



Life Sciences Industry Accounting Guide
Contingencies and Loss Recoveries

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Preface

The life sciences ecosystem encompasses a wide array of entities that discover, develop, and manufacture health care products. Such entities include pharmaceutical manufacturers; biotechnology companies; medical device, diagnostic, and equipment manufacturers; and service companies such as drug distributors, contract research organizations (CROs), contract manufacturing organizations (CMOs), and health technology companies.

Finance and accounting professionals in the life sciences industry face complex issues and must exercise significant judgment in applying existing rules to matters such as research and development (R&D) costs, acquisitions and divestitures, consolidation, contingencies, revenue recognition, income taxes, financial instruments, and financial statement presentation and disclosure. The 2026 edition of Deloitte's *Life Sciences Industry Accounting Guide* (the "Guide") addresses these and other relevant topics affecting the industry this year. It includes interpretive guidance; illustrative examples; recent standard-setting, legislative, and rulemaking developments (through March 6, 2026); and key differences between U.S. GAAP and IFRS[®] Accounting Standards. [Appendix B](#) lists the titles of standards and other literature we cited, and [Appendix C](#) defines the abbreviations we used. Key changes made to this Guide since publication of the 2025 edition are summarized in Appendix D.

We hope the Guide is helpful in navigating the various accounting and reporting challenges that life sciences entities face. We encourage clients to contact their Deloitte team for additional information and assistance.

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Chapter 5 — Contingencies and Loss Recoveries

5.1 Introduction

ASC 450 defines a contingency as an “existing condition, situation, or set of circumstances involving uncertainty . . . that will ultimately be resolved when . . . future events occur or fail to occur.” In the life sciences industry, contingencies often arise as a result of product liability issues; patent litigation cases, such as suits filed against the entity for patent infringement (e.g., generic at-risk launches); and compliance issues related to pricing, promotions, or manufacturing standards. In addition, for biotechnology and pharmaceutical firms, environmental issues and remediation proceedings have been the subject of considerable public and legislative discussion and initiatives. As a result, accounting standard setters such as the FASB, AICPA, and SEC have emphasized the accounting for and disclosure of environmental liabilities in the financial statements.

In the life sciences industry, a single event could trigger multiple contingencies or other elements, requiring an entity to separately evaluate each element to determine its appropriate recognition, measurement, and classification. For example, a regulatory action may result in the incurrence of incremental costs related to product recalls, leading to a change in product strategy, adjustments to customer sales allowances, or other events. Further, a litigation settlement may contain multiple elements, including cash payments, required future services, rights to IP, and other agreements or concessions between the parties.

The accounting for and disclosures about contingencies under ASC 450 differ depending on whether the contingency could result in a gain or a loss. The ASC master glossary defines a loss contingency as follows:

ASC Master Glossary
<p>Loss Contingency</p> <p>An existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses.</p>

Contingent liabilities are liabilities for which the possible loss outcome is unknown or uncertain, such as from pending litigation. The likelihood that a liability has been incurred ranges from “remote” to “reasonably possible” to “probable.” The ASC master glossary’s definitions of these terms provide no quantitative thresholds (see below), and accordingly, entities may need to exercise judgment when applying the terms. [Section 5.2.2.1.1](#) provides additional guidance on the determination of whether an event is “remote,” “reasonably possible,” or “probable.”

ASC Master Glossary**Probable**

The future event or events are likely to occur.

Reasonably Possible

The chance of the future event or events occurring is more than remote but less than likely.

Remote

The chance of the future event or events occurring is slight.

A gain contingency also includes characteristics of uncertainty but differs from a loss contingency in that the resolution of the uncertainty could potentially result in a gain. The recognition threshold for a gain contingency is substantially higher than that of a loss contingency. The ASC master glossary defines a gain contingency as follows:

ASC Master Glossary**Gain Contingency**

An existing condition, situation, or set of circumstances involving uncertainty as to possible gain to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

Because the accounting for a contingency involves the evaluation of the likelihood of occurrence or nonoccurrence of a future event that may confirm a previous loss, impairment of an asset, or incurrence of a liability, contingencies may be at risk of being overlooked for recognition or disclosure purposes. It is important to disclose certain contingencies, even those that are not recognized, so that financial statement users can understand an entity's risks and how they could potentially affect the financial statements.

The remainder of this chapter highlights accounting and disclosure issues commonly encountered by life sciences entities that are associated with contingencies. For more information as well as insights into topics not addressed below, see Deloitte's Roadmaps [Contingencies, Loss Recoveries, and Guarantees](#) and [SEC Comment Letter Considerations, Including Industry Insights](#).

5.2 Loss Contingencies

Accrual of a loss contingency is required when (1) it is probable that a loss has been incurred and (2) the amount can be reasonably estimated. An entity must determine the probability of the uncertain event and demonstrate its ability to reasonably estimate the loss from that event to accrue a loss contingency. Loss contingencies that do not meet both of these criteria for recognition may need to be disclosed in the financial statements.

Typically, under the accounting literature, an entity uses either a probability-based model or a fair value model when dealing with uncertainty related to losses. The probability-based recognition guidance in ASC 450-20 differs from that in other Codification topics under which an entity measures liabilities in accordance with a fair value objective. To measure a liability at fair value, an entity must consider events whose occurrence is less than probable. Therefore, a fair value measurement will result in the recognition of a liability for a conditional obligation for which the likelihood of future settlement, although more than zero, is less than probable; a liability would not be recognized in this situation under the guidance in ASC 450-20 that applies to loss contingencies.

5.2.1 Scope

All loss contingencies should be evaluated under ASC 450-20 unless they are within the scope of other authoritative literature. The table below contains a nonexhaustive list of examples of contingencies or uncertainties that are within the scope of other authoritative literature.

ASC 270	"[C]ontingencies and other uncertainties that could be expected to affect the fairness of presentation of financial data at an interim date." (ASC 450-10-60-1)
ASC 275	"[D]isclosure of certain risks and uncertainties that stem from the nature of an entity's operations and from significant concentrations in certain aspects of an entity's operations, many of which are noninsured or underinsured risks." (ASC 450-20-60-1)
ASC 326	<ul style="list-style-type: none"> • Collectibility of receivables or a loan portfolio. • Measurement of credit losses.
ASC 330	<ul style="list-style-type: none"> • "[I]nventories that are impaired by damage, deterioration, obsolescence, changes in price levels, or other causes." (ASC 450-20-60-4) • "[L]osses that are expected to arise from firm, uncancelable, and unhedged commitments for the future purchase of inventory." (ASC 450-20-60-5)
ASC 340-30	Contingencies related to "insurance and reinsurance contracts that do not transfer insurance risk." (ASC 450-10-60-2)
ASC 405-30	"[A]ssessments by state guaranty funds and workers' compensation second-injury funds and other assessments related to insurance activities, including insurance activities of an entity that self-insures." (ASC 450-20-60-6)
ASC 410-20	"[C]ontingencies associated with the retirement of a tangible long-lived asset" resulting "from the acquisition, construction, or development and/or the normal operation of a long-lived asset." (ASC 450-20-60-7)
ASC 410-30	Environmental remediation liabilities that are otherwise not within the scope of ASC 410-20.
ASC 460	"[C]ontingencies related to product warranties and product defects," "guarantees of indebtedness of others," and "obligations of commercial banks under financial standby letters of credit." (ASC 450-20-60-9 through 60-11)
ASC 470-60	"[C]ontingent payments of a troubled debt restructuring." (ASC 450-20-60-12)
ASC 606	For contracts with customers, estimating and constraining variable consideration (e.g., a sale with a right of return) included in the transaction price.

(Table continued)

ASC 610-20	For contracts with counterparties that are not customers, estimating and constraining variable consideration included in the transaction price.
ASC 610-30	When the amount of monetary assets to be received is uncertain in an involuntary conversion (destruction or damage of a nonmonetary asset).
ASC 710, 712, 715, and 718	Contingencies and uncertainties related to stock issued to employees, employment-related costs, including deferred compensation contracts and withdrawal from multiemployer plans. However, certain postemployment benefits are within the scope of ASC 450.
ASC 720-20	<ul style="list-style-type: none"> • “[C]ontingencies associated with a multiple-year retrospectively rated insurance contract accounted for as insurance.” (ASC 450-10-60-5) • “[C]ontingencies related to an insurance contract or reinsurance contract that does not, despite its form, provide for indemnification of the insured or the ceding company by the insurer or reinsurer against loss or liability.” (ASC 450-20-60-14)
ASC 740	Income tax uncertainty.
ASC 805-20	<ul style="list-style-type: none"> • “[C]ontingent obligations for contractual termination benefits and curtailment losses under employee benefit plans that will be triggered by the consummation of the business combination.” (ASC 450-10-60-7) • Contingencies recorded at fair value, if determinable.
ASC 842	“[V]ariable lease payments.” (ASC 450-20-60-15)
ASC 860	“[C]ontingencies related to agreements to repurchase receivables (or to repurchase the related property) that have been sold or otherwise assigned.” (ASC 450-20-60-17)
ASC 930-715	“Contingencies resulting from the Coal Industry Retiree Health Benefit Act of 1992.” (ASC 450-20-60-18)
ASC 944-20 and ASC 944-40	<ul style="list-style-type: none"> • “[C]ontingencies associated with multiple-year retrospectively rated contracts.” (ASC 450-10-60-11) • “[C]ontingencies related to the risk of loss that is assumed by a property and casualty insurance entity or reinsurance entity when it issues an insurance policy covering risk of loss from catastrophes.” (ASC 450-20-60-19)
ASC 954-450	“[C]ontingencies related to malpractice claims.” (ASC 450-20-60-21)

5.2.1.1 Differentiating Between Contingent Liabilities and Contractual or Legal Liabilities

Contingent liabilities involve uncertainty about whether a loss has been incurred and differ from contractual liabilities. Therefore, an entity must distinguish between a contingent liability, which is within the scope of ASC 450-20, and a contractual or legal liability, which is not. Contingent liabilities comprise only liabilities in which an entity's obligation to pay another entity is uncertain. Contractual or legal liabilities are debts or obligations between two or more parties that are typically settled by the transfer of cash, assets, or services; for these liabilities, there is generally little to no uncertainty about the likelihood of occurrence of the future settlement. A liability is not an unasserted claim or assessment under ASC 450-20 if the settlement of the liability is required by law or by contract.

Liabilities established by law or by contract are recorded at the stated amounts due unless otherwise indicated in U.S. GAAP.¹ The probability of payment is not relevant to the accounting for such liabilities. If an entity is required by law, regulation, or contract to make a future payment associated with an event that has already occurred, that event imposes a present duty upon the entity. An entity's uncertainty about whether an obligee will require performance does not allow the entity to choose to avoid the future sacrifice, nor does the uncertainty relieve the entity of the obligation. That is, when the obligating event has occurred, the entity has incurred a liability; accordingly, there is no contingency. For example, an entity must recognize accounts payable on the basis of the amount that it is contractually required to pay. The entity may not recognize accounts payable on the basis of the amount that it would expect to ultimately pay if the creditor filed suit to collect the liability. This conclusion is supported by analogy to ASC 410-20-25-15, which states that an "unambiguous requirement that gives rise to an asset retirement obligation coupled with a low likelihood of required performance still requires recognition of a liability." Once recognized, a contractual or legal liability that is not deferred revenue (i.e., a contract liability under ASC 606) should be derecognized only when the conditions for liability derecognition in ASC 405-20-40-1 have been met.

