

## Assurance and Accounting

# Contaminated Sites

## A Practical Approach to Section PS 3260

Section PS 3260, *Liability for Contaminated Sites*, was issued by the Public Sector Accounting Standards Board (PSAB or the “Board”) in June 2010. This Section establishes standards on how to account for and report a liability associated with the remediation of a contaminated site. It was effective for year ends beginning on or after April 1, 2014 and it applies to all governments and government organizations following Public Sector Accounting Standards (PSAS). In this publication we will walk through a practical approach to applying this standard.

### Three Step Approach

At first glance this standard can seem a bit overwhelming to apply. However, following a process will allow us to apply this standard efficiently. The three steps in this approach are as follows:

<b>STEP 1 – Identification</b>	Identify sites that are in the scope of PS 3260
<b>STEP 2 – Recognition</b>	For each site in scope, determine if it meets the recognition criteria in paragraph PS 3260.08
<b>STEP 3 - Measurement</b>	For each site that meets the recognition criteria, determine an appropriate estimate of the liability

Let's take a look at each step in detail.

#### Step 1: Identify Sites that are in the Scope of PS 3260

Step 1 is the most important step. Skipping this step and jumping right into determining whether a liability for a site can be recognized and trying to estimate that liability will create a lot of unnecessary work, because if a site is determined to not be in the scope of PS 3260 then no further work is required under the standard.

To know if a site is in scope, we first need to consider what the standard defines contamination as and a contaminated site to be.

Contamination	Contaminated Site
The introduction into air, soil, water or sediment of a chemical, organic or radioactive material or live organism that exceeds an environmental standard.	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.

Section PS 3260 provides some examples of what a liability for remediation normally results from<sup>1</sup>:

- All or part of an operation of entities outside the government reporting entity that is **no longer in productive use** for which the government accepts responsibility (e.g. abandoned gas station);
- An **unexpected event** resulting in contamination (e.g. accidental toxic chemical spills or natural disasters).

However, this standard does not apply to liabilities associated with asset retirement obligations (AROs), which are accounted for under Section PS 3280, *Asset Retirement Obligations*. As a result, you may be wondering how to differentiate between items that would be accounted for under Section PS 3260 vs. Section PS 3280. Determining which Section to apply involves professional judgment, but there are three main distinguishing factors to keep in mind: the **cause** for the remediation or retirement obligation; the **type** of obligation; and the **extent** of contamination. The following table helps illustrate the differences:

<sup>1</sup>The scope of Section PS 3260 was originally broader and captured more items. However, the scope of Section PS 3260 was updated when Section PS 3280, *Asset Retirement Obligations*, was issued to better differentiate which items fell within the scope of each standard. This change to Section PS 3260 is effective in the same period Section PS 3280 becomes effective.

	Contaminated Sites Section PS 3260 Applies	ARO Section PS 3280 Applies
Cause of retirement or remediation obligation	Arises from an <i>unexpected event</i> or improper use and contamination <i>must</i> exist.	Arises from the <i>acquisition, construction, development</i> and <i>normal use</i> of an asset. Does <i>not</i> need to be associated with contamination
Type of obligation	All liabilities, including those arising from both <i>direct responsibility</i> and <i>assumed responsibility</i> .	Restricted to <i>legal</i> obligations related to tangible capital assets <i>controlled</i> by the entity.
Extent of contamination	<i>Must</i> exceed an environmental standard.	<i>Does not</i> need to exceed an environmental standard.

In addition, refer to the flow chart in Appendix A for a series of questions to consider in determining which liability standard applies for a given situation. Section PS 3260 also points out some additional specific items that are not in scope, as guidance on how to account for these items is provided in other existing or proposed Sections of the PSA Handbook. All of this guidance is helpful in gaining an understanding of what is and is not within the scope of Section PS 3260.

In order to identify all potential contaminated sites, it is important to put together a team of knowledgeable people from different areas of the organization such as finance, public works, engineering, legal, procurement, etc. In Step 1, the team's goal is to put together a complete list of all potential contaminated sites. The team should also keep in mind that the most important sites to ensure are correctly identified are those that could result in a material misstatement to the financial statements.

