Contaminated Sites
Issues and Implementation
Action Plan for PS 3260

Public Sector

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The Public Sector Accounting Board’s accounting standard on Liability for Contaminated Sites (Section PS3260), will be a reality in less than a year for all entities reporting under the Public Sector Accounting (PSA) standards. This accounting standard will impact federal, provincial and municipal governments, as well as Crown corporations, universities, school boards, and hospitals reporting under the PSA standards. Issued in 2010, PS3260 has an effective date of year’s beginning on or after April 1, 2014.

This section addresses liabilities for remediation related to sites, or parts of a site no longer in active or productive use. This section does not apply to liabilities for closure and post-closure care of a solid waste landfill site when the site or a phase stops accepting waste. This is addressed under a separate section, PS3270, and not considered in this article.

Despite giving public sector entities four years to prepare for this new standard, many entities have yet to determine the extent of impact that PS3260 may have on their financial reporting. For some entities, this may result in unnecessary surprises with their reported results for the 2014-15 fiscal year, and create challenging discussions with audit committees. Public sector entities need to plan for contaminated sites now.
Why are contaminated sites an issue?

What makes the implementation of PS3260 especially difficult is the existing lack of information which restricts many governments from fully determining the impact on their financial reporting, and from reporting back on how effectively funds are being spent on remediation.

To illustrate, the Office of the Auditor General’s Commissioner of the Environment and Sustainable Development reported in June 2012 that the federal government faced up to $7.7 billion in environmental liabilities at March 31, 2011 across approximately 22,000 actual, suspected, or closed federal contaminated sites. As of 2013, 12,417 of these 22,000 sites were actual or suspected contaminated sites which had not yet been classified according to the Federal Contaminated Sites Inventory (implying insufficient information to enable an assessment of risk pertaining to the site). The potential environmental liability related to these unclassified sites and suspected sites could have a substantial impact on the financial reporting of the Government of Canada. The Commissioner’s report also noted that the federal government did not have a performance reporting system to enable identification of whether funds spent on cleaning up sites was delivering results.

The situation across many provinces and municipalities is very similar, with many contaminated sites still requiring additional analysis to determine the extent of any potential liability which should be recorded – with less than one year to go until PS3260 is effective. As a case in point, Nova Scotia’s Auditor General reported in June 2010 that the Province needed to improve monitoring of contaminated sites. A 2012 update on the OAG’s findings noted that the Province was still working to develop a system for public reporting on contaminated sites based on risk, to be completed summer 2013. The Province was also working to develop a contaminated sites inventory system for July 2013.

Similarly, the Report of the Auditor General of Newfoundland and Labrador in January 2011 noted that the Province needed to strengthen the identification and remediation of contaminated sites. The report commented that the provincial comptroller general did not have complete information to determine the Province’s liability for contaminated sites.

In addition to the lack of information many governments have related to their contaminated sites, the measurement of environmental liabilities requires substantial professional judgment and can vary widely year to year. How a government accounts for long term monitoring costs, for example, and the assumptions applied to index and discount future remediation expenditures can materially impact the amount of the liability reported.
Technical overview

While PS3260 does not change the fundamental definition of liability, it does provide guidance on applying the existing definition of a liability in the Public Sector Accounting Handbook to the specific context of contaminated sites.

PS3260 specifies that a liability for a contaminated site must be recognized when, as at the financial reporting date, all of the following criteria are met for a site or a portion of a site which is not in active use (text in italics added for interpretation and analysis):

(a) An environmental standard exists (most commonly through enacted federal, provincial or local legislation, applicable bylaws, permits, or conditions specified in contracts and agreements);

(b) Contamination exceeds the environmental standard (as established in an environmental site assessment by a professionally qualified environmental engineer);

(c) The government:
   (i) Is directly responsible (based on a legal obligation to perform the remediation from agreements or contracts, legislation of another government, or the government’s own legislation); or
   (ii) accepts responsibility (typically based upon a voluntary assumption of responsibility based on the government’s own actions or communications, provided these create an obligation meeting the definition of a liability);

(d) It is expected that future economic benefits will be given up (in other words, the government or government organization expects to expend their own resources to clean up the contaminated site); and

(e) A reasonable estimate of the amount can be made.