ASC 405-20

40-1 Unless addressed by other guidance (for example, paragraphs 405-20-40-3 through 40-4 or paragraphs 606-10-55-46 through 55-49), a debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
 1. Delivery of cash
 2. Delivery of other financial assets
 3. Delivery of goods or services
 4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.
- b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt.

¹ For example, the issue of how an entity should account for uncertain tax positions and breakage when a customer is not expected to exercise all of its contractual rights to goods or services in a revenue contract is specifically addressed in U.S. GAAP. [Chapter 4](#) of Deloitte's Roadmap *Income Taxes* addresses uncertain tax positions. [Section 8.8](#) of Deloitte's Roadmap *Revenue Recognition* addresses breakage associated with certain revenue contracts.

A contractual or legal liability is subject to the above liability derecognition guidance regardless of whether an entity believes that, on the basis of a probability assessment, such a liability can be settled for less than the stated legal obligation.

The examples below illustrate the accounting for a liability for which payment is required by law or contract but detection and settlement are uncertain.

Example 5-1

Probability Assessment Related to Sales Tax Liability for Which Payment Is Required by Law, but Detection and Settlement Are Uncertain

Entity Z has sold goods in Jurisdiction Y for 15 years and continues to sell them. By law, those sales would be subject to sales tax in Y if Z had nexus there. To assess whether Z has sales tax nexus in Y and should record a sales tax liability, Z diligently reviews prior-period sales records and interviews sales managers. Through this analysis, Z determines and documents that sales tax nexus in Y has existed for the past 15 years. Therefore, Z's products have always been taxable and subject to sales tax collection; however, Z has never collected sales tax or filed sales tax returns in Y. Entity Z has never been audited or contacted regarding a sales tax audit by tax authorities in Y. Entity Z believes that the risk of detection by the tax authorities in Y is low. However, Z believes that if the tax authorities in Y were presented with all of the facts about Z's activities, it is probable that Y would assert that Z is liable for uncollected sales taxes and demand payment. Entity Z believes that Y would settle for an amount less than the full liability.

Entity Z should record a sales tax liability on the basis of its sales activities for the full amount that it is legally obligated to remit to the tax authorities in Y. The sale of goods triggers the obligation to make the related sales tax payments. In measuring its sales tax liability, Z may not consider that the risk of detection by the tax authorities in Y is low. Further, Z must assume that the tax authorities in Y have all of the relevant facts about Z's operations in Y. Interest and penalties should also be included in the estimate of the liability if the imposition of interest and penalties is required by law.

Note that some state tax authorities may have a widely understood administrative practice and precedent in which, in the event of an examination and in the absence of a voluntary disclosure agreement, the tax authority would look back no more than a certain number of years to determine the amount of sales tax deficiency due. Alternatively, a statute of limitations may exist. Thus, Z should evaluate whether the tax authorities in Y will assess Z back to the first year of taxable sales (i.e., the full 15 years) or whether the liability will be limited by a statute of limitations or Y's administrative policies. In performing this evaluation, Z must use judgment to determine what constitutes "widely understood." If Z asserts that an administrative practice and precedent is widely understood, Z should document the basis of that assertion as well as any evidence to support it. Such evidence may include reliable knowledge of the tax authority's past dealings with Z on the same tax matter when the facts and circumstances were similar. An assessment of what Z believes it could negotiate as a settlement with the tax authority would generally not represent a "widely understood" administrative practice and precedent.

Similarly, Z should also adjust its liability to the extent that its customers have paid use tax on any portion of Z's sales during any part of the look-back period. However, because the obligating event is the sale of goods, Z should not record a sales tax liability for future sales until those sales actually occur.

Entity Z should regularly assess its sales tax obligations in the jurisdictions in which it conducts business. If Z has any uncertainty about those obligations, Z might need to obtain legal opinions. Sales tax liabilities should be adjusted upward as sales are made and should be adjusted downward only when the liability is paid or otherwise extinguished. (Note that sales taxes are not within the scope of ASC 740.)

Example 5-2**Royalty Liability for Which Payment Is Required by Contract, but Detection and Settlement Are Uncertain**

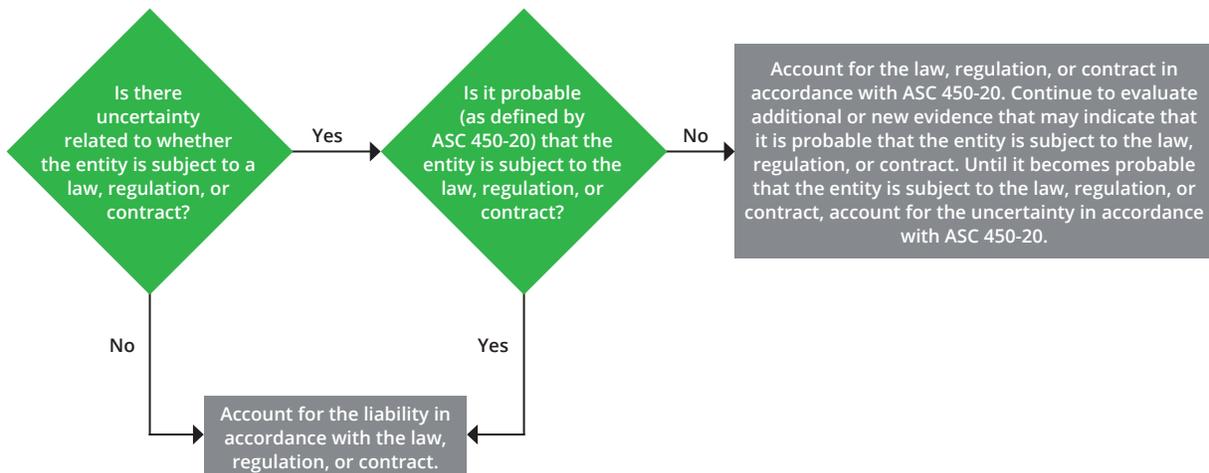
Company Y manufactures medical equipment and has a contractual obligation to pay, on the basis of sales volume, royalties to various patent holders. The amount of royalties paid each period is calculated by Y. In accordance with this obligation, patent holders have the right to audit Y's sales volume, but they have rarely exercised this right.

Company Y should record a royalty liability for the full amount that it is contractually obligated to pay according to the royalty agreements. The contracts require Y to make royalty payments on the basis of sales volume. Therefore, Y is under an obligation to the patent holders as the equipment is sold (i.e., Y has a present duty to the patent holders). The liability should be adjusted upward as sales are made and should be adjusted downward only when the liability is paid or otherwise extinguished in accordance with ASC 405-20-40-1.

In a scenario in which a patent holder cannot be located, Y should consider whether liability derecognition has occurred once the escheat laws of the relevant jurisdiction are complied with and the obligation no longer exists. Company Y's uncertainty about whether a patent holder will audit the sales volume does not allow it to avoid future payment. Finally, Y should not record a royalty liability for future sales until those sales actually occur.

**Connecting the Dots**

There may be uncertainty about whether an entity is subject to or within the scope of a current law, regulation, or contract owing to ambiguity about the interpretation of the current law, regulation, or contract. Examples include uncertainties related to a tax based on gross receipts, revenue, or capital. In these circumstances, an entity should evaluate the uncertainty in accordance with the flowchart below.

**5.2.1.2 Elements of a Litigation Settlement**

There may be litigation settlements in which the settlement agreement includes past obligations and disputes and modifies the ongoing contractual terms of the business relationship. When accounting for a litigation settlement that also includes a separate element (such as a revenue element) and bifurcating the elements, an entity should consider a [speech](#) made by Eric West, associate chief accountant in the SEC's Office of the Chief Accountant (OCA), at the 2007 AICPA Conference on Current SEC and PCAOB

Developments. We consider the interpretive guidance shared by Mr. West to be relevant and useful to private companies in addition to SEC registrants. Mr. West summarized a settlement arrangement as follows:

[A] company pays cash and conveys licenses to a plaintiff in order to settle a patent infringement and misappropriation of trade secrets claim. In exchange for the payment and licenses given, the company receives a promise to drop the patent infringement lawsuit, a covenant not to sue with respect to the misappropriation of trade secrets claim, and a license to use the patents subject to the litigation.

Mr. West noted that the different elements of the arrangement should be identified and that an entity will need to understand the nature of each item to make this identification. In addition to the litigation settlement component, there could be recognizable intangible assets related to the covenant not to sue and for patent licenses received. Regarding the license to patents given to the plaintiff, Mr. West noted:

If the licenses are expected to be used by the plaintiff in their operations, it may be appropriate for the company to recognize revenue or income with a corresponding increase in litigation settlement expense. However, if the licenses are given as part of a litigation defense strategy and don't have value to the plaintiff, it seems unlikely that any revenue should be recognized.

With respect to the amount of consideration to allocate to each element of the transaction, Mr. West noted the following:

While EITF 00-21 was written for multiple element revenue arrangements, we believe that its allocation guidance is also useful to determine how to allocate consideration paid in a multiple element legal settlement. In this regard, we believe that it would be acceptable to value each element of the arrangement and allocate the consideration paid to each element using relative fair values. [Footnote omitted]

Even though Mr. West was speaking about the separation guidance in EITF Issue 00-21, which was codified in ASC 605-25 and has been superseded by ASC 606, it is still appropriate for an entity to consider the principles of separation of performance obligations within the context of the revenue guidance in ASC 606. Specifically, as shown below, ASC 606 includes guidance on how to allocate consideration to different elements of a contract with a customer that are partially within the scope of ASC 606 and partially within the scope of another topic.

ASC 606-10

15-4 A contract with a customer may be partially within the scope of this Topic and partially within the scope of other Topics listed in paragraph 606-10-15-2.

- a. If the other Topics specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement guidance in those Topics. An entity shall exclude from the transaction price the amount of the part (or parts) of the contract that are initially measured in accordance with other Topics and shall apply paragraphs 606-10-32-28 through 32-41 to allocate the amount of the transaction price that remains (if any) to each performance obligation within the scope of this Topic and to any other parts of the contract identified by paragraph 606-10-15-4(b).
- b. If the other Topics do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply the guidance in this Topic to separate and/or initially measure the part (or parts) of the contract.



Connecting the Dots

In an agreement that contains a settlement of a litigation component and a revenue contract with a customer, an entity should bifurcate the revenue element and the nonrevenue element (i.e., litigation) and allocate the consideration to both elements in a manner consistent with Mr. West's remarks and ASC 606. There may be situations in which the entity has clear, compelling evidence that there is little to no value related to the litigation settlement; in those situations, the entire arrangement should be accounted for as a single element under ASC 606. When the entity determines that the entire arrangement should be accounted for as a single element under ASC 606, allocating consideration for the entire arrangement to the revenue element may be appropriate; however, the entity should not apply the residual method and allocate all of the proceeds to the revenue element by default.

