



## Capital projects: Managing the risk of natural disasters

Hurricanes Harvey, Irma, and Maria and other recent natural disasters have brought the ever-present possibility of unexpected catastrophes to the headlines. Across industries, organizations of every size are asking how to prepare for and manage the risks when unexpected acts of nature occur.

Consider these recent statistics. Extreme weather and natural catastrophes reached \$306 billion in total damage in 2017, with 16 events causing more than \$1 billion in damage each. Most of that damage—\$265 billion—came from hurricanes.<sup>1</sup> Moreover, the Intergovernmental Panel on Climate Change, a United Nations-sponsored group

that assesses climate change research, predicts that financial losses due to hurricanes could increase by more than 70% by 2100.<sup>2</sup>

That uptick likely reflects increased expenses resulting from market fluctuations, materials shortages, and labor scarcity, as well as the cost to rebuild. Yet companies rarely factor the event-driven risk of a natural disaster into their budgets for new capital construction or existing capital assets—or even into their revenue projections. This issue of *CFO Insights* discusses the importance of putting capital asset management plans into place that can

be called into action if disaster strikes. In addition, we will outline why basing those plans on solid capital and risk management principles can help equip companies with preparedness and flexibility in the unfortunate event of a natural disaster. 

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### Checklist for disaster preparedness

In anticipation of a possible natural disaster, adherence to capital and risk management principles can reduce the potential for loss. Below are some considerations when preparing for the unexpected:

#### Budget and plan for disaster recovery.

When planning and budgeting for a capital project, understand the potential risks and exposures that could occur for various types and levels of natural disasters, and be sure they are covered in the disaster recovery, business continuity, or crisis management plan. The plan should outline the operational, regulatory, and financial implications of a potential event, as well as identify sources of support that will be required to respond. These sources could include pre-contracted disaster response and recovery service agreements and appropriate levels of insurance sufficient to cover catastrophic-level events.

In addition, estimate and budget for the cost of repairs that will be needed immediately to resume or restore operations. The potential impact that a natural disaster could have on the supply chain should also be understood: What shortages can be expected? How will disruption to distribution prevent materials from arriving on time? Identifying backup supply services may be prudent, as is anticipating human resource shortages and guarding against their associated costs by pre-negotiating contracts and terms.

- **Know your coverage—and your coverage gaps.**

Make sure your organization's insurance policy adequately covers the cost of potential physical and operational damages that could result from a natural disaster. To determine appropriate coverage, values, and deductibles, it helps to update maximum probable loss studies annually. Also, understand what risks and exposures exceed the scope of traditional insurance in a disaster.

For example, insurance policies can be written to cover the loss of profits resulting from business interruption. Contingent business interruption coverage may be critical if there is an earnings loss resulting from damages incurred from a change in the ability of suppliers to deliver materials or for customers to purchase product. Ingress/egress coverage is important if access to your product (or its shipment) is hampered, for example, in a

flood. And a service interruption clause can address the loss of electricity or utility service that disrupts your business.

- **Establish a governance system to facilitate faster—and smarter—decision-making.**

When a natural disaster occurs, be prepared to establish a governing and reporting process that aligns with the existing capital project delivery and organizational structure as closely as possible. Make sure that process is streamlined, as too many layers may result in roles overlapping and critical functions not being fulfilled.

In addition, implementing standardized reporting templates/platforms that include integrated information and key performance indicators, can keep board governance committees well informed. Such improved reporting enables those governance committees to better understand project risks and make faster and smarter decisions, thereby potentially saving significant time and costs.

Once the governance system is established, evaluate the damage to assets and take stock of their location and condition. Then, prepare a system to track the damage and repair processes, including the extra expenses incurred for overtime paid to employees, increased security for damaged structures, and food and lodging to keep workers on site. In addition, consider the cost of service interruption, as well as the actual losses sustained by interruption of incoming services, including gas, water, electricity, phone, and other services needed to keep the operations up-and-running.

- **Determine a process for reporting and managing claims.**

If a natural disaster occurs, be prepared to assign a gatekeeper to manage insurance claims and disbursement of grant funds. The gatekeeper takes on responsibility for coordinating input from legal, operations, finance, and accounting, and serves as the point person when responding to the insurance auditor's questions. When multiple insurance carriers and policies are involved, the gatekeeper can also help coordinate claims.

In the aftermath of Hurricane Katrina, for example, Deloitte assisted the State of Louisiana as a gatekeeper in recovering from one of the largest disasters in US history. Initially, the team established an efficient process for complying with federal and state regulations associated with the management of Public Assistance (PA) funds. The team identified opportunities to improve accountability and fund reporting, as well as designed procedure and technology enhancements that resulted in streamlined processes and expedited payments. Processes were also implemented to capture, report, and submit administrative costs to the Federal Emergency Management Agency (FEMA) for reimbursement. Then, to help the state prepare for potential events in the future, the team made recommendations to enhance the organization of its PA program, assess workforce needs, and develop a strategic plan for a disaster recovery program.

