



# New Developments Summary

## Natural disasters and other loss events

### Accounting and financial reporting considerations

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#### Summary

The financial implications of natural disasters and other loss events are far-reaching. Hurricanes, earthquakes, and other loss events, such as fires or floods, can have financial reporting implications before, during, and in the aftermath of the event.

The accounting for, and financial statement classification of, the impact of a major loss event can be complex and require an entity to make judgments, estimates, and disclosures that may be material to its financial statements. An entity needs to consider the immediate and direct impact of the loss event on its organization for such matters as asset impairments, insurance recoveries, and exposure to environmental remediation liabilities, which requires a full understanding of the entity's insurance or other loss mitigation arrangements.

An entity may also need to consider the loss event's indirect impact on its organization for matters such as losses incurred by customers and suppliers. Losses incurred by customers and suppliers may call into question their ability to fulfill contractual obligations or to participate in forecasted transactions.

Further, an entity may need to consider the potential long-term impact of the loss event, such as the impairment of intangible assets, the impact on long-term business prospects, and potentially even the entity's ability to continue as a going concern.

This publication discusses several of the accounting and financial reporting considerations related to major loss events and includes references to accounting guidance that an entity should consider when it determines the appropriate accounting treatment for the major issues that frequently surface from these events, such as insurance arrangements, potential asset impairment, and the classification of losses and recoveries in the financial statements.

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## A. Accounting for insurance arrangements

Many entities maintain some form of third-party insurance to help mitigate losses that might result from a natural disaster. Insurance arrangements might cover varying degrees of property damage, lost profits (often referred to as “business interruption,” or BI), and other liabilities and expenses, such as environmental remediation, cleanup, or repairs.

The critical terms of an insurance policy, such as which types of losses are covered, policy deductibles, and the maximum amounts of insurance proceeds to which an entity may be entitled, are often difficult to interpret. Entities sometimes maintain layered insurance coverages through policies that involve several carriers, with each carrier being responsible for certain types of losses or subject to a specific dollar limit of coverage. Because of this, many entities look to claims adjustment specialists and legal counsel for assistance with interpreting the policies, submitting the claims, and reaching a final settlement with the insurer. This process can extend for a lengthy period after the event.

As a result, the accounting for insurance proceeds expected to be received is complex and requires an entity to make judgments and estimates related to insurance recoveries that may be material to the financial statements of the current and subsequent accounting periods. Please refer to Section C for considerations related to classification and disclosure for insurance arrangements.

### Property losses

While an entity might incur many different types of losses due to a natural disaster, one of the most common types of losses covered by insurance is property damage. The accounting guidance on involuntary conversions of property and the subsequent receipt of insurance proceeds is currently included in ASC 605-40, *Revenue Recognition: Gains and Losses*. When an entity adopts ASC 606, *Revenue from Contracts with Customers*, this same guidance will be moved to ASC 610-30, *Other Income: Gains and Losses on Involuntary Conversions*.

In a situation where property is destroyed, an entity might take one or more of the following actions:

- Record an immediate write-off of the net carrying amount (cost and accumulated depreciation/amortization) of any destroyed property, with a corresponding charge to the income statement. This should be done regardless of whether the entity maintains insurance coverage and the losses are covered, or whether the entity is required or intends to reconstruct the property. As a result, an entity might record the incurred loss in one accounting period, but might record the expected insurance proceeds in one or more accounting periods in the future.