The discussion above applies to both gain and loss contingencies that are settled by entering into a revenue contract with a customer. See [Chapter 3](#) of Deloitte's Roadmap *Revenue Recognition* for further discussion of contracts that include both revenue and nonrevenue elements. [Chapter 7](#) of that Roadmap addresses estimating stand-alone selling prices, including application of the residual method.

Further, the same allocation principle applies when the settlement does not contain a revenue element and is therefore entirely outside the scope of ASC 606 (i.e., the settlement is not with a customer, and none of the components constitute an output of the entity's ordinary activities). In those circumstances, an entity should still consider the allocation principle described in Mr. West's remarks and ASC 606 by analogy.

5.2.1.3 *Income Statement Classification for Settlements With Customers and Vendors*

When determining the appropriate income statement classification of a litigation settlement with a counterparty that is a customer, the entity should first look to the guidance on consideration payable to a customer in ASC 606-10-32-25 through 32-27 to determine whether the consideration is for a distinct good or service for which the entity can reasonably estimate fair value and, if so, classify such settlement payments in accordance with applicable U.S. GAAP. Similarly, when a litigation settlement involves a counterparty that is a vendor, the entity must consider ASC 705-20 to determine the appropriate income statement presentation of the settlement.

When the settlement counterparty is a customer or a vendor and the entity is able to determine the distinct litigation settlement benefit and can reasonably estimate the fair value of the litigation settlement benefit, the entity may recognize some or all of the settlement amount as an expense. To determine the appropriate amount to recognize as an expense, entities should consider the factors that Mr. West discussed in his [speech](#) at the 2007 AICPA Conference on Current SEC and PCAOB Developments. Mr. West summarized the classification of a settlement arrangement as follows:

Classification of the Settlement

In the fact pattern that I've talked about so far it would be appropriate to record the consideration allocated to the litigation within operating expenses since the company did not have a prior relationship with the plaintiff. However, we believe that a different answer may result if the plaintiff is also a customer of the defendant.

Assume a company settles a claim for over billing its customers for an amount that is in excess of the amounts they over billed. The company believed that the excess payment was necessary to preserve the customer relationship and had induced the customer to settle the claim. In this case we do not believe that classification of the entire payment as a settlement expense would be consistent with existing GAAP. Since the settlement payment was made to the company's customers, we believe that the payment is within the scope of EITF 01-9. [Footnote omitted] As you may know, this EITF addresses the accounting for consideration given by a vendor to a customer.

The scope is broadly written and includes all consideration given by a vendor to a customer. It also requires that cash consideration paid be classified as a reduction of revenues unless the vendor receives an identifiable benefit and the fair value of that benefit can be reliably measured. In this fact pattern, we believe that the excess amount paid to the customer represents both a payment to retain the customer and settle the litigation. However, if the company is unable to determine the fair value of each of these components, we believe that EITF 01-9 requires the entire payment to be classified as a reduction of revenues. **Had the company been able to directly value the litigation, classification of that portion of the settlement payment as an expense may have been appropriate.** [Emphasis added]

Even though Mr. West was speaking about the guidance in EITF Issue 01-9 on consideration payable to a customer, which was codified in ASC 605-25 and has been superseded by ASC 606, it is still appropriate for an entity to consider the principles outlined in the speech since the principle underlying the guidance in ASC 605-25 remains relatively consistent under ASC 606. Mr. West acknowledged that classification of a litigation component as an expense is appropriate in certain circumstances, specifically when (1) a prior customer/vendor relationship with the plaintiff does not exist or (2) a prior customer/vendor relationship does exist and the vendor receives an identifiable benefit for which the fair value of that benefit can be reliably measured.

Further, in evaluating the income statement classification of a litigation settlement in situations in which the counterparty is a vendor or customer, the entity should consider whether the settlement amount was based on an agreed-upon formula (e.g., whether it was based on total product sales to a customer or supplies purchased from a vendor) in such a way that there is a direct and observable correlation between the settlement amount and the previous revenue or purchase transaction. Such a correlation may be an indication that the settlement amount should be recognized as an adjustment to the transaction price received from a customer or to the cost of goods or services purchased from a vendor.

If settlement consideration payable to a customer is in exchange for a distinct good or service but the fair value cannot be reasonably estimated, the settlement consideration should be recognized entirely as a reduction in transaction price. For example, in a litigation settlement with a customer, an entity may determine that an element of the consideration pertains to settling the litigation and therefore is representative of a distinct benefit. The entity may have historical experience in settling similar cases and therefore may be able to readily determine the distinct litigation settlement benefit; however, unless the entity can reasonably estimate the fair value of the litigation settlement element, the entire settlement amount should be accounted for as a reduction in transaction price. For additional information regarding consideration payable to a customer, see [Chapter 6](#) of Deloitte's Roadmap *Revenue Recognition*.



Connecting the Dots

In certain circumstances, life sciences entities may need to exercise significant judgment in determining whether a litigation settlement involves a customer. For example, when the plaintiff is a governmental entity and the life sciences entity participates in governmental programs (e.g., Medicare or Medicaid), the life sciences entity (1) should consider whether the payment made to the governmental entity represents a payment made to a customer and (2) is encouraged to document its judgments related to income statement classification of the settlement contemporaneously.

Similarly, regarding classification of the settlement when payments are received from a vendor, entities should consider ASC 705-20, as discussed in [Chapter 6](#) of Deloitte's Roadmap *Revenue Recognition*, as well as the gain contingency recognition guidance, addressed below and in [Chapter 3](#) of Deloitte's Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

5.2.2 Recognition

ASC 450-20

25-1 When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. As indicated in the definition of contingency, the term *loss* is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses. The Contingencies Topic uses the terms *probable*, *reasonably possible*, and *remote* to identify three areas within that range.

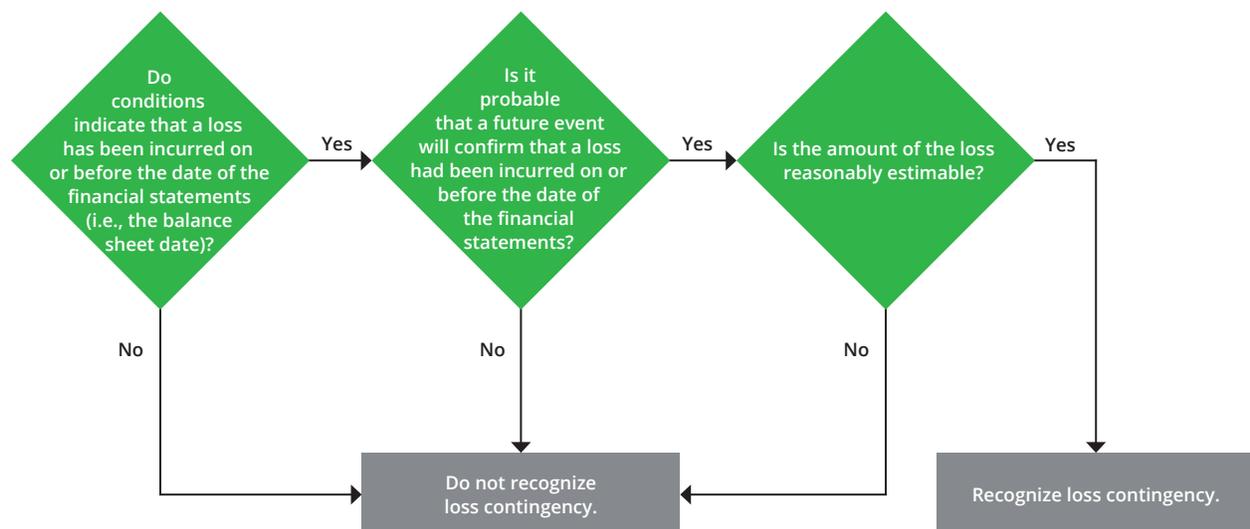
25-2 An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met:

- Information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- The amount of loss can be reasonably estimated.

The purpose of those conditions is to require accrual of losses when they are reasonably estimable and relate to the current or a prior period. Paragraphs 450-20-55-1 through 55-17 and Examples 1–2 (see paragraphs 450-20-55-18 through 55-35) illustrate the application of the conditions. As discussed in paragraph 450-20-50-5, disclosure is preferable to accrual when a reasonable estimate of loss cannot be made. Further, even losses that are reasonably estimable shall not be accrued if it is not probable that an asset has been impaired or a liability has been incurred at the date of an entity's financial statements because those losses relate to a future period rather than the current or a prior period. Attribution of a loss to events or activities of the current or prior periods is an element of asset impairment or liability incurrence.

When an entity obtains information before the financial statements are issued or available to be issued indicating that it is probable that a future event will confirm a financial statement loss that occurred on or before the date of the financial statements, the entity should accrue such a loss contingency provided that the loss can be reasonably estimated.

The flowchart below provides an overview of the contingent liability recognition criteria, taking into consideration all information about the loss that becomes available before the financial statements are issued (or are available to be issued).



A contingent liability is not recognized when either (1) it is not probable that a future event will confirm that a loss had been incurred on or before the date of the financial statements or (2) the amount of the loss is not reasonably estimable. The entity should carefully evaluate whether appropriate disclosure is necessary to keep the financial statements from being misleading. See additional disclosure requirements in [Section 5.2.6](#) of this Guide and [Chapter 2](#) of Deloitte's Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

5.2.2.1 Assessing the Probability of Whether a Loss Has Been Incurred

5.2.2.1.1 "Probable," "Reasonably Possible," and "Remote"

For an entity to recognize a loss contingency under ASC 450-20, it must be probable that one or more future events will occur or fail to occur, thereby confirming a loss. In the ASC 450-20 glossary, loss contingencies are categorized on the basis of the likelihood of occurrence as follows:

ASC 450-20 — Glossary	
Probable	The future event or events are likely to occur.
Reasonably Possible	The chance of the future event or events occurring is more than remote but less than likely.
Remote	The chance of the future event or events occurring is slight.

Although ASC 450-20 defines each of these terms, it provides no quantitative thresholds. The word "probable" is not intended to mean that virtual certainty is required before a loss is accrued. However, "likely to occur" is a higher threshold than "more likely than not," which is generally considered as indicating a chance of occurrence of more than 50 percent.

While no codified guidance defines the quantitative thresholds, an entity that is evaluating these thresholds may find it useful to consider interpretive guidance from paragraph 160 of AICPA Statement of Position 96-1, which states, in part:

If the FASB Statement No. 5 criteria of remote, reasonably possible, and probable were mapped onto a range of likelihood of the existence of a loss spanning from zero to 100 percent, the reasonably possible portion would span a significant breadth of the range starting from remote and ending with probable.

"Probable" is discussed in paragraph 49 of the Background Information and Basis for Conclusions of FASB Statement 114, which states, in part:

"[P]robable' . . . has, in the case of banks, come to mean 'virtually certain,' rather than 'more likely than not,'" and "the 'probable' requirement as it is sometimes applied has unduly delayed loss recognition . . . of problem assets." The Board did not intend "probable" to mean "virtually certain to occur." The Statement 5 definition of probable states that "the future event or events are *likely to occur*" (emphasis added). The Board recognizes that application of the term probable in practice requires judgment, and to clarify its intent the Board has reiterated the guidance in paragraph 84 of Statement 5 in paragraph 10 of this Statement. The term probable is used in this Statement consistent with its use in Statement 5. This Statement does not specify how a creditor should determine that it is probable that it will be unable to collect all amounts due according to a loan's contractual terms.

