Applying IFRS

Accounting for the financial impact of natural disasters

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EY

Building a better working world

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What you need to know

- As communities begin the process of recovering from the tragedy of a natural disaster, entities operating in those locations, or providing goods and services in them, raise questions about the related financial reporting effects under IFRS.
- Entities may incur impairments to assets both directly and indirectly related to operations in the affected region.
- Future operating losses do not meet the definition of a liability and are recognised in periods in which the losses are incurred.
- Insurance recoveries are recognised only when it is determined that the entity has insurance cover for the incident and a claim will be settled by the insurer. However, disclosure is required if insurance recoveries represent contingent assets.
- Entities should consider the effect of the disaster on the conditions relating to their qualification for hedge accounting.
- Entities should evaluate whether they need to provide additional disclosures.

Overview

As communities begin the process of recovering from the tragedy of a natural disaster, entities operating in those locations, or providing goods and services in them, raise questions about the related financial reporting effects. This publication provides a reminder of the existing accounting requirements that should be considered when addressing the financial effects of natural disasters, including:

- Asset impairments
- Insurance recoveries
- Hedge accounting
- Restructuring
- Decommissioning obligations
- Other considerations
- Classification in the statement of comprehensive income
- Financial statement disclosure requirements

Natural disasters may also trigger a number of regulatory reporting requirements. Entities should consider any applicable local regulatory reporting obligations that may give rise to additional disclosures about the direct and/or indirect effects of a natural disaster.

1. Asset impairments

If an entity determines that the events resulting from a natural disaster have triggered impairment indicators, an impairment test must be performed in accordance with IAS 36 *Impairment of Assets* for the respective asset(s) and/or cash-generating unit(s). Indicators of impairment as a result of a natural disaster could include:

- Observable indications that the asset's value has declined during the period significantly more than what would be expected as a result of the passage of time or normal use
- Significant changes with an adverse effect on the entity have taken place during the period, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated. For instance, a decline in customer demand in markets because of a change in operating forecasts, damaged reputation resulting from the disaster, and a change in regulation for safety measures for natural disasters by the government causing additional costs to the entity
- Similarly, significant changes have taken place, in the extent to which, or manner in which, an asset is used or is expected to be used. For instance, termination of operations because of restriction for entering the area where facilities are located, due to flood, liquefaction, nuclear pollution, etc.
- The carrying amount of the entity's net assets is more than its market capitalisation. For instance, natural disasters may lead to decreasing stock

prices, which again may indicate that the carrying value of the entity's net assets is higher than its market capitalisation

- Evidence of obsolescence or physical damage of an asset. For instance, in many cases an effect of natural disasters is that property, plant and equipment is damaged

Asset impairments may be indicated as a direct or indirect result of the disaster. For example, damage to a manufacturing facility located in the affected region would be a direct indicator. A jump in operating costs at a facility outside the affected region, resulting from the replacement of a supplier in the region with a more costly supplier elsewhere, may be an indirect indicator. The likelihood of a supply interruption or an increase in costs being an indicator of impairment and triggering an impairment depends on the significance and duration of the expected change. Short-term, temporary disruptions are not necessarily indicative of an impairment for assets with a long-term remaining useful life.

The complete destruction of a non-current asset results in the derecognition of that asset as opposed to an impairment. That is because the complete destruction of an asset means that the asset will be disposed of or removed, and no future economic benefits are expected either from its use or disposal. Entities consider accruing decommissioning costs when evaluating the consequences of damage to assets in the disaster. Estimates of the amount and timing of future cash flows may have changed if the asset has been impaired or destroyed, which could affect the carrying value of the asset. Refer to *Section 5 Decommissioning obligations* below for guidance on accounting for decommissioning costs.

Decisions about the recognition and measurement of losses are made independently of those relating to any compensation that might be a receivable from an insurance policy. Refer to *Section 2 Insurance recoveries* below for guidance on accounting for insurance recoveries.

