regulation requires it to be removed in a prescribed manner when the building is demolished. In this case, the asset retirement obligation is linked to the installation of the hazardous material and the obligation is recognized as the hazardous material is put into the building. However, if there is an x-ray machine that through its normal use creates radiological contamination, the obligation would be recorded as the asset is used and the radiological contamination is created.

Due to a catastrophic event (e.g. flood, forest fire), a public sector entity is required to dispose of tangible capital assets earlier than expected. Does the occurrence of the catastrophic event impact the asset retirement obligations?

KPMG's perspective

Catastrophic events are unexpected and unrelated to the normal use of tangible capital assets in the operations or the construction or acquisition of tangible capital assets. As a result, costs associated with catastrophic events are out of scope for PS 3280.

However, a catastrophic event may impact the assumptions used to calculate the asset retirement obligation. For example, if fire partially damages a building with asbestos, the public sector entity may decide to demolish the entire building earlier than it had originally anticipated. The earlier retirement date would be adjusted for in the calculation of the retirement obligation at period-end.

Certain tangible capital assets are fundamental to operations and will never be retired (e.g. small local government with one water treatment plant). Instead, routine repairs and maintenance will be performed on the asset. Would an asset retirement obligation need to be recognized for these assets?

KPMG's perspective

Certain tangible capital assets may be critical to a public sector entity's operations, and due to the significant replacement cost, it may be prohibitive for the entity to fully retire the asset in the short-term. This particularly could arise for certain tangible capital assets which are historical in nature or of cultural relevance. However, depreciable assets have a finite life and, at some point in the future, they will deteriorate to the point where they cannot be repaired and must be replaced. The entity may take the approach of replacing components of the asset over time to spread the replacement cost over multiple years. In such cases, the following guidance should be applied to each significant component of the asset.

When applying the PS 3280 guidance, the public sector entity should first consider the recognition criteria to identify all in-scope retirement obligations. The scoping analysis should be performed without considering the estimated timing of the retirement activities, which is a measurement issue. In other words, the timing of the retirement activities does not impact whether there is an in-scope retirement obligation.

If in-scope retirement activities are identified, the public sector entity will then need to estimate the liability, which includes determining the timing of the cash flows. PS 3280 only requires that the timing of the cash flows is estimated; perfect information about timing is not required. A public sector entity should consider all available information it has about the timing of the cash flows, including the asset's condition, asset management plans, multi-year capital budgets and the basis on which the asset's useful life was determine for amortization purposes.

It may be the case that discounting the cash flows results in an immaterial asset retirement obligation liability because the cash flows are expected to occur far into the future. The public sector entity should still record the liability since over time the liability will increase as the retirement activities become more imminent.

In addition to recording the liability, public sector entities are also required to disclose the estimated total undiscounted expenditures and the time period over which the undiscounted expenditures are expected to be incurred. As a result, even if the liability recorded is immaterial, the analysis above will be required to ensure the financial statement disclosures are complete.

A public sector entity decides that it will voluntarily perform certain retirement activities. In what circumstances would an asset retirement obligation be recognized?

KPMG's perspective

PS 3280 requires a legal obligation to incur retirement costs in relation to a tangible capital asset. If a public sector entity voluntarily chooses to perform certain retirement activities or performs retirement activities as part of its normal asset retirement practices, but there is no legal agreement, contract or legislation obligating it to perform the activities, then the retirement costs are outside the scope of PS 3280. While such obligations would not be assessed under PS 3280, they should be considered under PS 3200 Liabilities.

Retirement obligation within the scope of PS 3280 may occur from a government's own legislation (e.g. local government passes bylaws requiring the disposal of certain hazardous materials in a prescribed manner) or promissory estoppel (a promise conveyed to a third party that imposes a reasonable expectation of performance upon the promisor). Although these originate from with the entity, they are still legally enforceable acts that the entity is required to perform when retiring the assets.

Legislation exists that requires the public sector entity to perform retirement activities only when a specific event occurs. For example, asbestos only needs to be cleaned up and disposed when it is disturbed. Should the asset retirement obligation be recorded when the asset is acquired, constructed or developed, or when the specific event noted in the legislation occurs?

KPMG's perspective

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. The public sector entity needs to identify what is the event that gives rise to the legal obligation to incur the retirement costs.

For example, when a public sector entity acquires a building with asbestos, it is known with certainty at the time of purchase that the asbestos will need to be cleaned up and disposed at some point in the future.

It is a matter of timing rather than of fact that the asbestos will need to be cleaned up and disposed. The purchase of the building is the past event or transaction creating the legal obligation and the asset retirement obligation is recorded when the building is acquired.