In addition, the SEC’s November 16, 2011, [staff paper](#) comparing U.S. GAAP with IFRS Accounting Standards states the following regarding the quantitative threshold used to recognize environmental obligations:

Both IFRS and U.S. GAAP contain a “probable” threshold for the recognition of an environmental liability. Probable within IFRS is defined as more likely than not (i.e., more than 50%), whereas probable is not as clearly defined under U.S. GAAP (but is interpreted in this context to be a percentage somewhat greater than 50%).

[ASU 2014-15](#) discusses “probable” in the context of determining what constitutes substantial doubt about an entity’s ability to continue as a going concern. In ASU 2014-15, the FASB observes that “probable” in the ASC master glossary’s definition of “substantial doubt about an entity’s ability to continue as a going concern” carries the same meaning that it does in ASC 450’s definition of the word. The ASU’s general discussion of a Board member’s dissenting view indicates, in part:

As mentioned in paragraph BC17, a commonly cited academic paper (Boritz, 1991) noted that the threshold for the substantial doubt likelihood of an entity being unable to meet its obligations is between 50 and 70 percent. The guidance in this Update increases that threshold to probable, which many assert as being in the 70–75 percent range.

While there is diversity in practice related to the likelihood percentage that entities consider “probable” to represent, in a manner consistent with the discussion in ASU 2014-15, the threshold for “probable” would need to be at least 70 percent. Although “remote” is not discussed quantitatively in any guidance issued by the FASB, in practice, this term is used to indicate a likelihood of 10 percent or less.

A loss contingency is recognized only when the likelihood of a future event’s occurrence indicates that it is probable that a loss has occurred (provided that the loss contingency is also reasonably estimable). If the likelihood of a future event’s occurrence is only reasonably possible, entities should provide appropriate disclosures in accordance with ASC 450-20-50, although loss accrual is not appropriate. For events for which the likelihood that a loss has been incurred is remote, recognition is not appropriate and disclosure is not required under ASC 450-20; however, entities should use judgment in determining whether omitting disclosures would cause the financial statements to be misleading. For additional discussion of disclosure considerations, see [Section 5.2.6](#) of this Guide and [Chapter 2](#) of Deloitte’s Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

Entities may need to consider various factors and use significant judgment in determining the likelihood of a future event’s occurrence or nonoccurrence that will confirm whether a loss has been incurred on the date of the financial statements. Specifically, in the case of class action lawsuits or litigation, entities may need to consider (among other things) the opinion of in-house or external legal counsel, the entity’s history and experience with similar cases, prior case law, how the entity intends to respond, and the nature of the settlement mechanism.

Certain contingencies do not obligate the entity until the underlying future events occur. Although the entity may consider the underlying future event probable to occur, a liability would not be recognized since the event that drives the obligation has not yet occurred. If the underlying event does not occur, the entity is not obligated to pay the liability. Examples of such underlying future events include casualty events, the enactment of proposed legislation, the successful completion of an initial public offering (IPO), and the occurrence of a business combination. For further discussion on these topics, see [Chapter 2](#) of Deloitte’s Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

5.2.2.1.2 Occurrence of a Business Combination or Successful Completion of an IPO

Certain liabilities are contingent on the occurrence of a business combination or the successful completion of an IPO. For example, an amount may be payable upon completion of an IPO, or a restructuring plan may be adopted upon consummation of a business combination.

There are many external factors and uncertainties that can affect the successful completion of an IPO or the consummation of a business combination. These external factors and uncertainties make it difficult to determine whether the probability threshold has been met before the effective date of an IPO or a business combination. Therefore, the incurrence of a liability contingent on an IPO or a business combination cannot be considered probable until the transaction is completed. This position does not affect or apply to freestanding derivative contracts or embedded derivative features that are within the scope of ASC 815 (e.g., a put option contingent on an IPO).

A business combination is an event for which discrete accounting is required when the combination is consummated. Accordingly, when the occurrence of a liability is contingent on the completion of a business combination, one of the events that obligates the entity and therefore gives rise to the liability has not occurred until the combination has occurred. Because of the uncertainties involved in, and the discrete nature of, business combinations, a liability should not be accrued until the business combination is consummated.²

However, in certain situations, a liability may exist even if a proposed business combination is not consummated. The fact that an entity has agreed to settle a preexisting litigation matter as a condition to completing such a business combination does not necessarily mean that the contingent liability should be recognized only on completion of the business combination. For further discussion on these topics, see [Chapter 2](#) of Deloitte's Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

5.2.2.1.3 Assessing Whether a Loss Is Reasonably Estimable

When accruing a loss, an entity must determine, in accordance with the recognition criteria in ASC 450-20-25-2, whether the loss is probable and reasonably estimable. Recognition of a loss that cannot be reasonably estimated, even if it is probable that the loss has been incurred, would impair the integrity of the financial statements. Alternatively, the entity should not delay accrual of a loss because of the inability to estimate a single amount. The ability to estimate a loss within a range would indicate that some amount of a loss has occurred and that the entity should therefore accrue a liability in accordance with ASC 450-20-25-2(b). The entity may use past experience or other information to demonstrate its ability to reasonably estimate the loss.

If both recognition criteria under ASC 450-20-25-2 are met, the estimated loss will be charged to income. ASC 450-20-25-7 indicates that if a loss cannot be accrued in the period in which it is determined that it is probable that a loss has been incurred "because the amount of loss cannot be reasonably estimated, the loss shall be charged to the income of the period in which the loss can be reasonably estimated and shall not be charged retroactively to an earlier period. All estimated losses for loss contingencies shall be charged to income rather than charging some to income and others to retained earnings as prior period adjustments."

² This position is consistent with the guidance in ASC 420 and ASC 805-20-55-50 and 55-51, which indicate that the liability for termination benefits and curtailment losses that will be triggered by the consummation of a business combination should be recognized only upon completion of the business combination.

5.2.2.2 Other Recognition Considerations

5.2.2.2.1 Litigation, Claims, and Assessments

A common uncertainty that many life sciences entities will encounter is the risk of litigation. Class actions, product liabilities, lawsuits, and actions brought by government agencies are not uncommon, and an entity may need to accrue or disclose contingencies related to the risk of such litigation (e.g., the potential future obligation to pay an uncertain amount as a result of past activities) in the financial statements.

Adverse consequences of litigation could include the obligation to pay damages, the imposition of fines and penalties, the need to repay consideration from a revenue contract that was previously received, and even discontinuation of certain operations. Further, the entire nature of the entity may change as a result of the litigation (e.g., the entity may seek protection from the litigation through bankruptcy).

Types of litigation that an entity may face include the following:

- Antitrust.
- Restraint of trade.
- Breach of contract.
- Patent infringement.
- Product liability.
- Violation of federal securities laws.
- Government actions.
- Discrimination.
- Environmental protection matters.
- Violation of wage and price guidelines or controls.
- Renegotiation of government contracts.
- Income tax disputes.
- Violation of other laws and regulations (e.g., the Foreign Corrupt Practices Act).

In determining whether an accrual is required in connection with litigation, claims, and assessments, an entity should consider various factors that include, but are not limited to, the following:

- *The nature of the settlement mechanism* — The parties involved may have agreed to use a settlement mechanism other than the court system that is binding on the parties. Accordingly, it is necessary to evaluate, on the basis of the specific facts and circumstances, the ability of the party that is subject to an adverse legal judgment to appeal the matter.
- *The progress of the case* — If the planned appeal is not the entity's first appeal of an adverse judgment (i.e., the entity has been unsuccessful in prior appeals of the judgment), the entity should consider the results or findings of the earlier rulings when assessing its evidence for and against liability recognition.

- *The opinions or views of legal counsel and other advisers:*
 - A legal analysis usually will include counsel's opinion regarding the likelihood that the entity will prevail on appeal. For example, a legal opinion may state counsel's belief that the entity's chance for a successful appeal is probable, more likely than not, or reasonably possible. The terms "probable" and "reasonably possible" do not signify precise quantitative thresholds and may be interpreted and applied differently by different parties, as described above. The meaning of such terms should be understood in the context of the legal opinion related to the entity's specific facts and circumstances so that management's assertions about the likelihood of success on appeal can be compared with those of counsel. An indication from legal counsel that an entity plans to vigorously defend itself against a claim does not relieve the entity from evaluating the probability of a future loss.
 - Management should review the basis for counsel's conclusions and assess whether the reasons cited by counsel to support its assessment are consistent with the evidence used by the entity to support its decision about whether to record a loss contingency.
 - Management should fully consider any qualifications or conditions that counsel identified as affecting its assessment. In interpreting language used by counsel to explain its conclusion, management may find it helpful to consider the guidance applicable to audits of financial statements contained in AU-C Sections 620 and 501 of the AICPA's auditing standards, which apply to financial statement audits.
 - Counsel's opinion is a critical piece of evidence that needs to be analyzed carefully. Counsel's expression of an opinion that an entity will be successful on appeal does not, in itself, support a conclusion that an accrual of a loss is not warranted. In addition, ASC 450-20-55-12(c) notes that "the fact that legal counsel is unable to express an opinion that the outcome will be favorable to the entity should not necessarily be interpreted to mean that the condition in paragraph 450-20-25-2(a) is met." However, when the entity has received an adverse legal judgment, counsel's inability to express an opinion may leave the entity with insufficient positive evidence to overcome the judgment.
- *The experience of the entity or other entities in similar cases* — The prior experiences of the entity or other entities with similar litigation may serve as additional evidence of the entity's likelihood of success. For example, management could consider possible outcomes specific to (1) certain jurisdictions, (2) certain courts, (3) the use of certain defense strategies, or (4) other related aspects of the litigation.
- *Prior case law for similar cases* — Gaining an understanding of prior case law may enable the entity to identify certain precedents that could affect the likelihood of its success.
- *Management's decision regarding how the entity intends to respond:*
 - Although certain adverse legal judgments may be appealed, the entity's decision to appeal will depend on a variety of factors. The entity should consider its specific facts and circumstances when assessing the likelihood that it will seek an appeal.
 - Because an adverse legal judgment may involve multiple components, the entity should analyze each component thoroughly to determine whether a litigation accrual should be recorded. For example, the entity should determine whether it will appeal all components of the judgment or only selected components.

- *The entity's intended basis for an appeal* — As discussed above, an understanding of the legal basis for the entity's appeal, combined with a review of prior case law or the experiences of the entity or other entities in similar cases, may serve as evidence that helps the entity gauge the likelihood that it will prevail on appeal.
- *The audit committee's assessment of the entity's opportunity for appeal* — The audit committee's assessment of the entity's opportunity for appeal, considered along with the assessments of internal or outside counsel and the entity's management, may constitute additional information about the entity's defense strategy and its chances for success on appeal.