Entities with lending activities consider the requirements in IFRS 9 *Financial Instruments (or* IAS 39 *Financial Instruments: Recognition and Measurement*, if applicable), when evaluating loans made to debtors with operations (or collateral underlying the loan) in areas affected by natural disasters. This analysis should also consider the recoverability of amounts owed by debtors who may have no operations in the affected areas but have significant sales or suppliers in affected areas.

Other assets for which specific impairment guidance exists include:

- Inventory (IAS 2 *Inventories*)
- Debt and equity securities (IFRS 9 or IAS 39, if applicable)
- Equity method investments (IAS 28 *Investments in Associates* and *Joint Ventures)*
- Construction contracts (IFRS 15 *Revenue from Contracts with Customers* or IAS 11 *Construction Contracts,* if applicable)
- Investment property (IAS 40 *Investment Property*)
- Deferred tax assets (IAS 12 *Income Taxes*)

2. Insurance recoveries

An entity may experience a loss related to a natural disaster either through the impairment of an asset or the incurrence of a liability. For example, as a result of damage from a natural disaster, an entity may determine that an item of property, plant and equipment is impaired in accordance with IAS 36 or that a receivable from a customer is impaired in accordance with IFRS 9 (or IAS 39, if applicable). Alternatively, an entity may incur costs to repair a damaged facility or determine that it has a liability to repair an environmental damage in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The accounting for insurance claims will differ based on a variety of factors, including the nature of the claim, the amount of proceeds (or anticipated proceeds) and the timing of the loss and corresponding insurance recovery. In addition, any accounting for insurance proceeds will be affected by the evaluation of coverage for that specific type of loss in a given situation, as well as an analysis of the ability of an insurer to satisfy a claim. IAS 37 does not allow the recognition of contingent assets. Accordingly, an insurance recovery asset can only be recognised if it is determined that the entity has a valid insurance policy that includes cover for the incident and a claim will be settled by the insurer. This may be clear from the wording of the insurance policy, but could require confirmation from the insurer that the incident is covered and an appropriate claim will be settled.

Entities affected by a natural disaster will need to account for insurance claims based on a variety of factors.

The accounting for insurance recoveries is discussed in the following types of categories:

- Property, plant and equipment
- Business interruption
- Other recoveries

2.1 Property, plant and equipment

Entities often maintain insurance to mitigate the losses associated with property damage. The accounting for insurance compensation for property, plant and equipment is addressed in both IAS 16 *Property, Plant and Equipment* and IAS 37. Impairment or loss of items of property, plant and equipment and any compensation from third parties (e.g., insurers) are accounted for separately, as follows:

- Impairments of property, plant and equipment are recognised in accordance with IAS 36
- Items of property, plant or equipment are derecognised on disposal or when no future economic benefits are expected from the assets' use or disposal
- Compensation from third parties for property, plant and equipment that is impaired, lost or given up is included in profit or loss when it becomes receivable

Decisions about the recognition and measurement of losses are made independently of those relating to the recognition of any compensation that might be receivable. It is not appropriate to take potential proceeds into account when accounting for the losses. For example, when a building is completely

destroyed, the asset must be written off regardless of whether the entity can recover its losses through an insurance policy and intends to repair or replace the facility. When an item of property, plant and equipment is destroyed or damaged in one accounting period, and entitlement to the insurance proceeds cannot be determined until a subsequent period, the loss is recognised when incurred, notwithstanding the potential insurance recovery.

Although IAS 16 does not define the point at which compensation becomes receivable, IAS 37 prohibits the recognition of contingent assets. In such a situation, the recognition of the insurance recovery will only be appropriate when its realisation is virtually certain, in which case the insurance recovery is no longer a contingent asset. 'Virtually certain' is not defined in IAS 37 but it is certainly a much higher hurdle than 'probable' and, indeed, more challenging than the term 'significantly more likely than probable' in Appendix A of IFRS 5 *Non-current assets held for sale and discontinued operations*.[1] It is reasonable to interpret virtually certain to be as close to 100% as to make any remaining uncertainty insignificant. What this means in practice is that each case must be assessed on its own merits and any judgement should be made in the knowledge that, in any event, it is rarely possible to accurately assess the probability of the outcome of a particular event. However, to the extent that the inflow of economic benefits is probable (the event is more likely than not to occur), IAS 37 requires disclosure of the contingent asset.

