PUBLIC SECTOR
ACCOUNTING BOARD
PSAB
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CONSEIL SUR
LA COMPTABILITÉ
DANS LE SECTEUR
PUBLIC

Statement of Principles

Prepared by the
Public Sector Accounting Board

Retirement Obligations

August 2014

COMMENTS TO PSAB MUST BE RECEIVED BY
NOVEMBER 21, 2014

A PDF **response form** has been posted with this document to assist you in submitting your comments to PSAB. Alternatively, you may send comments via email (in Word format), to:**ed.psector@cpacanada.ca** addressed to:

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This Statement of Principles reflects proposals made by the Public Sector Accounting Board (PSAB). It presents key principles that the Board expects to include in a future exposure draft.

Individuals, governments and organizations are invited to send written comments on this Statement of Principles. Comments are requested from those who agree with the proposals as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Statement of Principles should clearly explain the problem and include a suggested alternative, supported by specific reasoning. All comments received by PSAB will be available on the website shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

Highlights

The Public Sector Accounting Board (PSAB) proposes, subject to comments received on this Statement of Principles, and following its due process, to expose a proposed new Section on retirement obligations associated with tangible capital assets controlled by a public sector entity. The Section would apply to public sector entities that base their accounting policies on the CPA Canada Public Sector Accounting (PSA) Handbook.

Main features

The main features of this Statement of Principles are as follows:

- Retirement obligations associated with tangible capital assets result from legal, constructive and equitable obligations.
- Retirement costs increase the carrying amount of the related tangible capital asset or a component thereof and are expensed in a rational and systematic manner.
- Subsequent remeasurement of the liability can result in either a change in the carrying amount of the related tangible capital asset or a component thereof, or an expense, depending on the nature of the remeasurement and whether the asset remains in productive use.
- Retirement obligations associated with tangible capital assets include post-retirement operation, maintenance and monitoring.
- A present value technique is often the best method with which to estimate the liability.

Background

Public Interest

Taxpayers want to have confidence that a public sector entity is:

- accounting for all its existing obligations;
- reporting its future revenue requirements;
- reflecting all its costs when reporting its deficit or surplus; and
- considering the full cost of its assets when making a decision regarding delivery of a good or service.

Why a standard should be developed

The PSA Handbook does not include a standard on retirement obligations, leaving preparers and auditors to rely on other sources of generally accepted accounting principles (GAAP). This can result in inconsistencies. Other available guidance was developed for private sector entities. A public sector entity has different responsibilities and objectives than a private sector entity. PSAB concluded guidance should be developed for the PSA Handbook.

A standard on retirement obligations would not create additional obligations and costs for a public sector entity but does result in their complete and consistent reporting.

A public sector entity has a retirement obligation as a result of an agreement, contract or legislation, or created by constructive and equitable obligation. The public sector entity has acquired, constructed or developed a tangible capital asset and/or used it. The obligation of the public sector entity exists.

Alternatively, by not recording a retirement obligation, a public sector entity is not reporting its true obligations, costs and future revenue requirements.

Implications of introducing a standard

A standard on retirement obligations would require a public sector entity to review existing agreements, contracts, legislation, etc. to identify retirement activities associated with its controlled tangible capital assets that should be reported.

If there is no existing retirement obligation, a liability would not be reported. It is only existing retirement obligations associated with controlled tangible capital assets that would be covered by this standard.

Additionally, a public sector entity would need to review their current accounting for retirement obligations.

Comments requested

PSAB welcomes comments from individuals, governments and organizations on all aspects of the Statement of Principles.

When comments have been prepared as a result of a consultative process within an organization, it is helpful to identify generically the source of the comment in the response. This will promote understanding of how the proposals are affecting various aspects of an organization.

Comments are most helpful if they relate to a specific principle, paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Statement of Principles should clearly explain the problem and include a suggested alternative, supported by specific reasoning, for alternative wording.

Supporting reasons for your comments are most valuable when they demonstrate how the Statement of Principles proposals, or your alternatives:

- produce more relevant information for accountability and decision-making by external users;

- improve the representation of the substance of the underlying transaction or event;
- contribute to improved measures and understanding of financial position and annual results;
- facilitate enhanced comparability; and
- provide sufficient information for external users to understand the financial statements.

Please respond to the following questions:

1. Do you agree developing a standard on retirement obligations for the PSA Handbook is in the public interest? If you do not agree, why not?
2. Do you agree that this standard should address only retirement costs associated with tangible capital assets controlled by a public sector entity? If not, what other assets might incur retirement costs?
3. Do you agree that retirement costs associated with waste or by-products produced by a tangible capital asset should be excluded from the scope of this standard? If you do not agree, why not?
4. Do you agree that a liability for a retirement obligation should be recognized only when there is a legal obligation? If you do not agree, why not?
5. Do you agree that a liability for a retirement obligation should be recognized only when there is a legal obligation, or a constructive or equitable obligation arising from application of promissory estoppel? If you do not agree, why not?
6. Do you agree that a liability for a retirement obligation should be recognized when there is a legal, or constructive or equitable obligation? If you do not agree, why not?
7. Do you agree that retirement costs should be capitalized as part of the carrying amount of the related tangible capital asset or a component thereof and amortized in a rational and systematic manner? Is this appropriate considering the net debt model of presentation and impairment provision guidance in the PSA Handbook? If not, what alternative is more appropriate and why?
8. Do you agree that a liability for a retirement obligation should be recognized at the individual component level regardless of how the tangible capital asset is accounted for? If not, what alternative is more appropriate and why?
9. Do you agree that a present value technique is often the best available method to measure a liability for a retirement obligation? If not, what alternative is more appropriate and why?

10. Do you agree that the measurement technique to be used in measuring a liability for a retirement obligation should not be explicitly specified in the standard? If you do not agree, why not?
11. Do you agree that the discount rate to be used in a present value technique should not be explicitly specified in the standard? If you do not agree, why not?
12. Do you agree that where a liability for a retirement obligation may be mitigated by a claim against a third party, the amount of the recovery is a separate asset, not an element of the liability? If you do not agree, why not?
13. Do you agree with the disclosure requirements? If you do not agree, what changes, deletions or additions would you make to these requirements, and why?
14. Are there additional matters that need to be considered?

Retirement Obligations

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BACKGROUND

.01 The provision of public goods and services requires many public sector entities to hold and operate significant **tangible capital assets**.[1] The types of goods and services provided include the provision of electric power, gas and other liquid fuels, telecommunications, transit systems, health care, education, garbage and hazardous waste disposal, water distribution and sewage treatment.

.02 For many tangible capital assets, there may be significant **retirement obligations** associated with their acquisition, construction or development. For example, there may be obligations associated with decommissioning an electricity generating facility, dismantling a hospital or school or for constructing a hazard waste storage facility. In addition, retirement obligations can arise from the ongoing use of tangible capital assets. For example, decontamination costs of a nuclear power generating facility may increase over time.

