Accounting for Hurricane Damage

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As the flood waters from Hurricane Harvey recede, not-for-profit organizations, many of whom have been first responders and helping hands throughout this disaster, will be faced with accounting for damage and destruction to their own property.

Financial accounting guidance for disasters is found in several places in the Accounting Standards Codification (ASC). In September 2005, the American Institute of Certified Public Accountants (AICPA) issued Technical Practice Aids, TIS Section 5400.05, “Accounting and Disclosures Guidance for Losses from Natural Disasters – Nongovernmental Entities.” That guidance has since been removed because subsequent changes in the ASC rendered the practice aid obsolete and it has not yet been replaced.

The guidance provided below has been gathered from a variety of sources. Facts and circumstances differ making a “one size fits all” approach inappropriate. However, we offer this guidance for nongovernmental, not-for-profit organizations to provide context and direction that may facilitate management’s determination of appropriate financial accounting for and reporting of issues arising from the storm. Blazek & Vetterling audit engagement teams are available to help as your sort through the issues specific to your organization.
Destruction, Impairment, or Disposal of Long-Lived Assets

Long-lived assets may have been destroyed or damaged by Harvey and the resulting flooding. For long-lived assets that have been destroyed, any undepreciated carrying amount should be written off and the resulting loss recognized.

Long-lived assets that have been damaged but continue to be used should be evaluated for impairment. ASC 360-10-35-15 through 35-36 provides guidance on accounting for impairment of long-lived assets. An impairment loss has occurred if the carrying amount of a long-lived asset group is not recoverable and exceeds its fair value. An asset group is the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. An asset group may consist of an individual asset; a subsidiary, department, facility, or location; or, in limited circumstances, an entire entity.

If the carrying amount of a long-lived asset (asset group) exceeds its fair value, the carrying amount should be written down and an impairment loss recognized. The adjusted carrying amount should be depreciated or amortized over the asset’s remaining estimated useful life. Impairment losses may not be recovered in subsequent periods.

Damage from Harvey may result in the sale, abandonment or other disposal of long-lived assets. Long-lived assets that meet the criteria for classification as “held for sale” described in ASC 360-10-45-9 through 45-11 should be reported at the lower of carrying amount or fair value less costs to sell. If the carrying amount exceeds fair value less costs to sell, a loss should be recognized.

While a long-lived asset continues to be held for sale, the adjusted carrying amount should be compared to fair value less costs to sell at each subsequent reporting date and further losses recognized, if appropriate. A gain would be recognized at a subsequent reporting date for future increases in fair value less costs to sell but only to the extent of cumulative losses previously recognized. A gain or loss on the ultimate sale of the asset would be recognized for the difference between proceeds and the latest adjusted carrying amount.

Long-lived assets which an organization ceases to use, should be written down to fair value less costs to sell or otherwise dispose. Long-lived assets that are temporarily idle, should be evaluated for impairment, if appropriate, but should not be accounted for as abandoned.

Involuntary Conversion of a Nonmonetary Asset to Monetary Assets – Insurance Recoveries

When a nonmonetary asset such as property or inventory is converted to a monetary asset such as insurance proceeds, in an involuntary conversion such as storm damage, any difference between the carrying amount of the nonmonetary asset and the monetary assets received should be recognized as a gain or loss as described in ASC 605-40. A gain may be recognized even if an entity has an obligation to re-invest the proceeds in other nonmonetary assets; replacement assets should be recognized at cost when purchased.

As described in ASC 450-20-25, a loss should be recognized if:

- it is probable that an asset has been impaired or a liability incurred as of the date of the financial statements, and
- the amount of loss or range of loss can be reasonably estimated.

If damage was sustained before the end of the fiscal year, it should be estimated and recognized in that reporting year. However, an entity should not recognize a loss that occurred after the end of the fiscal year even if the loss can be reasonably estimated and those statements have not yet been issued. In this situation, subsequent event disclosure should be considered with a description of the event and an estimate of the financial impact or a statement that an estimate cannot be made.
ASC 450-30, *Gain Contingencies*, and AICPA Technical Practice Aids, TIS Section 5100.35, *Involuntary Conversion: Recognition of Gain*, provide guidance on when insurance recoveries should be recognized. While loss contingencies are recognized as soon as a loss is probable and estimable, a contingency that might result in a gain generally is not recognized until it is realized, i.e., received. If insurance recoveries are received before the end of the fiscal year, the loss should be netted against the proceeds received and the resulting net gain or loss reported.