Another example is hazardous waste that results from the normal operations of a machine. The legal regulation may only require the hazardous waste to be cleaned up when it occurs. At the time the machine is acquired, no hazardous waste has occurred and there is no obligation for remediation. Therefore, no asset retirement obligation is recorded upon acquisition of the machine. When the machine is put into use and hazardous waste occurs, the event obligating the public sector entity to clean-up the hazardous waste has occurred and the remediation liability is recorded.

Lease arrangements

A lease agreement has a specific end date and requires the tangible capital assets to be restored to their original state at the end of the lease term. In practice, the lease will be renewed for additional terms for the foreseeable future. Does an asset retirement obligation need to be recognized?

KPMG's perspective

The lease agreement signed by the lessee and lessor is legally binding and can be enforced in a court of law. As a result, if the lease agreement states that there is a legal obligation for the lessee to return the assets to their original state, this represents a legal obligation that would be within the scope of PS 3280.

Uncertainty about the timing of retirement activities creates estimation uncertainty and is a measurement issue. It does not preclude the lessee from recognizing the asset retirement obligation. PS 3280 notes that it is extremely rare that a reasonable estimate of the liability cannot be made.

The timing of the retirement activities is usually linked to the lease's end date per the agreement unless there is persuasive evidence that an alternative retirement date is more appropriate. To identify an alternative retirement date, the lessee could consider renewal clauses, historical renewal practices with the lessor for other assets, or correspondence from the lessor indicating the desire to renew at the end of the lease term. The more material or significant the related liability, the more persuasive the evidence needs to be for the alternative retirement date. Consistency with the assumptions applied for recognition of the leased asset is also important. A different set of assumptions cannot be used for the asset retirement obligation than for the asset itself.

In the absence of sufficient evidence for an alternative retirement date, the lessee should use the lease end date in the lease agreement. If at the end of the lease term the lease is renewed, the lessee would adjust the assumptions used to measure the liability would be updated for the change in timing of the retirement activities.

A lease agreement states that the lease will be terminated when one party provides written notice to the other and requires the leased asset to be restored to its original state when the lease is terminated. How would the timing of the end of lease costs be estimated?

KPMG's perspective

In this scenario, the lease agreement is a legal contract that obligates the lessee to incur certain costs at the end of the lease term. The recognition criteria in PS 3280 are met and a liability needs to be recorded. The issue is the measurement of the liability and specifically when the cash flows will occur.

Since the lease agreement does not specify the lease end date, the lessee will need to review other available informaton which may include operating plans for the leased asset, the leased asset's remaining useful life, past practices for similar assets, as well as communications with the other party. The public sector entity may discuss the expected lease end date with the lessor to determine if the lessor has any imminent intentions to terminate the lease. Based on the available information, the lessee will need to make its best estimate of the expected timing of the cash flows. In subsequent periods, the liability is updated for any new information received about the lease termination date.

The lease agreement is silent on who is responsible for the asset retirement activities. Who should recognize the asset retirement obligation – the lessee or the lessor?

KPMG's perspective

The asset retirement obligation is recorded by the party that has the legal obligation to incur the costs.

If the lease agreement does not require the lessee to incur the costs, and there is no other legal agreement, contract or legislation creating the obligation for the lessee, no asset retirement obligation is recorded as a true legal obligation does not exist.

If the liability is not assumed by the lessee, generally, the liability is recorded by the owner of the assets or the lessor assuming the recognition criteria in PS 3280 are met.

Land has an indefinite life and is not retired. Is a land lease agreement that requires the removal of tangible capital assets on the land at the end of the lease term within scope of PS 3280?

KPMG's perspective

Land has an indefinite life and is not retired. However, in this scenario, the asset retirement obligation is related to the tangible capital assets on the land, and not the land itself. The land lease agreement is a legal contract that obligates the lessee to incur certain costs at the end of the lease term. The recognition criteria in PS 3280 are met and a liability needs to be recorded for the costs associated with removing the tangible capital assets on the land.

A public sector entity has entered into a land lease agreement as the lessor. There are buildings on the land, and at the end of the lease term, there is no requirement for the buildings to be demolished or otherwise retired by the lessee. The buildings are owned and operated by the lessee. Should the public sector entity (lessor) include the buildings in its assessment of tangible capital assets with potential retirement obligations when implementing PS 3280?

KPMG's perspective

In this scenario, the public sector entity should first review the lease agreement and consider past practices in similar situations to verify that the lessee does in fact have no liability for the building's retirement costs. The public sector entity may also engage in discussions with the lessee to confirm that they intend to abandon the building on the site at the end of the lease term.