.03 Furthermore, retirement obligations may be incurred or change throughout the life of a tangible capital asset. Legislative changes can occur resulting in more stringent or new obligations. Alternatively, new technological improvements may reduce the cost of existing retirement obligations.

.04 Additionally, retirement obligations may include activities and responsibilities to be undertaken once the tangible capital asset has been retired. For example, there may be ongoing obligations and activities, such as maintenance and monitoring, associated with an asset that is no longer in productive use.

The need for a standard

.05 The CPA Canada Public Sector Accounting (PSA) Handbook does not currently have specific guidance that can be applied to various types of retirement obligations. LIABILITY FOR CONTAMINATED SITES, Section PS 3260, addresses liabilities associated with the contamination of sites no longer in **productive use** (a comparison of the proposals in this Statement of Principles with Section PS 3260 and an explanation for the differences is provided in Appendix A). 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 to other retirement obligations where the period of benefit of the retirement costs is different.

[1] Terms that appear in bold are defined in the glossary.

.06 Without a general standard on retirement obligations, preparers and auditors must rely on GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150, which leaves the selection of accounting policies to them. 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 a retirement obligation is, and when and how to recognize and measure the liability.

.07 The Public Sector Accounting Board (PSAB) considered directing public sector entities to ASSET RETIREMENT OBLIGATIONS, Section 3110 in Parts II and V of the CPA Canada Handbook – Accounting because a number of government organizations were already applying this standard prior to their transition to the PSA Handbook and/or as a secondary source of generally accepted accounting principles (GAAP). PSAB decided that this approach may not be entirely appropriate because Section 3110 was developed for the private sector. A public sector entity has different responsibilities and objectives than a private sector entity. Typically, the role of tangible capital assets for a public sector entity is to provide goods and services rather than generate cash flow as it is for a private sector entity. There is a greater focus on accountability for a public sector entity in measuring financial performance compared to profitability for a private sector entity.

.08 Only a few private sector standard setters have addressed the issues associated with retirement obligations.

.09 Because of the current lack of guidance and the different responsibilities and objectives in the public sector, PSAB concluded that developing a standard on retirement obligations specifically for the public sector is worthwhile.

Intended outcomes and expected effects

.10 The intended outcome of a new standard is to improve the information available for financial statement users regarding retirement obligations in the public sector.

.11 The expected effects of developing a retirement obligation standard are:

(a) a faithful representation and consistent accounting treatment;

(b) a more comprehensive reporting of retirement obligations;

(c) enhanced comparability of financial statements amongst public sector entities;

(d) better information for user assessments of future revenue requirements and accumulated surplus/deficit of a public sector entity; and

(e) clearer guidance for identifying when retirement obligations exist and the appropriate measurement basis.

.12 The proposals do create a need for public sector entities to:

(a) review agreements, contracts, legislation, etc. to identify retirement activities;

(b) assess whether existing liabilities meet the proposals;

(c) determine whether there are unrecorded liabilities;

(d) estimate future cash flows, determining discount rates and other inputs in the measurement of a liability for a retirement obligation;

(e) transition existing balances to the new requirements; and

(f) assess the adequacy of their existing disclosure and presentation practices.

PURPOSE AND SCOPE

.13 The purpose of this Statement of Principles is to explain, and seek stakeholder feedback on, the proposed principles on how to account for and report a liability associated with a retirement obligation. Specifically it:

(a) defines which activities would be included in a liability for **retirement of a tangible capital asset**;

(b) establishes when to recognize and how to measure a liability for retirement; and

(c) provides related financial statement presentation and disclosure requirements.

.14 This proposal provides guidance for applying the definition of liabilities set out in FINANCIAL STATEMENT CONCEPTS, Section PS 1000, and LIABILITIES, Section PS 3200, to retirement obligations. This proposal limits retirement obligations to tangible capital assets controlled by a public sector entity. By definition, tangible capital assets are in productive use. Tangible capital assets include leased tangible capital assets reported by a public sector entity as a capital lease under LEASED TANGIBLE CAPITAL ASSETS, Public Sector Guideline PSG-2.

.15 This proposal does not apply to:

(a) costs associated with other non-financial assets such as intangibles and assets held for sale (for example, inventory);

(b) costs to acquire or construct a tangible capital asset, which are covered in TANGIBLE CAPITAL ASSETS, Section PS 3150;

(c) costs of routine replacement of a tangible capital asset, which are covered in TANGIBLE CAPITAL ASSETS, Section PS 3150;

(d) impairment of tangible capital assets, which are covered in TANGIBLE CAPITAL ASSETS, Section PS 3150;

(e) costs related to closure and post-closure care of landfill sites, which are covered in SOLID WASTE CLOSURE AND POST-CLOSURE LIABILITY, Section PS 3270;

(f) costs related to contaminated sites no longer in productive use, which are covered in LIABILITY FOR CONTAMINATED SITES, Section PS 3260;

(g) costs related to the improper use of a tangible capital asset;

(h) end-use expenditures such as those that transform a piece of land into a public park;

(i) costs resulting from a catastrophic event such as a flood;

(j) costs associated with the temporary removal from service of a tangible capital asset;

(k) costs related to obligations created by waste or by-products produced by a tangible capital asset such as sewage waste, which are considered to be a period cost; and

(l) costs related solely to a plan to sell or otherwise dispose of a tangible capital asset.

.16 Furthermore, while public sector entities may assume responsibility for **retirement costs** of an asset either abandoned or for which the owner does not have the financial ability to retire the asset, it is proposed that this guidance would only apply to retirement obligations for tangible capitals assets controlled by a public sector entity. This is in contrast to LIABILITY FOR CONTAMINATED SITES, Section PS 3260, which addresses when a public sector entity assumes responsibility for the remediation costs of others. If a public sector entity assumes responsibility for retirement costs of an asset that it does not recognize, the accounting treatment of those costs, while related to asset retirement, would likely be different as the asset is not being used by the public sector entity.

.17 Other retirement obligations not specifically addressed by these proposals, LIABILITY FOR CONTAMINATED SITES, Section PS 3260, or SOLID WASTE CLOSURE AND POST-CLOSURE LIABILITY, Section PS 3270, should be accounted for in accordance with LIABILITIES, Section PS 3200 and/or GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150.

APPLICABILITY

.18 Public sector entities (i.e., all levels of government, government components,[2] government organizations and government partnerships) can hold a variety of types of tangible capital assets that require retirement costs to be incurred.

.19 Having the same reporting requirements for all public sector entities following the PSA Handbook enhances the comparability and consistency of financial reporting within the public sector. This Statement of Principles proposes that all public sector entities, other than those that are directed to or comply with the standards applicable to publicly accountable enterprises in Part I of the CPA Canada Handbook – Accounting, would apply this proposed standard in their preparation of general purpose financial statements.

RECOGNITION OF LIABILITY

Principle 1

A liability for a retirement obligation should be recognized when, as at the financial reporting date:

(a) there is an agreement, contract, legislation, or a constructive or equitable obligation that obligates the public sector entity to incur retirement costs in relation to a tangible capital asset;

(b) the past event or transaction giving rise to the retirement liability (i.e., the acquisition, construction, development and/or use of the related tangible capital asset) has occurred;

(c) it is expected that future economic benefits will be given up; and

(d) a reasonable estimate of the amount can be made.