In the context of a potential insurance recovery, determining that there is a valid insurance policy for the incident and a claim will be settled by the insurer, may require evidence confirming that the insurer will be covering the claim. The likelihood of receiving compensation should be assessed continually to ensure that developments are appropriately reflected in the financial statements. The asset and the related income are recognised in the period in which it is determined that a compensation will be received. For example, if a previously unlikely receipt becomes probable, but it is still a contingent asset, it will only be disclosed.

This assessment extends to the analysis of information available after the end of the reporting period and before the date of approval of the financial statements. In applying IAS 10 *Events after the Reporting Period*, an asset is recognised only if the information about the insurance recovery that becomes available in the subsequent period provides evidence of conditions that existed at the end of the reporting period and its realisation was virtually certain at that time.

[1] According to paragraph 23 of IAS 37, an event is regarded as probable if the event is more likely than not to occur.

Example 1 — Recognition of an insurance recovery

Assume Entity A, with a 31 March 2017 year-end, owned property with a net book value of CU100 just before a natural disaster that completely destroys the property in March 2017. The fair value of the property was CU130 based on an independent appraisal shortly before the natural disaster. Also assume that Entity A's insurance policy provides for compensation for any insured loss based on the fair value of the property.

Entity A would recognise a CU100 loss on the property in the period the natural disaster occurred. A CU130 insurance recovery for the incurred loss would be recognised in the period it is determined that there is no contingency that the insurance entity will settle the claim. If settlement was only probable, the claim would be disclosed, but not recognised.

The illustration below considers that there is uncertainty in the settlement of the claim and has been simplified in that it assumes the complete destruction of the insured asset. These concepts would also apply to a recognised partial impairment of the insured asset.

Impact on financial statements as at 31 March 2017

	Threshold met at 31 March 2017	Threshold only met after 31 March 2017 but before the financial statements are approved
Claim is virtually certain	Recognise an asset of CU130 and a gain of CU 30	Disclose the claim
Claim probable, but not virtually certain	Disclose the claim	Disclose the claim
Claim not probable	No disclosure	No disclosure

Similar considerations apply to the recognition of a receivable for the compensation of repair and maintenance work under an insurance policy, even when an impairment or write-off of the insured asset is not required and regardless of whether compensation is greater than, equal to, or less than, the costs incurred. For example, if an entity believes it is entitled to a CU1,500 insurance compensation as a result of damage to an asset that is not impaired, but for which the entity has incurred repair costs of CU1,000 at the year-end, the CU1,500 compensation will only be recognised once the entity determines that the insurance policy includes this damage and a claim will be settled by the insurer.

How we see it

In the case of a natural disaster, it is often unclear which events and costs are covered by insurance policies and significant uncertainty will exist as to whether or not any compensation will be available. Until such uncertainties are adequately resolved, it would not be appropriate to recognise an asset. In many situations, direct confirmation from the insurer may be the most reliable source of evidence that the entity is covered and that a claim will be accepted.

2.2 Business interruption

An entity's business interruption policies require a careful analysis of the terms and conditions due to the wide variety of terms relating to the nature and level of losses covered. Many policies cover temporary relocation costs (e.g., duplicate rent) that may be easily quantified after the loss event. Others cover lost revenue or operating margins that typically are measured over a longer term require comparisons with similar periods in prior years. In such cases, no compensation would be available if revenue or operating margins recover during the measurement period. For example, a claim under a policy with a quarterly measurement period would not be valid if a retailer were to lose an entire month's revenue, but recover that revenue before the end of the quarter.

Similar to the treatment of compensation from property, plant and equipment, insurance recoveries for business interruption are not recognised if they represent contingent assets.