If it is determined that the lessor is required to incur the costs for the building's retirement, then the public sector entity will need to determine whether the recognition criteria in PS 3280 are met and an asset retirement obligation liability should be recognized. For example, if the buildings have no asbestos and there are no other legally required retirement activities, then even though retirement costs may be incurred in the future, no asset retirement liability is recognized under PS 3280 because the retirement activities are not legally required. However, if the buildings have asbestos that the public sector entity will need to remove at a future date, then an asset retirement obligation liability will need to be recognized.

Timing of cash flows

A public sector entity does not have asset management plans or asset condition reports that identify when assets will be replaced or retired. Even though there are estimated useful lives being used to amortize the tangible capital assets, the assets will likely be used for longer than the remaining useful life. How can the timing of cash flows for retirement activities be estimated?

KPMG's perspective

PS 3280 requires use of the best available information to estimate the asset retirement obligation. At each financial reporting date, the estimate is reviewed and updated for any new information that has become available.

In the absence of asset management plans, asset condition reports and accurate remaining useful lives for assets, the public sector entity can consider:

- Historical practices for similar assets – For example, a similar asset may have been retired ten years after the end of the useful life used for amortization purposes. This may provide a basis for estimating that the asset being assessed will last an additional ten years after its current useful life.
- Similar assets owned by similar organizations – A public sector entity could obtain information from other similar organizations about the remaining useful life of a similar asset. The public sector entity should evaluate the information received to ensure it is relevant and reliable.
- Internal asset condition assessments – The public sector entity could inquire with the individuals within its organization about the repairs and maintenance practices and how long it is expected the asset can be used in the operations. The expertise of the individuals providing the information should be considered to ensure the assessment is reliable.

If the information available is considered insufficient to create a reasonable estimate for the timing of the cash flows, the public sector entity may need to get an external expert to assist with evaluating the remaining life of the asset.

The public sector entity could also choose to apply the useful life used for amortization purposes as an initial estimate of the timing of the retirement activities until other information is available.

The lack of information about the timing of the cash flows would not preclude the public sector entity from recording the liability.

As part of the PS 3280 implementation project, the public sector entity identifies that some of the useful lives of tangible capital assets are inaccurate. What is the appropriate accounting treatment for the change in useful life of the assets? Should the adjustment be recorded through a prior period restatement or prospectively?

KPMG's perspective

The public sector entity should first evaluate whether the difference in the useful life is due to an error or a change in estimate. Generally, if the useful life is being refined based on new information or analysis that is available because of the PS 3280 implementation project then the change in useful life is considered a change in estimate and the impact is recorded prospectively. The amortization expense recognized for the assets in prior periods is not restated. Instead, the impact of the new useful lives on amortization expense is recognized prospectively.

For example, a building costs $1,000,000 and is amortized over 20 years with amortization expense of $50,000 per year. After five years, the net book value is $750,000. As part of the PS 3280 implementation project, the remaining useful life is revised from 15 years to 25 years. In each subsequent year, the annual amortization expense is revised to $30,000 ($750,000 divided by 25 years), and there is no restatement to adjust the $250,000 of amortization previously recognized.

Even though an asset has an in-scope legal obligation, the public sector entity will never pay cash to retire the asset. Does an asset retirement obligation need to be recorded?

KPMG's perspective

PS 3280 requires that all four of the recognition criteria are met to recognize an asset retirement obligation. One of these criteria is that future economic benefits (e.g. cash or other assets) will be given up for the retirement activities. If this criterion is not met, no liability is recorded.

For example, a local government may have pipes in the ground that have asbestos. Although there are legal requirements requiring asbestos to be cleaned up and disposed when the pipes are removed, the local government has built a major road over the pipes and will never dig up the road to remove the pipes. Therefore, no costs will be incurred for the asbestos and no asset retirement obligation is recorded. In this situation, the local government would need to ensure it monitors its plans for the road to ensure there are no changes that would result in the pipes needing to be removed.

Can capitalized retirement costs be amortized over a different useful life than the related tangible capital asset?

KPMG's perspective

Canadian public sector accounting standards directs public sector entities to capitalize the costs directly attributable to the acquisition, construction, development or betterment of tangible capital assets. PS 3280 is consistent with this concept and notes that retirement costs are no different from other costs that have or will be incurred to use the tangible capital asset for its intended purpose. Further, determining the period over which a tangible capital asset should be amortized is based on its usage or service potential and is not based on the nature of the costs incurred for the asset. Therefore, capitalized retirement costs should be amortized over the same remaining useful life as other capitalized costs for the tangible capital asset.

Discounting the cash flows

PS 3280 recommends, but does not require, discounting of the cash flows for retirement activities. When should a public sector entity apply discounting?

KPMG's perspective

PS 3280 notes that a present value technique 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. Public sector entities are also not required to consistently apply discounting across all assets. In other words, it may be applied to certain assets and not others.