- Apply the same accounting guidance related to the construction of any other long-lived asset and consistently follow other historical capitalization policies if the entity reconstructs the destroyed property.
- Evaluate, on a property-by-property basis, the amount of expected insurance proceeds recoverable as of the balance-sheet date, and record these estimated insurance proceeds to the extent that receipt of these proceeds is deemed “probable,” which is defined in the ASC Master Glossary as “the future event or events are likely to occur.” The corresponding credit is recorded as a reduction of the loss incurred from the write-off of the carrying value of the related property. However, the amount of the receivable and the related income statement credit that is recorded cannot exceed the carrying amount of the property that was written off, even if it is probable that insurance proceeds in excess of the asset’s net carrying amount will be recovered. This is because any expected recoveries in excess of losses incurred are viewed as gain contingencies under ASC 450-30, *Contingencies: Gain Contingencies*, and this guidance generally requires any expected recoveries in excess of losses incurred to be recorded only when the insurance proceeds are received, or when all contingencies related to the insurance claim are resolved, as of the balance-sheet date.
- Consider events subsequent to the balance-sheet date through to the date when the interim or annual financial statements are issued (or are made available to be issued), which might corroborate or refute any of the assertions made at the balance-sheet date related to losses incurred or expected insurance proceeds to be recovered. For example, if subsequent events provide additional evidence related to the estimated insurance proceeds that are deemed probable of recovery, an entity can adjust the amount of the estimated receivable (upward or downward), but any upward adjustment would still be subject to the requirement that the estimated insurance proceeds recorded cannot exceed the actual losses incurred. Further, for any additional estimated insurance proceeds that were not recorded as of the balance-sheet date because they were subject to gain contingency guidance at the balance-sheet date, the actual receipt of these insurance proceeds may occur, or all contingencies related to the insurance claim may be resolved, subsequent to the balance-sheet date. However, receipt of this portion of the insurance proceeds after the balance-sheet date is not, by itself, sufficient evidence that all contingencies were resolved as of the balance sheet date. As a result, under the accounting guidance related to gain contingencies, an entity is not permitted to reflect the impact of this type of subsequent event at the balance-sheet date, unless either of these events took place on or prior to the balance-sheet date.
- Re-evaluate, for each subsequent accounting period through the final resolution of the claim(s), the important judgments and estimates related to the accounting for incurred losses and estimated insurance proceeds, including the amounts of estimated insurance proceeds (deemed probable of recovery), actual and expected losses incurred, and the status of any amounts previously accounted for as gain contingencies. Adjustments to previously recorded amounts of estimated insurance proceeds and/or incurred losses are accounted for as changes in estimates in the accounting period when these changes become known, assuming that these changes do not result from accounting errors made in any prior period(s).
- Apply many of the same principles mentioned above to account for incurred losses (typically, repair and cleanup costs) other than asset write-offs or impairments, and account for the related estimated insurance proceeds that would reimburse the entity for these losses. As a result, the entity should record the costs to repair the damages only when incurred, and should record estimated insurance proceeds only to the extent of the losses incurred. Gain contingency accounting applies in situations where estimated insurance proceeds exceed either the repair costs incurred to date or the total amount of repair costs that are ultimately incurred.

### Fixed-asset recordkeeping

The information that is critical to the accurate recording of any asset write-off is obtained from an entity's accounting records. As a result, the quality of an entity's accounting records, including its fixed-asset subsidiary ledgers (for both financial accounting and income tax reporting purposes), will significantly impact the entity's ability to adjust the recorded fixed-asset balances, and to accurately reflect the impact of an involuntary conversion or a partial write-off of any affected properties.

## Business interruption and other losses

Many entities are also insured for what is commonly referred to as "business interruption" losses, or BI. The most common "loss" covered under the BI provisions of an insurance policy is for adverse changes to an entity's business after an event that has or will result in lower levels of an operating benchmark (such as revenue or gross profit) compared to the same operating benchmark for a specified accounting period prior to the event. Policy terms for BI can vary widely, so the operating benchmarks and the comparative amounts and periods covered, among other terms, must be carefully analyzed to determine how the BI coverage operates.

Recoveries of lost revenues or gross profits (collectively, lost profits) are accounted for as gain contingencies because lost profits are not considered an incurred loss. Further, neither expected lost profits nor future anticipated operating losses are accruable.