A liability for a retirement obligation cannot be recognized unless all of the criteria above are satisfied.

Retirement versus replacement

.20 For purposes of these proposals, the term "retirement" is defined as the permanent removal of a tangible capital asset from productive use. That term encompasses, but is not limited to, its sale, abandonment, or disposal in some other manner. However, it does not encompass the temporary idling of a tangible capital asset. Nor does it encompass routine replacement of a tangible capital asset. After a public sector entity retires a tangible capital asset, that asset is no longer under the control of that entity, in existence, or capable of

[2] The Re-exposure Draft, "Amendments to the Introduction," issued February 2014, proposes to introduce the term "government component" into the Introduction to Public Sector Accounting Standards.

being used in the manner for which the asset was originally acquired, constructed, or developed. Activities necessary to prepare a tangible capital asset for an alternative use are not associated with the retirement of the asset and are not within the scope of these proposals.

.21 Numerous types of tangible capital assets held by public sector entities typically are not permanently removed from service. For example, infrastructure assets such as roads, sewer systems and bridges 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. Pipes in a sewer system for example are usually just replaced. Routine replacement of a tangible capital asset is not a retirement obligation unless there is a particular agreement, contract, legislation or other circumstance that obligates the public sector entity to incur retirement costs. These proposals apply only to those obligations that cannot be avoided relating to when a public sector entity retires a tangible capital asset. This may occur when a sewer system line is being relocated. The retirement of the original sewer system line may be covered by these proposals.

Legal obligations

.22 A liability for a retirement obligation can arise from a legal obligation. A legal obligation establishes a clear duty or responsibility to others that justifies recognition of a liability. Legal obligations are usually straightforward to identify. For purposes of this proposal, a legal obligation can result from:

(a) agreements or contracts;

(b) legislation of another government; or

(c) a government’s own legislation.

.23 An agreement or contract could take the form of a licence governing the operation of a nuclear facility or a particular asset such as a furnace. The licence may contain legally enforceable obligations related to the retirement of the facility or the furnace. The operator, through the licence, agrees to those terms and conditions that may create a liability to incur the costs of retiring that facility or furnace.

.24 In other cases, another government's legislation may create a legal obligation. For example, a provincial ministry of environment has issued an order under its environmental protection act that a local government is required to decommission and remediate an energy-from-waste facility.

.25 A government’s own legislation can also create a legally enforceable obligation. For example, a province may require its own electricity generating facility to be decommissioned and remediated.

.26 Where a retirement obligation is established by agreement, contract or legislation, the obligation to incur costs to retire the tangible capital asset is legally enforceable and compliance is mandatory. Breaches may be enforced through prosecution, fines, jail and similar penalties, order, or loss of permit.

.27 A public sector entity would evaluate the existence of its duty or responsibility to retire a tangible capital asset by reviewing the existing arrangements for its acquired, constructed or developed tangible capital assets as at the financial statement date. Proposed new requirements would not be taken into account. While proposed changes may result in a future liability or a change in the measurement of an existing one, these changes are future events.

Constructive and equitable obligations

.28 While most liabilities for a retirement obligation arise from legal obligations, in some cases, there may not be an agreement, contract or legislation in place. Instead a public sector entity voluntarily creates a similar situation through its own actions and communications. This may occur when a public sector entity acknowledges and sufficiently communicates its decision to incur retirement costs in connection with a tangible capital asset not legally required by agreement, contract, or legislation.

.29 LIABILITIES, Section PS 3200, notes that present obligations do not only result from legally enforceable agreements, contracts, or legislation, but may also result from constructive or equitable obligations. Some constructive and equitable obligations may be enforced by a court in accordance with the legal principle known as **promissory estoppel**. Under promissory estoppel, the public sector entity has conveyed to a third party a reasonable expectation of performance and the third party relies on this promise to his or her detriment.

.30 Evidence a public sector entity has created a constructive and equitable obligation includes, but is not limited to, consideration of the following:

(a) The government body, management board or person with the appropriate level of authority has committed the public sector entity to an asset retirement plan.

(b) The retirement plan identifies the specific tangible capital asset.

(c) The retirement plan has been communicated to those directly affected (for example, residents of surrounding communities) through public consultation, information sessions, workshops or other activities in such detail to allow those affected to determine the benefits that would accrue to them.

(d) The retirement plan specifically identifies the activities to be undertaken and the amount of the expected costs to be incurred.

(e) The time frame for implementing the retirement plan has been identified and indicates that significant changes to the plan are not likely.

(f) The details of the retirement plan are such that there is a reasonable expectation that the promise can be relied upon.

(g) Those affected by the communications and actions of the public sector entity have a valid expectation that it will carry out that plan.

.31 It is proposed that legal, constructive and equitable obligations, associated with the retirement of a tangible capital asset, establish a clear duty or responsibility to another party that justifies recognition of a liability for a retirement obligation. The assessment of constructive and equitable obligations can be subjective and involve professional judgment as indicated in LIABILITIES, Section PS 3200, and LIABILITY FOR CONTAMINATED SITES, Section PS 3260. However, not reporting the obligations in which the public sector entity has lost its discretion to avoid proceeding with would arguably be not representing the full extent of the liabilities of the entity. It should be noted that the concept of constructive and equitable obligations is broader than the concept of promissory estoppel included by other standard setters in their asset retirement obligation standards (for example, ASSET RETIREMENT OBLIGATIONS, Section 3110 in Parts II and V of the CPA Canada Handbook – Accounting).

.32 LIABILITIES, Section PS 3200, notes that not all obligations are liabilities. Only those obligations that meet the definition and characteristics of a liability are to be recognized.

Past event or transaction

.33 For there to be a liability for a retirement obligation, there must be an agreement, contract, legislation, or a constructive or equitable obligation. This may exist on the acquisition, construction or development of a tangible capital asset, or, alternatively, may occur on the passage of a new or amended agreement, contract or legislation, or on the creation of a constructive or equitable obligation, after the tangible capital asset has been acquired, constructed or developed.

.34 The existence of an agreement, contract, legislation, or a constructive or equitable obligation is not the event that creates the liability. It is the acquisition, construction, development, change in circumstance and/or the subsequent use of the tangible capital asset that is the obligating event. For example, if a public sector entity applied to operate an open-pit mine and the permit required the operator to return the land to its original condition once mining operations cease, there is no liability until the operator begins to open the mine causing the need to return the land to its original condition. Similarly, if there are obligations related to the use of the asset, until the asset is being used, there is no liability.

A change in circumstance during the life of the tangible capital asset requiring the recording of a liability could be the creation of a constructive or equitable obligation (for example, where a constructive and equitable obligation is created when a public sector entity publicly announces that an operating bridge will be permanently removed from service).