Some public sector entities are choosing not to discount the cash flows when there is significant uncertainty about the timing of the cash flows. Under this view, discounting the cash flows introduces additional estimation uncertainty into the estimate of the liability over and above the uncertainty around the timing of the cash flows. This results in a liability that is even less representative of the cash flows that will be expended in the future period to retire the asset.

Public sector entities will need to determine their approach to discounting cash flows as part of their asset retirement obligation policy. The policy should clearly articulate whether all or some retirement obligations will use a present technique and, if some retirement obligations will not be discounted, the parameters used to make this decision. The use of specific parameters to determine the discounting approach is important to ensure different retirement obligations are calculated using a consistent approach.

What is the appropriate discount rate to use?

KPMG's perspective

The discount rate should reflect the time value of money and the risks specific to the liability for asset retirement obligations, for which future cash flow estimates have not already been adjusted. Assumptions inherent in the cash flows and the discount rate should be internally consistent. For example, if the cash flows include the effect of inflation then the discount rate should also incorporate the same inflation assumptions.

Public sector entities should not automatically assume that the discount rate used in other accounting policies such as employee future benefit plans will be the same rate used for asset retirement obligations. The assumptions used in these discount rates (e.g. duration, risk or nature of the cash flows) may be significantly different from those used in the asset retirement obligations.

Determining the appropriate discount rate will require professional judgement. Public sector entities should consider including guidance in their asset retirement policies for how the appropriate discount rate will be determined.

One approach to determining the discount rate is to consider what the interest rate would be if the public sector entity borrowed an amount similar to the total undiscounted retirement costs, with the same principal repayments as the cash outflows for the retirement activities, and with the same extinguishment date of the debt as for the asset retirement liability. This approach may be more appropriate if the public sector entity is likely to borrow to fund the retirement costs.

Another approach is to consider the opportunity cost to the public sector entity of setting aside an amount of cash equal to the undiscounted retirement costs for a similar time span as the retirement obligations. In other words, how much could the public sector entity earn if it invested cash to fund the asset retirement obligations. This approach may be more appropriate if the public sector entity is likely to self-fund the retirement costs.

Should the discount rate be updated at each reporting period date?

KPMG's perspective

PS 3280 requires the carrying amount of the liability to be reassessed at each financial reporting date and updated for new information that becomes available over the useful life of the tangible capital asset. This includes revisiting estimates and assumptions made at the implementation date to ensure they are still reasonable.

From a practical perspective, the public sector entity should consider how persuasive the evidence is that the discount rate has changed from the initial estimate and how significant the impact of the change is on the liability. If the change in the discount rate is simply the substitution of one estimate with another that is no more evidence-based then the discount rate could be left unchanged. However, if the change in the discount rate is due to changes in risks or the timing of cash flows, then updating the discount rate results in a better estimate of the liability.

Public sector entities should also consider materiality. If a change in the discount rate does not result in a significant change in the liability, then there could be an argument to leave the discount rate unchanged. Public sector entities should work collaboratively with their auditors to determine whether the impact on the liability is material.

Calculating the asset retirement obligation

During scoping, the public sector entity noted that there is a 50% likelihood that an asset has an asset retirement obligation. Should only 50% of the cash flows be included in the liability?

KPMG's perspective

Public sector entities may not have sufficient evidence to conclude with certainty that an asset has an associated retirement obligation and an assessment based on likelihood may need to be applied. However, once it has been determined that an asset is likely to have a retirement obligation and is in scope of PS 3280, the estimated liability is not reduced by the likelihood factor. An asset either does or does not have retirement obligations. Therefore, it would not be appropriate to reduce the liability by 50% on the premise that there is a 50% likelihood that the asset has a retirement obligation.

However, if for example the assessment is that 50% of a building's square footage has a related retirement obligation, then the liability would only be determined for 50% of the building's square footage.

What types of retirement activities should be included in the retirement obligation?

KPMG's perspective

PS 3280 requires costs directly attributable to asset retirement activities that meet the recognition criteria to be included in the estimate of the liability. Directly attributable costs can include payroll and benefits, equipment and facilities, materials, legal and other professional fees and overhead costs. It also includes post-retirement operation, maintenance and monitoring that are an integral part of the tangible capital asset's retirement and the cost of tangible capital assets acquired as part of the asset retirement to the extent that those assets have no alternative use.

Only costs related to the nature and extent of asset retirement obligations in accordance with legal agreements, contracts, legislation or promissory estoppel should be included in the liability. For example, there are legal requirements for the disposal of asbestos but not necessarily any legal requirements for the demolition of a building at the end of its life. Therefore, the costs associated with the disposal of the asbestos would be included in the liability but not the demolition costs. The exception might be if demolition is selected as the method by which the asbestos retirement obligation is most likely to be fulfilled. In this case, the demolition is the mode used to fulfill the legal obligation to dispose of the asbestos in the prescribed manner and the demolition costs could be included in the liability.

