

City of London - Internal Audit

PS 3280 - Asset Retirement Obligations (ARO) Audit

Final Report – June 1, 2023

Prepared By: Geoff Rodrigues, CPA, CA, CIA, CRMA, ORMP, CSC
Partner, Enterprise Risk Services
MNP LLP
Email: Geoff.Rodrigues@mnp.ca

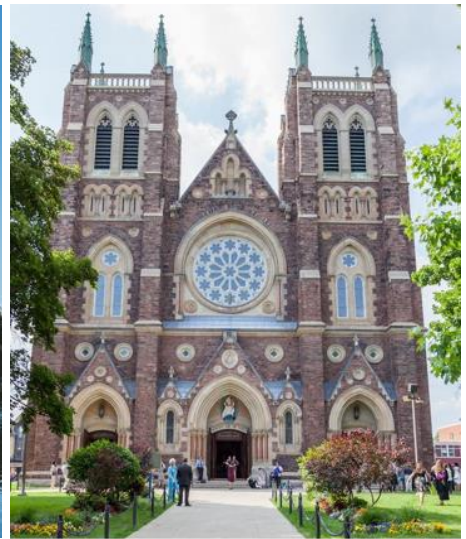


Table of Contents

1.0	BACKGROUND	3
2.0	OBJECTIVE	3
3.0	SCOPE	4
4.0	RISK	4
5.0	APPROACH	5
6.0	STRENGTHS	5
7.0	SUMMARY OF OBSERVATIONS	6
7.1	ACKNOWLEDGEMENT OF COOPERATION AND EFFORTS	7
7.2	LIMITATIONS AND RESTRICTIONS	8
8.0	DETAILED OBSERVATIONS AND RECOMMENDATIONS	9
	APPENDIX A – RATING SCALE	13
	APPENDIX B – REPORT DISTRIBUTION LIST	14

1.0 BACKGROUND

The City of London (“City”) is a municipality with a population of approximately 543,551 (as of 2021) and it provides various community support services to its residents including neighborhood support programs, infrastructure services, recreational amenities and cultural facilities. As a municipality, the City is continually attempting to improve its operating efficiency, effectiveness, and transparency for the benefit of its residents.

In August 2018, the Public Sector Accounting Board (“PSAB”) issued the new PS 3280 Asset Retirement Obligations Standard (“ARO”) to establish an accounting standard for public sector entities that addresses the accounting and reporting of legal obligations associated with the retirement of tangible capital assets. The new standard is effective for annual financial statements relating to fiscal years beginning on or after April 1, 2022, and earlier application is permitted.

The standard must be applied by all public sector entities who prepare their financial statements under PSAB, including all Canadian municipalities. Before Section PS 3280 was issued, there was no specific guidance in PSAB addressing the accounting for various types of asset retirement obligations.

The new PS 3280 provides new requirements for the accounting of AROs. The standard consists of:

- 1) Clarification that this guidance deals with obligations to retire tangible capital assets of a public sector entity that are predictable and unavoidable. This requires that public sector entities:
 - i) Have a legal obligation to permanently remove a tangible capital asset from service (i.e., retire); and,
 - ii) Control the tangible capital asset that needs to be retired.
- 2) Guidance on when an ARO is recognized, as outlined when the below four criteria are met:
 - i) There is a legal obligation to incur retirement costs in relation to a tangible capital asset;
 - ii) The past transaction or event giving rise to the liability has occurred;
 - iii) It is expected that future economic benefits will be given up; and,
 - iv) A reasonable estimate of the amount can be made.
- 3) Guidance on what variables to consider when initially measuring an ARO, including:
 - i) Which costs to include;
 - ii) Estimation technique; and
 - iii) Determining the discount rate.
- 4) Guidance on subsequent measurement and measurement uncertainty.
- 5) Disclosure guidance pertaining to AROs.
- 6) Guidance on transitional provisions.

With this awareness and in accordance with the City’s FY2022 internal audit plan, an audit of *PS 3280 – Asset Retirement Obligations* will be performed to help identify key controls to improve current control processes.

