

ASSURANCE AND ACCOUNTING

LIABILITY FOR CONTAMINATED SITES

The new Section PS3260, Liability for Contaminated Sites, in the Public Sector Accounting Handbook establishes standards on how to account and report a liability associated with the remediation of a contaminated site. The standard is not effective until fiscal years beginning on or after April 1, 2014. This may seem like a long ways off but the date may be deceiving. This standard may require the use of site assessments, engineers and / or other specialists to determine if a site is contaminated so the transitional period is intended to give stakeholders enough time to obtain the information to determine if there is a liability and how much that liability may be.

Contamination is the introduction into air, soil, water or sediment of a chemical, organic or radioactive material or live organism that exceeds an environmental standard. A contaminated site is a site at which substances occur in concentrations that exceed the maximum acceptable amounts under an environmental standard. A contaminated site does not include airborne contamination or contaminants in the earth's atmosphere unless such contaminants have been introduced into soil, water bodies or sediment.

A liability for remediation may occur in the following situations:

- An operation of the government organization that is no longer in productive use (abandoned military installations);
- An operation of entities outside the government reporting entity that is no longer in productive use for which the government accepts responsibility (abandoned gas station);
- Changes to environmental standards relating to an operation that is no longer in productive use (new regulations requiring the destruction of stored PCBs); and
- An unexpected event resulting in contamination (accidental toxic chemical spills or natural disasters).

Recognition

A liability for remediation of contaminated sites must be recognized when, as at the financial reporting date, ALL of the following criteria are satisfied:

- An environmental standard exists;
- Contamination exceeds the environmental standard;
- The government or government organization is directly responsible or accepts responsibility;
- It is expected that future economic benefits will be given up; and
- A reasonable estimate of the amount can be made.

Environmental Standard

An environmental standard is generally set out in the form of a statute, regulation, by-law, order, permit, contract or agreement. As a result, it is legally enforceable and binding, and compliance is mandatory. When evaluating the existence of an environmental standard, existing or enacted legislation, contracts or agreements in effect at the financial statement date would be considered. Governments should also be aware that it is possible for internal government policies or guidelines to create an environmental standard, as these policies and guidelines may create constructive or equitable obligations.

An environmental standard may be both quantitative and qualitative. In the case of qualitative standards, the benchmarks for determining whether the environmental standard has been breached are highly variable and will require professional judgement to determine whether the standard has been breached. Quantitative standards are generally more easily verifiable.

Contamination

To determine if contamination exists that exceeds an environmental standard, the government or government organization will have to assemble and review all available historical and current information pertaining to the site or group of sites. Factors to consider include:

- The nature of past activities at the site(s) or adjacent properties;
- Site(s) location, hydrology and geology;
- Results from testing and field investigations;
- Similarities to and experience at other known contaminated sites;
- Significance of site(s); and
- Cost versus benefit of conducting detailed site assessments.

Uncertainty about the existence or non-existence of contamination in excess of an environmental standard does not eliminate the need for the entity to determine whether they have to recognize a liability. The determination will depend on 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 should be recognized, if the amount can be reasonably estimated.

Responsibility

A government may be directly responsible for remediation because of its own past activities that have caused contamination (for example, operation of transportation works yards) and when activities occurred on government-owned land or land that the government has since acquired, and a responsible party cannot be identified (for example, "inherited" responsibility for abandoned mines on Crown land through bankruptcy proceedings / court decisions).

Most liabilities for remediation arise from legal obligations, settlement of which can be enforced by a court of law; however, some may result from constructive and equitable (moral or ethical) obligations. An essential characteristic of a liability is that there is a present obligation resulting from a past event that leaves little, if any, discretion to avoid it. To determine if a government has taken on responsibility as the result of constructive or equitable obligations, the entity must look to see if they have created a valid expectation among others that leaves them with no realistic alternative but to remediate the contaminated site. For example, the government or government organization may have an established history of complying with environmental standards or they may have done the following:

- The government body, management board or person with the appropriate level of authority has committed the government 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) through public consultation, information sessions, workshops or other activities 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.