Should inflation be included in the calculation of the asset retirement obligation?

KPMG's perspective

There is no prescriptive guidance in PS 3280 about inclusion of inflation in the calculation of the asset retirement obligation and public sector entities will need to apply professional judgement to determine whether inflation should be included. Generally, including inflation in the calculation may provide a better estimate of the future cash expenditures that will be incurred.

Public sector entities should ensure that inflation is not inadvertently double counted in the liability. For example, if the cost estimate received from a third-party already includes the impact of inflation then an additional inflation factor should not be included. Further, inflation assumptions in the cash flows and discount rate should be consistent.

Where adjustments are applied for inflation, public sector entities should also consider whether the consumer price index ("CPI"), the Engineering News-Record ("ENR") construction cost index or another index is the most appropriate estimate of inflation. For example, the ENR construction cost index may be more relevant if the retirement activities are similar to construction activities. The CPI index may be more relevant if the retirement activities include the purchase of consumer good and services.

What types of overhead costs can be included in the asset retirement obligation?

KPMG's perspective

PS 3280 requires only overhead costs directly attributable to the legally required retirement activities to be included in the asset retirement obligation. Some professional judgement will need to be applied to determine what overhead costs can be included in the obligation. Public sector entities should consider which overhead costs are unavoidable when carrying out the retirement activities. For example, legal fees incurred to obtain permits to perform the retirement activities would be directly associated and unavoidable costs which should be included in the obligation. Costs related to accounting for asset retirement obligations and costs of engaging experts to estimate the asset retirement costs are not directly attributable to the retirement activities and would be expensed as incurred.

A public sector entity has a tangible capital asset with a retirement obligation. This asset is componentized in the financial records for amortization purposes. How should the retirement obligation be allocated to the components?

KPMG's perspective

The asset retirement obligation should be allocated to only those components with associated retirement obligations to ensure the retirement costs are amortized over the same useful life as the component to which it relates. A reasonable allocation basis should be used where specific identification of the obligation to the component is not possible. For example, retirement costs for asbestos in a building could be allocated to its components based on square footage or based on proportion of carrying value. Public sector entities should ensure only those components with associated retirement obligations are allocated a portion of the retirement costs. For example, if the roof of a building is a separate component and has no asbestos, no retirement cost should be allocated to the roof.

Solid waste landfills

PS 3270 Solid Waste Landfill Closure and Post-Closure Liability has been withdrawn and replaced with PS 3280 Asset Retirement Obligations. What is the impact on the solid waste landfill liability recorded in the financial statements?

KPMG's perspective

Under PS 3270, public sector entities accounted for the solid waste landfill liability based on usage of the site's capacity. A proportionate amount of the estimated total closure and post-closure costs was recorded as a liability and expensed based on the portion of the total estimated capacity of the site used. This resulted in the full liability for the costs being recognized at the end of the site's life.

Under PS 3280, public sector entities are directed to account for the liability when the past event or transaction occurs which obligates it to incur the costs. This can be either the acquisition, construction or development of the site or normal use of the site. Public sector entities will need to evaluate the solid waste landfill closure and post-closure activities to determine whether they are related to the acquisition, construction or development of the site or its normal use. For example, if the environmental approval requires that a final cover and vegetation is put in place irrespective of the landfill site usage, then the related liability will be recorded when the approval is received. Alternatively, if the closure activity relates to only the portion of the site that is in use, the liability would be recorded as additional portions of the site are used.

The implementation of PS 3280 will result in the solid waste landfill liability being recorded earlier in the site's life rather than incrementally based on usage. The higher liability results in a higher tangible capital asset cost if the site is in productive use, which must be amortized over the site's remaining useful life. The aggregate amount of retirement costs recognized for the site will not vary between legacy accounting under PS 3270 and PS 3280. However, the timing of expense recognition will change. Higher expenses will be recognized earlier in a site's useful life under PS 3280, and lower expenses in the later years of the site's life relative to PS 3270.

Since PS 3280 has general guidance related to all asset retirement obligations, applying its principles to solid waste landfills may require more professional judgement.

Case study

Case facts

Construction of a solid waste landfill starts on January 1, 2022 and the landfill begins accepting waste on January 1, 2023. The landfill will stop accepting waste on December 31, 2032. The landfill's capacity is 100,000 tons which will be used evenly over the site's life.

The estimated closure costs related to the final cover and vegetation in 2033 is $100,000. The site's environmental approval requires that a final cover and vegetation be put in place regardless of the landfill site's use.