2.0 OBJECTIVE

The objective of this review is to conduct an assessment to ensure appropriate processes are in place to mitigate risks pertaining to the implementation of *PS 3280 – Asset Retirement Obligations* by reviewing existing key control processes including identification, recognition, measurement, review, and monitoring of AROs, identifying gaps in the design of current control processes, and performing select operating effectiveness tests over key controls, where required.

3.0 SCOPE

This audit followed a structured approach to review the Asset Retirement Obligation Process. The scope of this review included the following:

1. Review of any existing policies, process documentation and procedures that are currently being used to recognize asset retirement obligations.
2. Review of roles, responsibilities and structures that support the administration of the ARO process.
3. Evaluated key controls regarding identification, recognition of ARO, recognition and allocation of asset retirement costs, measurement (initial, subsequent, uncertainty), recoveries, transitional provisions, presentation, and disclosure which supports the accounting treatment under *PS 3280 – Asset Retirement Obligations*.

The assessment of Information Technology General Controls (“ITGC”) is out of the scope for this review. As part of the ARO assessment, MNP obtained an understanding of the associated applications and a possible ITGC controls involved in the execution of the ARO process.

4.0 RISKS

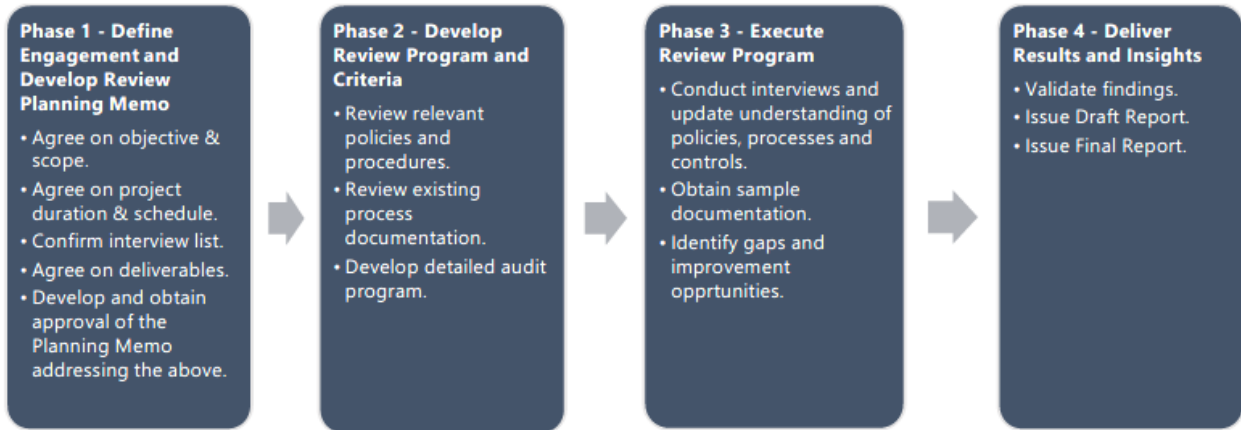
Given the stated objective, several inherent¹ risks have been considered in the planning of this audit which include:

- Lack of controls around fraud risks (e.g., segregation of duties, unauthorized changes to employee or supplier data) associated with ARO preparation and processes.
- Lack of controls around risks relating to financial statement assertions:
 - Existence/ Occurrence - AROs as stated in the financial statement do not exist; transactions recognized in the financial statements did not happen;
 - Completeness - all transactions that are completed and intended to have been recorded have not been recognized in the financial statements;
 - Valuation/Accuracy - ARO balances have not been recorded at the correct value; transactions have not been reflected in the financial statements at the appropriate amounts;
 - Rights & Obligations - AROs represented in the financial statements are not the property of the organization; and,
 - Presentation/Disclosure – AROs presented on the financial statements are not in an acceptable format and do not include all of the necessary information and related disclosures as required.

¹ The risk derived from the environment without the mitigating effects of internal controls; Institute of Internal Auditors

5.0 APPROACH

In accordance with MNP’s Internal Audit methodology, the high-level work plan for the audit includes the following phases:



6.0 STRENGTHS

During the course of this audit, a number of strengths pertaining to ARO were identified as described in the table below.