Under gain contingency guidance, estimated insurance related to BI are not recorded as of the balance-sheet date unless the proceeds are actually received or unless all contingencies related to the insurance claim are resolved. Further, many insurance policies might include contingency provisions stating that no (or reduced) insurance proceeds would be available if certain operating benchmarks after an event exceed predetermined levels, or if current operating benchmarks are not less than comparable prior-period operating benchmarks by at least a predetermined amount or percentage. The entity cannot assert that all contingencies related to the claim are resolved until the actual performance benchmarks for the period are known (and, depending upon the insurer's rights of inspection, verified by the insurer). Estimated future proceeds should be recorded only after all contingencies are resolved.

Additionally, parties might not agree to BI reimbursements or the entity might not receive BI reimbursements until several post-event measurement periods have been completed. This delay can be due to several factors, including the length of time that it takes the entity to compile the financial information necessary to calculate lost profits for the future periods covered under the terms of the policy. In this situation, it is possible that portion(s) of the BI reimbursement related to measurement periods after the loss event, but prior to the parties agreeing to all BI reimbursements, would no longer be subject to any contingencies because the actual operating benchmarks for these prior periods, and the amount of the recovery, are already known (that is, all contingencies have been resolved for a portion of expected proceeds). However, even though cash has been received and the operating benchmarks are known, other contingencies might remain, which must be resolved prior to gain recognition.

### **BI claims paid prior to the end of the measurement period**

Some insurance policies provide for payment of all or a significant amount of BI proceeds upon settlement of a claim, which might occur before several of the measurement periods upon which the reimbursement is based. An entity needs to carefully analyze the policy terms and conditions of the insurance arrangement to determine if its right to retain any or all of the proceeds received is subject to one or more contingencies as of the balance-sheet date. Some policies stipulate that a portion of the cash advances made by the insurer is nonrefundable. Under the gain contingency guidance, an entity is unable to recognize some or all of a BI reimbursement that is subject to a contingency, such as an insurer's right to "claw back" previous reimbursements, until all contingencies have been resolved.

The BI provisions of an insurance policy might also provide for reimbursement of other incurred costs, such as temporary relocation, wages paid when a factory is idle, or other incremental costs that an entity might incur as a result of an event. Even though reimbursement for these types of costs may be included within the BI provisions of an insurance policy, the basic principles behind the accounting for potential reimbursements of these types of costs are the same as those that apply to recoveries of losses related to property. As a result, recoveries of these types of costs, after they have been incurred, should be recorded (as a receivable of estimated insurance proceeds and an income statement credit) when it is probable that reimbursement will be received. Any estimated recoveries in excess of amounts incurred are subject to the gain contingency guidance.

### **Important judgments and estimates**

At various times prior to the final settlement of an insurance claim and the ultimate receipt of the insurance proceeds, an entity is required to exercise judgment in many areas, including when it estimates the amount of the insurance proceeds to which it is entitled, and determines when all contingencies related to the receipt of the insurance proceeds are resolved. These judgments are extremely important because, oftentimes, the period between the event and the ultimate settlement of a claim can extend over several interim or even annual accounting periods.

In addition, the critical terms of an insurance arrangement are often difficult to interpret. In order to make appropriate assertions related to the amount of recoverable losses and when contingencies have been resolved, an entity must have a clear understanding of its particular insurance arrangement as well as the insurer and the environment in which it operates. This information is especially critical because an entity would want to record a significant amount of the estimated insurance proceeds that are likely to be recovered close to the time when the incurred losses are recorded, which is usually prior to the final settlement with the insurer. To record estimated insurance proceeds up to the amount of incurred losses, the entity must be able to assert that recovery of the amount is probable. The gain contingency guidance, which is a much higher standard, must be met to record any proceeds in excess of incurred losses, including any BI proceeds.