The mere act of budgeting for remediation activities does not result in incurring a liability. As well, a government announcement to provide long-term funding for remediation activities may not result in a liability.

Future Economic Benefits

The existence of contamination that exceeds an environmental standard may create a liability regardless of whether a government chooses to perform remediation activities or not. A government may have a present obligation to remediate the contamination now or at some future date. The timing of the settlement does not relieve the government of its present obligation or recognition of the associated liability. The timing would be reflected in the measurement of the liability.

Uncertain Responsibility

There may be a situation when an environmental standard exists and contamination exceeds the standard. The government has determined that it is not directly responsible, nor does it accept responsibility. However, there is uncertainty as to whether the government may be responsible. As a result, the government may have a contingent liability. If it is likely that a future event will confirm the government's responsibility, a liability will be recognized if it can be reasonably estimated.

It is important to note that uncertainty about whether contamination exists is not the type of uncertainty that characterizes a contingent liability. This type of uncertainty is a measurement issue.

Measurement

A liability for remediation should be estimated based on information available at the financial statement date. The estimate of a liability should include costs to bring a site up to the current minimum standard for its use prior to contamination. The directly attributable costs would include post-remediation operation, maintenance and monitoring that are an integral part of the remediation strategy for a contaminated site and would include items like: payroll and benefits, equipment and facilities, materials, and legal and other professional services. Costs related to natural resource damage (for example, revegetation outlays) are included only if incurred as part of an environmental standard. The estimate would also include costs of tangible capital assets acquired as part of remediation activities to the extent those assets have no alternative use. Although the tangible capital asset is providing goods and services, there are no ongoing operations against which the costs can be allocated so the cost of the asset required for remediation activities is reported as an expense, not an asset, in the period when a liability is recognized.

In many cases it will be necessary to estimate the amount of a liability in situations when a detailed site investigation has not been completed, but there is evidence to suggest that contamination exists that exceeds an environmental standard. Consideration would be given to available site assessment information and experience gained at other sites that have typical or common characteristics such as similarities in historical land use activities. Estimating the amount of a liability requires the exercise of professional judgment and be based on the best available information.

When the estimate is based on a site assessment, a government may not complete a subsequent site assessment in each reporting period because of the cost of gathering and processing 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.

Events like new technological developments, lapsed time since the last site assessment, new information from site assessments on similar contaminated sites and a change in legislation may suggest the need to have a new site assessment performed.

The measurement technique adopted by a government should result in the best estimate of the amount required to remediate contaminated sites. This best estimate is the amount that a government or government organization would rationally pay to settle or otherwise extinguish the liability at the financial statement date. The estimate of expenditures would require professional judgment supplemented by experience, third party quotes and, in some cases, reports of independent experts. When the cash flows required to settle or otherwise extinguish a liability are expected to occur over extended future periods, a present value technique is often the best available technique with which to estimate the measure of a liability.

At each financial reporting date, the entity must review the carrying amount of any liability for remediation with any adjustments being accounted for in the period in which the revisions to the estimate are made.

Disclosure

For a liability for contaminated sites, a government or government organization must disclose:

- The nature and source of the liability;
- The basis for the estimate of the liability;
- When a net present value technique is used, the estimated total undiscounted expenditures and discount rate;
- The reasons for not recognizing a liability; and
- The estimated recoveries.