<p>Experienced and Knowledgeable Personnel</p>	<p>Key personnel directly involved in the ARO Process have strong expertise and experience in preparation and review of ARO. Furthermore, due to the long service tenure of these individuals in managing capital assets operations, there is a high level of institutional knowledge which serves the transition to <i>PS3280 – Asset retirement obligations</i> well.</p>
<p>Measurement Process of Facilities ARO</p>	<p>Management has created a robust step-by-step process of preparing the facilities asset retirement obligation calculations. This process document will help ensure that any personnel involved in the calculations are provided appropriate guidelines to accurately calculate the facilities asset retirement obligations.</p>
<p>Assessment of ARO by Asset Class</p>	<p>Management has prepared summarized assessments of ARO by asset class per <i>PS3280 – Asset retirement obligations</i>. The document provides background and answers questions on:</p> <ul style="list-style-type: none"> • Recognition • Measurement • Presentation • Disclosure <p>This ensures all asset classes with potential AROs are assessed per <i>PS3280 – Asset retirement obligations</i>.</p>

7.0 SUMMARY OF OBSERVATIONS

The following table presents a summary of observations identified, recommendations, and their respective risk rating based on the rating scale identified in **Appendix A**. These observations and recommendations were discussed with the City's Management responsible for the respective control area. Management has agreed with the observations and provided action plans to address the recommendations. A full list of the observations identified, and the detailed associated recommendations and management action plans are included in **Section 8.0** of this report.

Ref	Summary of Observations	H	M	L
1	<p><u>Consolidated ARO Listing</u></p> <p>ARO estimates require a review of the listing of current and new assets/liabilities. It was noted that there is no consolidated listing of ARO liabilities to compare against the listings received from service areas, this can result in an incomplete listing of liabilities used for calculations of ARO at fiscal year end.</p> <p>There is a risk of incompleteness of the ARO listing of liabilities. The listings used for calculations are not comprehensive and do not include all liabilities reported in prior and current year, therefore resulting in the potential for an understated liability.</p>			
2	<p><u>Measurement Uncertainty</u></p> <p>ARO estimates are reviewed and revised at the end of the year to ensure the carrying amount of the ARO liability is accurate and complete. It was noted that potential or new AROs are not inquired for the indeterminate settlement date, if the triggers of indeterminate settlement date are not reviewed and assessed when performing analysis, this could result in an understated liability. Per <i>PS3280 – Asset retirement obligations</i>, uncertainty about the timing and amount of settlement of the asset retirement obligation will not remove that obligation but will affect the measurement of the liability.</p> <p>There is a risk that ARO assets included in estimates have indeterminate settlement dates resulting in errors in estimation of ARO liability.</p>			
3	<p><u>ARO Disclosure checklist</u></p> <p>Annual preparation of financial statements requires disclosures of ARO per <i>PS3280 – Asset retirement obligations</i>. There is no ARO disclosure checklist to support the reconciliation of disclosure section of <i>PS3280 – Asset retirement obligations</i> to ensure the AROs have been appropriately presented and disclosed in the financial statements.</p> <p>There is a risk that the financial statements may not contain complete disclosures of asset retirement obligations.</p>			