The estimated closure costs in 2033 related to completion of facilities for monitoring and recovering gas are $250,000. The liability for closure costs is incurred when the site starts accepting waste.

The post-closure period is five years (January 1, 2035 to December 31, 2039) and costs $10,000 per year. Environmental approval requires the same closure and post-closure activities regardless of site use. The liability for post-closure costs is incurred when the site starts accepting waste.

Assume all cash outflows are incurred at year-end and the discount rate is 3%.

Summary of cash flows

	December 31					
	2033	2034	2035	2036	2037	Total
Closure cost – cover and vegetation	$100,000	-	-	-	-	$100,000
Closure cost – facilities for monitoring	$250,000	-	-	-	-	$250,000
Post-closure costs	$10,000	$10,000	$10,000	$10,000	$10,000	$50,000
Total	**$360,000**	**$10,000**	**$10,000**	**$10,000**	**$10,000**	**$400,000**

Application of PS 3270

On December 31, 2023, the present value of the closure and post-closure costs are $295,533 and 10% of the site's capacity has been used (10,000 tons out of a total of 100,000 tons). The liability and expense recognized is $29,553 ($295,533 x 10%).

On December 31, 2024, the present value of the closure and post-closure costs are $304,398 and 20% of the site's capacity has been used (20,000 tons out of a total of 100,000 tons). The incremental liability and expense recognized is $31,327 (($304,398 x 20%) - $29,553). The total liability recorded is $60,880 ($304,398 x 20%).

Application of PS 3280

On December 31, 2023, the present value of the closure and post-closure costs are $295,533, which equals the liability recognized. The tangible capital asset recognized is $258,233 (amount capitalized on January 1, 2023 of $286,925 less one year's worth of amortization of $28,692). A total expense for 2023 of $37,300 is recognized comprised of $28,692 of amortization expense and $8,608 of accretion expense (difference between the liability of $286,925 as at January 1, 2023 and the liability of $295,533 as at December 31, 2023).

On December 31, 2024, the present value of the closure and post-closure costs are $304,398, which equals the liability recognized. The tangible capital asset recognized is $229,541 (amount capitalized on January 1, 2023 of $286,925 less two years' worth of accumulated amortization of $57,384). A total expense for 2024 of $37,557 is recognized comprised of $28,692 of amortization expense and $8,865 of accretion expense (difference between the liability of $295,533 as at December 31, 2023 and the liability of $304,398 as at December 31, 2024).

Comparison between PS 3270 and PS 3280

Year end	Liability			Expense		
	PS 3280	PS 3270	Difference	PS 3280	PS 3270	Difference
2023	$295,533	$29,553	$265,980	$37,300	$29,553	$7,747
2024	$304,398	$60,880	$243,518	$37,557	$31,327	$6,230
2025	$313,530	$94,059	$219,471	$37,825	$33,179	$4,646
2026	$322,936	$129,175	$193,761	$38,098	$35,115	$2,983
2027	$332,624	$166,312	$166,312	$38,381	$37,138	$1,243
2028	$342,603	$205,561	$137,042	$38,671	$39,250	$(579)
2029	$352,881	$247,017	$105,684	$38,971	$41,455	$(2,484)
2030	$363,468	$290,774	$72,694	$39,279	$43,757	$(4,478)
2031	$374,372	$336,935	$37,437	$39,597	$46,160	$(6,563)
2032	$385,603	$385,603	-	$39,924	$48,669	$(8,745)
2033	$37,171	$37,171	-	$11,568	$11,568	-
2034	$28,286	$28,286	-	$1,115	$1,115	-
2035	$19,135	$19,135	-	$849	$849	-
2036	$9,709	$9,709	-	$574	$574	-
2037	-	-	-	$291	$291	-
			Total	**$400,000**	**$400,000**	**-**

Transitional provisions

How would PS 3280 be applied under each of the three transitional provisions?

Retroactive approach

The retroactive approach is based on the guidance in PS 2120 Accounting changes. In this approach, PS 3280 is applied as though it has been in effect since the date obligation first occurred and is based on historical assumptions applicable at that point in time. The public sector entity has the option to restate prior years or make a cumulative adjustment in the current year for the impact of the change in prior years through an adjustment to the cumulative surplus / deficit or through operating results.

Prospective approach

The prospective approach can take three forms based on the circumstances of the specific situation:

1. Asset retirement obligations where the event giving rise to the obligation (i.e. acquisition, construction, development or normal use of the asset) occurred on or after April 1, 2022.
2. Asset retirement obligations where the event giving rise to the obligation arose prior to April 1, 2022 and the obligation has not been previously recognized.
3. Asset retirement obligations where the event giving rise to the obligation arose prior to April 1, 2022 and the previously recognized obligation requires adjustment in applying this standard.