The team should consider the following as they compile a list of potential contaminated sites that fall within the scope of Section PS 3260:

<input type="checkbox"/>	Are there any sites with known contamination?
<input type="checkbox"/>	Are there any sites where unexpected contamination has occurred (e.g. from a chemical spill)?
<input type="checkbox"/>	Are there any sites that have a history of contamination (e.g. a site previously used for industrial purposes)?
<input type="checkbox"/>	Are there any sites not in use and why are these sites not in use (e.g. sites that are fenced in, contain signs that say do not enter / use)?
<input type="checkbox"/>	Are there any other sites not yet included on the list where contamination may exist?

Once all the sites that fall within the scope of Section PS 3260 have been identified it is time to move onto the next step and determine if each site meets the recognition criteria.

### Step 2: For Each Site in Scope, Determine if it Meets the Recognition Criteria in Paragraph PS 3260.08

Paragraph PS 3260.08 outlines the criteria for recognition and explains that a liability for remediation of a contaminated site should be recognized when at the financial reporting date:

- a) An environmental standard exists;
- b) Contamination exceeds the existing environmental standard;
- c) The government is directly responsible or accepts responsibility for the contamination;
- d) It is expected that future economic benefits will be given up; and
- e) A reasonable estimate of the amount can be made.

An obligation for remediation of contaminated sites cannot be recognized as a liability under Section PS 3260 unless all of the above criteria are satisfied.

Let's take a deeper look at each of these recognition criteria.

#### a) Determining if an Environmental Standard Exists

**Environmental Standard**—*Any guidelines, objectives, criteria or other kinds of limits placed on the presence or discharge of a contaminant into the natural environment.*

Environmental standards are generally set out in the form of a statute, regulation, by-law, order, permit, contract or agreement. They are legally enforceable and binding, and compliance is mandatory. An environmental standard can be both quantitative and qualitative. When evaluating the existence of an environmental standard, existing or enacted legislation, contracts or agreements that are in effect at the financial statement date would be considered, but future proposed changes in legislation would not be taken into account. 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.

#### b) Determining if Contamination Exceeds the Existing Environmental Standard

The existence of an environmental standard does not in itself create a liability. Instead, it is the existence of contamination that exceeds an environmental standard at the financial reporting date that is necessary for recognition of a liability. When determining if contamination exceeds the environmental standard all available historical and current information pertaining to the site or group of sites would need to be reviewed. Section PS 3260 provides some examples of factors to consider such as:

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

A government may be uncertain about whether or not contamination exceeds an environmental standard, however, this uncertainty does not eliminate the need for the government to determine whether or not it has to recognize a liability. Instead, this determination depends on the probability that future site investigations will confirm that contamination exceeding an environmental standard existed at the financial statement date. If the probability is likely and a reasonable estimate of the amount can be made then the government should recognize a liability. Section PS 3300, Contingent Liabilities, defines “likely” as the probability of the occurrence (or non-occurrence) of the future event(s) is high.

### c) Determining if the Government is Directly Responsible or has Accepted Responsibility

#### *Direct Responsibility*

A government may be directly responsible for remediation due to its own past activities that have caused contamination.

**Example:** *The government operated a transportation works yard where there was an unexpected chemical spill.*

A government may also be directly responsible when activities occurred on government-owned land or land the government has since acquired, and a responsible party either cannot be identified or lacks the means for remediation.

**Example:** *The government “inherited” responsibility for abandoned mines on Crown land through bankruptcy proceedings and court decisions.*

#### *Accepted Responsibility*

A government may also voluntarily accept responsibility for the remediation of a contaminated site by its own actions or promises. While most liabilities for remediation arise from legal obligations, the settlement of which can be enforced by a court of law, some may result from constructive or 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 an entity 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 government must determine if it has created a valid expectation among others that leaves it with no realistic alternative but to remediate the contaminated site.

**Example:** *A person in the government with the appropriate level of authority commits the government to a remediation plan; the plan identifies the specific location of the contaminated site, the target level of reduction in the risk the site poses to human health and the environment, the costs that will be incurred to achieve these targets and the time frame for the plan; significant changes in the plan are not likely; the remediation plan has been communicated to those directly affected in sufficient detail so they can determine the benefit that would accrue to them; and the details of the plan are such that there is a reasonable expectation by those affected that the promise can be relied upon.*

#### *Uncertain Responsibility*

A situation may occur where an environmental standard exists, contamination exceeds this standard, the government is not directly responsible and it does not accept responsibility, however, there is uncertainty as to whether the government may be responsible. In this situation, the government may have a contingent liability. A future confirming event may be required to determine whether the government is responsible. 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 remember that uncertainty about whether or not contamination exists (for example, due to a site assessment not yet being completed) is not the same type of uncertainty that characterizes a contingent liability, because in this case the future event that will resolve the uncertainty is within the government's control. Instead this would be a measurement issue.