.35 PSAB considered the guidance in SOLID WASTE LANDFILL CLOSURE AND POST-CLOSURE LIABILITY, Section PS 3270. Section PS 3270 requires the liability for closure and post-closure care to be recognized as the landfill site's capacity is used. Under Section PS 3270, the retirement obligation increases proportional to the filling of the site. PSAB concluded this pattern of incurrence of a retirement cost liability may not be consistent with the incurrence of obligations for all tangible capital assets. It may be appropriate in some cases, but not in all. While the benefit of such an approach is a gradual recognition of a retirement obligation on the statement of financial position and a gradual increase in net debt, this pattern may not reflect the actual incurrence of all retirement obligations to a public sector entity.

.36 A liability for a retirement obligation can be incurred on:

(a) the acquisition, construction or development of a tangible capital asset including a leased tangible capital asset (for example, a leasehold improvement that is required to be removed on termination of the lease); or

(b) the normal use of a tangible capital asset (for example, contamination created through the use of a nuclear facility).

Existence uncertainty

.37 In some circumstances, a public sector entity may have doubts as to the existence of retirement obligations because of uncertainty as to the meaning or application of a law, regulation or contract. For example, a public sector entity may hold tangible capital assets subject to the legislation of a foreign country. It may be unclear as to the meaning or application of that legislation regarding the need to incur retirement costs by the public sector entity. In these circumstances, the guidance in CONTINGENT LIABILITIES, Section PS 3300, applies in determining whether to recognize a liability for a retirement obligation.

Measurement uncertainty

.38 A retirement obligation may result from the acquisition, construction, development or normal use of a tangible capital asset that has an indeterminate useful life and thereby result in an indeterminate settlement date for the retirement obligation. Uncertainty about the timing of settlement of the retirement obligation does not remove that obligation from the scope of these proposals but will affect the measurement of a liability for that obligation and possibly the timing of recognition of the liability. For example, a public sector entity acquires a factory that contains asbestos. At the acquisition date, regulations are in place that require the entity to handle and dispose of this type of asbestos in a special manner if the factory undergoes major renovations or is demolished. Otherwise, the entity is not required to remove the asbestos from the factory. The entity currently has no intent to renovate or demolish the factory. Although timing of the performance of the retirement activity is conditional on the factory undergoing major renovations or being demolished, existing regulations create a duty or responsibility for the entity to remove and dispose of the asbestos. The obligating event occurs when the entity acquires the factory. If only a portion of the factory is to be renovated, only retirement costs associated with that portion of the factory may be measurable at that time.

.39 Uncertainties affecting the measurement of a liability for a retirement obligation are disclosed in accordance with MEASUREMENT UNCERTAINTY, Section PS 2130.

RECOGNITION AND ALLOCATION OF RETIREMENT COSTS

Principle 2

Upon initial recognition of a liability for a retirement obligation, a public sector entity should recognize a retirement cost by increasing the carrying amount of the related tangible capital asset or a component thereof by the same amount as the liability. The public sector entity should allocate that retirement cost to expense in a rational and systematic manner. 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.

Capitalization

.40 When recording a liability for a retirement obligation, there are two alternatives to consider with respect to the recognition of the costs:

(a) record as an expense; or

(b) record as an asset (either as part of the related tangible capital asset, as a separate tangible capital asset or as a separate asset).

.41 The first alternative considers that retirement costs are not part of the cost of a tangible capital asset and are simply a cost of operating the asset. They do not provide future economic benefits to the public sector entity and, therefore, cannot be recognized as an asset. Retirement costs are not betterments, as discussed in TANGIBLE CAPITAL ASSETS, Section PS 3150, as the service potential of the tangible capital asset is not enhanced by having to incur retirement costs. Furthermore, paragraph PS 3150.10 does not specifically include retirement costs as an identified cost of a tangible capital asset.

LIABILITY FOR CONTAMINATED SITES, Section PS 3260, takes this approach; however, Section PS 3260 applies to sites that are no longer in productive use.

.42 The second alternative considers that retirement costs are a necessary and integral cost of owning and operating a tangible capital asset. Financial statements under the PSA Handbook are prepared primarily using the historical cost basis of measurement. Therefore, tangible capital assets are recorded at cost under TANGIBLE CAPITAL ASSETS, Section PS 3150. A tangible capital asset balance is a measure of the costs associated with it, not a measure of fair value. Retirement costs are an overall cost of a tangible capital asset. These costs are necessary to enable the use of the tangible capital asset. They are known costs that are part of its overall life cycle. If a similar tangible capital asset were to be acquired but with no associated retirement costs, it would be expected that the acquisition cost of the tangible capital asset without retirement costs would be higher. The timing of settling these costs (i.e., at the end of the useful life of the tangible capital asset) would not impact their accounting. The public sector entity cannot use the tangible capital asset and then not incur these obligations. The costs of retirement would be treated with other costs of acquiring, constructing or developing a tangible capital asset. This is consistent with the focus of the PSA Handbook on accountability.

.43 The proposal is that retirement costs be capitalized and treated as part of the cost of the related tangible capital asset. While retirement costs by themselves do not provide future economic benefits, in combination with the costs of acquiring, constructing or developing the tangible capital asset, they do. LIABILITY FOR CONTAMINATED SITES, Section PS 3260, requires costs to be expensed on recording a liability as the contaminated site is no longer in productive use and there are no future economic benefits associated with such costs. Conversely, retirement costs relate to tangible capital assets that are in productive use.

.44 The timing of recognizing the liability for a retirement obligation (i.e., whether the retirement liability is recognized at the inception of the tangible capital asset or during its useful life) and the source of the liability (i.e., whether the retirement liability results on acquisition, construction or development of the tangible capital asset, or from its normal use) would not impact the accounting for such costs, which are necessary and integral costs of owning and operating the tangible capital asset.

.45 Recognizing retirement costs as a separate asset (or as a separate tangible capital asset) is not consistent with recognizing other costs of a tangible capital asset. Other costs (for example, installation costs) relating to a tangible capital asset are not recognized separately based on their nature.

Components

.46 A public sector entity may account for its tangible capital assets either on a network basis or on a component basis as set out in TANGIBLE CAPITAL ASSETS, paragraph PS 3150.12. Recognizing retirement obligations at a network or component level produces different results. For example, consider a kiln (network) to be retired after a 10-year period for which the bricks (component) need to be retired every five years. Accounting for retirement obligations at the network level would recognize the obligation for the kiln, including the bricks at the end of year 10. Accounting for retirement obligations at the component level would recognize the obligation for the bricks at the end of year five. These alternatives were considered in the development of this proposal.

.47 The proposal is that a liability for a retirement obligation be accounted for at the component level regardless of how the public sector entity accounts for its tangible capital assets. Accounting for retirement liabilities at the component level best reflects the more immediate retirement obligations of the public sector entity (for example, of the bricks at the end of year five rather than of the kiln at the end of year 10). Furthermore, having one approach improves consistency in reporting of retirement obligations between public sector entities.