Although the FASB provides no direct guidance on factors to consider in determining as of the balance-sheet date whether the receipt of insurance proceeds is probable or whether all contingencies related to the insurance claim are resolved, the following additional factors might help an entity in making these important judgments:

- Whether the insurer provides a written confirmation as of the balance-sheet date acknowledging (1) receipt of the claim, (2) assets/events covered and the related coverage amounts, and (3) the degree of certainty related to the likelihood that the estimated recovery amount will change (that is, does the insurer expect the entity to repay or refund any previously paid amounts)
- Whether the insurer is either disputing the credibility of any portion of the amounts claimed, or denying that coverage is available for any portion of the amounts claimed
- The insurer's ability to pay the claim
- Prior claims payment history with the insurer, including the terms of any interim claim payments
- Whether the entity might be required to reimburse the insurer through additional premiums or other funding mechanisms included in the terms of the insurance arrangement

These factors are not all inclusive, nor are they relevant to the evaluation of every insurance arrangement.

#### **Does the insurer have the ability to pay?**

Once an entity is confident that it has made an appropriate evaluation of its insurance coverages and has calculated a reliable estimate of the insurance proceeds to which it is entitled, it should consider the ability of the third-party insurer(s) to pay the claim. For example, even a seemingly well capitalized insurer might experience funding difficulties when a natural disaster impacts a significant concentration of insured entities.

### **Other forms of assistance**

Entities other than insurers, such as federal, state, and local government agencies, may also provide monetary assistance to entities that incur losses from natural disasters. This assistance can take many forms, including tax assistance, reimbursements of incurred losses, or a grant that might require an entity to comply with specified conditions. Assistance that is provided through a reduction in income tax expense falls within the scope of ASC 740, *Income Taxes*, but there is no specific accounting guidance related to other forms of assistance that an entity might receive from a government agency. Although IFRS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, is not authoritative guidance under U.S. GAAP, many entities look to this standard for guidance on how to account for arrangements with government entities.

As a result, entities should carefully analyze the terms and conditions of any reimbursements that they are entitled to or receive from a government agency when determining the amount and timing of recognizing such reimbursements in the financial statements.

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## **B. Potential impairment of assets**

### **Long-lived assets to be held and used, including goodwill**

The guidance under ASC 360, *Property, Plant, and Equipment*, and ASC 350, *Intangibles – Goodwill and Other*, addresses the recognition and measurement of impairment losses for long-lived assets, such as property and equipment, finite-lived intangibles, indefinite-lived intangibles, and goodwill. While the

accounting models for recognizing and measuring impairment losses differ among the various types of long-lived assets, an entity is required to evaluate each type of long-lived asset for impairment when certain events or changes in circumstances (referred to as “triggering events”) indicate any one of the following scenarios:

- *For property and equipment and finite-lived intangibles:* The carrying amount may not be recoverable (ASC 360-10-35-21).
- *For indefinite-lived intangibles:* It is more likely than not that an asset is impaired (ASC 350-30-35-18B).
- *For goodwill:* It is more likely than not that the fair value of a reporting unit has been reduced below its carrying amount (ASC 350-20-35-3C).

The effects of a natural disaster might be a triggering event that indicates potential impairment, and, as a result, impairment evaluations and the related impairment testing might be required. A direct result of a natural disaster, such as damage to a property that plays an important role in an entity’s operations, is usually more obvious than an indirect result, such as the temporary or permanent loss of a key customer or supplier. However, in determining whether the direct or indirect results of a natural disaster might require an impairment test, an entity should consider the length of time that it will take to resume “normal” operations because adverse effects that are expected to be temporary are not usually considered to be indicators of impairment.

Although an entity might initially conclude, for valid reasons, that the effects of a natural disaster do not indicate potential impairment, subsequent events might require the entity to revisit these conclusions for several accounting periods after the event. For example, subsequent events might indicate that the entity’s initial assertion that the adverse effects will be temporary might no longer be appropriate, or other previously unforeseen indicators of impairment (triggering events) might surface. An entity is required to exercise judgment, both at the time of the event and in subsequent accounting periods, when it determines that impairment is indicated.

