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# **Audit Alert:** Accounting and disclosure considerations of Hurricanes Irma and Maria

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After the passing of Hurricanes Irma and María over Puerto Rico, many companies have suffered damages to their property and, in other cases, they have experienced business interruptions for some time. Most of those companies have insurance policies covering damages to property and interruptions caused by these natural disasters. Accounting for insurance recoveries depends in the nature of the claim.

## Business interruption

FASB Accounting Standards Codification (ASC) 225-30-00 through 30-50 provides general guidance regarding Business Interruption Insurance.

### What is business interruption insurance?

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. This type of insurance is designed to protect prospective earnings of the insured company.

The types of costs and losses covered by business interruption insurance typically include the following:

- gross margin that was lost or not earned due to the suspension of normal operations
- a portion of fixed charges and expenses in relation to that lost gross margin
- other expenses incurred to reduce the loss from business interruption (for example, rent of temporary facilities and equipment, use of subcontractors, among others)

In a business interruption, income not generated during the interruption period is not considered a loss to be recorded in the financial statements. On the other hand, the write-off of an asset or the salaries paid to idle workers would be considered a loss recorded in the financial statements for which an insurance recovery should be recorded in the financial statements to the extent that the realization of the **insurance claim is considered to be probable.**

The recovery of lost revenue or profits is to be **recognized only when the contingency has been resolved and using a gain contingency model.** Various factors should be evaluated when considering if a gain can be recognized such as if a signed agreement exists or if the insurance company acknowledges they will cover such losses.

On the other hand, a loss contingency should be recorded when an event occurs and the loss associated with such event is probable and reasonably estimable.

### Property damage

Property damaged by a natural disaster and that was not fully depreciated will most likely result in a loss for the entity. Some considerations to take into consideration when evaluating and recording the loss for property damage includes the asset's salvage or resale value. Such evaluation should be made following the guidance in ASC 360, Property and Equipment for computing impairment losses. 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.  If recovery for property loss is expected, a receivable should be recorded for the amount expected to be recovered and not to exceed the loss recorded.

### Insurance recoveries

Guidance on insurance recoveries is provided by ASC 605-40. This standard provides clarification regarding the accounting for involuntary conversions of nonmonetary assets (such as property and equipment) to monetary assets (such as insurance proceeds). An involuntary conversion of a nonmonetary asset to monetary assets and the subsequent reinvestment of the monetary assets is not equivalent to an exchange transaction between an entity and another entity but instead, the same is considered a monetary transaction. To the extent that the cost of a nonmonetary asset differs from the amount of monetary assets received, the transaction results in the realization of a gain or loss that shall be recognized.

If a nonmonetary asset is damaged or destroyed in one accounting period and recovery is made in a subsequent accounting period, the gain or loss shall be recognized in accordance with ASC 450.

Insurance recoveries should be evaluated separately from their related loss even though these should be classified in a manner consistent with the related losses. Generally, insurance recoveries will be classified within income from continuing operations including related gains or losses.

No asset resulting from an insurance recovery should be recorded if the realization of the claim is not considered probable. If the realization of the claim is considered to be probable, asset should be recorded **only to the extent of the loss recorded** in the financial statements. Any amount expected to be recovered in excess should only be recorded when realized since such amount will result in a gain.

### Accounting for insurance proceeds

The entity should remove from books the value of the damaged asset and record the insurance proceeds. In the case no loss recovery from insurance is made, the asset will be write-off and its entire value will be recorded as a loss. On the other hand, if full recovery is made from the insurance, the entity should record the total proceeds received and the total loss. An entry will be recorded to remove the asset from books and record the loss and another entry will be made to record proceeds received and eliminate loss recorded.

In the case the insurance does not fully cover the loss, the entity will record the write-off of the asset, the proceeds received from insurance and a gain or loss depending if the amount received is higher or lesser than the loss recorded.
An entity can decide how to classify recoveries of business interruption insurance in the income statement, provided that the classification complies with US GAAP.

### Financial statements disclosures

Disclosures in the financial statements may be necessary for losses incurred, insurance claims made and expected insurance recoveries.

Specifically, for business interruptions, the following information shall be disclosed in the notes to the financial statements in the period(s) in which insurance recoveries are recognized:

- the nature of the event resulting in business interruption losses
- the aggregate amount of business interruption insurance recoveries recognized during the period and the line item(s) in the statement of operations in which those recoveries are classified.

### Insurance claim services

Grant Thornton member firms have deep expertise in many industries, as well as significant experience with claims resulting from hurricanes, floods, fires, explosions, and other insured events. Our professionals have worked for insurance carriers, brokers and carrier accounting firms, and can anticipate potential claim pitfalls at the outset of the process.
Read more here http://bit.ly/2z1Xt2d

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact us for further assistance in relation to this or any other matter.

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