.48 While not all public sector entities recognize tangible capital assets at a component level, retirement costs would be assessed at the component level. However, a public sector entity need not separately report in its financial statements the components of a tangible capital with an associated retirement obligation. While encouraged to do so, it is not required. As a result, a liability for a retirement obligation may be recognized associated with a component not separately reported as a tangible capital asset. The retirement costs in such a case would be linked to the overall tangible capital asset. However, the cost of a retirement obligation related to a component would be recognized over the useful life of that component and not over the useful life of the entire tangible capital asset.

.49 Furthermore, it is proposed that retirement costs resulting from the normal use of a tangible capital asset or component thereof are recognized as a liability (for example, retirement costs resulting from the use of a nuclear facility relating to contamination of the nuclear plant). Alternatively, it is proposed retirement costs resulting from the normal use of a tangible capital asset are not recognized as a liability for a retirement obligation when the costs relate to the cleanup of a waste or by-product produced by the tangible capital asset (for example, costs resulting from the use of a nuclear facility relating to contamination of heavy water not recognized as a tangible capital asset). Retirement costs related to waste or by-products produced by a tangible capital asset are not within the scope of these proposals as such costs are not associated with the retirement of a tangible capital asset. Such retirement costs are included in the scope of ASSET RETIREMENT OBLIGATIONS, Section 3110 in Parts II and V of the CPA Canada Handbook – Accounting.

Cost allocation

.50 Retirement costs would be recognized in a rational and systematic manner. Application of a rational and systematic allocation method does not preclude a public sector entity from capitalizing an amount of retirement costs and allocating an equal amount to expense in the same accounting period. For example, assume an entity acquires a tangible capital asset with an estimated life of 20 years. As that asset is used, the entity incurs additional retirement obligations of equal amount each year. Application of a rational and systematic allocation method would not preclude that entity from capitalizing and then expensing the retirement costs incurred each year. In such cases, the result would be similar to that under SOLID WASTE LANDFILL CLOSURE AND POST-CLOSURE LIABILITY, Section PS 3270.

.51 It also may be appropriate to fully recognize retirement costs as an expense prior to a change in usage of a tangible capital asset when those retirement costs relate specifically to the nature of the usage. For example, it may be appropriate to expense retirement costs resulting from the use of a piece of land as a quarry prior to using the land as a golf course. In other cases, where the retirement costs relate to the tangible capital asset, not to the nature of its usage, retirement costs may be more appropriately recognized as an expense over the useful life of the tangible capital asset regardless of a change in its usage. For example, retirement costs relating to asbestos in a building may be more appropriately recognized as an expense over the useful life of the building regardless of how the building is being used.

.52 If retirement obligations result from the passage of new legislation or the creation of a constructive or equitable obligation during the life of the tangible capital asset, those costs are capitalized and amortized in a rational and systematic manner, and not reported as a prior period adjustment or as a current period “catch-up” expense. Amortizing these costs over the remaining life of the related tangible capital asset or a component thereof, or some other appropriate period depending on its usage, best demonstrates the accounting period in which the economic resources are consumed. It reflects the view that economic resources cannot be accounted for nor consumed in periods prior to the costs being known and recorded. Only when the obligation arises should the costs start to be accounted for. The retirement costs relate to the use of the tangible capital asset going forward.

.53 The proposal that retirement costs be capitalized and treated as part of the cost of the tangible capital asset is supported by other standard setters in the private sector. However, a major consideration for respondents to this Statement of Principles relates to the difference in reporting a public sector entity's financial position. The PSA Handbook requires that the difference between financial assets and liabilities be reported. Capitalizing retirement costs will result in the entire amount of a liability for a retirement obligation affecting the "net financial assets/debt" indicator but accumulated surplus or deficit will not be affected as the cost of the tangible capital asset will be increased by a similar amount.

.54 Another consideration is the impairment provisions in the PSA Handbook. In the PSA Handbook, a tangible capital asset is impaired when conditions indicate that it no longer contributes to a public sector entity's ability to provide goods and services, or that the value of future economic benefits associated with it is less than its net book value. This is in contrast to private sector standards where a tangible asset is impaired when its carrying value exceeds projected cash flows from the continuing use of the asset. Retirement costs could be capitalized and then written down in the private sector because future cash flows are not sufficient. In the public sector, if the future economic benefits relate to service potential rather than cash flows, retirement costs may not be written down, as the service potential of the tangible capital asset may not be impaired. This difference applies to all costs of a tangible capital asset.

.55 This proposal reflects that financial statements under the PSA Handbook are prepared primarily using the historical cost basis of measurement. Therefore, tangible capital assets are recorded at cost under TANGIBLE CAPITAL ASSETS, Section PS 3150. A tangible capital asset balance is a measure of the costs associated with it, not a measure of fair value. Retirement costs are an overall cost of a tangible capital asset. The focus of the PSA Handbook is on accountability.

MEASUREMENT

Principle 3

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

Nature of costs to be included

.56 Consistent with TANGIBLE CAPITAL ASSETS, Section PS 3150, only those costs directly attributable to the retirement of the tangible capital asset would be included in the estimate of the liability and capitalized as part of the tangible capital asset. 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 retirement activity. Costs would include only those related to the nature and extent of the retirement obligation in accordance with the agreement, contract, legislation, or constructive or equitable obligation establishing the liability.

.57 It is expected costs related to the retirement of the tangible capital asset that are included as part of the obligation. Other costs relating to the maintenance of the tangible capital asset and costs relating to such items as unexpected contamination are not covered by this standard and are more appropriately considered to be period costs.

Post-retirement costs

.58 In some cases, asset retirement obligations involve ongoing activities such as the operating, maintenance and monitoring of a nuclear facility that has been shut down. Even after the nuclear facility has been retired, there may be ongoing costs in relation to the retirement that would be included in the retirement obligation.

.59 Factors considered for excluding post-retirement costs in the determination of a retirement liability (i.e., for treating these costs differently than other retirement costs) include the following:

(a) Additional measurement uncertainty is associated with estimating such long-term costs, which may involve operating, maintenance and monitoring activities that extend indefinitely.

(b) The measurement uncertainty outweighs any benefits from the recognition of these costs as a liability.

(c) Projected future operating, maintenance and monitoring costs are not recognized as a liability on acquisition of a tangible capital asset.

(d) It is often difficult to differentiate between ongoing and post-retirement operating, maintenance and monitoring costs.

(e) When a tangible capital asset has been retired, a legal obligation may no longer exist.

.60 Factors considered for including post-retirement costs in the determination of a retirement liability (i.e., for treating these costs consistent with other retirement costs) include the following:

(a) Post-retirement costs relating to ongoing operating, maintenance and monitoring of a tangible capital asset after retirement are as integral to the owning and operating of the tangible capital asset as are other costs specific to retiring the tangible capital asset.

(b) These costs would be accounted for consistent with other retirement costs.

(c) They are necessary costs related to a tangible capital asset incurred after the end of its useful life.

(d) The operating, maintenance and monitoring that are part of retirement activities are part of the retirement liability and not a separate future service obligation.