2.3 Other recoveries

Natural disasters can often result in additional obligations, for example, obligations to repair environmental damage. When the cost of meeting those obligations is covered by insurance, the related reimbursements would be accounted for in accordance with IAS 37. Decisions about the recognition of a provision are made independently of those relating to the recognition of any related reimbursement. An obligation is recognised as soon as settlement becomes probable, whereas a receivable is recognised only when settlement of the insurance claim is virtually certain. Accordingly, the receivable may be recognised at a later date than the provision for the related obligation. IAS 37 also limits the amount that may be recognised for a reimbursement of expenditure required to settle a provision to the amount of the provision recognised.

Example 2 — Recognition of an insurance reimbursement
Assume that after a natural disaster, Entity A recognises a CU1 million provision for its obligation for environmental rehabilitation, which it will undertake itself. Entity A's insurance policy covers the cost of hiring an external contractor to perform the environmental rehabilitation. Before the end of the reporting period, the insurer has confirmed it will pay Entity A up to CU1.5 million as the environmental rehabilitation is performed. Entity A would recognise a CU1 million provision for environmental rehabilitation costs and a corresponding virtually certain insurance reimbursement asset that is limited to CU1m. Any increase in the estimate of the rehabilitation costs to be incurred up to CU1.5 million would result in a corresponding increase in the amount recognised for the reimbursement asset.

'Netting off' insurance reimbursement assets with provisions is not allowed in the statement of financial position.

2.4 Presentation of insurance proceeds

2.4.1 Statement of financial position and statement of comprehensive income

'Netting off' is not allowed in the statement of financial position, with any insurance reimbursement asset classified separately from any provision. However, the expense relating to a provision can be shown in the profit or loss net of any corresponding reimbursement.

2.4.2 Statement of cash flows

IAS 7 *Statement of Cash Flows* requires cash flows related to property, plant and equipment to be classified in cash flows from investing activities. Cash flows from operating activities are described as cash flows from the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. Insurance proceeds used for fixed asset expenditures that qualify for recognition in property, plant and equipment are classified as cash flows from investing activities. Insurance proceeds used for items that are not property, plant and equipment (i.e., repairs and maintenance) are classified as operating activities.

How we see it

Evaluating cash flows from insurance proceeds requires careful consideration of the nature of the claim. If the claim relates partially to business interruption and partially to property, plant and equipment, the cash inflows would be allocated between cash flows from operating activities (e.g., for the business interruption portion of the claim) and cash flows from investing activities (e.g., for the property, plant and equipment portion of the claim).

3. Hedge accounting

The natural disaster and potential subsequent events can disrupt many business transactions that may be postponed or cancelled. For example, entities may have been forecasting purchases of local goods or sales of their goods to local entities. Prior to the disaster, many such transactions may have constituted 'highly probable' hedged transactions in cash flow hedges under IFRS 9 (or IAS 39, if applicable). However, purchases and sales that were considered highly probable a few weeks prior to the natural disaster, may no longer be highly probable (in full or partially) or may not be expected to occur at all.

Entities consider whether any hedges of forecast transactions may cease to qualify for hedge accounting (in full or partially) as a result of the disaster. The disaster could also affect the probability of hedged forecast transactions, occurring at the same time, in the same amounts and under the same terms as originally designated, which may result in higher levels of ineffectiveness in the hedging relationship going forward. If the occurrence of the forecast transaction is no longer highly probable, the entity must cease hedge accounting. If the forecast transaction is no longer expected to occur, the entity reclassifies the accumulated gains or losses on the hedging instrument from other comprehensive income into profit or loss as a reclassification adjustment. However, if the occurrence of the forecast transaction is no longer highly probable but still expected, the cumulative effective portion remains in

other comprehensive income until the forecast transaction either occurs or is no longer expected to occur.

After a natural disaster, an entity must assess the effectiveness of hedge relationships and identify any changes in their risk management objective. In particular, under IFRS 9, an entity would have to discontinue hedge accounting if it were determined that there is no longer an economic relationship, or if credit risk dominates the hedging relationship as a result of the natural disaster. Furthermore, the hedge ratio may need to be adjusted if the hedged item and hedging instrument no longer move in relation to each other as originally expected. The entity has to assess whether it expects this to be the case going forward and, if so, to 'rebalance' the hedge ratio to reflect the change in the relationship between the value drivers in hedged item and hedging instrument. For entities that use statistical methods such as regression analysis to assess ongoing qualification for hedge accounting, new data incorporating the effects of the disaster must be added to the assessment and cannot be discarded.