**Example:** *Underground sources of drinking water within a government's jurisdiction are contaminated. The government operates a solid waste landfill site within the vicinity of the contaminated wells. At the financial statement date, the environmental regulator for the jurisdiction is conducting an investigation into the nature and source of the contamination. The government has determined it is not responsible, nor does it accept responsibility, for remediation of the contamination. However, there is uncertainty about responsibility that will be resolved by a ruling of the environmental regulator.*

*In this situation, the government may have a contingent liability. The existence of contamination that exceeds an environmental standard is an existing condition or situation. A decision by the environmental regulator that the government is or is not responsible is the future event not wholly within the government's control that will resolve the uncertainty. The outcome of the future event will confirm the incurrence or non-incurrence of a liability. Therefore, the government will need to perform an assessment of the probability that the outcome of the regulator's decisions will confirm the government is*

*responsible in determining whether or not it has a liability for remediation to record.*

#### **d) Determining Whether it is Expected that Future Economic Benefits will be Given Up**

Whether or not a government chooses to perform remediation, the existence of contamination that exceeds an environmental standard may create a liability since a government may have a present obligation to remediate the contamination now or at some point in the future. The timing of the settlement would be reflected in the measurement of the liability, it would not relieve the government of its present obligation or recognition of the associated liability.

However, it is possible that a present obligation would not be recognized as a liability when it is not expected that the government will actually give up future economic benefits. Consider the following:

**Scenario:** *A government is responsible for an abandoned mine site on Crown land where a site assessment has confirmed that contamination exists that exceeds an environmental standard. The site is in a remote location and the contamination is contained at the site. The contamination is not likely to affect public health and safety, cause damage, or otherwise impair the quality of the surrounding environment. Due to these factors, the government does not expect to remediate the site. The site will continue to be monitored as part of the government's ongoing environmental protection program.*

In this situation, although the first three criteria for recognition are met, due to the fact that the government does not expect to and it is very unlikely the government will be forced remediate the site it is not expected that future economic benefits will be given up. As a result, not all of the criteria under paragraph PS 3260.08 are met and therefore the government would not recognize a liability for remediation. However, disclosure of why the government does not expect to give up economic benefits would need to be provided in the notes to the financial statements.

#### **e) Determining Whether a Reasonable Estimate of the Amount can be Made**

If the above four criteria have been met for a contaminated site, it would be very unusual that the government could not determine a reasonable estimate of the amount required to remediate the contaminated site. Step 3 will take a deeper look at estimating the amount of the liability for remediation.

In determining whether the recognition criteria are met for each contaminated site that has been identified as being in scope of Section PS 3260, the team should consider the following:

- |                          |  |
|--------------------------|--|
| <input type="checkbox"/> | Have we identified all the existing environmental standards the government is required to comply with?   |
| <input type="checkbox"/> | Has contamination actually exceeded any of these environmental standards? <ul style="list-style-type: none"> <li>• Are there any sites where contamination is suspected, but for which an environmental site assessment has not yet been obtained? If so, when will a site assessment occur?</li> <li>• Or if no site assessment will be obtained, what has been done to confirm whether it is likely or not that contamination exceeding an environmental standard exists.</li> </ul>                     |
| <input type="checkbox"/> | Is the government directly responsible for the contaminated site?  |
| <input type="checkbox"/> | If not directly responsible, has the government accepted responsibility for the contaminated site? <ul style="list-style-type: none"> <li>• What information do we have to support that this responsibility has been accepted?</li> <li>• Has legal counsel been consulted?</li> </ul>   |
| <input type="checkbox"/> | Is there uncertainty as to whether the government is responsible for remediating a contaminated site? <ul style="list-style-type: none"> <li>• If so, what would make this uncertainty realized?</li> <li>• What is the probability the site will need to be remediated?</li> <li>• Has legal counsel been consulted?</li> </ul>   |
| <input type="checkbox"/> | Are there any sites where contamination exceeding an environmental standard exists, but for which the government does not expect to give up future economic benefits and it is unlikely the government would be forced to remediate these sites? <ul style="list-style-type: none"> <li>• What support do we have for this conclusion?</li> <li>• What circumstances could change this conclusion?</li> <li>• What is the probability that the government will be forced to remediate the site?</li> </ul> |
| <input type="checkbox"/> | Are there any contaminated sites where the government is unable to come up with a reasonable estimate of the amount for remediation? <ul style="list-style-type: none"> <li>• What is the reason why this amount cannot be determined?</li> </ul>  |

Once we have determined which sites meet the criteria for recognition it is time to move onto the next step and determine an estimate of the liability for remediation for each of those contaminated sites.