(e) The same transactions or events that give rise to a retirement liability also apply to the post-retirement costs activities.

(f) They are not future period costs as the tangible capital asset will no longer be in use when these expenditures are incurred.

.61 The proposal is for post-retirement costs to be included as part of the estimate of a liability for a retirement obligation when they are integral and directly attributable to the retirement activity. These costs have the same period of economic benefit as other costs of retirement, are integral costs of operating and owning the tangible capital asset, and are part of the retirement obligation rather a separate future obligation.

Assets acquired for retirement purposes

.62 Retirement activities may also involve the acquisition of another tangible capital asset. For example, as part of the ongoing monitoring of a retired nuclear plant, a laboratory may need to be constructed and operated to monitor the effects of radiation.

.63 There are two alternatives to account for expenditures to acquire tangible capital assets that are required as part of retirement activities:

(a) exclude them from the estimate of the retirement liability, accounting for their acquisition as a separate transaction, capitalizing and amortizing these costs over the estimated useful life of that asset; or

(b) include them in the estimate of the retirement liability relating to the tangible capital asset being retired, capitalizing these costs as part of the related tangible capital asset.

.64 The first option takes the perspective that tangible capital assets, regardless of whether they are acquired as part of retirement activities, are economic resources of a public sector entity from which future economic benefits are expected to be obtained. For example, there is no difference between excavation equipment acquired to retire an oil well and excavation equipment that is acquired to build a school. It could be argued that both are an economic resource from which future economic benefits are expected to be obtained and, therefore, the costs would be allocated over the useful life of the acquired asset.

.65 The second option recognizes that expenditures to acquire tangible capital assets as part of retirement activities are outlays to extinguish a liability rather than to create future economic benefits. The purpose of acquiring these tangible capital assets is not to generate future cash flows or provide goods and services. They are acquired to retire the related tangible capital asset.

.66 The proposal is to include the costs of a tangible capital asset acquired for purposes of retirement in the estimate of the liability for the asset being retired. Consistent with post-retirement costs, these costs are a fundamental part of the retirement obligation rather than a separate future obligation.

.67 However, when the need to acquire another tangible capital asset for purposes of retirement becomes known only when the related asset is no longer in productive use, the cost of that asset would be recognized as an expense in the period. This treatment is consistent with SOLID WASTE LANDFILL CLOSURE AND POST- CLOSURE LIABILITY, Section PS 3270. Under Section PS 3270, assets acquired as part of closure and post-closure activities when the landfill or phase stops accepting waste, such as leachate treatment and monitoring, are recognized as a liability and an expense. This treatment is also consistent with LIABILITY FOR CONTAMINATED SITES, Section PS 3260. Similar to most contaminated sites, there are no ongoing operations against which to allocate the costs of the tangible capital asset.

.68 Additionally, a tangible capital asset acquired as part of retirement activities may have an alternative use. For example, a water treatment plant is acquired to treat water from a retired mine site and is also used to process potable water for consumption. Only that portion of the plant used for retirement activities would be included in the estimate of the liability.

Measurement techniques

Principle 4

Measurement of a liability for a retirement obligation should result in the best estimate of the amount required to retire a tangible capital asset or a component thereof. A present value technique is often the best available method with which to estimate the measure of a liability.

.69 In addition to the general guidance on measurement techniques in FINANCIAL STATEMENT CONCEPTS, Section PS 1000, guidance on measurement of a long-term liability is included in LIABILITY FOR CONTAMINATED SITES, Section PS 3260.

.70 Similar to a liability for contaminated sites, a liability for a retirement obligation is typically a long-term obligation to be settled over several years, unique to both the tangible capital asset and to the public sector entity. Estimates are often essential in measuring a liability for a retirement obligation as in most situations there is not a readily available market-determined observable amount.

.71 The proposal is that a liability for a retirement obligation be measured similar to a liability for contaminated sites in LIABILITY FOR CONTAMINATED SITES, Section PS 3260. The measurement technique adopted would result in the best estimate of the amount required to retire the tangible capital asset or a component thereof. The amount would be based on the best estimate of the expenditures required to complete the retirement. The estimate of expenditures would require professional judgment and could be supplemented by experience, third-party quotes and, in some cases, reports of independent experts. Often, a present value technique will be the best method by which to estimate the liability.

.72 A key input into a present value technique, such as a discounted cash flow calculation, is the discount rate. It is not being proposed that a specific discount rate be used because it can depend on a number of entity-specific factors as well as the present value technique being used (for example, a traditional or expected cash flow approach). The discount rate would not reflect risks for which future cash flow estimates have been adjusted. When a public sector entity determines its discount rates by reference to its cost of borrowing, the period to retirement would be consistent with the borrowing duration. In other cases, an average rate or an extrapolated rate might be appropriate.

CHANGES IN ESTIMATES

When to remeasure the estimates

Principle 5

The carrying amount of a liability for a retirement obligation should be reviewed at each financial reporting date.

.73 A liability for a retirement obligation is generally long-term in nature and the measurement of the amount is likely to change as new information becomes available over the useful life of the tangible capital asset.

.74 The estimate of the liability would be reviewed using requirements in existing agreements, contracts, legislation, or constructive or equitable obligations at each financial statement date.

.75 The amount of the liability may not necessarily become determinable at a specific point in time. The amount of the liability may become determinable over a continuum of events and activities as information becomes available. For example, new information regarding the eventual costs to be incurred may become available as the public sector entity retires similar tangible capital assets. The estimate of costs may become better known as the public sector entity completes the retirement activities. In the interim, the public sector entity would recognize the liability based on management's best estimate of future retirement costs.

.76 When a present value technique is used, a public sector entity makes its best estimate of the appropriate discount rate, the amount of future retirement costs and their timing when initially measuring a liability. As more experience is acquired or as additional information is obtained, those estimates need to be updated. At each financial reporting date, the discount rate used should be reviewed to assess its ongoing appropriateness. These proposals are consistent with the guidance in LIABILITY FOR CONTAMINATED SITES, Section PS 3260. The prescriptiveness of the discount rate outlined in these proposals does vary from the requirements in ASSET RETIREMENT OBLIGATIONS, Section 3110 in Parts II and V of the CPA Canada Handbook – Accounting.

.77 If new information regarding the estimate of the liability becomes available between the financial statement date and the issuance of the financial statements, SUBSEQUENT EVENTS, Section PS 2400, would be considered.

.78 A liability for a retirement obligation continues to be recognized until it is settled or otherwise extinguished.

How to account for the change in estimates

Principle 6

In periods subsequent to initial measurement, a public sector entity should recognize period-to-period changes in a liability for a retirement obligation resulting from:

(a) revisions to either the timing, the amount of the original estimate of undiscounted cash flows or the discount rate, as part of the cost of the related tangible capital asset or a component thereof ; and

(b) the passage of time as an expense.

Costs of the related tangible capital asset, or a component thereof, should be amortized in a rational and systematic manner going forward.

