

Advisor alert—*Liability for contaminated sites*

February 2018

Overview

Section PS 3260 *Liability for Contaminated Sites* of the Public Sector Accounting Handbook (the “Handbook”) provides the recognition, measurement, presentation and disclosure requirements for liabilities associated with the remediation of contaminated sites. The standard has had and continues to have a significant effect on reported financial results and operations and sometimes requires the use of specialists in determining whether a liability for contaminated sites exists and the amount at which this liability should be measured.

Summary of Standard

Scope

Under PS 3260, a site is considered contaminated if substances occur in concentrations that exceed maximum acceptable levels under an environmental standard. This does not include air borne contamination or contaminants in the earth’s atmosphere, unless such contaminants have been introduced into soil, water bodies or sediment. Typical examples of situations whereby a liability for remediation would result include:

- all or part of an operation that is no longer in productive use (for example, abandoned military installations);
- all or part of an operation of an entity the public sector entity does not own that is no longer in productive use for which the

public sector entity accepts responsibility (for example, an abandoned gas station);

- changes to environmental standards relating to all or part of an operation that is no longer in productive use (for example, new regulations requiring the destruction of a stored chemical); and
- an unexpected event resulting in contamination (for example, accidental toxic chemical spills or natural disasters).

Public sector entities should note that the section does not apply to the following:

- costs for the acquisition or betterment of tangible capital assets to the extent that the costs do not exceed the future economic benefits related to the asset or post-remediation fair value of the asset if held for sale (for example, redevelopment of a contaminated site for use or sale);
- asset retirement obligations for long-lived assets in productive use that result from their acquisition, construction or development and ongoing use (for example, operating a gas station in a municipal work yard);
- liabilities associated with the disposal or sale of long-lived tangible capital assets (for example, privatization of a water utility); and

- liabilities for closure and post-closure care of a solid waste landfill site when the site stops accepting waste.

The exclusion of these items from the scope of the section does not preclude the entity from having to record a liability under other sections of the Handbook (for example, PS 3200 *Liabilities* or PS 3270 *Solid Waste Landfill Closure and Post-Closure Liability*).

Recognition

A liability for remediation of contaminated sites is recognized when all of the following conditions exist:

- 1 an environmental standard exists;
- 2 contamination exceeds an environmental standard;
- 3 the entity is directly responsible or accepts responsibility;
- 4 it is expected that future economic benefits will be given up; and
- 5 a reasonable estimate of the amount can be made.

Environmental standard

An environmental standard is generally set by statute, regulation, by-law, order, permit, contract or agreement and is legally enforceable and binding. Failure to comply may result in prosecutions, fines or similar penalties. The entity does not have to consider proposed changes in legislation, regardless of the effective date. An environmental standard can also be created by internal policies or guidelines developed by a government or third party. Voluntary compliance with these environmental standards may also create a liability.

An environmental standard may be both quantitative and qualitative. Quantitative standards are the most easily verifiable; however, some legislation may prohibit adverse environmental impacts in qualitative terms. For qualitative standards, entities may

have to exercise more professional judgment in determining whether contamination has exceeded an environmental standard.

Contamination

In order to determine if contamination exists that exceeds an environmental standard, an entity will have to assemble and review all available historical and current information pertaining to the site or group of sites including, but not limited to:

- a the nature of past activities at the site(s) or adjacent properties;
- b site(s) location, hydrology and geology;
- c results from testing and field investigations;
- d similarities to and experience at other known contaminated sites;
- e significance of site(s); and
- f cost versus benefit of conducting detailed site assessments.

The section does not specifically require an entity to obtain site assessments for each site to assess the contamination level.

Nevertheless, public sector entities should understand that the event that would resolve the uncertainty about whether contamination exceeds an environmental standard (i.e. the completion of a site assessment) is within the entity's control. The lack of this confirming evidence does not absolve the entity from having to record a liability. The fact that an entity has evidence to suggest contamination may exist, but it may lack the specific information to confirm that it exists in excess of an environmental standard is a measurement issue only. In the case of uncertainty, the entity has to assess the probability that future site investigations will confirm that contamination that exceeds an environmental standard existed at the financial statement date. If the probability is likely that future site investigations will confirm contamination, a liability must be

recognized, if the amount can be reasonably estimated.

Example

A municipality owns various mining sites with similar characteristics (e.g. their geographical location, type of deposit they mine). In the current year, site assessments were performed at a few of the larger sites, and they demonstrated that there was contamination of a specific chemical in excess of federal environmental standards. The smaller sites were not subjected to site assessments to establish their potential contamination level.

The fact that site assessments were not performed on the smaller sites cannot be used as a reason for not evaluating if a liability exists and should be recognized. The entity would have use the knowledge they have from the larger, similar sites which were analyzed, along with past experience and any other data available to assess the probability that the smaller sites are contaminated in excess of an environmental standard.

Responsibility

A public sector entity may be directly responsible for the remediation or it may accept responsibility for the remediation of a contaminated site. The entity may voluntarily assume responsibility for remediation of contaminated sites (for example, abandoned gas stations) through its own actions or promises, but the obligation must still meet the basic definition of a liability to be recognized; as a result, obligations that are based on the intention of an entity may not meet this definition. Most liabilities for contaminated sites will arise from legal obligations, the settlement of which can be enforced by a court of law. Nevertheless, some liabilities may arise from constructive and equitable obligations (those that can be inferred from the facts in a particular situation or by an established pattern of past practices and those that are based on ethical or moral considerations,

respectively). Some constructive and equitable obligations may be enforced by a court in accordance with the legal principle known as promissory estoppel¹ or other legal principles having similar effect. Professional judgment should be used in these situations to determine if the entity has created a valid expectation among others that leaves it with no realistic alternative but to remediate a contaminated site or group of sites.