Ref	Summary of Observations	H	M	L
4	<p><u>Evidence of review in ARO estimates workbooks</u></p> <p>ARO estimates are prepared and reviewed at the end of the year. As a part of review of the ARO estimate workbooks, it was noted that there is no evidence of review documented in the ARO estimates workbooks.</p> <p>There is a risk that without evidence of review, there could be a failed control should external audit test ARO controls.</p>			
5	<p><u>Lack of review of ARO estimates</u></p> <p>ARO estimates are calculated at the end of the fiscal year to ensure the carrying amount of a liability is accurate and current. It was noted that the ARO estimates workbooks are reviewed and prepared by the same individual. Therefore, there is lack of segregation of duties (“SOD”) for review of ARO estimates.</p> <p>Without a segregation of duties, there is a risk of material errors or omissions in ARO going undetected. Additionally, lack of review of ARO estimates will result in a failed control with external audit.</p>			
6	<p><u>Consolidation and Formalization of ARO Processes</u></p> <p>The ARO process requires various teams to assess the assets for AROs and prepare calculations. However, there is no formally documented and approved procedural manual pertaining to ARO that provides a detailed overview of key processes and outlines who is responsible for the process.</p> <p>There is a risk that without documentation and standardization of processes, the processes will not be executed in a consistent manner resulting in undesirable outcomes. In addition, there could be a loss of institutional knowledge should key team members leave the organization or be unavailable for a period if it is not documented.</p>			
7	<p><u>Journal entry reconciliation to ARO Calculation</u></p> <p>ARO estimates are prepared at the end of the fiscal year to ensure the carrying amount of liability is accurate and current. It was noted that the ARO calculations do not contain a summary tab showing the journal entry to be posted, a lack of summary can result in external auditors being unable to reconcile the journal entry to the ARO estimates.</p> <p>There is a risk that the ARO calculations do not reconcile to the journal entry posted at year end resulting in errors.</p>			

7.1 ACKNOWLEDGEMENT OF COOPERATION AND EFFORTS

Internal Audit would like to express our appreciation for the cooperation and efforts made by City personnel within the Operations Team who manage the Tangible Capital Assets and administer the transition to *PS3280 – Asset retirement obligations*. Their contributions assisted in ensuring a successful engagement.

7.2 LIMITATIONS AND RESTRICTIONS

This report is intended solely for the information and use of the City of London and should not be distributed to third parties without MNP's prior written consent. Any use that a third party makes of this report, and any reliance or decisions made based on it, are the responsibility of such third party. MNP accepts no liability or responsibility for any loss or damages suffered by any third party as a result of decisions made or actions taken based on this report.



8.0 DETAILED OBSERVATIONS AND RECOMMENDATIONS

#	Observation	Priority	Recommendation	Management Response
1	<p><u>Consolidated ARO Listing</u></p> <p>ARO estimates require a review of the listing of current and new assets/liabilities. It was noted that there is no consolidated listing of ARO liabilities to compare against the listings received from service areas, this can result in an incomplete listing of liabilities used for calculations of ARO at fiscal year end.</p> <p>There is a risk of incompleteness of the ARO listing of liabilities. The listings used for calculations are not comprehensive and do not include all liabilities reported in prior and current year, therefore resulting in the potential for an understated liability.</p>	Medium	<p>Management should keep a tracker of ARO liabilities and reconcile these with the lists received from service areas. Any new liability identified should be added to the Master List maintained by the Capital Asset team.</p> <p>Additionally, management should include the assessment of ARO recognition criterion within the Master List of ARO liabilities.</p>	<p>Action Plan:</p> <p>A master list and tracker will be created for all ARO liabilities. The list will be reconciled each year to ARO listings received from Services Areas. New liabilities will be added where required and any settled liabilities will be removed. The document will include an overview of recognition criteria to ensure knowledge of requirements.</p> <p>Accountability:</p> <p>Finance Supports will create and maintain the master list.</p> <p>Service Areas will add to and confirm existing ARO's, and highlight settled liabilities.</p> <p>Timeline:</p> <p>The list will be completed by the end of the 1st quarter of 2024 to ensure a complete ARO listing for the 2023 financial statements.</p>
2	<p><u>Measurement Uncertainty</u></p> <p>ARO estimates are reviewed and revised at the end of the year to ensure the carrying amount of the ARO liability is accurate and complete. It was noted that potential or new AROs are not inquired for the indeterminate settlement date, if the triggers of indeterminate settlement date are not reviewed and assessed when performing analysis, this may result in an understated liability. Per <i>PS3280 – Asset retirement obligations</i>, uncertainty about the timing and</p>	Medium	<p>Management should review the list of potential and new ARO assets, as part of review of the ARO assets, management should obtain agreements for all new ARO assets to identify any uncertainty with respect to timing and measurement of the asset. Furthermore, for existing AROs, inquire whether there are any changes to existing agreements that may result in uncertainty of timing and as a result affect the measurement of the liability.</p>	<p>Action Plan:</p> <p>Finance Supports will create a questionnaire that will be sent on an annual basis to Service Area representatives requesting information about new or existing AROs. The questionnaire will request information regarding the settlement date and, for existing AROs, whether that date has changed since the previous year. Finance Supports will then ensure that the settlement date is considered as part of the measurement estimate.</p>