Example 1 in ASC 450-20-55-18 through 55-21 and Cases A through D of Example 2 in ASC 450-20-55-22 through 55-35 illustrate the accounting for various litigation scenarios. For further discussion on these topics, including the evaluation of an adverse legal judgment's impact on the recognition and measurement of a loss contingency, see [Chapter 2](#) of Deloitte's Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

5.2.2.2.2 Injury or Damage Caused by Products Sold

ASC 450-20

55-2 If it is probable that a claim resulting from injury or damage caused by a product defect will arise with respect to products or services that have been sold, accrual for losses may be appropriate. The condition in paragraph 450-20-25-2(a) would be met, for instance, with respect to a drug product or toys that have been sold if a health or safety hazard related to those products is discovered and as a result it is considered probable that liabilities have been incurred. The condition in paragraph 450-20-25-2(b) would be met if experience or other information enables the entity to make a reasonable estimate of the loss with respect to the drug product or the toys.

Life sciences entities may be subject to recalls on their products (e.g., medical devices, pharmaceutical drugs). While some product recalls are voluntary (e.g., the drug manufacturer has chosen to remove the drug from the shelves or has notified consumers and doctors to stop using the product or return it), other recalls may be required by law or a regulator (e.g., the FDA).

If an entity is not otherwise required by law or a regulator to initiate a product recall, the obligating event triggering liability recognition for the costs (i.e., repurchasing inventory) associated with a voluntary product recall would generally be the announcement of the recall. Except as provided for in a warranty arrangement, an entity has no legal obligation or duty associated with product design or manufacturing defects after the product is sold. Because there is no legal obligation, there is no event that gives rise to a probable loss until a recall is announced voluntarily. If, however, a warranty arrangement exists, the obligating event is the identification of a problem with the product or the need for product recall, not the voluntary recall announcement.

Alternatively, an entity may conclude, on the basis of current laws or regulations, that it is probable that such a law or regulation will require the entity to initiate a product recall as a result of adverse events or conditions associated with the product in the distribution channel (i.e., inventory that has been sold but has not yet been consumed). In such a situation, the obligating event triggering liability recognition for the costs of the recall is the existence of the current law or regulation, and liability recognition for the estimated costs of the recall would generally be required once the entity has concluded that it is probable that such a law or regulation will require a recall and the associated costs can be reasonably estimated. Further, such a conclusion could be reached before formal notification by a regulator that a recall will be mandated.



Connecting the Dots

Entities may need to exercise significant judgment when determining whether a product recall is mandated by current law or regulation or should be considered voluntary. This distinction is critical since the timing of liability recognition for the recall may vary depending on the determination.

Given the complexity and the significant judgment that may be required, entities are encouraged to consult with their legal and accounting advisers when making this determination.

The above discussion regarding the obligation associated with a product recall does not take into account situations in which a product may have caused harm or damage that could result in potential loss against a company. In such a situation, a loss contingency would be recorded once the loss is deemed probable and reasonably estimable in accordance with ASC 450-20-25-2. Further, entities should consider whether the nature of a product recall calls into question the potential impairment of any inventory on hand.

Unless other authoritative literature requires entities to classify costs of fulfilling product recalls in a particular manner (i.e., in accordance with the guidance in ASC 606 on consideration for a product returned from a customer), such costs should be classified as operating costs in the financial statements because they result from an inherent business risk.

Example 5-3

Voluntary Recall Initiated by an Entity

Big Pharma develops and manufactures health care products, including medicines and vaccines to advance wellness, prevention, treatments, and cures. In May and June 20X9, Big Pharma distributes 25,000 bottles of a pediatric drug to various distributors. The drug is commonly used to reduce fever and relieve symptoms from conditions such as the flu and a common head cold.

In August 20X9, Big Pharma discovers that 8,500 of the bottles, specifically the 3 oz. cherry flavor, were distributed with the incorrect dosage cups. The dosage instruction provides dosing in teaspoons, while the dosage cups included in the packaging were labeled in tablespoons. Since 1 tablespoon contains 3 teaspoons, Big Pharma is concerned that the usage of the tablespoon dosage cups could result in dangerous overdoses if the cups' labeling was overlooked.

There is no law or regulation in place requiring Big Pharma to recall the drugs for including the incorrect dosage cups. In addition, no consumer lawsuits have been brought against Big Pharma regarding this matter. However, Big Pharma weighs the potential overdose risks of consumers' overlooking the measurement metric on the dosage cup and decides to voluntarily recall the product. On August 11, 20X9, Big Pharma announces the recall for the 8,500 affected bottles. Upon announcing the recall, Big Pharma recognizes a liability for the estimated costs of removing the bottles from distributors and retail stores, replacing them, and notifying consumers. Because Big Pharma was not otherwise required by law to initiate the product recall, the obligating event triggering the liability recognition is the announcement of the recall on August 11, 20X9. Any liability related to potential consumer lawsuits would be accounted for in accordance with ASC 450-20. Such accounting would be separate from that for the costs Big Pharma expects to incur in connection with the recall.

Example 5-4**Recall Required by a Regulator**

Medical Device Co. develops and manufactures infusion pumps that are sold to various hospitals and clinics. The devices are used to infuse certain medication into a patient's circulatory system.

In March, Medical Device Co. discovers that one of its products, Infusion Y, was prone to malfunction because of a faulty liquid-crystal display (LCD). Although there have been no incidents reported or litigation brought against Medical Device Co., the Infusion Y devices are unsafe for use in the LCD's current state, and if the faulty LCD were reported to the FDA, the FDA would mandate a product recall and bar Medical Device Co. from selling the Infusion Y product.

In April, Medical Device Co. announces a product recall to (1) refund the hospitals and clinics that bought the Infusion Y product and (2) reacquire all sold inventory.

Although the recall is announced in April and the regulator has not yet provided formal notification of a mandated recall for the Infusion Y product, Medical Device Co. had determined in March that it was probable that the FDA would require the company to recall the product upon discovery of the faulty LCD. Further, Medical Device Co. concluded that sufficient information was available in March to make a reasonable estimate for the cost of the recall. Accordingly, Medical Device Co. should record a liability for the product recall in March, before the April recall announcement or a regulator-mandated recall. Any liability related to potential lawsuits would be accounted for in accordance with ASC 450-20. Such accounting would be separate from that for the costs Medical Device Co. expects to incur in connection with the recall.

5.2.3 Measurement**ASC 450-20**

30-1 If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued. Even though the minimum amount in the range is not necessarily the amount of loss that will be ultimately determined, it is not likely that the ultimate loss will be less than the minimum amount. Examples 1-2 (see paragraphs 450-20-55-18 through 55-35) illustrate the application of these initial measurement standards.

Once the recognition criteria under ASC 450-20-25-2 are met, entities should accrue the estimated loss by a charge to income. If the amount of the loss is a range, the amount that appears to be a better estimate within that range should be accrued. If no amount within the range is a better estimate, the minimum amount within the range should be accrued, even though the minimum amount may not represent the ultimate settlement amount.

A contingent liability should be estimated independently from any possible claim for recovery (see [Section 5.4](#) for the accounting for loss recoveries). For example, entities may enter into certain insurance contracts to protect themselves from a litigation loss, but the presence of insurance does not relieve the entity from being the primary obligor, since an entity generally would be unable to transfer to an insurance company its primary obligation to a potential claimant without the claimant's consent. Because a potential claimant typically is not asked to consent to an insurance contract between the entity and an insurance company, the entity may be unclear about the circumstances in which its primary obligation to a potential claimant could shift to the insurance company under an insurance contract.

Some have asserted that since workers' compensation arrangements and other similar insurance arrangements arise from and are governed by state law, it is possible for the insurance company, rather than the insured entity, to be the primary obligor to the claimant/employee by operation of law. In a typical workers' compensation arrangement, an entity purchases a policy from a third-party insurance company and the insurance company pays the full cost of all claims directly to the employees, subject only to the deductible. Actual claim experience will not further affect the entity's potential economic upside or downside aside from any insurance provisions that allow rates to be adjusted retrospectively.

While such arrangements may exist, it is expected to be rare that a legal analysis of the insurance contract and the applicable workers' compensation laws and regulations would support an assertion that the insurance company is the primary obligor. An entity that asserts that it no longer is a primary obligor in those or similar circumstances would need sufficient analysis and documentation to support its conclusion.

5.2.3.1 Offer to Settle Litigation

Entities will often make offers to settle litigation. An offer by management to settle litigation creates a presumption that it is probable that a liability has been incurred. The settlement offer establishes a low end of the range under ASC 450-20-30-1, resulting in accrual of a liability. Withdrawal of a settlement offer before acceptance and before issuance of the financial statements generally would not change this conclusion since the existence of the offer provides evidence that the company may be willing to settle the litigation for at least that amount.

The presumption that a settlement offer triggers accrual of a liability and the establishment of a low end of the range is generally considered to be a high hurdle to overcome, and its rebuttal should be based on persuasive evidence. The evidence should substantiate that it is not probable that the offer will be accepted. In addition, the evidence should substantiate that it is not probable that further negotiations will lead to an out-of-court settlement for which the entity will owe payment to the counterparty. In certain circumstances, an out-of-court settlement may be the only realistic litigation strategy because a trial is deemed too risky. In such circumstances, the extension of an offer to settle out of court is a strong indicator that the entity will ultimately settle with the counterparty for an equal or greater amount. Accordingly, when an offer has been extended to settle out of court, it must be at least reasonably possible that the litigation will ultimately be settled via court proceedings or arbitration and the entity will not be obligated to make a payment. An entity that believes that the presumption has been overcome should consider consulting with its accounting advisers.

It may not always be appropriate to accrue a contingent liability at the amount of a settlement offer. For example, if the counterparty to the settlement offer has rejected the offer and proposed a higher settlement amount, the amount an entity should accrue for the loss may exceed the settlement offer made by the entity. In such situations, an entity should use judgment and consider the relevant facts and circumstances.



Connecting the Dots

An entity should carefully consider all facts and circumstances when assessing whether an "offer" has been extended to settle litigation. Questions may arise about distinguishing when a formal offer has been made from when parties have explored potential settlement amounts. In determining whether there is a formal offer to settle, an entity should consider whether approval from additional members of management or the board of directors is required. Further, the evidence available to substantiate that an offer does not constitute the low end of the range is often subjective, and the entity should be careful when evaluating whether the presumption can be overcome.

Example 5-5**Offer to Settle Litigation**

Company X is in the medical device business and has been named as the defendant in a lawsuit alleging personal injury resulting from use of one of its surgical devices. After year-end but before issuance of the financial statements, X offers to settle the litigation for \$10 million. The plaintiff has not responded to the offer, and X believes that if the matter ultimately goes to trial, the outcome is uncertain. Company X's management believes that the parties are still far from deciding on a settlement value and therefore that the plaintiff is not likely to accept the offer. However, given the significant exposure X faces in a trial, it is probable that the matter will eventually be settled.

The offer to settle is significant objective evidence that it is probable that a liability has been incurred as of the date of the financial statements and that the amount of the offer constitutes the minimum amount in the range and should be accrued in the financial statements in accordance with ASC 450-20-30-1. Company X must also disclose any additional reasonably possible exposure to loss in its financial statements if the disclosure requirements in ASC 450-20-50-3 are met.