In all three scenarios, the valuation and accounting of the asset retirement obligation is completed at the time PS 3280 is adopted. Under the prospective approach, public sector entities apply PS 3280 as of the year of adoption without considering previous years. If an asset retirement obligation already exists, it is adjusted for any changes resulting from adoption of PS 3280.

Assuming there are no previous asset retirement obligations recorded, 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 discounting is applied to arrive at the future obligation.

The prospective approach does not require any adjustment to the opening deficit / surplus to implement PS 3280 but results in higher future expenses due to higher amortization costs if the asset is still in productive use. If the asset is no longer in productive use, or if the asset was never recognized by the public sector entity the change in the liability is recognized with a corresponding expense in the current year.

Modified retroactive approach

In the modified retroactive approach, the public sector entity removes any existing asset retirement obligation and associated costs recognized to date from its financial statements as at the beginning of the year of adoption. Subsequently, a liability for any existing asset retirement obligations, adjusted for accumulated accretion to that date, is recorded. This would amount to the present value of the liability at the beginning of the year. An asset retirement cost is capitalized as an increase to the carrying amount of the related tangible capital asset. The value of the asset is calculated as the value on the date the obligation existed from (i.e. asset acquisition date). Accumulated amortization represents the amortization that would have been recorded had this standard been in effect. An adjustment to opening accumulated surplus is required. If the asset is no longer in productive use, the public sector entity should recognize the liability with a corresponding adjustment to opening accumulated surplus.

The impact of asset retirement obligations for fully amortized assets can be recorded in one of three ways:

1. **Though opening accumulated surplus with no restatement of the asset's useful life:** The asset and liability are recorded as of the date the obligation first existed. The asset is amortized, and the liability is accreted, based on the original useful life of the asset resulting in the asset being fully amortized and the liability value being the future obligation as of the adoption date.
2. **Through opening accumulated surplus with restatement of the asset's useful life:** The asset and liability are recorded as of the date the obligation first existed. The asset is amortized, and the liability is accreted, based on the revised useful life of the asset. This method results in better matching of the expense to the future economic benefits derived from the asset.
3. **On a prospective basis:** The present value of the future cash flows is recorded as an asset and liability as of the date PS 3280 is adopted. Amortization and accretion expense are recognized based on the revised remaining useful life of the asset. There is no adjustment to opening accumulated surplus.

Case study

Case facts

A public sector entity purchases a building with asbestos for $15 million on July 1, 2017. The remaining useful life of the building is 15 years and at the end of its life, the building will be demolished. Legislation requires the public sector entity to remove the asbestos from the building prior to demolition. The public sector entity adopts PS 3280 for the year ended December 31, 2023 at which time management estimates that the asbestos removal will cost $1.5 million. The public sector entity has a discount rate of 3% and its policy is to amortize buildings on a straight-line basis over its useful life.

The following table presents the annual asset and liability balances, and the related expense if PS 3280 was applied from July 1, 2017. The July 1, 2017 asset and liability balances represent the present value of the future outflows at that date.

Date	Asset	Liability	Amortization expense	Accretion expense
July 1, 2017	$962,793	$962,793	-	-
December 31, 2017	$930,700	$977,128	$32,093	$14,335
December 31, 2018	$866,514	$1,006,442	$64,186	$29,314
December 31, 2019	$802,328	$1,036,635	$64,186	$30,193
December 31, 2020	$738,141	$1,067,734	$64,186	$31,099
December 31, 2021	$673,955	$1,099,766	$64,186	$32,032
December 31, 2022	$609,769	$1,132,759	$64,186	$32,993
December 31, 2023	$545,583	$1,166,742	$64,186	$33,983
December 31, 2024	$481,397	$1,201,744	$64,186	$35,002
December 31, 2025	$417,210	$1,237,797	$64,186	$36,052
December 31, 2026	$353,024	$1,274,931	$64,186	$37,134
December 31, 2027	$288,838	$1,313,179	$64,186	$38,248
December 31, 2028	$224,652	$1,352,574	$64,186	$39,395
December 31, 2029	$160,466	$1,393,151	$64,186	$40,577
December 31, 2030	$96,279	$1,434,946	$64,186	$41,795
December 31, 2031	$32,093	$1,477,994	$64,186	$43,048
December 31, 2032	-	$1,500,000	$32,093	$22,006
		Total	**$962,793**	**$537,207**

Retroactive approach

In the retroactive approach, an asset and liability of $962,713 are recognized on July 1, 2017. The comparative balances in the financial statements for 2022 are restated to reflect this on adoption of PS 3280 in 2023. The impact of amortization and accretion expense from 2017 to 2021 would be adjusted through opening accumulated surplus when restating the 2022 balances.