### Step 3: For Each Site that Meets the Recognition Criteria, Determine an Appropriate Estimate of the Liability

A liability for remediation should be estimated based on information available at the financial statement date and it should include costs required to bring a site up to the current minimum standard for its use prior to contamination. The estimate of a liability would include costs directly attributable to remediation activities such as:

- Post-remediation operation, maintenance and monitoring costs that are an integral part of the remediation strategy for a contaminated site, which would include costs such as payroll and benefits, equipment and facilities, materials, legal and other professional services costs;
- Costs of tangible capital assets acquired as part of remediation activities to the extent those assets have no alternative use; and
- Costs related to natural resource damage (e.g. revegetation outlays), but only if they are incurred as part of an environmental standard.

In situations where there is evidence to suggest contamination exists that exceeds an environmental standard, but for which a detailed site assessment has not yet been completed, in estimating the amount of the liability consideration would be given to available site assessment information and experience gained at other sites that have typical or common characteristics.

A government may not complete a subsequent site assessment each year due to the costs of completing such an assessment. When this is the case, in the years between a review of the estimate of the liability could be based on an extrapolation of previously completed site assessments and would take into consideration such factors as changes to the remediation strategies, technological changes, experience gained, changes in assumptions, actual expenditures, changes in legislative standards, and unforeseen changes in cost estimates. When the effect of any change is significant a new site assessment may be required.

The measurement technique used by the government to determine the liability should result in the best estimate of the amount required to remediate the contaminated site.

**Best estimate** is the amount a government would rationally pay to settle or otherwise extinguish the liability at the financial statement date.

The amount would be based on the best estimate of the expenditures required to complete the remediation. Professional judgment supplemented by experience, third party quotes and potentially reports of independent experts will be required to

estimate the expenditures. A present value technique is often the best technique to use when the cash flows required to settle or otherwise extinguish the liability are expected to occur over extended future periods.

In some situations, an entity may expect to be able to recover remediation costs from a third party (e.g. claim made under insurance contract). Under PS 3260, expected recoveries cannot be netted against the liability. Instead any recoveries are recognized in accordance with the recognition criteria in paragraphs PS 3260.62-.64.<sup>2</sup> At each financial statement date, the government must review the carrying amount of any liability for remediation. Any adjustments to the liability would be accounted for in the period in which the revisions are made. The liability continues to be recognized in the government's financial statements until it is settled or otherwise extinguished.

In Step 3 the team's goal is to ensure that the estimate of the liability for remediation of each contaminated site is reasonable. In doing so the team should consider the following:

- |                          |  |
|--------------------------|--|
| <input type="checkbox"/> | Was the information used in estimating the liability available at the financial statement date?                      |
| <input type="checkbox"/> | Are the costs included in the estimated liability directly attributable to the remediation activities?               |
| <input type="checkbox"/> | Have we taken into consideration available site assessment information and experience gained at other similar sites? |
| <input type="checkbox"/> | Was an appropriate measurement technique used?   |
| <input type="checkbox"/> | Have we evaluated the consistency of information across similar sites?   |
| <input type="checkbox"/> | Has an expert been used? If not, is an expert needed?  |
| <input type="checkbox"/> | Have any expected recoveries been recorded separate from the liability?  |

At this point in the process the liability for remediation of all contaminated sites will be recognized and presented in the financial statements. To help users of the financial statements understand this liability the following disclosures must be included in the notes.

### Disclosure

According to PS 3260, the financial statement should disclose information about:

- 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.

<sup>2</sup>Section PS 3260 previously allowed for recoveries to be netted against the liability. However, this was inconsistent with Section PS 3280, Asset Retirement Obligations, which does not allow for recoveries to be netted. As a result, Section PS 3260 has been updated to be consistent with Section PS 3280. This change to Section PS 3260 is effective in the same period Section PS 3280 becomes effective.

Any uncertainty that affects the measurement of a liability for remediation of a contaminated site would be disclosed in accordance with the requirements of Section PS 2130, *Measurement Uncertainty*.