In the case of a natural disaster, it is likely that there will be an impact on the effectiveness of hedging relationships, that may be so significant that an entity may conclude that the eligibility criteria for hedge accounting are no longer met under IFRS 9 (or IAS 39, if applicable). In such cases, an entity would need to identify the specific event or change in circumstances that caused the hedging relationship to fail, and continue to follow hedge accounting up until the precise date of such an event, which is likely to be the date of the initial disaster (e.g., earthquake and tsunami).

IFRS 9 allows for designation of a non-financial component as a hedged item, and, accordingly, the volume of eligible hedging relationships might increase for entities exposed to commodity price movements. Such hedge relationships are more likely to be impacted by natural disasters.

4. Restructuring

As a result of a natural disaster, an entity may decide to sell or abandon certain assets or execute a restructuring plan. A restructuring is a programme that is planned and controlled by management, and materially changes either the scope of a business undertaken by an entity or the manner in which business is conducted. IAS 37 addresses the accounting for costs associated with exit or disposal activities. Exit activities may include:

- Sale or termination of a line of business
- Closure of a business location in a country or region or relocation of business activities from one country or region to another
- Changes in management structure, for example, eliminating a layer of management
- Fundamental reorganisations that have a material effect on the nature and focus of an entity's operations

4.1 Recognition

Restructuring costs are recognised only when the general recognition criteria in IAS 37 are met, i.e., there is a present obligation (legal or constructive) as

a result of a past event, in respect of which a reliable estimate of the probable cost can be made. For constructive obligations to restructure, IAS 37 also requires that the entity has both a detailed formal plan and has raised a valid expectation in the parties affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

IAS 37 provides examples of the entity's actions that may provide evidence that the entity has started to implement a plan, for example, dismantling the plant, selling assets, or making a public announcement of the main features of the plan. However, it also emphasises that the public announcement of a detailed plan to restructure will not automatically create an obligation. The important principle is that the announcement is made in such a way, and in sufficient detail, to give rise to valid expectations in other parties such as customers, suppliers and employees that the restructuring will be carried out.

In order for an announced plan to give rise to a constructive obligation, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. Any extended period before commencement of implementation, or if the restructuring will take an unreasonably long time, will mean that recognition of a provision is premature, because the entity is still likely to have an opportunity to change the plan.

How we see it

If a board's decision for restructuring is the only relevant event arising before the end of the reporting period, this is not sufficient to create a constructive obligation. The conditions for recognising a restructuring provision require the plan to be detailed and specific, to have gone beyond the directors' powers of recall, and to be executed without delay or significant alteration.

4.2 Measurement

A restructuring provision is measured using the measurement requirements of IAS 37, i.e., the provision is measured at the best estimate of the expenditure required to settle the present obligation, taking into account the risks and uncertainties of the obligation and when the time value of money is material, discounting to present value. A restructuring provision includes only the direct expenditures arising from the restructuring, which are those that are necessarily entailed by the restructuring and not associated with the ongoing activities of the entity. The costs often incurred as part of a restructuring include employee termination benefits under a one-time termination plan, contract termination costs and costs to consolidate or close a facility.

In addition, costs related to the future conduct of the business are recognised as the related services are provided. Future operating losses are not recognised unless they relate to an onerous contract. Careful consideration is needed to distinguish costs of recovering from a natural disaster that relate to future conduct of the business from those related to a restructuring.

5. Decommissioning obligations

Decommissioning obligations arise when an entity is required to dismantle or remove an asset at the end of its useful life and to restore the site on which it has been located, for example, when an oil rig or nuclear power station reaches the end of its economic life.

Rather than allowing an entity to build up a provision for the required costs over the life of the facility, IAS 37 requires that the liability is recognised as soon as the obligation arises, which will normally be at commencement of operations. Similarly, IAS 16 requires the initial cost of an item of property, plant and equipment to include an estimate of the amount of the costs to dismantle and remove the item and restore the site on which it is located.

