For Information

Asset Retirement Obligations Accounting Standard Implementation: Status Update

Date: June 1, 2023
To: TTC Audit Risk Management Committee
From: Chief Financial Officer

Summary

This report provides an overview of the requirements associated with the new accounting standard, PS 3280 Asset Retirement Obligations (ARO), and an update on its implementation status at the TTC.

ARO refers to any legal obligation, such as legislation, an agreement or other enforceable promise, which requires costs to be incurred at the time a tangible capital asset is retired or at the end of its useful life. The new accounting standard will require that these legally and obligatory retirement costs be reflected in the financial statements at the time the asset is acquired to account for the full cost of an asset.

The TTC's unique asset types, such as subway stations and tunnels, which typically have long useful lives, unknown retirement dates, and uncertainties on expected retirement costs, make implementing the ARO standard complex. The TTC has established a four-phased project plan, as outlined below:

- **Phase 1 Planning:** Identification of departmental subject matter experts and creation of ARO policy and procedures.
- **Phase 2 Scoping:** Identifying which Tangible Capital Assets are subject to the standard.
- **Phase 3 Measurement:** Use of costing models and estimates to determine the value of the ARO obligation.
- **Phase 4 Financial Reporting:** Completion of the financial statement note disclosure for the 2023 year-end financial statements.

The planning and scoping phases have been completed and the identification of in-scope assets has been reviewed and concurred by the TTC's external auditors (KPMG). Work has now commenced on the measurement phase and the TTC is on schedule to fully implement the ARO standard for the December 31, 2023 Year-End Financial Statements.

Financial Summary

At this time, no financial impact is anticipated from the adoption of the ARO accounting standard. Currently, prior to the adoption of the ARO standard, obligations related to asset retirement are funded as the work is completed. It is anticipated that from a funding perspective, this approach will continue.

To provide greater visibility of the costs associated with asset retirement, the ARO standard requires anticipated costs to satisfy the legal obligations upon asset retirement to be recorded on the financial statements when the assets are acquired. This value will be reflected in liabilities and added to the value of the capital asset on the Statement of Financial Position. Processes to determine the value of asset retirement obligations to both establish and update the liability on an annual basis are being developed.

Equity/Accessibility Matters

The report has no accessibility or equity issues or impact.

Decision History

The Public Sector Accounting Standards Board (PSAB) approved a new standard, PS 3280, in 2018 to provide specific guidance on the retirement of Tangible Capital Assets (TCA) at the end of their useful life.

KPMG LLP's Audit Plan for the Year-Ended December 31, 2022, which was reviewed at the February 13, 2022 Audit and Risk Management Committee meeting, highlighted the ARO standard as one of the new accounting standards that would become effective for the December 31, 2023 Financial Statements.

KPMG LLP's Audit Plan for Year Ended December 31, 2022

Issue Background

The PSAB approved a new standard, PS 3280, to provide specific guidance on the retirement of TCAs at the end of their useful life. AROs are defined as costs expected to be incurred based on a legal obligation, at the time of tangible capital asset retirement or disposal. A legal obligation is deemed to exist when the TTC has a responsibility to another party, which can result from signed agreements, government legislation or promises made to a third party.

Adoption is required for the December 31, 2023 Year-End Financial Statements.

Comments

The TTC has established a four-phased project plan to implement the new PS 3280 ARO accounting standard, as described below:

- Phase 1: Planning
- Phase 2: Scoping
- Phase 3: Measurement
- Phase 4: Financial Reporting

Phase 1: Planning

The planning phase involved forming a project team, developing a project plan, reviewing existing asset management policies, drafting an asset retirement obligations policy and associated procedures, and identifying key subject matter experts and stakeholders throughout the organization. Finance is leading the implementation project with representatives participating from Legal, Safety and Environment and other operational departments. Finance Department staff have engaged with comparable organizations to identify a preliminary list of in scope assets. Departmental subject matter experts and external partners, such as the City of Toronto, were also involved in identifying contracts and regulations that which would give rise to ARO on specific assets. Departmental subject matter experts are currently assisting Finance staff in leveraging past experience with retirements or remediation completed to date to support the process of developing the expected cost of retirement for identified sources of ARO.