#	Observation	Priority	Recommendation	Management Response
	<p>amount of settlement of the asset retirement obligation will not remove that obligation but will affect the measurement of the liability.</p> <p>There is a risk that ARO assets included in estimates have indeterminate settlement dates resulting in errors in estimation of ARO liability.</p>			<p>Accountability:</p> <p>Finance Supports will create and send the questionnaire to Service Area representatives on an annual basis to ensure that the settlement date is considered as part of the measurement estimate.</p> <p>Service Area representatives will complete and return the questionnaire. They will determine the settlement date and highlight changes made from the previous year.</p> <p>Timeline:</p> <p>The questionnaire will be done by the end of the 4th quarter 2023 to gather relevant information for the 2023 financial statements.</p>
3	<p><u>ARO Disclosure checklist</u></p> <p>Annual preparation of financial statements requires disclosures of ARO per <i>PS3280 – Asset retirement obligations</i>. There is no ARO disclosure checklist to support the reconciliation of disclosure section of <i>PS3280 – Asset retirement obligations</i> to ensure the AROs have been appropriately presented and disclosed in the financial statements.</p> <p>There is a risk that the financial statements may not contain complete disclosures of asset retirement obligations.</p>	Medium	<p>Management should complete the presentation and disclosure checklist after preparation of the ARO sections of the financial statements.</p> <p>Management can add a disclosure and presentation checklist tab in the excel workbook for presentation and disclosures. The checklist would include the standard copied from PS3280.63, .64, .65 and .66.</p>	<p>Action Plan:</p> <p>Management has created a template for presentation and disclosure that provides the required information to insert into the financial statements. A tab will be added to the template document for a checklist that includes the standard requirements copied from PS3280.63, .64, .65 and .66.</p> <p>Accountability:</p> <p>Tangible Capital Assets will add the checklist tab to the excel document.</p> <p>Timeline:</p> <p>The checklist will be added by the end of the 1st quarter of 2024 to ensure proper presentation and disclosure for the 2023 financial statements.</p>

#	Observation	Priority	Recommendation	Management Response
4	<p><u>Evidence of review in ARO estimates workbooks</u></p> <p>ARO estimates are prepared and reviewed at the end of the year. As a part of review of the ARO estimate workbooks, it was noted that there is no evidence of review documented in the ARO estimates workbooks.</p> <p>There is a risk that without evidence of review, there could be a failed control should external audit test ARO controls.</p>	Medium	Management should document evidence of review of the ARO estimates workbook, this would include sign offs, commentary on reconciliations and sample reviews of agreements.	<p>Action Plan:</p> <p>Management will add a tab to the estimate calculation workbooks that will include a table to be filled out by the reviewing manager. The table will require information as to who has done the review, the date the review was complete and a section for an explanation stating what was reviewed and reconciled to ensure correctness and completion.</p> <p>Accountability:</p> <p>Finance Supports will add the tab and table to the workbook documents to ensure evidence of review.</p> <p>Timeline:</p> <p>The table will be added to the workbooks by the end of the 1st quarter of 2024 to ensure accuracy for the 2023 financial statements.</p>
5	<p><u>Lack of review of ARO estimates</u></p> <p>ARO estimates are calculated at the end of the fiscal year to ensure the carrying amount of a liability is accurate and current. It was noted that the ARO estimates workbooks are reviewed and prepared by the same individual. Therefore, there is lack of segregation of duties (“SOD”) for review of ARO estimates.</p> <p>Without a segregation of duties, there is a risk of material errors or omissions in ARO going undetected. Additionally, lack of review of ARO estimates will result in a failed control with external audit.</p>	Medium	Management should perform a review of all the ARO estimate schedules prior to posting the journal entry. Evidence of review should be documented as described in Observation #4, above.	<p>Action Plan:</p> <p>Within the table outlined under the action plan for Observation 4, a section will be added to state who prepared the workbook. It will be noted that the preparer and the reviewer must be two different individuals.</p> <p>Accountability:</p> <p>Finance Supports will add the tab and table to the workbook documents to document evidence of independent review.</p> <p>Timeline:</p> <p>The table will be added to the workbooks by the end of the 1st quarter of 2024 to ensure accuracy for the 2023 financial statements.</p>