Recognition of a receivable and the related revenue or gain from potential insurance recoveries presents a much higher threshold than recognition of a loss. Not all forms of insurance result in a clear transfer of risk from losses. Mere existence of an insurance policy is not evidence of the transfer of risk and acceptance of responsibility by the insurance provider. A variety of circumstances will impact the ultimate determination of amounts that insurance providers are obligated to pay, as well as the ability of insurance providers to satisfy claim obligations.

In the absence of verifiable evidence at the reporting date of acceptance of liability by an insurance provider, it generally is not appropriate to recognize a receivable and the related revenue or gain. If, as of the reporting date, all actions have been completed by the insured and the insurance provider to result in the insurance provider accepting responsibility, such as claim paperwork filed, adjuster evaluations completed, and verifiable acceptance of responsibility by the insurance provider, it may be appropriate to recognize a receivable. Verifiable evidence might be written notification from the insurance provider of claims to be paid, confirmation of such information, or receipt of payment. However, receipt of a payment after year-end, is not necessarily evidence that all the events necessary to recognize a receivable had occurred at the reporting date.

Appropriate disclosure should be made of a gain contingency, such as the general expectation that there may be some insurance recoveries. However, disclosure should avoid misleading information as to the likelihood of realization of the recoveries.

**Clean-up Costs**

Unless circumstances require the accrual of an environmental remediation liability in accordance with ASC 410-30, such as release of potentially toxic materials caused by the storm, clean-up costs are recognized when they are incurred.

**Other Impairments and Liabilities**

Generally, a loss contingency should be recognized if it is probable that an asset has been impaired as of the date of the financial statements and the amount or range of loss can be reasonably estimated. Entities should evaluate all assets impacted by *Harvey* for impairment and all contractual obligations for potential recognition.

**Inventory** – If *Harvey* caused physical destruction of inventory or an adverse change in its utility or salability, entities should assess whether an impairment or write-off is required in accordance with ASC 330-10-35-1 through 35-11. Entities that allocate fixed overhead to inventory may need to expense fixed overhead in the period it is incurred if it cannot be allocated to inventory because it results from abnormally low production or an idle plant. Freight, handling, spoilage, and similar costs are expensed when incurred.

**Receivables** – Accounts, pledges, and loans receivable due from entities affected by *Harvey* or any other disaster should be evaluated for collectability. Write-offs or additional allowances or loan reserves may be needed.
Prepaid expenses and other assets – Deferred or capitalized costs pertaining to future events, performances, or other activities that have been cancelled or are reasonably expected not to have any future economic benefit, should be evaluated for impairment and adjusted as appropriate.

Commitments and contingencies – There are circumstances in which the outstanding unrecognized obligations to pay or to perform on a contract may exceed the fair value of remaining contractual rights resulting in a loss contingency. Examples include a contractual obligation to pay certain amounts for a planned future activity or event that is no longer reasonably expected to take place, or a performance contract in which an entity is not reasonably expected to be able to perform, or a noncancelable lease agreement for property that has been destroyed or permanently impaired. ASC 450-20 provides guidance on loss contingencies.

Guarantees – An organization which has provided a guarantee to pay or to perform on behalf of another organization under certain circumstances may be required to recognize or re-evaluate an existing liability. ASC 460-10 and 450-20 provide guidance on guarantees and loss contingencies.

Business Interruption Insurance

ASC 225-30-20 provides this definition: Insurance that provides coverage if business operations are suspended due to the loss of use of property and equipment resulting from a covered cause of loss. Business interruption insurance coverage generally provides for reimbursement of certain costs and losses incurred during the reasonable period required to rebuild, repair, or replace the damaged property.

Insurance recoveries pertaining to lost revenues represent a gain contingency that, as previously discussed, generally is not recognized until received. If some portion of the proceeds pertains to fixed costs incurred during the period of interruption, such coverage may be comparable to involuntary conversion of a nonmonetary asset. GAAP allows entities to choose how they classify business interruption insurance recoveries in the statement of activities so long as the classification is not contrary to other existing GAAP.

In the period in which business interruption insurance recoveries are recognized, the notes to the financial statements should disclose the nature of the event that resulted in the losses, the aggregate amount of recoveries recognized, and the line in the statement of activities where they are classified.

Contributions Received and Made

Contributions received – A contribution is recognized when an unconditional promise to give has been made by a donor and received by a donee. Guidance is provided in ASC 958-605-25 for recognition of contributions received by not-for-profit entities. While there is currently no specific guidance on recognition of government grants by not-for-profit organizations, the guidance on contributions may be applicable to assistance provided by FEMA. Complex compliance requirements and the potential for subsequent audit of costs by FEMA are considerations in evaluating the timing and amount recognized.