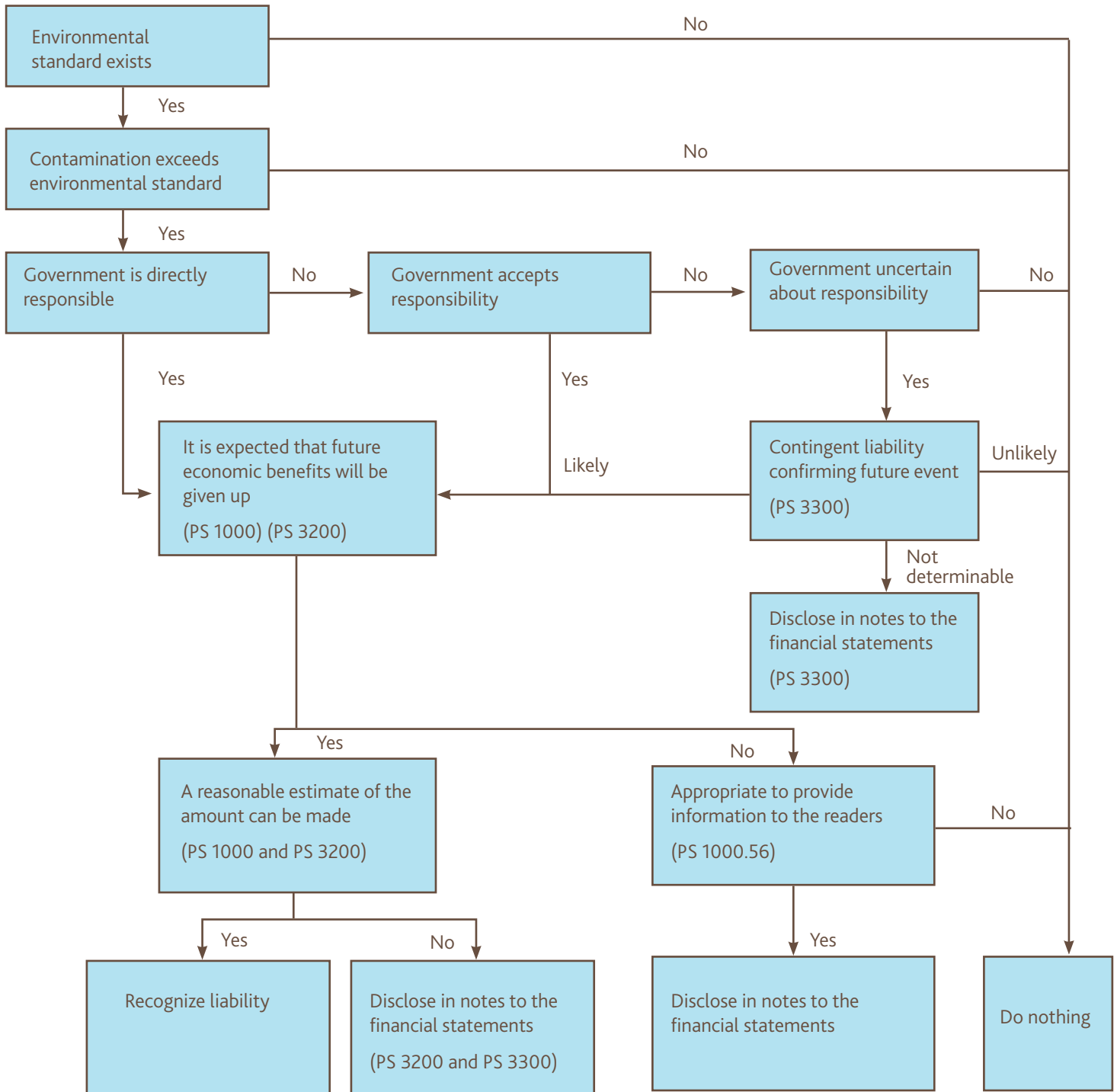
Transitional Provisions

As mentioned at the beginning of this publication, this Section applies to fiscal years beginning on or after April 1, 2014. Earlier adoption is encouraged.

Conclusion

Section 3260, Liability for Contaminated Sites will not be an easy standard to apply as it may require specialists to determine if there is contamination in excess of an environmental standard. If you believe this standard will apply to you, talk to your BDO advisor today.

Appendix - Decision Tree



The information in this publication is current as of November 18, 2011.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

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