5.2.4 Remeasurement and Derecognition of a Contingent Liability**5.2.4.1 Remeasurement**

Unlike a contractual or legal liability (discussed above), whose measurement is established on the basis of the contract or law, the initial and subsequent measurement of a contingent liability in accordance with ASC 450-20-30 may involve a number of judgments. These uncertainties may necessitate the continual evaluation and remeasurement of the contingent liability as new information becomes available. Such remeasurement in accordance with ASC 450-20-30 could produce an estimated amount that is lower or higher when compared with the amount previously recognized, thereby resulting in a reduction or increase, respectively, of the contingent liability. If the new information indicates a reduction of the previously recognized liability, such a reduction should not be viewed as tantamount to derecognition of the contingent liability. That is, the remeasurement of a previously recognized contingent liability on the basis of new information that supports a lower estimated probable loss should not be viewed as a partial derecognition of a loss whose occurrence was and continues to be considered probable; rather, it should be viewed and accounted for as a change in estimate in accordance with ASC 250.

There may also be circumstances in which sufficient and reliable data are no longer available to support an estimate that was previously made for a contingent liability whose occurrence remains probable. For example, an entity may recognize a contingent liability on the basis of an actuarial analysis of historical loss data, but the availability of settlement data during recent periods may have declined significantly because of external factors. The decrease in the availability of recent loss data may have diminished the entity's ability to reasonably estimate the amount of the previously recognized contingent liability. However, the entity may believe that it is still probable that one or more future events will confirm that a liability has been incurred. Therefore, while the entity concludes that a loss associated with the contingent liability remains probable, it will nonetheless need to assess whether the previously accrued amount continues to represent an appropriate estimate or whether another estimate should be made on the basis of the recent circumstances associated with the availability of recent data, which could result in a reduction, or even a complete reversal, of the previously recognized loss. When the entity is evaluating whether it is appropriate to remeasure a contingent liability in such a circumstance, it should carefully support remeasurement with compelling and sufficiently reliable evidence that provides a reasonable basis for concluding that there has been a change in its previous judgment regarding the amount of the estimated loss to accrue. Further, clear disclosure of the change in facts and circumstances should be considered.

5.2.4.2 *Derecognition When Settlement Is No Longer Considered Probable*

A contingency that fails to meet one or both of the two criteria in ASC 450-20-25-2 does not reach the threshold for recognition in the financial statements. However, questions may arise about when it is appropriate for an entity to derecognize a previously recognized contingent liability when settlement is no longer considered probable.

For example, an entity may recognize a contingent liability related to the probable incurrence of a loss because of pending litigation. Subsequently and on the basis of the facts and circumstances related to the litigation, the entity may conclude that such a loss is no longer considered probable, even though the matter is not subject to legal release or the statute of limitations given the noncontractual nature of the contingency. In such a scenario, derecognition of the contingent liability would be reasonable given the conclusion that a loss is no longer considered probable. However, the assessment of whether a contingency is likely to occur often involves considerable subjectivity. In those cases, it may be prudent to reduce or reverse an existing accrual only when there is reasonably clear or compelling evidence that a loss is no longer considered probable. When determining the sufficiency of evidence to support derecognition, an entity should consider the potential that derecognition in certain circumstances could be misleading to financial statement users because it could inappropriately communicate that the liability has been extinguished when the contingency still exists. The entity should clearly disclose the change in the accrual and the underlying facts and circumstances.

The example below illustrates a scenario in which derecognition of a contingent liability may be appropriate when settlement is no longer considered probable.

Example 5-6

Derecognition of a Contingent Liability

Company S is a defendant in a lawsuit filed in 20X2 by a competitor, Company Z. In 20X4, a jury finds in favor of Z and awards damages of \$10 million. Company S's management determines that it is probable that a liability has been incurred despite its intent to appeal the verdict, and S recognizes a loss in the 20X4 financial statements. In December 20X8, the appeals court sets aside the previous jury verdict and remands the case back to the lower court for another trial. Company S has obtained an opinion from its legal counsel that says S has meritorious defenses and that the outcome of the new trial is uncertain after taking into account the reasons for the findings of the appeals court. Company S therefore derecognizes the previously recognized contingent liability given that it has determined that the evidence supported a conclusion that it was no longer probable that it would incur a loss in accordance with the litigation.

Company S should ensure that it has properly disclosed the change in facts and circumstances in the financial statements. In addition, although this illustrative example is provided to present the analysis an entity may undertake to determine when to derecognize a contingent liability, as a practical matter, entities may often find it challenging to obtain sufficiently compelling evidence to support a conclusion to reverse some or all of an existing contingent liability before complete elimination of the uncertainty. Company S will need to consider the totality of evidence available, including counsel's views.

5.2.5 Balance Sheet Classification

ASC 210-10 — Glossary

Current Liabilities

Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. . . .

ASC 210-10**Classification of Current Liabilities**

45-5 A total of current liabilities shall be presented in classified balance sheets.

45-6 The concept of current liabilities includes estimated or accrued amounts that are expected to be required to cover expenditures within the year for known obligations the amount of which can be determined only approximately (as in the case of provisions for accruing bonus payments) or where the specific person or persons to whom payment will be made cannot as yet be designated (as in the case of estimated costs to be incurred in connection with guaranteed servicing or repair of products already sold).

45-9 Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually 12 months, are also generally included [in current liabilities] . . .

The balance sheet classification of an accrued contingent liability should be based on the period in which the entity expects the contingency to be settled. A liability should be classified as short-term if it is expected to be settled within one year or less of the balance sheet date (or longer if the entity's operating cycle is greater than one year). Otherwise, the liability should be classified as long-term.

Entities should undertake a balanced analysis to determine the appropriate classification without presuming either short-term or long-term classification by default. As part of this analysis, entities should consider the specific circumstances associated with the liability, including any outstanding offers to settle the obligation. Such offers should be viewed as akin to due-on-demand obligations, which would generally require short-term classification unless the outstanding offer is based on a long-term payment plan.

Entities should have persuasive evidence to support the classification of a liability. The need for persuasive evidence may increase when an entity has concluded that long-term classification is appropriate. This evidence should clearly demonstrate the entity's expectation regarding the settlement period of the liability.

The following are additional considerations related to the classification of a contingent liability:

- A contingent liability that is measured on the basis of the entity's best estimate of the current amount the entity would be required to pay to another party to settle a dispute is generally recognized as a current liability.
- If an insurance recoverable receivable is recognized, the contingent liability and insurance receivable should generally be classified consistently. The determination of whether the liability and related asset are classified as current or long-term will depend on the facts and circumstances.

5.2.6 Disclosures

5.2.6.1 Disclosure Considerations Under ASC 450-20 and ASC 275

Disclosures of loss contingencies required under ASC 450-20 are intended to provide users of financial statements with an understanding of risks and how they could potentially affect the financial statements.

When performing accrual accounting, an entity must make estimates in current-period financial statements to reflect current events and transactions, the effects of which may not be precisely determinable until some future period. The final results may not match original expectations. Uncertainty about the outcome of future events is inherent in economics, and an entity should understand that fact when reading reports on economic activities, such as published financial statements. A business, to a great extent, is a function of the environment in which it operates. Thus, it can be affected by changing social, political, and economic factors. In addition, every entity is subject to uncertain future events that may affect the entity or the industry in which it operates. These uncertainties may or may not be considered contingencies as defined by ASC 450-10-20. As a result, the disclosures required by ASC 275-10-50 supplement and, in many cases, overlap the disclosures required by ASC 450-20-50.

Not all uncertainties inherent in the accounting process give rise to contingencies as that word is used in ASC 450. Estimates are required in financial statements for many of an entity's ongoing and recurring activities. The fact that an estimate is involved does not by itself constitute the type of uncertainty referred to in the definition of a contingency in ASC 450-10-20. For example, the fact that estimates are used to allocate the known cost of a depreciable asset over the asset's useful life does not make depreciation a contingency; the eventual expiration of the use of the asset is not uncertain. Thus, depreciation of assets is not a contingency as discussed in ASC 450-10-55-2. In addition, matters related to depreciation (e.g., recurring repairs, maintenance, and overhauls) are similarly outside the scope of ASC 450. Amounts owed for services received, such as advertising and utilities, are not contingencies even though the accrued amounts may have been estimated; there is nothing uncertain about the fact that those obligations have been incurred.

Some degree of estimation is required for nearly all financial statement amounts. However, many lawsuits that may create a material liability are not recorded because one or both conditions for recognizing a contingent liability are not met; they are nonetheless disclosed to the extent that a loss is reasonably possible.

Neither ASC 450-20 nor any other authoritative literature contains definitive guidelines on measuring the difference between estimates that are affected by uncertainty that can be estimated reasonably and those that cannot be estimated reasonably. Although estimates generally include some level of uncertainty, they are not necessarily loss contingencies. Thus, estimates regarding events in the normal course of business have frequently been included in the financial statements without specific disclosure since ASC 450-20-50 requires disclosure of only contingencies. ASC 275-10-50 extends disclosure requirements to numerous risks and uncertainties, many of which are not considered contingencies.

ASC 450-20

Accruals for Loss Contingencies

50-1 Disclosure of the nature of an accrual made pursuant to the provisions of paragraph 450-20-25-2, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading. Terminology used shall be descriptive of the nature of the accrual, such as estimated liability or liability of an estimated amount. The term *reserve* shall not be used for an accrual made pursuant to paragraph 450-20-25-2; that term is limited to an amount of unidentified or unsegregated assets held or retained for a specific purpose. Examples 1 (see paragraph 450-20-55-18) and 2, Cases A, B, and D (see paragraphs 450-20-55-23, 450-20-55-27, and 450-20-55-32) illustrate the application of these disclosure standards.

ASC 450-20 (continued)**Pending Content (Transition Guidance: ASC 220-40-65-1)**

50-1 Disclosure of the nature of an accrual made pursuant to the provisions of paragraph 450-20-25-2, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading. Terminology used shall be descriptive of the nature of the accrual, such as estimated liability or liability of an estimated amount. The term *reserve* shall not be used for an accrual made pursuant to paragraph 450-20-25-2; that term is limited to an amount of unidentified or unsegregated assets held or retained for a specific purpose. Examples 1 (see paragraph 450-20-55-18) and 2, Cases A, B, and D (see paragraphs 450-20-55-23, 450-20-55-27, and 450-20-55-32) illustrate the application of these disclosure standards. See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.

50-2 If the criteria in paragraph 275-10-50-8 are met, paragraph 275-10-50-9 requires disclosure of an indication that it is at least reasonably possible that a change in an entity's estimate of its probable liability could occur in the near term. Example 3 (see paragraph 450-20-55-36) illustrates this disclosure for an entity involved in litigation.

Unrecognized Contingencies

50-2A The disclosures required by paragraphs 450-20-50-3 through 50-6 do not apply to credit losses on instruments within the scope of Topic 326 on measurement of credit losses. (See paragraph 310-10-50-21.)