When an entity determines that an impairment test is required, it must follow all of the guidance related to impairment testing, including both the level at which the impairment test must be performed (asset, asset group, or reporting unit), along with the order of impairment testing. Under this guidance, long-lived assets are aggregated at the required levels, and are tested for impairment in the following order:

1. Indefinite-lived intangibles
2. Property and equipment and finite-lived intangibles at the asset group level
3. Goodwill at the reporting unit level

### **Long-lived assets to be disposed of by sale**

As discussed under “Property losses” under Section A, the complete destruction of a property is accounted for as a write-off of the entire net carrying value of the destroyed property, and is therefore not an impairment of the asset. An entity may also have assets (or asset/disposal groups) that, prior to an event, met the criteria to be classified as assets held for sale, and were therefore carried at the lower of (1) net carrying amounts, or (2) fair value less cost to sell. The effects of a natural disaster can also affect the subsequent accounting for the assets previously classified as held for sale.

Under the presentation guidance in 360-10-45-10, *Property, Plant and Equipment*, if an asset that initially met the held-for-sale criteria no longer meets the criteria, the asset is reclassified as held and used, and

the carrying amount might change as the result of the entity applying the subsequent measurement guidance in ASC 360-10-35-44 to the asset.

Even if the effects of the natural disaster do not initially result in an asset no longer meeting the held-for-sale criteria, there are other considerations related to the effects of a natural disaster on the subsequent accounting for assets held for sale, which include the following:

- The period required to complete the sale of a disposal group might now exceed one year (from the date when the disposal group initially met the held-for-sale criteria). If this is the case, the disposal group would be reclassified to held and used, unless certain conditions are met that allow for an exception to the one-year requirement.
- The effects of a natural disaster might cause significant changes to the fair value less cost to sell of a disposal group, which might result in an additional write-down of the carrying value of the disposal group.

### Other asset types

While impairment of long-lived assets is typically the most apparent financial reporting effect of a natural disaster, other current and noncurrent assets, either considered individually or as part of an asset group, might also need to be evaluated for impairment as a direct or indirect result of the event. The guidance also includes impairment evaluation and measurement models for many of these asset types, including the following:

- Trade receivables (from customers)
- Inventories
- Loans
- Investments accounted for under either the cost method or the equity method
- Deferred taxes

An entity should look to the specific guidance that applies to measuring impairment losses for these types of assets and for any other types of affected assets. The specific guidance applicable to the evaluation of financial assets (and, in certain cases, financial liabilities) will be affected if an entity has already adopted the provisions of ASU-2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*.

A natural disaster may not only have an adverse effect on the reporting entity that has incurred direct losses, including property damages, but can also impact one or more other entities that have an important relationship with the reporting entity, such as customers, vendors, and/or investees. Sometimes, the entity itself may not have incurred any losses as a direct result of the natural disaster, but these other entities may have (such as property damage). As a result, it is important that the entity understands the implications of natural disasters and other loss events for these other entities, and considers these implications when evaluating the potential impairment of any assets that are associated with these relationships.



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## C. Financial statement classification considerations

### Income statement

The guidance in ASC 360-10-45-4 requires an entity to include an impairment loss related to a long-lived asset (or asset group) that will be held and used within income from continuing operations before income taxes. However, if the statement of operations includes a subtotal for income from operations, the impairment loss must be included in that subtotal. Similar statement of operations classification guidance applies to environmental remediation-related expenses (see Section D).

Unlike gains and losses from impairments of long-lived assets and environmental remediation costs, there is no requirement in the guidance to include gains or losses from an involuntary conversion within the subtotal for income from operations. Further, income statement classification guidance is not provided for most other types of incurred losses or for the related insurance proceeds. However, the recognition guidance in ASC 605-40-25 clearly states that insurance proceeds related to an involuntary conversion should not be recorded as an offset to the capitalized cost of a replacement property, even if the terms of the insurance policy require the entity to use the proceeds for this purpose.

The guidance in ASC 225-30-45, *Income Statement: Business Interruption Insurance*, which addresses the income statement classification of BI proceeds, merely indicates that an entity may choose how to classify BI proceeds as long as that classification is not contrary to existing guidance.