Once the related tangible capital asset or a component thereof is retired, all subsequent changes in a liability for asset retirement obligations should be reported as an expense as they occur.

.79 There are two alternatives to account for the change in measurement of a liability for a retirement obligation:

(a) record as part of the related tangible capital asset or a component thereof, and amortize in a rational and systematic manner; or

(b) record as an expense.

.80 The first alternative considers a change in measurement of the liability to be a change in estimate which affects the financial results of future periods. As retirement costs on their initial recording are to be capitalized and amortized over the period of benefit, changes in estimate of retirement costs would similarly be accounted for.

.81 The second option considers the change in measurement of the liability to be a period cost resulting from the operations, transactions and events of the accounting period. The change in estimate of the liability provides no future benefits to the public sector entity.

.82 Accounting for a change in estimate is discussed in ACCOUNTING CHANGES, Section PS 2120. A change in an accounting estimate would be accounted for in the period of change and applicable future periods, if the change affects the financial results of both current and future periods.

.83 The proposal is that changes in measurement of a liability for a retirement obligation (other than changes that result from the passage of time) be recorded as part of the related tangible capital asset or a component thereof, and amortized in a rational and systematic manner going forward. Retirement costs on initial recording were capitalized and amortized over the period of benefit and changes in estimate of these costs would similarly be accounted for. These costs are necessary to enable the tangible capital asset to provide goods or services, or generate cash flows over its useful life. They are known costs that are part of the overall life cycle of the tangible capital asset or a component thereof. The timing of occurrence of these costs (i.e., over the useful life of the tangible capital asset or a component thereof) would not impact their accounting.

.84 The passage of time also impacts the measurement of a long-term liability such as those for retirement obligations. In cases where the effect of time value of money is material, a present value technique is often most appropriate. As the liability for a retirement obligation approaches its settlement date, the liability balance increases as the discounting of the future cash flows decreases. This is often referred to as the unwinding of the discount.

.85 The proposal is that a change in measurement of a liability for a retirement obligation resulting from the passage of time be expensed in the period and reported in the statement of operations.

.86 A change in measurement resulting from the passage of time is not a change in estimate of the amount or timing of future cash flows. It is not a change in the discount rate used to calculate the present value of a liability for an asset retirement obligation. It results from events of the accounting period (i.e., the passage of time). The effect of capitalizing the entire change in measurement (including the change due to the passage of time) would be equivalent to capitalizing the undiscounted amount of the retirement costs over the life of the tangible capital asset. It would be equivalent to financing a tangible capital asset and recording the tangible capital asset at the amount of the undiscounted financing payments. The change in measurement resulting from the passage of time is often called an **accretion expense**.

.87 Once the related tangible capital asset, or a component thereof, is retired, all subsequent changes in a liability for retirement obligations would be expensed as they occur. There is no longer any period of future benefit associated with such retirement costs as the tangible capital asset or component is no longer providing a good or service, or generating cash flows. This is consistent with LIABILITY FOR CONTAMINATED SITES, Section PS 3260.

RECOVERIES

Principle 7

A recovery of a retirement obligation is to be presented as a separate asset and not netted against the liability when:

(a) the recovery can be appropriately measured;

(b) a reasonable estimate of the amount can be made; and

(c) it is expected that future economic benefits will be obtained.

A recovery should be recognized in the period in which the transactions or events occurred that gave rise to the revenue.

.88 Recoveries of retirement obligations may result, for example, when a public sector entity is able to recover retirement costs from insurance proceeds.

.89 Recoveries similar to the guidance in LIABILITY FOR CONTAMINATED SITES, Section PS 3260, and CONTINGENT LIABILITIES, Section PS 3300, would be recognized when the amount can be reasonably estimated, appropriately measured and it is expected that future economic benefits will be obtained.

.90 There are two alternatives to consider in accounting for a recovery of a retirement obligation — treat the recovery as a separate asset or as a reduction to the liability.

.91 Treating the recovery as a separate asset would result in the liability on the statement of financial position being recognized gross of the recovery. The recovery balance would be recognized in the period in which the transaction or event occurred that gave rise to the revenue.

.92 Treating the recovery as a reduction to the liability would result in the liability on the statement of financial position being recognized net of the recovery. The retirement costs net of the recovery balance would be expensed in a rational and systematic manner.

.93 Under both of these alternatives, in the statement of operations, the expense relating to the retirement costs (i.e., the amortization expense) may be presented net of the revenue from the recovery.

.94 The proposal is that a recovery of a retirement obligation be recorded as a separate asset. The recovery is a separate transaction distinct from the occurrence of the obligation to incur retirement costs. There is no legal right to offset the recovery from the obligation to incur retirement costs. The counterparty to the recovery is not the same as the counterparty to the obligation. Presenting a liability at gross amount and a separate asset for the recovery better presents to financial statement users the future costs associated with retirement activities and the amount to be recovered from other parties.

PRESENTATION AND DISCLOSURE

Principle 8

A public sector entity should disclose the following information:

(a) a general description of the liability for a retirement obligation and the associated tangible capital asset or a component thereof;

(b) the amortization method used for the retirement costs;

(c) the basis for the estimate of the liability;

(d) a reconciliation of the beginning and ending aggregate carrying amount of the liability showing separately the changes attributable to:

  (i) the liability incurred in the current period;

  (ii) the liability settled in the current period;

  (iii) the change resulting from the passage of time (i.e., accretion expense); and

  (iv) revisions in estimated cash flows;

(e) when a net present value technique is used, the estimated total undiscounted expenditures, the estimated timing of settlement of these expenditures and the discount rate used; and

(f) the reasons for not recognizing a liability.

.95 Because of the often complex, long-term nature of a liability for a retirement obligation and the professional judgment required in its calculation, it is important to provide financial statements users with information that explains the basis of the calculation and its key inputs.

.96 A clear and concise description of the accounting policy for a liability for a retirement obligation would be included in the notes to the financial statements. The description of the accounting policy is necessary for the users' interpretation of the financial statements of the public sector entity.

.97 Disclosure of the carrying amount of a liability for a retirement obligation at year end allows financial statement users to understand the magnitude of the future obligation. To allow users to understand the nature of the change in the liability balance between year ends, it is proposed a reconciliation be included in the notes to the financial statements showing the changes attributable to:

(a) the liability incurred in the current period,

(b) the liability settled in the current period,

(c) the change resulting from the passage of time (i.e., accretion expense), and

(d) revisions in estimated cash flows.

.98 The notes to the financial statements would also disclose the basis of recognition and measurement of the liability. When a net present value technique is used, disclosure of the key assumptions, such as the estimated total undiscounted expenditures, discount rate and time period over which the undiscounted expenditures are to be incurred would be disclosed.

.99 It would also disclose the associated tangible capital asset or a component of it for which the liability is related. The disclosure and presentation requirements for the tangible capital asset or a component thereof are addressed in TANGIBLE CAPITAL ASSETS, Section PS 3150.