As you can see from the criteria above, the existence of an environmental standard in and of itself is not the obligating event that creates a liability. The existence of contamination that exceeds an environmental standard at the financial reporting date is a necessary condition for recognition of a liability.

The expectation that future economic benefits be given up is also critical. A government would typically not be required to recognize a liability for a contaminated site to be remediated solely through natural attenuation (where contaminants are cleaned up or attenuated naturally through soil or groundwater, with no disbursements for remediation costs for the government). Since the government is not sacrificing any future economic benefits to perform the remediation, a liability would not be required under PS3260. Similarly, with contamination caused by asbestos, a government is generally not required to immediately clean up the contamination, though they must disclose the presence of the contamination to potential purchasers. The government would be giving up future economic benefits when the fair market value of the building with the asbestos is less than its cost.

Initial application of this standard may be accounted for retroactively or prospectively.

For sites which remain in active use, this section doesn’t apply and entities would continue to assess potential obligations for remediation against the definition of a liability in PS3200, Liabilities.

Liability measurement – The devil is in the details

The estimate of a liability should include those costs directly attributable to remediation activities, based on information available at the financial statement date. The estimated costs would include post-remediation operations, maintenance and monitoring that are an integral part of the remediation strategy for a contaminated site. Costs of assets acquired as part of remediation activities, to the extent those assets have no alternative use, should also be factored into the costs.

Directly attributable costs would include, but are not limited to, payroll and benefits, equipment and facilities, materials, and legal and other professional services relate to the remediation of the contaminated site. Estimated costs would be those required to bring a site up to the current minimum acceptable standard for its use prior to contamination – which is not necessarily to a perfect state.
Costs such as revegetation of the affected land, consultations with stakeholders, project management and training are only included in measurement of the liability to the extent that they directly relate to the actual remediation of the site. Substantial judgement needs to be applied in determining whether an expenditure truly relates to the remediation. Those in charge of financial reporting should not act in isolation but should consult with remediation project teams and professional engineers to determine the objective and desired outcome of each expenditure. To illustrate – resodding and planting of trees on contaminated land to make the area more visually appealing to the community would typically not be considered part of the remediation process, and therefore, would generally not be included in the liability. On the other hand, if the grass and trees were required as they establish roots in the soil which limits the flow of contaminants into a nearby water stream, it could be directly linked to remediation and would then be included in the liability.

Remediation projects often involve incurring expenditures over many years. When remediation costs are planned to be incurred over many years, the costs should be escalated to cover expected increases in costs over the duration of the project. Escalation should cover anticipated increases in the cost of equipment, material, labour, fuel, and freight amongst others. Professional judgement needs to be applied to determine the most appropriate escalation factor to apply, based on the anticipated rate of inflation for these items. Similarly, where project cost estimates are prepared based on assessments from prior years which have not have been updated to current year dollars, the prior-year estimate should be redeveloped or indexed for an inflationary factor to calculate impact in current year dollars.

The estimate of the liability should also be discounted when the estimated costs to settle the liability are based on future cash requirements which are expected to be incurred beyond the end of the next fiscal year. Professional judgement is again required to determine the most appropriate discount rate that should be applied. Estimated future cash flows could be discounted using the Government of Canada or Provincial lending rates to approximate its current value, or using actuarial discount rate assumptions as applied to other public sector entities.

Given the uncertainty and complexity of many remediation projects, total estimated project costs can often include two forms of contingencies – a contingency for design allowance, and a general risk contingency. A design allowance is often included to represent
a contingency for the accuracy of cost estimates, expressed as a percentage of project costs. The design allowance reflects known uncertainties in future operating and capital expenditures, based on best practices. Based upon the likelihood of the design allowance being incurred, it is often included in the liability measurement. Total project costs may also include a further risk contingency to reflect worst case class estimate uncertainties. The extent of uncertainties related to the likelihood of incurring these additional costs, would impact if they are included in the liability estimate.