Any new obligations resulting from a natural disaster, other than the existing decommissioning obligations, would not fall into scope of IFRIC 1 and would be recorded as expenses.

IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* applies to any decommissioning, restoration or similar liability that has been both included as part of the cost of an asset measured in accordance with IAS 16 and recognised as a liability in accordance with IAS 37. Any new obligations resulting from a natural disaster, other than the existing decommissioning obligations, would not fall into scope of IFRIC 1 and would be recorded as expenses because these relate to new events and not the original decommissioning obligation. A natural disaster can significantly change the timing and amount of the estimated cash flows required to settle the decommissioning, restoration or similar liability. IFRIC 1 addresses how the effect of the following events that change the measurement of an existing decommissioning, restoration or similar liability are accounted for:

<table>
<tr><th>Event</th><th>Accounting</th></tr>
<tr><td>A change in the estimated outflow of resources embodying economic benefits (e.g., cash flows) required to settle the obligation.</td><td rowspan="2">The adjustment to the liability is recognised in the carrying value of the related asset or in other comprehensive income, depending on whether the asset is measured at cost or revaluation.*</td></tr>
<tr><td>A change in the current market-based discount rate (this includes changes in the time value of money and the risks specific to the liability).</td></tr>
<tr><td>An increase that reflects the passage of time (also referred to as the unwinding of the discount).</td><td>The periodic unwinding of the discount is recognised in profit or loss as a finance cost as it occurs.</td></tr>
</table>

* If the related asset is measured using the cost model, the change in the liability is added to, or deducted from, the cost of the asset to which it relates. Where the change gives rise to an addition to cost, the entity considers the need to test the new carrying value for impairment. Because of the nature of natural disasters, impairment of any increase in the value of the related asset may be a very real possibility. Conversely, reductions over and above the remaining carrying value of the asset are recognised immediately in profit or loss. The adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life.

Example 3 — Reduction in the economic life of an asset
After a natural disaster, it is determined that a power plant will have to be closed earlier than previously expected. The entity determines that the remaining useful economic life of the asset has reduced from 35 years to 10 years. Accordingly, in the absence of other changes, the present value of the decommissioning liability will increase because of the shorter period over which cash flows are discounted (flows). This increase is added to the carrying value of the asset, which is tested for impairment. The remaining carrying value is depreciated prospectively over the following 10 years.

If the related asset is measured using the revaluation model, changes in the liability alter the revaluation surplus or deficit previously recognised for that asset. Changes to the provision are recognised in other comprehensive income and they increase or decrease the value of the revaluation surplus in respect of the asset, except to the extent that:

- A decrease in the provision reverses a previous revaluation deficit on that asset that was recognised in profit or loss
- A decrease in the provision exceeds the carrying amount of the asset that would have been recognised under the cost model

  Or
- An increase in the provision exceeds the previous revaluation surplus relating to that asset

in which case, the change is recognised in profit or loss. Changes in the provision might also indicate the need for the asset (and, therefore, all assets in the same class) to be revalued.

6. Other considerations

6.1 Future operating losses

Entities may incur other losses directly or indirectly related to a natural disaster. An entity may anticipate having future operating losses for a period of time after a natural disaster. For example, an entity may have repair costs, lost revenue due to plant closures or losses due to an overall decline in the economy. Additional costs might be incurred in renting alternative production facilities, providing transport or accommodation for employees or outsourcing business functions.

Future operating losses and costs do not meet the definition of a liability (because they do not arise from a present obligation resulting of a past event), and therefore are not recognised until incurred.

6.2 Onerous contracts

A contract is considered onerous when the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. The present obligation under an onerous contract is recognised and measured as a provision. For example, when a manufacturing entity has contracts to sell goods

at a fixed price and, because of the natural disaster, it cannot deliver the goods itself without procuring them from a third party, the provision for the onerous contract will reflect the lower of the penalty for terminating the contract or the present value of the net cost of fulfilling the contract (i.e., the excess of the cost to procure the goods over the consideration to be received).