The TTC's ARO policy has been drafted to provide guidance for the recognition, measurement, presentation and disclosure of ARO and related roles and responsibilities of Finance and departmental staff. Upon implementation, and as part of the TTC ARO policy, Finance staff will have corporate responsibility for ensuring TTC compliance with the ARO policy, standards and practices; reporting ARO, and completing related financial statement note disclosures in accordance with the PSAB accounting standard. Department staff will be responsible for identifying new assets or contracts as well as any changes in legislation or regulations that which may give rise to new ARO. Finance staff will work jointly with operational staff to account for all changes, including any changes to the estimated expected cost of asset retirement and related work completed.

Phase 2: Scoping

All public-sector entities reporting under PSAB are required to determine which assets have legal obligations that will result in future costs to retire the asset. In order to determine the TTC's asset retirement obligations, a review of applicable regulations, By-laws, contracts and agreements was undertaken with subject matter experts and stakeholders throughout the organization. Asset types based on known sources of asset retirement obligations were scoped in, with consideration given to the TTC's financial statement materiality. As a result, the majority of asset retirement obligations identified for the TTC relate to the removal of asbestos in buildings and structures, fuel storage tanks, decommissioned surface tracks and redundant electrical poles. Lease agreements associated with industrial and office facilities have also been determined to have associated AROs.

Asset types that are considered to be out-of-scope include revenue and non-revenue vehicles, maintenance and IT equipment, land properties and construction in progress. Revenue and non-revenue vehicles and equipment were determined out-of-scope given that these assets are normally sold or auctioned at the end of their useful life. In cases where these assets are not sold or auctioned, parts are disassembled and reused for other purposes.

While land properties that were contaminated may have associated legal obligations for site monitoring and remediation, the reporting of these obligations are addressed by the existing PS 3260 Contaminated Site accounting standard and related liabilities are already reflected in TTC financial statements. Asset retirement liabilities associated with assets that are currently being constructed will be recorded and recognized in the financial statements once these assets have been fully constructed.

The scoping process is now complete and the identification of applicable assets has been reviewed and concurred by the TTC's external auditors (KPMG).

Phase 3: Measurement

The measurement of an asset retirement obligation is based on the best estimate of future, directly attributable costs to be incurred in order to fulfill the legal obligation associated with the tangible capital asset's retirement. Staff are currently in the process of determining the expected cost for each of the in-scope ARO identified.

The measurement phase is the most challenging phase of ARO implementation. An example of this complexity is the removal of asbestos and other designated substances in buildings and structures (subway tunnels and stations, office buildings, garages, carhouses and substations), which would be required upon asset retirement. Cost estimation is complex given that the cost of retirement will vary depending on the age of the asset, the extent of the abatement work required and limitations in available information (e.g. asbestos survey information). Once the extent of remediation work required is determined, the cost of completing the work needs to be estimated, leveraging any appropriate past experience, third-party quotes, estimation models and potentially an independent expert. The measurement phase is expected to be completed by fall 2023.

Phase 4: Financial Reporting

Upon implementation of the accounting standard, one of three transition options may be used for financial reporting: retroactive, modified retroactive, or prospective application. The TTC has decided to use the modified retroactive application consistent with the City of Toronto's transition approach. By using the modified retroactive application, the estimated ARO liability will be recorded as well as a corresponding increase in the cost base for the related tangible capital asset. This increase in the cost base will be amortized over the life of the asset, with the proportion of the increase related to the asset life used since the asset was acquired, reflected in the accumulated amortization to the time of adoption of the ARO standard: December 31, 2023. The balance of the increase will be amortized over the remaining asset life.

The new asset retirement obligation liability will be presented in the financial statements and related notes disclosure for the fiscal year ended December 31, 2023, with December 31, 2022 comparative amounts restated.

Contact

John Montagnese, Executive Director – Finance
416-393-3654
john.montagenese@ttc.ca

Signature

Josie La Vita
Chief Financial Officer