- **Prepare for complexities.**

Quantifying and addressing losses from a natural disaster can be complicated. Hurricanes Harvey, Irma, and Maria illustrated the possibility of natural



occurrences that cause multiple or overlapping causes of loss (e.g., a second hurricane hits during the indemnity period of the first). Physical/infrastructure constraints resulting from the event may lead to post-loss challenges that affect an organization's ability to rebuild (e.g., changes to the landscape or surrounding infrastructure that affect the feasibility of the location). If you are in the midst of a capital project, be prepared to make business decisions, not insurance decisions, especially when updates and improvements are possible that can strengthen future operations.

- **Develop a business continuity and communication plan.**

Managing and executing a business continuity plan that defines roles and responsibilities and keeps stakeholders informed in the event of a natural disaster is critical (see "[Stacking the deck: What's an effective crisis response?](#)" *CFO Insights*, July 2017). While many organizations have business continuity plans in place, implementation often requires flexibility and a concerted effort to orchestrate in an actual event. Clarify who will be making decisions and how they will be communicated. Keep in mind that management should be updated with accurate and adequate information to help ensure they have the right details to make timely and informed decisions.

Next, prioritize the stakeholders who have influence and the stakeholders who will be affected by a natural disaster, and identify the most appropriate communications channels to reach them. Workforce, suppliers, business partners, and customers will all be affected in the event of a natural disaster, and maintaining timely and reliable channels of communication with these stakeholders will be critical to an effective and efficient recovery.

- **Be aware of additional sources of funding after a disaster.**

In the event of a natural disaster, investigate grants and other government programs to supplement funding from insurance and internal sources. Multiple funding streams directed toward recovery are usually available, including funding from FEMA, the Small Business Administration (SBA), and Housing and Urban Development (HUD). FEMA disaster assistance programs may be available for

public assistance and hazard mitigation too, so be aware of eligibility requirements, application deadlines, and expedited assistance programs.

- **Embrace a grant management strategy.**

Finally, when grant funds are received, having a plan for grant administration can help speed and streamline rebuilding efforts. For example, after a tornado hit a city in Missouri in 2011, Deloitte helped the administration manage \$158 million in grants to rebuild. The team helped evaluate planned projects for potential duplication of benefits and developed a broad design and implementation strategy to manage projects over the life of the grants. Monitoring and reporting on grant funds helped the city comply with regulations. Then, as programs moved from design to implementation, the team assisted the city with overseeing funding

recipients and closing out each project. Through technical training, workshops, and the development of strategy and compliance standards, the team helped equip the city to effectively manage future funds.

Putting appropriate strategies in place to manage capital projects after a natural disaster may result in faster recovery and lower costs to the organization. When a hurricane, tornado, wildfire, or other natural disaster strikes, business—and capital project—continuity depends on improving the flow of information required to make timely decisions. Organizations can rebuild smarter and be "hardened to crisis" by implementing a pragmatic plan focused on sustainability and continuous improvement. The result can be a capital investment with built-in long-term resiliency.

### How to account for insurance recoveries

Assessing the extent to which insurance coverage exists may be challenging and require the assistance of an entity's legal counsel. In determining the accounting for insurance recoveries, an entity should first perform an assessment similar to the following:

- Does the entity have insurance, and is the specific loss insured? The entity should consider whether "insurance" actually exists and whether the specific events are covered. For example, an entity may have finite insurance that does not necessarily transfer significant insurance risk.
- Will there be disputes over the cause and extent of the damage? In determining the amount of expected insurance recoveries to recognize, an entity should consider the potential for disputes with the insurance company and its likelihood of prevailing.
- What is the financial viability of the insurance company? Before recording an insurance receivable, entities should consider the insurer's ability to pay. Entities can look to the following in making that assessment:

- Quarterly and annual statutory filings. A first step is to consider whether the insurer's surplus/capital is large enough to cover estimated losses. Another factor to consider is how much of the insurer's business is located in an affected region.
- An entity's insurance broker (if applicable) or a rating agency may have already performed these assessments and may be able to provide additional information.
- Insurance entity ratings can also be obtained from major rating agencies, including Moody's Investors Service (for financial strength), Fitch (for claims-paying ability), Standard & Poor's (for claims-paying ability), and A.M. Best (for financial strength).

*For more information on the financial reporting implications of disasters, read this edition of the [Financial Reporting Alert](#), which covers asset impairments; income statement classification of losses; insurance issues; environmental remediation, liabilities, clean-up and operating losses; stock compensation performance conditions and modifications; derivative and hedging considerations; employee benefits issues; assistance received from outside entities (e.g., Red Cross), disclosures; regulatory relief issues as well as other considerations.*

## Endnotes

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1. "Extreme hurricanes and wildfires made 2017 the most costly US disaster year on record," *The Washington Post*, January 8, 2018.  
[https://www.washingtonpost.com/news/energy-environment/wp/2018/01/08/hurricanes-wildfires-made-2017-the-most-costly-u-s-disaster-year-on-record/?noredirect=on&utm\\_term=.5451e822e52f](https://www.washingtonpost.com/news/energy-environment/wp/2018/01/08/hurricanes-wildfires-made-2017-the-most-costly-u-s-disaster-year-on-record/?noredirect=on&utm_term=.5451e822e52f)
2. "Warming seas could lead to 70 percent increase in hurricane-related financial loss," University of Vermont, October 12, 2017.  
<https://phys.org/news/2017-10-seas-percent-hurricane-related-financial-loss.html>

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