#	Observation	Priority	Recommendation	Management Response
6	<p><u>Consolidation and Formalization of ARO Processes</u></p> <p>The ARO process requires various teams to assess the assets for AROs and prepare calculations. However, there is no formally documented and approved procedural manual pertaining to ARO that provides a detailed overview of key processes and outlines who is responsible for the process.</p> <p>There is a risk that without documentation and standardization of processes, the processes will not be executed in a consistent manner resulting in undesirable outcomes. In addition, there could be a loss of institutional knowledge should key team members leave the organization or be unavailable for a period if it is not documented.</p>	Medium	<p>A manual outlining the end-to-end process of the recognition, measurement, presentation, and disclosure of ARO under <i>PS3280 – Asset retirement obligations</i>. This framework should outline the key roles and responsibilities of each key stakeholder.</p> <p>Key processes should also be documented within a procedural manual and should outline the detailed steps of each process and the responsibilities of staff. This information should be communicated and accessible to relevant staff.</p>	<p>Action Plan:</p> <p>All procedures required for ARO will be assembled and documented in a single framework. The framework will contain all processes from start to finish including recognition, measurement, presentation, and disclosure as well as who is responsible for each step. The document will be shared with Service Area representatives and will remain available and accessible on CityHub for future reference.</p> <p>Accountability:</p> <p>Finance Supports will create, maintain, and distribute the framework.</p> <p>Timeline:</p> <p>The framework will be completed by the end of the 4th quarter of 2023 to ensure proper processes for the 2023 financial statements.</p>
7	<p><u>Journal entry reconciliation to ARO Calculation</u></p> <p>ARO estimates are prepared at the end of the fiscal year to ensure the carrying amount of liability is accurate and current. It was noted that the ARO calculations do not contain a summary tab showing the journal entry to be posted, a lack of summary can result in external auditors being unable to reconcile the journal entry to the ARO estimates.</p> <p>There is a risk that the ARO calculations do not reconcile to the journal entry posted at year end resulting in errors.</p>	Low	<p>Management should prepare a summary tab and show the journal entry to be posted in the system. The journal entry should be linked to the total ARO estimate in the respective schedules by asset class (Post Closure, Facilities, Leases).</p>	<p>Action Plan:</p> <p>Management will add a tab to the workbook to allow for the summary of the journal entry to be prepared.</p> <p>Accountability:</p> <p>Finance Supports will add the tab to the workbook documents.</p> <p>Timeline:</p> <p>The table will be added to the workbooks by the end of the 1st quarter of 2024.</p>

APPENDIX A – RATING SCALE

The findings outlined in this report have been assessed based on a rating scale defined in the table below:

Rating	Description
Low	The finding is not critical but should be addressed in the longer term to improve either internal controls, efficiency of the process, or mitigate a minor risk.
Medium	The finding represents a control weakness or risk that could have or is having an adverse effect on the ability to achieve process objectives and/or a significant impact to the City's residents. The finding requires Management action within the short-to-intermediate term.
High	The finding represents a significant control weakness or risk that could have or is having a major adverse effect on the ability to achieve process objectives and/or a material impact to the City's residents. The finding requires immediate Management action.

APPENDIX B – REPORT DISTRIBUTION LIST

This report was distributed to the following parties:

City of London	
To:	
	Audit Committee
	Anna Lisa Barbon, Deputy City Manager, Finance Supports
	Paul Yeoman, Director, Parks and Forestry
	Michele Shears, Manager of Tangible Capital Assets, Operations – Capital Assets and Projects
MNP LLP	
	Geoff Rodrigues, Engagement Partner
	Jas Chahal, Quality Assurance Partner
	Raima Z Khairi, ARO Specialist
	Deepak Jaswal, Engagement Leader