### Transition

As previously mentioned, this standard is effective for fiscal years beginning on or after April 1, 2014. Section PS 3260 does not contain specific transitional provisions. Instead, it states that if the application of the Section results in a change in accounting policy, Section PS 2120, *Accounting Changes*, applies. In this situation, the government is adopting a new accounting policy so it looks to paragraph PS 2120.13 which states:

*When a change in an accounting policy is made to conform to new Public Sector Accounting Standards or to adopt Public Sector Accounting Standards for the first time, the new standards may be applied retroactively or prospectively.*

Therefore, the government has the option of adopting this Section retroactively with restatement of prior periods or prospectively.

If the government chooses retroactive application with restatement of prior periods this means that:

- Section PS 3260 is applied to events and transactions from the date of origin of such items;
- The financial statements for each prior period presented for comparative purposes are restated to reflect the new policy; and
- The balance of the accumulated surplus / deficit at the beginning of the earliest period presented is restated to reflect the cumulative effect of the change on periods prior to that date.

If the government chooses prospective application this means that:

- The new accounting policy is applied only to events and transactions occurring after the date of the change; and
- To any outstanding related balances **existing at** the date of the change. No cumulative catch-up adjustment is made to such balances.

### Conclusion

Applying Section PS 3260 can seem overwhelming at first, but by putting together the right team and following a step by step process the standard can be applied in an efficient manner. If you have questions about how this standard affects your organization contact your BDO advisor today. The following checklist outlines items to consider at each step in the process of applying Section PS 3260.

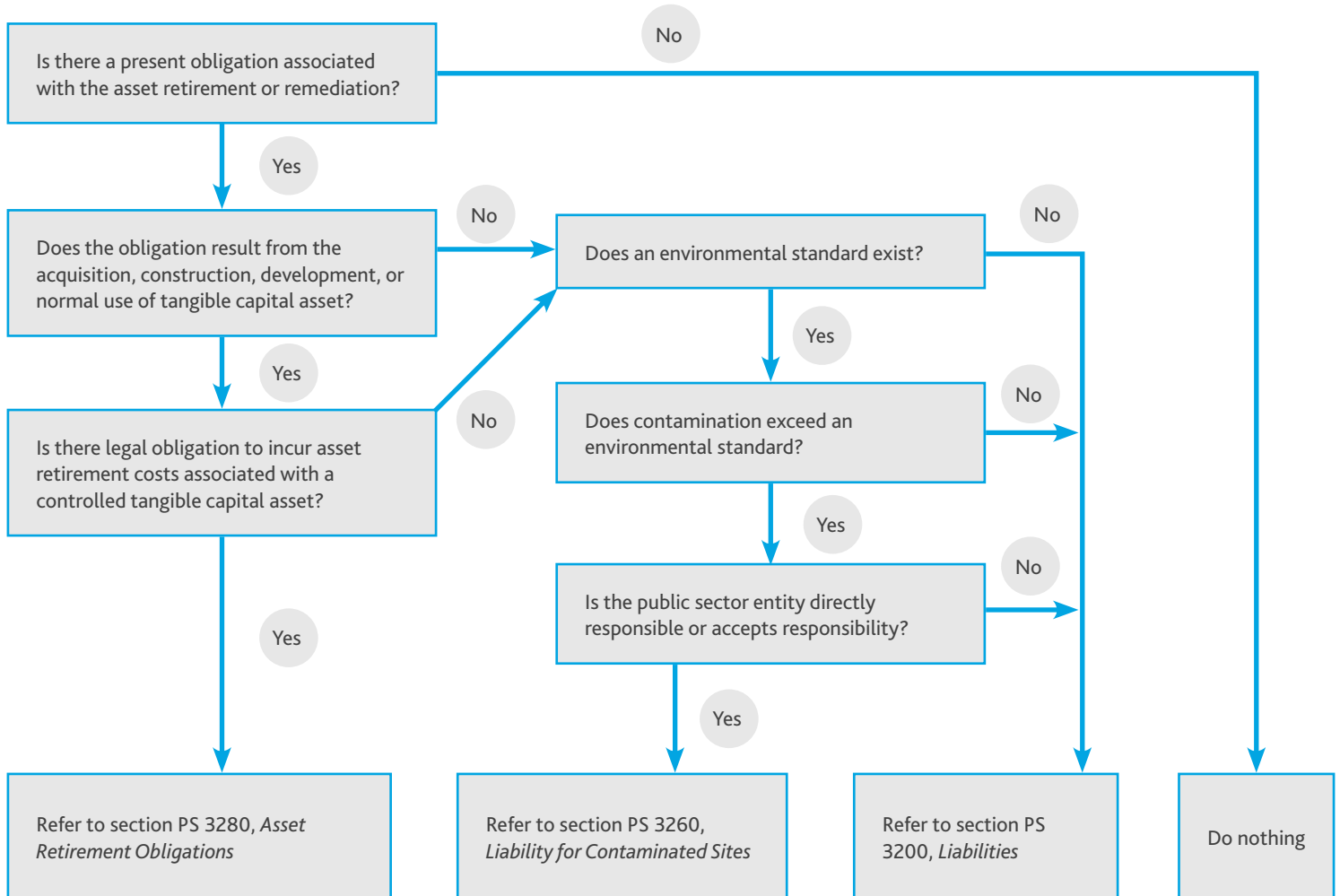
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# APPENDIX A—DETERMINE WHICH SECTION APPLIES