In 2022, the asset is $609,769, the liability is $1,132,759, amortization expense is $64,186 and accretion expense is $32,993. The impact of accretion and amortization for remaining prior years of $452,810 is adjusted through opening accumulated surplus.

Prospective approach

In the prospective approach, a liability of $1,132,759 is recognized which represents the present value of the future obligation at the beginning of 2023. An asset of $1,132,759 is also recognized without any adjustment for amortization. The asset is amortized over the building's remaining useful life of ten years and the liability is accreted over the same time period to arrive at the future obligation. There is no adjustment to accumulated surplus to implement PS 3280 but there are higher future expenses since the asset is still in productive use.

Modified retroactive approach

In the modified retroactive approach, the December 31, 2022 balance would represent the 2023 opening amount for the liability. Therefore, the liability on adoption of PS 3280 would be $1,132,759. The asset cost base is value on the building's acquisition date of $962,793. Accumulated amortization on the asset cost is $353,023, which represents the amortization expense from the acquisition date to December 31, 2022. The difference between the net book value of the asset and the liability of $522,989 is adjusted through opening accumulated surplus.

Subsequent to the initial implementation, the annual amortization expense and accretion expense is recognized.

Is there a preferred transition approach?

KPMG's perspective

There is no preferred transition approach. Each public sector entity will need to consider the asset retirement cost information it has available and the financial reporting impacts of each option to determine which transitional approach is most appropriate for them. Measurement of the obligation can be viewed differently depending on the transition method selected.

Public sector entities that consolidate into senior governments or parent entities may receive prescriptive guidance on which transitional provision to apply to make the consolidation process easier and/or to ensure consistency in the implementation of PS 3280 amongst similar organizations.

Is restatement of prior year comparative balances in the financial statements required in the year that PS 3280 is adopted?

KPMG's perspective

Restatement of prior year comparative balances is required under the retroactive and modified retroactive transitional approaches unless the public sector entity does not have sufficient information to restate the prior year balances. Generally, it is expected that most public sector entities will have enough information to restate the prior year comparative balances. Under the prospective approach, the impacts of adopting PS 3280 are recognized in the year of adoption and therefore, there is no restatement of prior year comparatives required.

Other topics

Since land is a non-depreciable asset, is the accounting treatment for asset retirement obligations associated with land different from depreciable assets?

KPMG's perspective

There is no difference in the PS 3280 accounting treatment for depreciable and non-depreciable assets. Generally, it is unusual for land to have retirement activities since it does not have an end of life. However, there many be retirement activities related to assets (e.g. buildings) or activities that are occurring on the land. Public sector entities should analyze any potential retirement activities associated with land in a similar manner as it would for other tangible capital assets.

The requirement to remediate contamination on a site is covered in PS 3260 Liability for Contaminated Sites and PS 3280 Asset Retirement Obligations. What is the difference between the guidance in PS 3260 and PS 3280 and when should each standard be applied?

KPMG's perspective

There are three distinguishing factors between PS 3260 and PS 3280:

1. Cause for the retirement or remediation obligation – PS 3280 addresses asset retirement obligations from the acquisition, construction, development or normal use of assets. PS 3260 deals with costs related to the improper use of an asset or costs from an unexpected event resulting in contamination.
2. Type of obligation – Both PS 3260 and PS 3280 provide guidance on legally enforceable obligations. However, PS 3260 also includes obligations voluntarily assumed by the entity.
3. Extent of contamination – In PS 3260, a liability is recognized if the contamination is in excess of an environmental standard / threshold. PS 3280 does not include such a requirement.

It is also important to note that expenditures to settle the obligation are not typically recognized as an asset under PS 3260 as they are under PS 3280. PS 3280 includes a decision tree which will assist public sector entities differentiate between PS 3260 and PS 3280.

PS 3280 does not include any guidance related to funding the asset retirement costs. What should public sector entities do if there are unfunded liabilities, or the implementation of PS 3280 will result in an accumulated deficit?

KPMG's perspective

Implementation of PS 3280 is expected to generate discussion about funding gaps for asset retirement costs, and more generally, about capital management and infrastructure deficits. No prescriptive accounting guidance is provided in PS 3280 because these topics relate to operational rather than financial reporting decisions, and different public sector entities will fund asset retirement costs in different manners. For example, a local government may increase its tax levy to fund the obligations, whereas a hospital may be reliant on senior government funding in the year the asset is retired.

It is recommended that all public sector entities take the implementation of PS 3280 as an opportunity to discuss and plan for asset retirement costs. This will include internal discussions with senior management and Boards / Councils.

If a public sector entity is subject to balanced budget or other regulations related to deficits, it is recommended that discussions are held with senior government to obtain further guidance about how such matter need to be managed.

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