PSAB Public Sector Accounting Board

Section PS 3280, Asset Retirement Obligations (AROs): Issues Applying the Modified Retroactive Transition Method

Extract, PSA Discussion Group Report on the Public Meeting – April 8, 2021

ASSET RETIREMENT OBLIGATIONS, Section PS 3280, added to the PSA Handbook in August 2018, is effective on April 1, 2022. One complex area of the standard is the modified retroactive transition method. Some entities raised two issues about applying this method for to:

1. A building constructed with asbestos before legal requirements for managing asbestos disposal were enacted.
2. A fully depreciated asset that is still in productive use.

Issue 1

Issue 1 asked when an ARO would exist and when amortization of it would begin in this scenario: a building was constructed with asbestos 20 years before legal requirements to manage asbestos disposal were enacted.

The specifics of the scenario were:

- Government A is adopting Section PS 3280 for the first time and has chosen to apply the modified retroactive method in paragraphs PS 3280.69-.71.
- All requirements of paragraph PS 3280.09 regarding whether a liability for an ARO exists are present at the implementation date.
- Government A's building has an ARO related to an asbestos remediation estimated at $1 million. In 1950, the building was constructed with asbestos. In 1970, the province enacted legal requirements to remove asbestos in a prescribed manner.
- Government A anticipates the asbestos remediation will occur in 2025, when it will disburse $1 million to settle the obligation.

The Group was asked to consider two views:

A. The ARO should be recognized as at the construction, or acquisition date. Amortization of capitalized ARO costs should start at the construction date (i.e., 1950 in this fact pattern).

B. The ARO should be recognized at the date the legal obligation became effective. Amortization of capitalized ARO costs should start at the date the legal obligation was created (i.e., 1970 in this fact pattern).

A few Group members noted that ARO estimation has many assumptions and moving parts. The objective should be to recognize the obligation. Justifying either View A or B is possible. So, the recognizing the obligation should be prioritized over choosing the most theoretically pure or precise approach, especially if the differences in amounts recognized between the two Views are not material.

One Group member noted that, under View A, Government A might not have enough information to estimate the ARO as at the construction date in 1950. And, regardless, no legal obligation could exist before the legislation. So, View B is most appropriate. Another Group member countered that the damage to the asset requiring remediation when the asset is retired occurred at construction when the asbestos was used in the building. So, the liability should be recognized as at the construction date in accordance with View A.

Some Group members noted the preferred approach at implementation might be View A to get the obligation more easily on the books. But View B would be preferred for accounting for new AROs after the standard has been implemented. For example, View B would better reflect the substance if an entity were to purchase the asset after the asbestos legislation has been passed. Others argued for a consistent approach at implementation and going forward.

Further comments from individual Group members included:

- The intent of the modified retroactive transition method is to simplify the requirements of the full retroactive method.
- PSAB may want to clarify how paragraphs PS 3280.17, PS 3280.21 and PS 3280.71 interact in the standard.
- ARO liabilities may fluctuate if new technologies emerge that reduce the ultimate cost of retiring the related assets.

Overall, many Group members supported View B, either as the only option or an acceptable option. Some other Group members thought View A was acceptable and pragmatic.

Issue 2

Issue 2 asked how paragraph PS 3280.30 would apply in recognizing an ARO if the related asset is fully amortized at the implementation date but remains in productive use.

The specifics of the scenario were:

- The scenario is a modification of the Transitional Provisions example in Appendix B to Section PS 3280, which assumes that the asset to which the ARO applies has remaining useful life. In contrast, the scenario in the submission assumed the asset is fully amortized yet still in productive use.
- An entity is adopting Section PS 3280 for the first time and chooses to apply the modified retroactive application provisions in accordance with paragraphs PS 3280.69-.71.

- Section PS 3280 will be implemented on April 1, 2022. Therefore, for measurement purposes, the scenario uses information and assumptions to derive cash flow estimates related to an asset retirement obligation on April 1, 2022.
- The public sector entity did not recognize an ARO in the past. Significant assumptions are as follows:
    - The tangible capital asset related to the ARO was acquired on April 1, 1995, for $4 million and was estimated to have a useful life of 20 years.
    - The entity uses straight-line amortization.
    - The depreciation expense for the asset was $200,000/year.
    - The asset was fully amortized by 2015 but remains in productive use by the entity.
    - The entity estimates that the asset will be in productive use until March 31, 2025.
    - The entity incurred 100 percent of the ARO on acquisition of the asset (April 1, 1995).
    - As at April 1, 2022, undiscounted expected cash flows required to satisfy the ARO on March 31, 2025, are $250 million.
    - The April 1, 2022, discount rate is 2.5 per cent.

Three views were considered regarding implementation on April 1, 2022:

A. The ARO should be recognized in its entirety as a debit to accumulated surplus/deficit and as a liability when the standard is implemented.

B. The ARO should be capitalized to the asset when the standard is implemented and amortized over the remaining period in which the entity expects to have it in productive use.

C. The ARO should be capitalized to the asset upon its initial recognition (April 1, 1995), and the asset amortized over a revised useful life. Revise the asset's useful life and adjust the accumulated amortization and amortize the ARO over the remaining revised useful life (30 years being the period from April 1, 1995, to March 31, 2025). The change in useful life is treated as a change in estimate.

Most Group members preferred View C, indicating that a change in estimate is a more accurate and defensible approach than Views A and B. Although this option provides heightened transparency, it requires more work, and it is inconclusive whether it provides better information to users. View A was the next favoured option, given its practicality and focus on getting the obligation on the books but was the least technically strong option. View B was least preferred but deemed the simplest option to use if its effect was not materially different than View C. However, if View B has a material effect on amortization, it could unfairly penalize the entity's results over the asset's remaining productive life. In dismissing a possible fourth option, one Group member clarified that the scenario could not be considered a correction of an error as defined in ACCOUNTING CHANGES, Section PS 2120, as the change in useful life was based on new and better information.

The Group asked PSAB consider if an update to TANGIBLE CAPITAL ASSETS, Section PS 3150, is required to ensure a regular review of assets' useful lives. Two Group members indicated that the circumstances in which an asset's useful life might be amended under Section PS 3150 did not seem to address the scenario in question when applying Section PS 3280. Specifically, useful life only becomes important when new costs are added to the asset because of the ARO.