ASSET RETIREMENT OBLIGATIONS: ASPE 3110

Definition

- An **asset retirement obligation (ARO)** is a **legal obligation** associated with the **retirement** of a **tangible long-lived asset** that an entity is required to settle as a result of an
    - existing or enacted law, statute, ordinance or
    - written or oral contract or
    - by the doctrine of promissory estoppel (reliance on a promise is reasonable and foreseeable; and damage would result to the party promised if promise not enforced)
- **Retirement** of a long-lived asset is the **permanent** removal from service by sale, abandonment, recycling or disposal in some other manner

Recognition

- A **liability** is recognized for the ARO when a **reasonable estimate** of the amount of the obligation can be made
- The ARO must also meet the definition of a liability
    - they embody a duty to others that entails yielding of economic benefits
    - little or no discretion to avoid it; and
    - event obligating the entity has already occurred
- Therefore, if the obligation is to clean up a site, the ARO is recorded as the contamination occurs

Measurement

- The amount recognized as an ARO shall be the **best estimate** of the cost required to settle the present obligation at the balance sheet date
    - The amount entity would pay to settle the obligation at the balance sheet date
    - This best estimate is usually the **present value** of the future cash outflows
- The estimate is made using the **technology currently** available (unless the development of new technology is supported by sufficient objective evidence)
- **New legislation** is taken into account when sufficient objective evidence exists that the legislation is **virtually certain** to be enacted
- ARO is reviewed at each balance sheet and adjusted to reflect the current best estimate

Recognition and allocation of an asset retirement cost

- When the liability for an ARO is recognized, increase the carrying amount of the related long-lived asset by the same amount (cr. Liability, dr. long-lived assets)
- The ARO that is recognized as a long-lived asset is amortized over the useful life of that long-lived asset
- The changes to the liability recognized due to the passage of time (i.e. from discounting) is recognized as **accretion expense** on the income statement (it is not classified as interest expense)
- The changes to the liability recognized due to changes in the cash flows are adjusted to the liability and the long-term asset the ARO applies to

Comparison to IFRS

- ARO Is covered under IAS 37 (Provisions) and IAS 16 (PPE)
- Under IFRS
    - ARO can arise due to **constructive obligations** (in addition to legal obligations)
    - Accretion expense if called **Interest expense** under IFRS