The guidance related to the recovery of environmental claims requires an entity to classify an environmental claim recovery in the same income statement caption as the incurred loss (see “Environmental liabilities” under Section D for a discussion on obligations for environmental matters that could result from a natural disaster).

As a result, an entity is required to exercise judgment in determining the income statement classification of its incurred losses and the related insurance proceeds.

### Balance sheet

At balance-sheet dates after the date of an event, an entity may present receivables from insurers related to estimated insurance recoveries, along with amounts payable to third-party vendors for construction costs or other services (including environmental obligations) that are recoverable under the related insurance arrangements. Because of the interrelationship between these amounts, entities should consider the guidance in ASC 210-20, *Balance Sheet: Offsetting*, to determine if it is appropriate to report these assets and liabilities on a net basis. In most disaster circumstances, however, some or all of the conditions requisite to the existence of a right of offset in ASC 210-20 do not exist.

The time frame between the event and the final settlement of the insurance claim can often be lengthy. While an entity may believe the receipt of insurance proceeds is probable, it may be unable to determine when it will actually receive these proceeds. In all circumstances, an entity should make its best estimate of when it expects to receive insurance, and should consider if this estimate impacts the classification of the receivable as either current or noncurrent.

### Cash flows

The guidance in ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, clarifies the presentation of proceeds from the settlement of insurance claims in the cash flows statement. Under this guidance, cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage (that is, based on the nature of the loss). ASU 2016-15 is

effective for public business entities in fiscal years beginning after December 15, 2017 and one year later for other entities, but can be early adopted as long as all of its amendments are adopted at the same time. Previous guidance was less precise about the classification of insurance proceeds related to BI, but did indicate that proceeds directly related to investing or financing activities, such as from the destruction of property, are not required to be classified as operating cash flows.

In some instances, total covered losses, of all types, might exceed the coverage limit specified in the insurance policy, and the entity might ultimately receive a lump-sum settlement for only this amount. Or, an entity may have incurred total covered losses that do not exceed the coverage limit, but the entity and its insurer agree to one lump-sum settlement amount for all of the covered losses. An entity may be required to exercise judgment in allocating a lump-sum settlement to each type of loss because, as discussed in the next paragraph, this allocation is important to the classification of insurance proceeds in the cash flows statement.

For insurance proceeds received in a lump-sum settlement, the guidance in ASU 2016-15 requires an entity to determine the cash flows statement classification on the basis of the nature of each loss included in the settlement. Since a lump-sum settlement may cover more than one type of loss, an entity first needs to allocate the lump-sum settlement to each type of loss, and to use this allocation as the basis to determine how the proceeds should be classified in the cash flows statement. For example, when an entity applies this guidance, proceeds allocated to the destruction of a long-lived asset are classified as investing activities, but proceeds allocated to BI are classified as operating activities.

#### **Financial statement disclosures**

An entity should follow its existing policies and procedures related to the identification and evaluation of matters to disclose in the financial statements, but should also consider that its evaluations in prior accounting periods were not performed after a natural disaster. Many of the disclosure questions that have historically been marked "N/A" in an entity's disclosure evaluation checklists may now apply. Because these areas may not have applied in the past, an entity's finance department may need to determine, for the first time, whether the impact of a natural disaster applies to the situations contemplated in certain areas of the existing guidance, and to refresh their understanding of the related disclosure requirements. Disclosure requirements exist for substantially all the specific areas under existing guidance that are considered in accounting for the effects of a natural disaster. Many of the required disclosures are easy to identify because the accounting for the impact of an event is within the scope of a specific Codification topic or subtopic that also includes disclosure requirements. However, an entity should also consider the disclosure requirements in the following areas:

- Risks and uncertainties (certain significant estimates and current vulnerability due to certain concentrations)
- Loss contingencies (if no liability has been recognized)
- Subsequent events

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## D. Other considerations

### Hedged forecasted transactions (cash flow hedges)

An entity may have relied on assertions related to the amounts and timing of probable forecasted transactions with customers or vendors as evidence to support the application of hedge accounting to a hedging relationship (the cash flow hedge) at inception and on an ongoing basis. A natural disaster can impact both the timing, amount, and probability of a forecasted transaction that was designated at hedge inception. To maintain hedge accounting, an entity must evaluate the probability of a forecasted transaction occurring. As a result, a change in the probability assertion might preclude the entity from continuing to apply hedge accounting to the relationship, and might also require an evaluation of whether and when any balances in accumulated other comprehensive income (resulting from historical changes in the fair value of derivatives) should be reclassified to earnings.