50-3 Disclosure of the contingency shall be made if there is at least a reasonable possibility that a loss or an additional loss may have been incurred and either of the following conditions exists:

- a. An accrual is not made for a loss contingency because any of the conditions in paragraph 450-20-25-2 are not met.
- b. An exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 450-20-30-1.

Examples 1–3 (see paragraphs 450-20-55-18 through 55-37) illustrate the application of these disclosure standards.

50-4 The disclosure in the preceding paragraph shall include both of the following:

- a. The nature of the contingency
- b. An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.

50-5 Disclosure is preferable to accrual when a reasonable estimate of loss cannot be made. For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 450-20-25-2(a) but that is not accrued because the amount of loss cannot be reasonably estimated (the condition in paragraph 450-20-25-2(b)). Disclosure also shall be made of some loss contingencies that do not meet the condition in paragraph 450-20-25-2(a) — namely, those contingencies for which there is a reasonable possibility that a loss may have been incurred even though information may not indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.

50-6 Disclosure is not required of a loss contingency involving an unasserted claim or assessment if there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless both of the following conditions are met:

- a. It is considered probable that a claim will be asserted.
- b. There is a reasonable possibility that the outcome will be unfavorable.

50-7 Disclosure of noninsured or underinsured risks is not required by this Subtopic. However, disclosure in appropriate circumstances is not discouraged.

ASC 275-10

50-7 Various Topics require disclosures about uncertainties addressed by those Topics. In particular, Subtopic 450-20 specifies disclosures to be made about contingencies that exist at the date of the financial statements. In addition to disclosures required by Topic 450 and other accounting Topics, this Subtopic requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or in disclosure of gain or loss contingencies, as described below.

50-8 Disclosure regarding an estimate shall be made when known information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that both of the following criteria are met:

- a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
- b. The effect of the change would be material to the financial statements.

50-9 The disclosure shall indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. If the estimate involves a loss contingency covered by Subtopic 450-20, the disclosure also shall include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required. The words reasonably possible need not be used in the disclosures required by this Subtopic.

50-11 This Subtopic's disclosure requirements are separate from and do not change in any way the disclosure requirements or criteria of Topic 450; rather, the disclosures required under this Subtopic supplement the disclosures required under that Topic as follows:

- a. If an estimate (including estimates that involve contingencies covered by Topic 450) meets the criteria for disclosure under paragraph 275-10-50-8, this Subtopic requires disclosure of an indication that it is at least reasonably possible that a change in the estimate will occur in the near term; Topic 450 does not distinguish between near-term and long-term contingencies.
- b. An estimate that does not involve a contingency covered by Topic 450, such as estimates associated with long-term operating assets and amounts reported under profitable long-term contracts, may meet the criteria in paragraph 275-10-50-8. This Subtopic requires disclosure of the nature of the estimate and an indication that it is at least reasonably possible that a change in the estimate will occur in the near term.

50-12 If a loss contingency meets the criteria for disclosure under both Topic 450 and paragraph 275-10-50-8, this Subtopic requires disclosure that it is at least reasonably possible that future events confirming the fact of the loss or the change in the estimated amount of the loss will occur in the near term.

In addition to being required to provide the primary disclosures under ASC 450-20, an entity must provide certain additional disclosures under ASC 275 when it is reasonably possible that a change in estimate will occur in the near term. The disclosure requirements under ASC 450-20 and ASC 275 are summarized in the table below.

Possibility That a Loss Has Been Incurred	Ability to Estimate a Loss	Disclosure Requirements of ASC 450-20 and ASC 275
Reasonably possible	May or may not be reasonably estimable	Disclose all of the following: <ul style="list-style-type: none"> • “The nature of the contingency” (e.g., a description of the patent infringement). See ASC 450-20-50-4(a). • “An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.” See ASC 450-20-50-4(b). • A statement indicating that it is at least reasonably possible that the estimated amount of the loss will change in the near term if (1) “[i]t is at least reasonably possible that the estimate . . . will change in the near term” and (2) “the effect of the change would be material.” See ASC 275-10-50-8.
Probable	Not reasonably estimable	Disclose both of the following: <ul style="list-style-type: none"> • “The nature of the contingency” (e.g., a description of the patent infringement). See ASC 450-20-50-4(a). • A statement that the amount of the loss cannot be reasonably estimated. See ASC 450-20-50-4(b).
Probable	Reasonably estimable	Disclose all of the following: <ul style="list-style-type: none"> • “The nature of the contingency” (e.g., a description of the patent infringement). “The term <i>reserve</i> shall not be used for an accrual made pursuant to paragraph 450-20-25-2; that term is limited to an amount of unidentified or unsegregated assets held or retained for a specific purpose.” See ASC 450-20-50-1 and ASC 450-20-50-4(a). • The total amount of the loss that has been recognized (if such disclosure must be provided to ensure that the financial statements are not misleading). See ASC 450-20-50-1. • A statement indicating that it is at least reasonably possible that the estimated amount of the loss will change in the near term if (1) “[i]t is at least reasonably possible that the estimate . . . will change in the near term” and (2) “the effect of the change would be material.” See ASC 275-10-50-8. • The exposure to loss in excess of the amount accrued under ASC 450-20 if there is at least a reasonable possibility that such an excess loss may have been incurred. The disclosure should include both of the following: <ul style="list-style-type: none"> ◦ “The nature of the contingency.” ◦ “An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.” See ASC 450-20-50-3 and 50-4.
Remote	Not reasonably estimable	No specific disclosure requirements related to remote contingencies; however, disclosures may be provided if their omission could cause the financial statements to be misleading.



Connecting the Dots

In the life sciences industry, a substantial portion of the commercial value of an innovative product is usually realized during the period in which the product has market exclusivity. A product's market exclusivity is generally determined by patent rights held by the innovator company and the regulatory forms of exclusivity to which the innovative drug or device is entitled, which vary by jurisdiction. Once the period of market exclusivity lapses, generic or competitor versions of a product are frequently approved and marketed, potentially resulting in a significant and rapid decline in sales for the innovator company.

Because of the complexities involved in patent law and regulatory exclusivity, patent infringement litigation is common in the industry. Defendants in such litigation (which are often generics companies) frequently consider the above provisions of ASC 450-20 and ASC 275 in determining the accounting and disclosure related to these matters. Plaintiffs in such litigation (which are often branded companies) should also consider the disclosure requirements of ASC 275-10-50-16, under which an entity must disclose a concentration that exists on the date of the financial statements when (1) the "concentration makes the entity vulnerable to the risk of a near-term severe impact" and (2) "[i]t is at least reasonably possible that the events that could cause the severe impact will occur in the near term." Example 6 in ASC 275-10-55-13 and 55-14, which is reproduced below, illustrates the application of the disclosure guidance in ASC 275-10-50-16.

ASC 275-10

Example 6: Patent Expiration

55-13 This Example illustrates the disclosures required by paragraph 275-10-50-16. Felt Pharmaceutical Company is a national pharmaceutical manufacturer headquartered in Atlanta, Georgia. Felt markets a wide range of pharmaceutical products. One of its better-known name-brand products, a significant source of profits and cash flow, is an antibiotic on which there is a patent that will expire in six months. Competitors are preparing to enter the market with generic alternatives when Felt's patent expires, and the concentration therefore has the potential for a severe impact. The following illustrates the disclosure required by this Subtopic.

Felt Pharmaceutical Company is a national pharmaceutical manufacturer with sales throughout the United States. The patent on one of its major products expires next year. This product accounts for approximately one-third [or "a significant portion"] of the entity's revenues and a higher percentage of its gross profit.

55-14 The disclosure focuses on the nature of the business and on Felt's current vulnerability due to a concentration of its patented products. Disclosure is required because the concentration exists at the date of the financial statements, because the effect on Felt's cash flows and profitability of competitors entering the market when the patent expires could be a severe impact, and because it is considered at least reasonably possible that the events that could cause the severe impact will occur in the near term. Because the risk is evident from the description of the concentration, no further explanation of the risk is necessary.

Example 3 in ASC 450-20-55-36 and 55-37 illustrates the determination and disclosure of a range of estimates.

ASC 450-20

Example 3: Illustrative Disclosure

55-36 Entity A is the defendant in litigation involving a major competitor claiming patent infringement (Entity B). The suit claims damages of \$200 million. Discovery has been completed, and Entity A is engaged in settlement discussions with the plaintiff. Entity A has made an offer of \$5 million to settle the case, which offer was rejected by the plaintiff; the plaintiff has made an offer of \$35 million to settle the case, which offer was rejected by Entity A. Based on the expressed willingness of the plaintiff to settle the case along with information revealed during discovery and the likely cost and risk to both sides of litigating, Entity A believes that it is probable the case will not come to trial. Accordingly, Entity A has determined that it is probable that it has some liability. Entity A's reasonable estimate of this liability is a range between \$10 million and \$35 million, with no amount within that range a better estimate than any other amount; accordingly, \$10 million was accrued.

55-37 Entity A provides the following disclosure in accordance with Section 450-20-50.

On March 15, 19X1, Entity B filed a suit against the company claiming patent infringement. While the company believes it has meritorious defenses against the suit, the ultimate resolution of the matter, which is expected to occur within one year, could result in a loss of up to \$25 million in excess of the amount accrued.



SEC Considerations

ASC 450-20-50-4 requires disclosures about the nature of any material contingency, including the amounts that might be paid, if a loss is at least reasonably possible. In addition, SEC Regulation S-K, Item 303, requires discussion of items that might affect a company's liquidity or financial position in the future, including contingent liabilities.

The SEC staff has consistently commented on and challenged registrants' compliance with the disclosure requirements in ASC 450-20. For example, Scott Taub, deputy chief accountant in the SEC's OCA, noted the following in a [speech](#) at the 2004 AICPA Conference on Current SEC and PCAOB Developments:

Given [the requirement to record an accrual if payment is both probable and estimable and the requirement to disclose the nature of any material contingency, including the amounts that might be paid, if a loss is at least reasonably possible], the recording of a material accrual for a contingent liability related to an event that occurred several years before should not be the first disclosure regarding that contingency. Rather, disclosures regarding the nature of the contingency and the amounts at stake should, in most cases, have already been provided. Disclosures should discuss the nature of the contingency and the possible range of losses for any item where the maximum reasonably possible loss is material. Vague or overly broad disclosures that speak merely to litigation, tax, or other risks in general, without providing any information about the specific kinds of loss contingencies being evaluated are not sufficient.

Furthermore, I should point out that Statement 5 and Interpretation 14 [codified as ASC 450-20] require accrual for probable losses of the most likely amount of the loss. While the low end of a range of possible losses is the right number if no amount within the range is more likely than any other, I find it somewhat surprising how often "zero" is the recorded loss right up until a large settlement is announced. [Footnote omitted]

The SEC staff made similar remarks at subsequent conferences, including the 2010 AICPA Conference on Current SEC and PCAOB Developments. To ensure compliance with the requirements in ASC 450-20, registrants should continually review their disclosures and update them as additional information becomes available.

Non-SEC registrants may also consider the preceding SEC staff remarks given that the disclosure objectives outlined by the staff would generally be expected to apply to these entities' financial statements as well.