Evidence that an entity may have a present obligation for remediation separate from legal documents may include:

- the public sector entity body or person with the appropriate level of authority has committed the entity to a remediation plan;
- the remediation plan identifies the specific location of the contaminated site or sites;
- the remediation plan has been communicated to those directly affected (for example, residents of surrounding communities) in such detail as to allow those affected to determine the benefits that would accrue to them;
- the remediation plan specifically identifies the target level of reduction in risk the site(s) pose to human health and the environment and the amount of the environmental costs to be incurred to achieve those targets;
- the time frame for implementing the plan has been identified and indicates that significant changes to the plan are not likely; and
- the details of the plan are such that there is a reasonable expectation that the promise can be relied upon.

Budgeting for remediation activities alone does not mean a liability for remediation actually exists. Also, announcements to provide long-term funding for remediation activities may not result in a liability because the entity maintains total discretion over the

eventual disposition of the funds committed to remediation activities.

If there is uncertainty as to whether the government may be responsible, the entity should assess the likelihood a future event will confirm that it was responsible; if it is likely, a liability would be recognized if the amount can be reasonably estimated. If it is unlikely that the entity will be responsible, no liability would be recognized. If the outcome of the future event cannot be determined, the existence, nature and extent of the contingent liability would be disclosed.

Measurement

The estimate of the liability should consist of the costs directly attributable to the remediation activities and includes integral post-remediation operation, maintenance and monitoring costs that are a part of the remediation strategy for the contaminated site. The costs that would be included in the liability are:

- costs directly attributable to remediation activities (for example, payroll and benefits, equipment and facilities, materials, and legal and other professional services); and
- costs of tangible capital assets acquired as part of remediation activities to the extent they have no other alternative use.

The estimated costs would be those required to bring the site(s) up to the current minimum environmental standard for the site's use prior to contamination.

The measurement of the liability will require the use of estimates and professional judgment and should be based on the best information available at the balance sheet date. The carrying amount of a liability for contaminated sites would be reviewed at each financial reporting date with any revisions to the amount previously recognized accounted for in the period in which revisions are made.

The cost of a tangible capital asset required for remediation activities is reported as an expense, not an asset, in the period when a liability is recognized. If the asset has an alternative future use, only that portion of its estimated cost related to its use in remediation activities would be included in the estimate of a liability. When the asset is actually acquired, only those expenditures that relate to the alternative use would be capitalized and amortized to expense over the remainder of its useful life in the periods of alternative use.

The entity may not complete a site assessment for a contaminated site each reporting period because of the cost of gathering and processing the information required. In the years between completions of site reassessments, a review of the estimate of the liability could be based on an extrapolation of previously completed site assessments, taking into consideration such factors as changes to the remediation strategies, technological changes, experience gained, changes to assumptions, actual expenditures, changes in legislative standards, and unforeseen changes in cost estimates. When the effect of any change is significant, recognition of a new estimate may be necessary. An entity may need to perform a detailed reassessment of a contaminated site if there are:

- technological developments;
- lapsed time since the last site assessment was completed;
- new information from a detailed site assessment, site characterization or technical review done on a similar contaminated site; or
- a change in legislation.

The entity should use a measurement technique that results in the best estimate of the amount required to remediate the contaminated sites. The best estimate should represent the amount that the entity would rationally pay to settle or otherwise

extinguish the liability at the financial statement date. Entities will have to use professional judgment to determine the appropriate measurement technique and estimate of expenditures; they should also supplement this judgment with experience, third party quotes and reports of independent experts.

If the payments required to settle the liability will occur over an extended period of time or at a future date, this timing should be reflected in the measurement of the liability. Generally, a present value technique is the best measurement technique to estimate the liability.

The liability should be reduced for any expected recoveries net of costs associated with the effort to collect them (for example, insurance proceeds related to the contamination), if a reasonable estimate of the amounts involved can be made.

Any disbursements that are made related to the liability would be deducted from the liability as they are made.

Disclosure

The section requires disclosure of the following concerning a liability for contaminated sites:

- 1 the nature and source of the liability;

- 2 the basis of recognition and measurement of the liability including significant assumptions used (for example, discount rate and anticipated timing of future expenditures, when possible);
- 3 when a net present value technique is used, the estimated total undiscounted expenditures and discount rate;
- 4 the reasons for not recognizing a liability (for example, the reason why a reasonable estimate of the amount involved cannot be made or why it is not expected that future economic benefits will be given up); and
- 5 the estimated recoveries.

Additional disclosures may also be required under other sections of the handbook, such as PS 2130 *Measurement Uncertainty*, PS 3200 *Liabilities* and PS3300 *Contingent Liabilities*.

Effective Date

This section is effective for all entities applying public sector accounting standards for fiscal years beginning on or after April 1, 2014; earlier adoption is permitted.

If you have any questions about this standard, please contact your Grant Thornton LLP advisor.

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ⁱ Promissory estoppel is defined 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-recevoir".