Contributions received for which the donor specifies the use of the contribution, and that use is more specific than the broad limits of the organization resulting from the nature of the entity, the environment in which it operates, and the purposes for which it operates, should be classified as restricted and the use of those funds tracked to ensure appropriate use and financial reporting.
Organizations may receive assets for their own disaster needs or for the purpose of providing assistance to others. If an organization does not have the right to direct the use of the assets or to determine the specific beneficiaries, the transaction may be an agency transaction and not a contribution.

Agency transactions – An organization that acts as an intermediary solely to facilitate the transfer of financial assets (cash and similar instruments) between a donor and a specified beneficiary, should recognize assets received and a corresponding liability. An intermediary is permitted, but not required, to recognize nonfinancial assets received (land, buildings, use of facilities or utilities, materials and supplies, intangible assets, or services) and a corresponding liability but should follow and disclose a consistent accounting policy with respect to such transactions. Intermediary transactions do not result in recognition of revenue or expense by intermediaries.

An organization that acts as an agent by accepting assets from a donor to be used for or on behalf of a specified beneficiary should follow the guidance in ASC 658-605-25-24 through 25-32 in evaluating the proper accounting treatment.

Contributions made – Guidance is provided in ASC 958-720-25 for recognition of contributions made by not-for-profit entities. A contribution made is recognized when an organization has an obligation to transfer promised assets to a specified beneficiary. This generally occurs when an organization approves a specific grant or when the specified beneficiary is notified.

Some of the IRS implications of providing disaster relief to organizations and individuals are discussed in our memo on Providing Disaster Relief.

Classification of Related Activities and Balances

Accountings Standards Update 2015-01, superseded the previous guidance on extraordinary items with guidance on unusual or infrequently occurring items. Previously, items were “extraordinary” if they were both unusual in nature and infrequent in occurrence. Extraordinary items were required to be segregated from continuing operations and classified separately, net of tax, in the income statement.

Under the new guidance in ASC 225-20:

A material event or transaction that an entity considers to be of an unusual nature or of a type that indicates infrequency of occurrence or both shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be presented as a separate component of income from continuing operations or, alternatively, disclosed in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes. Similarly, the EPS effects of those items shall not be presented on the face of the income statement.

Generally, the issues addressed by both the former and current guidance pertain to for-profit concepts of continuing operations, income taxes, and earnings per share. If a not-for-profit organization considers a hurricane to be infrequent in occurrence (not reasonably expected to recur in the foreseeable future, taking into account the environment in which the entity operates) OR unusual in nature (possessing a high degree of abnormality and clearly unrelated to or only incidentally related to the ordinary activities of the entity), it should be reported as a separate component of changes in net assets, which is analogous to net income from continuing operations. For entities that report an intermediate measure of operations, this does not mean that the effect of Harvey must be classified as a component of changes in net assets from operations.
Although an entity may present the net gain or loss as a separate component of changes in net assets, disaggregation of the net gain or loss into its constituent elements (such as impairment losses, insurance recoveries, clean-up costs, etc.) may be provided either on the statement of activities or in the notes to the financial statements.

Receivables and payables should not be netted in the statement of financial position unless the conditions for offset are met as described in ASC 210-20-45.

According to ASC 230-10-45-16(c), insurance proceeds should be classified as operating in the statement of cash flows unless they are directly related to investing or financing activities such as from destruction of building. Accounting Standards Update 2016-15 which is not effective for non-public business entities until fiscal years beginning after December 15, 2018 but may be early adopted, requires cash receipts from insurance proceeds of this nature to be classified based on the nature of the loss. Proceeds received due to loss of a long-lived asset would be classified as inflows from investing activities while proceeds from business interruption insurance would be classified as inflows from operating activities.

**Subsequent Event**

If an entity’s fiscal year ends on or after August 31, 2017, Harvey is a current event, the effects of which need to be evaluated for recognition in the current year financial statements. If an entity’s fiscal year ended on or before July 31, 2017 and the financial statements have not yet been issued, Harvey is a subsequent event and management’s evaluation of subsequent events should include the impact of Harvey.

ASC 855-10-25 states that events or transactions that provide evidence about conditions that existed at the balance sheet date, including estimates used in preparing financial statements, are generally recognized in the financial statements while events or transactions that provide evidence about conditions that did not exist at the balance sheet date are generally not recognized in the financial statements. Examples of nonrecognized subsequent events given in ASC 855-10-55 include “Loss of plant or inventories as a result of fire or natural disaster that occurred after the balance sheet date but before financial statements are issued or are available to be issued.” This generally puts Harvey in the category of a nonrecognized subsequent event. However, even a nonrecognized subsequent event may need to be disclosed to keep financial statements from being misleading. Such disclosure would include a description of the event and an estimate of the financial impact or a statement that an estimate cannot be made.