The treatment of long term monitoring costs also requires professional judgement. PS3260, Contaminated Sites, indicates that such costs should be included in the liability estimate in certain instances. An assessment needs to be performed as to whether the long-term monitoring costs are integral to the remediation strategy of a site. For example, does the long term monitoring performed determine the effectiveness of the remediation strategy, and enable the remediation strategy to be adopted based on actual conditions and progress? If so, this may suggest that long term monitoring is essential to remediation, and should be included in the measurement of the liability.

**An action plan for PS3260**

Based upon the complexity and challenges of implementing PS3260, management of government entities with contaminated sites should be working now on their action plan. However, PS3260 should not become an unnecessarily labour intensive project if the focus is placed on the right areas. For government entities with no inactive sites (and no active sites with inactive components, such as wings or floors of a building not being used), or those with inactive sites but no suspected contamination, PS3260 will not have much impact. For all others, work should be underway now to ensure March 31, 2015 year end reporting timelines can be met.

First and most importantly, senior management and audit committees should be educated to the potential impact of PS3260 on reported financial results. Depending upon the number of contaminated sites, the extent of contamination present, and the location of the site, the financial impact could be very significant. Even though some government entities financial statements previously included certain environmental liabilities, they may not have included all sites, or measured the liabilities consistently as required by PS3260.

Secondly, all relevant functions should be engaged in overseeing the implementation of PS3260 – not only Finance, but also Property Management, Operations, Procurement, and Legal. Many of the inputs required to identify and measure potential liabilities for contaminated sites will come from the
teams overseeing remediation efforts. The ability to validate key assumptions is essential to supporting the integrity of financial information reported for contaminated sites.

Government entities should be working now to prepare an inventory of all their active and inactive sites – not just those which are potentially contaminated. Not only does the sites inventory help to guide the assessment of financial reporting impact of PS3260, but it also helps demonstrate to the financial statement auditor the sites considered in the determination of the contaminated sites liability ultimately recorded. In addition to assessing the measurement of significant liabilities, financial statement auditors will need comfort that all potential contaminated sites have been considered. The best way to demonstrate this completeness is through a full inventory of sites, along with an assessment of which sites are potentially contaminated.

As sites are inventoried for government entities, consideration should be given to developing a framework to classify and account for risk which may drive the estimates for remediation. Where entities are dealing with a large number of sites, a framework will better support efficient groupings of sites with similar risk profiles, and the benchmarking of sites. The framework also provides additional documentation the financial statement auditor can consider when assessing appropriate implementation of PS3260.

A gap analysis of existing accounting policies against the requirements of PS3260 should be performed. This will further identify the extent of changes required to meet the requirements of the section.

Once any probable contaminated sites have been identified, professional engineers should be engaged to perform an environmental site assessment to confirm whether contamination exists which exceeds an established standard. An environmental site assessment by a qualified professional engineer is essential to support the measurement of the liability for a contaminated site. Where site assessments have been performed in previous fiscal periods, consideration should be given to whether technology or the understanding of extent of contamination for the site has changed which would warrant a re-assessment. Detailed work plans developed for a site by the project team should also be evaluated, considering the degree of consistency with the environmental site assessment, and the nature of identified expenditures which should be captured within the liability. Where an entity has multiple sites, it is essential that the nature of expenditures included within the liability be consistent site to site.
Conclusion

The Public Sector Accounting Board’s PS3260, Liability for Contaminated Sites will become effective in less than a year, on April 1, 2014. Government entities have significant work remaining to fully assess the impact this standard may have on their financial reporting. Though many government entities recorded environmental liabilities previously on their financial statements, PS3260 requires an added rigour of assessment regarding which sites are contaminated, as well as improved consistency of liability measurement. Given the extent of coordination required with operational areas outside of finance, and the potential need to engage environmental engineers to perform site assessments, PS3260 may require a longer lead time for implementation than other sections for certain entities. Communication with senior management and audit committees is also essential to ensure they understand financial reporting changes that may be coming next year. Now is the time to start. Wishing you all a good implementation!

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