When a natural disaster has occurred, contracts should be reviewed to determine if there are any special terms that may relieve an entity of its obligations (e.g., force majeure). Finally, before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract.

6.3 Constructive obligations

Additional non-legal obligations may arise as a result of a natural disaster. For example, an entity with no previous environmental obligations may establish a constructive obligation that it will repair environmental damage as a result of the disaster. Such a constructive obligation will only result in the recognition of a provision if by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities and as a result, it has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

The general recognition requirements of IAS 37 would have to be met. That is, there is a present obligation as a result of a past event[2] (in this case a constructive obligation); it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

6.4 Contingent liabilities

A contingent liability is:

- A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity

Or

- A present obligation that arises from past events, but is not recognised because it is either not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability

A previously contingent liability may no longer be contingent as a result of a natural disaster and thus may need to be recognised in accordance with IAS 37.

Contingent liabilities are not recognised, but they are disclosed.

When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

When a previously contingent liability, for example, a legal obligation to repair environmental damage as a result of a natural disaster, is no longer contingent

[2] When it is unclear whether there is a present obligation, IAS 37 notes that a past event gives rise to a present obligation if it is 'more likely than not' that a present obligation exists at the end of the reporting period.

and it meets the recognition requirements of IAS 37, it is recognised and measured in accordance with IAS 37.

6.5 Expenditure to be settled by a third party

When the expenditure required to settle a provision is expected to be settled by a third party and the entity will not be liable if the third party fails to pay, the entity has no liability and no provision is recognised. An example might be when the entity is occupying a facility leased from another party and that other party is liable for repairs.

6.6 Going concern

Deterioration in operating results and financial position due to natural disasters after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, IAS 10 states that the effect is so pervasive that it results in a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting. Financial statements prepared on a 'non-going concern' basis of accounting may still be described as complying with IFRS as long as that other basis of preparation is sufficiently described in accordance with IAS 1 *Presentation of Financial Statements*. IAS 1 requires specific disclosures either when (a) the financial statements are not prepared on a going concern basis, or (b) when management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

7. Classification in the statement of comprehensive income

IAS 1 requires that when items of income or expense (a term covering both profit or loss and other comprehensive income) are material, their nature and amount are disclosed separately. The standard provides examples of circumstances that would give rise to the separate disclosure of items of income and expense, which include:

(a) Write-downs of inventories to net realisable value, or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs

(b) Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring

(c) Disposals of items of property, plant and equipment

(d) Disposals of investments

(e) Discontinued operations

(f) Litigation settlements

(g) Other reversals of provisions

This information may be given on the face of the statement of comprehensive income or in the notes. In line with the permissive approach taken to the format of the performance statements under IFRS, the level of prominence given to such items is left to the judgement of the entity concerned. However, regarding (e) above, IFRS 5 sets out the information required to be presented on the face of profit or loss and in the notes.

IAS 1 does not permit an entity to present any items of income or expense as extraordinary items.

8. Financial statement disclosure requirements

New obligations and uncertainties resulting from a natural disaster will require additional disclosures.

The financial statement disclosure for entities directly and/or indirectly affected by natural disasters will vary depending on the magnitude of their losses and the availability of information. In many cases, the financial statement disclosure requirements are addressed based on the nature of the loss (e.g., asset impairments, hedging, decommissioning costs) or the timing of the loss (e.g., events after the reporting period). Because the natural disaster may result in new obligations and uncertainties that an entity may not have previously experienced, the following discussion provides a brief summary of some of the financial statement disclosures addressing impairments, provisions, contingencies, uncertainties and subsequent events.

8.1 Impairments

For each class of assets, an entity should disclose:

- Impairment losses recognised in profit or loss during the period and the line item(s) of the statement of comprehensive income in which those impairment losses are included
- Reversals of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of comprehensive income in which those impairment losses are reversed
- Impairment losses on revalued assets recognised in other comprehensive income during the period
- Reversals of impairment losses on revalued assets recognised in other comprehensive income during the period

The above information may be presented with other information disclosed for the class of assets, e.g., in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period.