The following flowchart can be used to help determine which standard an entity should look for guidance in accounting for an obligation.



## APPENDIX B—THREE STEP APPROACH CHECKLIST

The following checklist outlines items to consider at each step in the process of applying Section PS 3260.

<b>Step 1: Identify sites that are in the scope of PS 3260</b>	
<input type="checkbox"/>	Are there any sites with known contamination?
<input type="checkbox"/>	Are there any sites where unexpected contamination has occurred (e.g. from a chemical spill)?
<input type="checkbox"/>	Are there any sites that have a history of contamination (e.g. a site previously used for industrial purposes)?
<input type="checkbox"/>	Are there any sites not in use and why are these sites not in use (e.g. sites that are fenced in, contain signs that say do not enter / use)?
<input type="checkbox"/>	Are there any other sites not yet included on the list where contamination may exist?
<b>Step 2: For each site in scope, determine if it meets the recognition criteria in paragraph PS 3260.08</b>	
<input type="checkbox"/>	Have we identified all the existing environmental standards the government is required to comply with?
<input type="checkbox"/>	Has contamination actually exceeded any of these environmental standards? <ul style="list-style-type: none"> <li>• Are there any sites where contamination is suspected, but for which an environmental site assessment has not yet been obtained? If so, when will a site assessment occur?</li> <li>• Or if no site assessment will be obtained, what has been done to confirm whether it is likely or not that contamination exceeding an environmental standard exists.</li> </ul>
<input type="checkbox"/>	Is the government directly responsible for the contaminated site?
<input type="checkbox"/>	If not directly responsible, has the government accepted responsibility for the contaminated site? <ul style="list-style-type: none"> <li>• What information do we have to support that this responsibility has been accepted?</li> <li>• Has legal counsel been consulted?</li> </ul>
<input type="checkbox"/>	Is there uncertainty as to whether the government is responsible for remediating a contaminated site? <ul style="list-style-type: none"> <li>• If so, what would make this uncertainty realized?</li> <li>• What is the probability the site will need to be remediated?</li> <li>• Has legal counsel been consulted?</li> </ul>
<input type="checkbox"/>	Are there any sites where contamination exceeding an environmental standard exists, but for which the government does not expect to give up future economic benefits and it is unlikely the government would be forced to remediate these sites? <ul style="list-style-type: none"> <li>• What support do we have for this conclusion?</li> <li>• What circumstances could change this conclusion?</li> <li>• What is the probability that the government will be forced to remediate the site?</li> </ul>
<input type="checkbox"/>	Are there any contaminated sites where the government is unable to come up with a reasonable estimate of the amount for remediation? <ul style="list-style-type: none"> <li>• What is the reason why this amount cannot be determined?</li> </ul>
<b>Step 3: For each site that meets the recognition criteria, determine an appropriate estimate of the liability</b>	
<input type="checkbox"/>	Was the information used in estimating the liability available at the financial statement date?
<input type="checkbox"/>	Are the costs included in the estimated liability directly attributable to the remediation activities?
<input type="checkbox"/>	Have we taken into consideration available site assessment information and experience gained at other similar sites?
<input type="checkbox"/>	Was an appropriate measurement technique used?
<input type="checkbox"/>	Have we evaluated the consistency of information across similar sites?
<input type="checkbox"/>	Has an expert been used? If not, is an expert needed?
<input type="checkbox"/>	Have any expected recoveries been recorded separate from the liability?