.100 In some limited cases, a public sector entity may not be able to make a reasonable estimate of the measurement of the liability, for example when the public sector entity has limited experience with the retirement of a certain type of tangible capital asset or when the extent of the retirement costs is uncertain. When a reasonable estimate of the measurement of the liability cannot be made, information in accordance with LIABILITIES, Section PS 3200, should be disclosed. Disclosure of the fact and the reason the retirement obligation is not recognized in the financial statements allows financial statement users to be aware of obligations that may be reported once the uncertainty is removed. It provides the financial statement users a better assessment of the overall financial position of the public sector entity going forward.

GLOSSARY

Accretion expense is the increase in the carrying amount of a liability for retirement obligations due to the passage of time.

A **retirement obligation** is an obligation (legal, constructive or equitable) associated with the retirement of a tangible capital asset controlled by a public sector entity.

Promissory estoppel is defined in Black's Law Dictionary as "the principle that a promise made without consideration may nonetheless be enforced to prevent injustice if the promisor should have reasonably expected the promisee to rely on the promise and the promisee did actually rely on the promise to his or her detriment. The Quebec Civil Code does not recognize the doctrine of promissory estoppel but Quebec courts have developed a similar concept known as "la fin de non-reçevoir".

Retirement cost is the estimated amount of the liability for retiring a tangible capital asset or a component thereof.

Retirement of a tangible capital asset is the permanent removal of a tangible capital asset from service. This term encompasses sale, abandonment or disposal in some other manner.

Tangible capital assets are non-financial assets having physical substance that:

(i) are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets;

(ii) have useful economic lives extending beyond an accounting period;

(iii) are to be used on a continuing basis; and

(iv) are not for sale in the ordinary course of operations.

A tangible capital asset is in **productive use** when held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets. It does not encompass the temporary idling of a tangible capital asset.

APPENDIX A

COMPARISON WITH CONTAMINATED SITES, SECTION PS 3260

In developing the retirement obligation proposals, PSAB considered the guidance in LIABILITY FOR CONTAMINATED SITES, Section PS 3260. A comparison of the proposals in this Statement of Principles with Section PS 3260 and an explanation for the differences are provided below:

	Retirement obligation proposals	Section PS 3260	Explanation
Related asset	Tangible capital asset in productive use.	Operations no longer in productive use.	Results in a different treatment of the cost – capitalize or expense immediately.
	Tangible capital asset controlled by a public sector entity.	Public sector entity can assume responsibility for operations no longer in productive use.	If a public sector entity assumes a retirement obligation relating to an asset of others, it is a liability but not a retirement obligation.
Accounting for expected costs including expected contamination	Capitalize as part of the cost of the tangible capital asset.	Expense	If there are no ongoing operations, then there are no services being provided against which to allocate the costs.
Accounting for unexpected contamination	Not in the scope of the proposals.	Expense	Only expected contamination is part of the retirement costs.
Types of obligations	Include constructive and equitable obligations.	Include constructive and equitable obligations.	
Types of costs	Those directly attributable.	Those directly attributable.	
Measurement	Non-prescriptive measurement technique and discount rate to be used.	Non-prescriptive measurement technique and discount rate to be used.	

APPENDIX B

ILLUSTRATIVE EXAMPLES

Offshore oilfield

A public sector entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of its useful life and restore the seabed. Ninety percent of the eventual retirement costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10 percent arise through the extraction of oil. At the end of the reporting period, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event – The construction of the oil rig creates a legal obligation under the terms of the licence to remove the rig and restore the seabed and, thus, is an obligating event. At the end of the reporting period, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. It is expected that future economic benefits will be given up.

Conclusion – A liability for a retirement obligation is recognized for the best estimate of 90 percent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. The 10 percent of costs that arise through the extraction of oil will be recognized as a liability when the oil is extracted.

Nuclear plant

The following example illustrates the recognition and measurement provisions of these proposals.

Background

- A nuclear plant is constructed for $200,000,000 with a 50 year expected life.
- Projected retirement costs incurred on construction are $20,000,000. Retirement costs are projected to increase by $500,000 each year as a result of expected additional contamination from operating the nuclear plant.
- Fuel rods are considered component parts and are capitalized as part of the nuclear plant with a cost of $5,000,000. These fuel rods will be retired every 10 years. Retirement costs with the fuel rods are $1,000,000. Retirement obligations for the fuel rods are assumed to be incurred on retirement of the prior fuel rods in years 1, 10, 20, 30 and 40 and paid in the subsequent years.
- The appropriate discount rate = 3% for the retirement costs.
- The public sector entity amortizes tangible capital assets and their components over their useful life using a straight line method.

Resulting balances

Balances in representative years as a result of accounting for retirement costs as an addition to the related tangible capital asset and amortizing going forward are provided below:

Statement of financial position accounts	**End of year 1**	**End of year 10**	**End of year 15**	**End of year 30**	**End of year 50**
Tangible capital asset					
- construction cost	$ 200,000,000	205,000,000	205,000,000	215,000,000	220,000,000
- retirement costs incurred on construction ($20,000,000)	4,562,142	4,562,142	4,562,142	4,562,142	4,562,142
- retirement costs from operation ($500,000 per year)	117,475	1,346,721	2,184,910	5,588,929	12,750,828
- retirement costs relating to fuel rods ($1,000,000 every 10 years)	744,094	1,488,188	1,488,188	2,976,376	3,720,470
Total	$ 205,423,711	212,397,051	213,235,240	228,127,447	241,033,440
Liability for a retirement obligation					
- retirement costs incurred on construction ($20,000,000)	$ 4,699,006	6,131,137	7,107,668	11,073,515	20,000,000
- retirement costs from operation ($500,000 per year)	117,475	1,532,784	2,665,375	8,305,136	25,000,000
- retirement costs relating to fuel rods ($1,000,000 every 10 years)	766,417	1,766,417	862,609	1,766,417	1,000,000
Total	$ 5,582,898	9,430,338	10,635,652	21,145,068	46,000,000

Statement of operations accounts	**Year 1**	**Year 10**	**Year 15**	**Year 30**	**Year 50**
Amortization expense					
- construction cost	$ 4,400,000	4,400,000	4,400,000	4,400,000	4,400,000
- retirement costs incurred on construction ($20,000,000)	91,243	91,243	91,243	91,243	91,243
- retirement costs from operation ($500,000 per year)	2,350	29,877	52,000	179,111	1,769,034
- retirement costs relating to fuel rods ($1,000,000 every 10 years)	74,409	74,409	74,409	74,409	74,409
Total	$ 4,568,002	4,595,529	4,617,652	4,744,763	6,334,686
Retirement expense (i.e. accretion expense)	$ 162,609	252,997	309,776	594,203	1,339,806
Total expense	$ 4,730,611	4,848,526	4,927,428	5,338,966	7,674,492

Conclusion

Amortization expense will increase in the later years when retirement costs are incurred from the normal operations of the tangible capital asset. As the tangible capital asset approaches the end of its useful life, there are fewer years over which the retirement costs are to be amortized. Accretion expense also increases in the later years as a result of the time value of money.