There are also specific disclosure requirements for individual assets (including goodwill) or cash-generating units, for which an impairment loss has been recognised or reversed during the period, such as:

- Events and circumstances that led to the recognition or reversal of the impairment loss
- Impairment loss recognised or reversed
- The nature of the asset or a description of the cash generating unit
- The recoverable amount of the asset (or cash-generating unit) and whether this is its fair value less costs of disposal or its value in use. Further disclosures are required if the recoverable amount is fair value less costs of disposal, while if the recoverable amount is value in use, the entity should disclose the discount rate(s) used in the current estimate and previous estimate (if any) of value in use

8.2 Provisions

For each class of provision, an entity provides a reconciliation of the carrying amount of the provision at the beginning and end of the period showing:

- Additional provisions made in the period, including increases to existing provisions
- Amounts used, i.e., incurred and charged against the provision, during the period
- Unused amounts reversed during the period
- The increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate

Comparative information is not required.

In addition, for each class of provision an entity discloses the following:

- A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits
- An indication of the uncertainties about the amount or timing of those outflows. When necessary to provide adequate information, an entity discloses the major assumptions made concerning future events (this refers to future developments in technology and legislation and is of particular relevance to environmental liabilities)
- The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement

8.3 Contingent liabilities

Unless the possibility of any outflow is remote, an entity must disclose by class of contingent liability at the end of the reporting period:

- A brief description of the nature of the contingent liability
- An estimate of its financial effect
- An indication of the uncertainties relating to the amount or timing of any outflow
- The possibility of any reimbursement

8.4 Contingent assets

When an inflow of economic benefits is probable an entity must disclose:

- A brief description of the nature of the contingent asset at the end of the reporting period
- When practicable, an estimate of their financial effect, measured using the principles set out for provisions in IAS 37
- When any of the information above is not disclosed because it is not practicable to do so, that fact is stated. IAS 37 emphasises that the disclosure must avoid giving misleading indications of the likelihood of income arising

8.5 Reduced disclosures for seriously prejudicial information

With respect to the above-mentioned disclosures required for provisions, contingent liabilities or contingent assets, an entity may only refrain from providing some or all of the disclosures listed above to the extent that the information can be expected to seriously prejudice the position of the entity in a dispute with other parties. Use of this exception is expected to be extremely rare and is limited to the specific items of information otherwise required to be disclosed. However, the entity is still required to disclose the general nature of the matter, together with the fact that, and the reason why, the information has not been disclosed.

8.6 Sources of estimation uncertainty

Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. IAS 1 requires disclosure of information about the assumptions concerning the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities *within the next financial year* (with the exception of assets and liabilities measured at fair value based on recently observed market prices).

IAS 1 requires that, in respect of the assets and liabilities that are subject to estimation uncertainty, such as non-current assets subject to impairment, the notes include details of their nature and their carrying amounts as at the end of the reporting period. The disclosures are required to be presented in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures that an entity would make include:

- The nature of the assumption or other estimation uncertainty
- The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity
- The expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected
- An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved

Disclosure of some of these key assumptions is required by other standards. For example, IAS 37 requires disclosure, in certain instances, of major assumptions concerning future events affecting classes of provisions. Another example is IAS 36 that requires disclosure, in certain circumstances, of each key assumption on which management has based its cash flow projections.

When it is impracticable to disclose the extent of the possible effects of an assumption or other source of estimation uncertainty at the end of a reporting

period, the entity discloses that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions used could require a material adjustment to the carrying amount of the asset or liability affected. However, in all cases the entity discloses the nature and carrying amount of the specific asset or liability affected by the assumption.

How we see it

Entities affected both directly and indirectly by the natural disaster may be required, under IAS 1, to disclose information about those assets and liabilities that are subject to significant estimation uncertainty.

8.7 Subsequent events

Entities directly affected by a natural disaster occurring after the end of the reporting period, but before the date of issuing their financial statements will likely need to disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made. Additionally, entities that may be indirectly affected by the event, such as an entity with a concentration of revenue from customers in the affected area, should consider whether subsequent event disclosures are necessary as these could influence the economic decisions that users make on the basis of the financial statements.

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