Asset Retirement Obligation Update and Funding Strategy

Report Purpose
To provide Council with an update on the Asset Retirement Obligations liability for the year ending December 31, 2023, and to seek Council approval of an interim funding strategy.

Recommendation
THAT the transfer of a one-time 2023 surplus allocation of $750,000 to reserve to cover asset retirement obligation costs, be approved.

Our Strategic Goals
Governance Requirement

Report
The Public Sector Accounting Standards (PSAS) Board introduced PS3280, a new accounting standard for Asset Retirement Obligations (ARO) impacting Strathcona County's (the County) Financial Statements for the year ended December 31, 2023. In April 2023, Financial and Strategic Services (FSS) brought forward a report to Council outlining the standard and committed to return with an update to quantify the ARO liability and to propose a funding strategy.

The ARO standard requires the County to identify legal obligations associated with the retirement of tangible capital assets. AROs are initially measured on the date of acquisition of the asset or when the legal obligation becomes known. It is financially prudent for an organization to put an appropriate funding strategy in place to ensure obligations can be met upon an asset's retirement or demolition. Recording the obligation within the financial statements increases transparency as it provides the reader with a more comprehensive view of the County's future financial obligations.

AROs are not the same as Contaminated Sites which are covered in another standard. Contaminated Sites are assets that require remediation when contamination exceeds a permitted environmental standard and are usually sites that are no longer in use, such as landfills.

<u>Identified ARO Liability and Impact on Financial Statements</u>
FSS worked in partnership with Fleet and Facility Management, Human Resources (Occupational Health and Safety), Corporate Asset Management and other key operational departments to identify ARO liabilities associated with County owned buildings and utility infrastructure. The ARO liability reflects Administration's best estimate of the amount of remediation cost required for the County's tangible capital assets. Estimates were made using professional judgment, third-party quotes, and several assumptions. These estimates will be continually reassessed, considering any new information that may arise within the year. Administration engaged the County's external auditors throughout the development of it's ARO approach to ensure the methodology was compliant with the new standard.

For the year ended 2023, the total ARO liability that will be included in the financial statements is $11.2 million. The ARO liability differs from other liabilities as there is no requirement to fund if upfront. Therefore, it has not yet impacted the operating surplus for tax purposes as it is currently not funded, and it will only have an impact once a funding strategy is implemented. The liability is associated with 81 facilities across the County and is primarily associated with materials containing contaminants to which the County is legally required to remediate upon their demolition or replacement, including asbestos, lead, ozone-depleting substances, and polychlorinated biphenyls. The value of the ARO liability was anticipated and Administration engaged with the external auditors to ensure the methodology is compliant with the new standard.

Proposed ARO Funding Strategy

A proposed funding strategy for ARO liability has been developed to ensure that the County is set up to comply with future remediation requirements, while also being mindful of the potential impact to taxpayers. A proposed funding strategy is outlined below.

Capital impact – if a facility is to be replaced or a renovation will be completed, the ARO liability information will be utilized to inform the capital budget of the anticipated remediation costs and will be included in budget requests submitted to Council for approval. Capital projects are typically funded using the capital funding envelope.

- AROs associated with approved capital projects – based on the current information, of the $11.2 million liability, $8.1 million will need to be addressed within the 10-year budget capital plan. The additional $0.1 million can be absorbed within the current approved capital budget.
- AROs associated with capital beyond the 10-year capital plan – an estimated $2.2 million will need to be addressed and added to capital projects planned beyond the 10-year time horizon.

Operating impact – if a facility is expected to be demolished, the ARO liability information will be used to inform the operating budget and will be included within the operating budget in the year of the anticipated demolition. Based on current information, of the $11.2 million liability, $0.8 million is anticipated to be incurred in operating costs. Timelines for demolition are yet to be determined. Two options are available to Council to fund these future costs:

1. An annual reserve contribution to be added to the 2025 budget, or
2. A one-time 2023 surplus allocation to be used to kickstart the reserve.

A one-time surplus allocation would defer any additional taxpayer impact; therefore, FSS recommends proceeding with option two.

Ongoing impact – the $11.2 million represents the estimated costs for remediation as at December 31, 2023. There will be an ongoing need to reassess the funding requirements based on inflationary factors, as well as possible changes to legal requirements. The County will need to incorporate the impact of both changes into the funding strategies articulated above. The increase related to inflation will be known as an accretion expense. The impact will be incorporated into future operating budgets to increase reserve contributions to fund this component. To provide perspective, in 2023 it was $0.4 million.

Next Steps

Once the financial statements for 2023 have been audited and approved, the County will have met its compliance requirement for the new standard. Going forward, the ARO liability will be continually reassessed, and funding will be monitored on an ongoing basis and incorporated into either the capital or operating budget. In addition, engagement with internal partners will continue to ensure that ARO liability is appropriately extinguished upon completion of remediation work. Third-party assessments of County infrastructure will become an ongoing practice within the County to ensure the requirements of this standard continue to be met.

Council and Committee History

April 18, 2023	Strathcona County's Adoption of the New Public Sector Accounting Standard – Asset Retirement Obligation was presented to Council for information.

Other Impacts
Policy: FIN-001-024: Municipal Reserves; FIN-001-008: Allocation of Year-End Operating Surplus for Tax Purposes
Legislative/Legal: n/a
Financial/Budget: Significant as described above.
Interdepartmental: Corporate Asset Management, Human Resources, and key operational departments including Fleet and Facility Management and Utilities
Master Plan/Framework: n/a

Enclosure

1	Asset Retirement Obligation Update and Funding Strategy presentation

Authors: Amanda Fonos and Jay Bohachyk, Financial and Strategic Services

Director: Carmen Dragan-Sima, Director, Financial and Strategic Services
Associate Commissioner: Jennifer Cannon, Chief Financial Officer and Associate Commissioner, Corporate Services
Lead Department: Financial and Strategic Services