### Environmental liabilities

An entity should follow the guidance in ASC 410-30, *Asset Retirement and Environmental Obligations: Environmental Obligations*, related to the accounting for environmental liabilities under the laws of a particular jurisdiction. The guidance in ASC 410-30 does not apply, however, to environmental obligations that result from matters that are not subject to environmental laws. When applicable, this guidance is applied on a site-by-site basis. An entity should consider this guidance when it evaluates the impact of environmental matters that result directly from a loss event.

A natural disaster might cause an entity to incur additional obligations under environmental laws. These obligations might be reimbursed under the entity's insurance arrangements or under government-sponsored reimbursement arrangements; however, the existence of insurance coverage or other reimbursement arrangements does not impact whether an entity should recognize a liability for an environmental obligation.

Recognizing a liability for an environmental obligation should follow a model similar to the model in ASC 450, *Contingencies*. Under that model, a liability is recognized when it is probable that the entity has incurred a loss (or an asset has been impaired) and the entity can reasonably estimate the amount of the loss. However, the guidance in ASC 410-30 includes considerations related specifically to environmental obligations for evaluating whether it is probable that a loss has been incurred, along with guidance on whether an entity has the ability to reasonably estimate a liability.

Guidance related to insurance recoveries for environmental losses is also included in ASC 410-30. Under this guidance, an asset related to any potential claim for recovery of an environmental loss is recognized only when an entity deems the realization of the claim for recovery is probable. The discussion under "Balance sheet" in Section C, about whether an entity should net assets related to potential recoveries with the liabilities to third parties that perform the services, also applies to assets and liabilities that result from environmental losses.

### Leasing arrangements

A natural disaster might damage or destroy a leased property, which might then prevent the lessor from being able to provide the leased property and/or to benefit from its use. Lease agreements sometimes contemplate these conditions, and might include provisions that outline each party's responsibilities in this situation. Both the lessor and the lessee, either as a requirement under the lease agreement or on their own, might maintain insurance to cover losses related to the leased property and the leasehold improvements. Similar to terms of insurance arrangements, lease terms can vary significantly, so lessors

and lessees should carefully review lease agreements to understand each other's rights and responsibilities in the event of damage to or destruction of a leased property.

When a lessee is a party to an unexpired operating lease agreement and the leased property has been destroyed or damaged to the extent that the lessee will have no future economic benefit from its continued use, the lessee should consider the guidance in ASC 420, *Exit or Disposal Cost Obligations*, when it evaluates the accounting implications. Under this guidance, if a lessee permanently stops using an asset subject to an operating lease, it is required to record a liability as of the "cease-use date" (usually the date of the event) at fair value based on the remaining lease obligation, less estimated sublease rentals that could be reasonably obtained. Insurance arrangements related to potential recoveries of these and other losses (including property damage) under leasing arrangements are accounted for by lessors and lessees in the same manner as other incurred losses, as described in Section A.

Entities that have already adopted ASC 842, *Leases*, will account for the above events under a different accounting model because the new guidance requires a lessee to record a right-to-use asset and a lease obligation for most leases. Under ASC 842, a lessee that permanently ceases to use a leased asset subject to an operating lease is required to evaluate the related right-to-use asset for impairment under ASC 360.

A lease agreement might subsequently be modified to take into consideration the effects of a natural disaster. Lessors and lessees should review the subsequent measurement guidance in ASC 840, *Leases*, or the guidance in ASC 842 if early adopted, to determine whether these modifications result in the revised agreement being considered a new agreement.

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