5.2.6.2 Disclosure of Unasserted Claims

ASC 450-20-50-6 indicates that a disclosure of a loss contingency involving an unasserted claim is not required unless both of the following conditions are met:

- a. It is considered probable that a claim will be asserted.
- b. There is a reasonable possibility that the outcome will be unfavorable.

This exception is specific to unasserted claims and should not be applied by analogy to claims other than unasserted claims. An entity must evaluate all the facts and circumstances in determining whether to disclose such a loss contingency.

5.2.6.3 Disclosure of Loss Contingencies Occurring After Year-End

ASC 855-10-50-2 requires an entity to disclose a nonrecognized subsequent event if it is "of such a nature that [it] must be disclosed to keep the financial statements from being misleading." Although the determination of whether to provide such a disclosure is a matter of judgment, it would seem prudent for an entity to disclose any matter that could materially affect its financial position, results of operations, or trend of operations. In addition, an entity should consider disclosing any accruals made in the subsequent reporting period as a nonrecognized subsequent event within the current-period financial statements if the accruals (1) are unusual or material to earnings of the current reporting period or (2) materially affect the trend of earnings.

Disclosures about a loss or loss contingency occurring after year-end should include (1) the nature of the loss or loss contingency and (2) an estimate of the amount or range of loss or possible loss or a statement that such an estimate cannot be made. If the effect on the entity's financial position is material, it may be useful for the entity to provide supplemental pro forma financial data reflecting the loss as if it had occurred as of the date of the financial statements.

5.2.6.4 Disclosure of Firmly Committed Executory Contracts

Although the ASC master glossary does not define "executory contract," an entity may find the following considerations useful in assessing the meaning of this term:

- Although never finalized and ultimately removed from the EITF's agenda, EITF Issue 03-17 refers to an executory contract as "a contract that remains wholly unperformed or for which there remains something to be done by either or both parties of the contract."
- IAS 37 refers to an executory contract as a contract "under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent."

The ASC master glossary defines a firm purchase commitment as "an agreement with an unrelated party, binding on both parties and usually legally enforceable," that is both (1) specific in "all significant terms, including the price and timing of the transaction," and (2) "includes a disincentive for nonperformance that is sufficiently large to make performance probable." Disincentives for nonperformance may be, for example, in the form of (1) a fixed payment requirement for each period under the agreement regardless of whether the purchaser takes delivery or (2) the inability of a purchaser to change the contractual delivery and payment terms with a supplier without a penalty payment for nonperformance.

Life sciences entities should consider the need for disclosure of a firmly committed executory contract to prevent the financial statements from being misleading. In addition, SEC registrants should consider whether commitments related to executory contracts should be included in their SEC Regulation S-K disclosures (e.g., within MD&A as a known “trend, event, or uncertainty” that may affect future earnings or other measures of performance).

ASC 440-10

50-2 An unconditional purchase obligation that has all of the following characteristics shall be disclosed in accordance with paragraph 440-10-50-4 (if not recorded on the purchaser’s balance sheet) or in accordance with paragraph 440-10-50-6 (if recorded on the purchaser’s balance sheet):

- a. It is noncancelable, or cancelable only in any of the following circumstances:
 1. Upon the occurrence of some remote contingency
 2. With the permission of the other party
 3. If a replacement agreement is signed between the same parties
 4. Upon payment of a penalty in an amount such that continuation of the agreement appears reasonably assured.
- b. It was negotiated as part of arranging financing for the facilities that will provide the contracted goods or services or for costs related to those goods or services (for example, carrying costs for contracted goods). A purchaser is not required to investigate whether a supplier used an unconditional purchase obligation to help secure financing, if the purchaser would otherwise be unaware of that fact.
- c. It has a remaining term in excess of one year.

Unrecognized Commitments

50-4 A purchaser shall disclose unconditional purchase obligations that meet the criteria of paragraph 440-10-50-2 and that have not been recognized on its balance sheet. Disclosures of similar or related unconditional purchase obligations may be combined. The disclosures shall include all of the following:

- a. The nature and term of the obligation(s)
- b. The amount of the fixed and determinable portion of the obligation(s) as of the date of the latest balance sheet presented, in the aggregate and, if determinable, for each of the five succeeding fiscal years
- c. The nature of any variable components of the obligation(s)
- d. The amounts purchased under the obligation(s) (for example, the take-or-pay or throughput contract) for each period for which an income statement is presented.

The preceding disclosures may be omitted only if the aggregate commitment for all such obligations not disclosed is immaterial.

50-5 Disclosure of the amount of imputed interest necessary to reduce the unconditional purchase obligation(s) to present value is encouraged but not required. The discount rate shall be the effective initial interest rate of the borrowings that financed the facility (or facilities) that will provide the contracted goods or services, if known by the purchaser. If not, the discount rate shall be the purchaser’s incremental borrowing rate at the date the obligation is entered into.

Recognized Commitments

50-6 A purchaser shall disclose for each of the five years following the date of the latest balance sheet presented the aggregate amount of payments for unconditional purchase obligations that meet the criteria of paragraph 440-10-50-2 and that have been recognized on the purchaser’s balance sheet.

An entity should provide the incremental disclosures required by ASC 440-10-50-2 that pertain to unconditional purchase obligations or firmly committed executory contracts. Specifically, when an executory contract is material and has not been recognized in the financial statements, the entity should comply with the disclosure requirements of ASC 440-10-50-4(a)–(d). When the entity has recognized an executory contract on the balance sheet, it should disclose total payments for each of the five years after the date of the latest balance sheet.



SEC Considerations

In addition to providing the footnote disclosures required by ASC 440-10-50, an entity must provide incremental disclosures within MD&A under SEC Regulation S-K, Item 303. Because the disclosures required by SEC Regulation S-K may be broader than those required by ASC 440-10-50-2, SEC registrants may reflect different amounts related to purchase obligations in the notes to the financial statements than they do in MD&A.

For further discussion on the accounting for firmly committed executory contracts, see [Chapter 2](#) of Deloitte's Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

5.2.7 Subsequent-Event Considerations

Entities should have processes in place to capture and evaluate events that occur after the balance sheet date but before the financial statements are issued or are available to be issued to determine whether the events should be recognized in current-period or subsequent-period financial statements.

The recognition, measurement, and disclosure principles related to loss contingencies described in this chapter apply to the period after the balance sheet date but before the financial statements are issued or are available to be issued.

ASC 450-20 includes guidance related to the accounting for subsequent events.

ASC 450-20

25-2 An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met:

- a. Information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated.

The purpose of those conditions is to require accrual of losses when they are reasonably estimable and relate to the current or a prior period. Paragraphs 450-20-55-1 through 55-17 and Examples 1–2 (see paragraphs 450-20-55-18 through 55-35) illustrate the application of the conditions. As discussed in paragraph 450-20-50-5, disclosure is preferable to accrual when a reasonable estimate of loss cannot be made. Further, even losses that are reasonably estimable shall not be accrued if it is not probable that an asset has been impaired or a liability has been incurred at the date of an entity's financial statements because those losses relate to a future period rather than the current or a prior period. Attribution of a loss to events or activities of the current or prior periods is an element of asset impairment or liability incurrence.

ASC 450-20 (continued)

25-6 After the date of an entity's financial statements but before those financial statements are issued or are available to be issued (as discussed in Section 855-10-25), information may become available indicating that an asset was impaired or a liability was incurred after the date of the financial statements or that there is at least a reasonable possibility that an asset was impaired or a liability was incurred after that date. The information may relate to a loss contingency that existed at the date of the financial statements, for example, an asset that was not insured at the date of the financial statements. On the other hand, the information may relate to a loss contingency that did not exist at the date of the financial statements, for example, threat of expropriation of assets after the date of the financial statements or the filing for bankruptcy by an entity whose debt was guaranteed after the date of the financial statements. In none of the cases cited in this paragraph was an asset impaired or a liability incurred at the date of the financial statements, and the condition for accrual in paragraph 450-20-25-2(a) is, therefore, not met.

The guidance in ASC 450 indicates that entities should consider information available before the financial statements are issued or are available to be issued when determining whether it is probable that an asset has been impaired or a loss event has occurred as of the balance sheet date. ASC 450 does not specifically address events occurring after the balance sheet date that provide additional information related to the measurement of a loss contingency; however, entities should consider the subsequent-event guidance that is codified in ASC 855-10.

ASC 855-10**Recognized Subsequent Events*****Evidence About Conditions That Existed at the Date of the Balance Sheet***

25-1 An entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. See paragraph 855-10-55-1 for examples of recognized subsequent events.

55-1 The following are examples of recognized subsequent events addressed in paragraph 855-10-25-1:

- a. If the events that gave rise to litigation had taken place before the balance sheet date and that litigation is settled after the balance sheet date but before the financial statements are issued or are available to be issued, for an amount different from the liability recorded in the accounts, then the settlement amount should be considered in estimating the amount of liability recognized in the financial statements at the balance sheet date.
- b. Subsequent events affecting the realization of assets, such as inventories, or the settlement of estimated liabilities, should be recognized in the financial statements when those events represent the culmination of conditions that existed over a relatively long period of time.

Nonrecognized Subsequent Events***Evidence About Conditions That Did Not Exist at the Date of the Balance Sheet***

25-3 An entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued. See paragraph 855-10-55-2 for examples of nonrecognized subsequent events.

ASC 855-10 (continued)

55-2 The following are examples of nonrecognized subsequent events addressed in paragraph 855-10-25-3:

- a. Sale of a bond or capital stock issued after the balance sheet date but before financial statements are issued or are available to be issued
- b. A business combination that occurs after the balance sheet date but before financial statements are issued or are available to be issued (Topic 805 requires specific disclosures in such cases.)
- c. Settlement of litigation when the event giving rise to the claim took place after the balance sheet date but before financial statements are issued or are available to be issued
- d. 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
- e. Changes in estimated credit losses on receivables arising after the balance sheet date but before financial statements are issued or are available to be issued
- f. Changes in the fair value of assets or liabilities (financial or nonfinancial) or foreign exchange rates after the balance sheet date but before financial statements are issued or are available to be issued
- g. Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the balance sheet date but before financial statements are issued or are available to be issued.

50-2 Some nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity shall disclose the following:

- a. The nature of the event
- b. An estimate of its financial effect, or a statement that such an estimate cannot be made.



Connecting the Dots

ASC 450 and ASC 855 provide guidance on how to evaluate events occurring after the balance sheet date. The period through which subsequent events must be evaluated differs for (1) SEC filers and “conduit bond obligor[s] for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets)” and (2) entities that are neither SEC filers nor conduit bond obligors. SEC filers and conduit bond obligors should evaluate events that occur through the date on which the financial statements are issued, whereas entities that are neither SEC filers nor conduit bond obligors should evaluate events that occur through the date on which the financial statements are available to be issued. To determine whether an entity is a conduit bond obligor, entities should refer to the definitions of “SEC filer” and “conduit debt securities” in the ASC master glossary.

If an event takes place after the balance sheet date but before the financial statements are issued or are available to be issued, and the event indicates that it is probable that an asset has been impaired or a liability has been incurred as of the balance sheet date, the event is considered a recognized subsequent event. The event provides additional evidence of the loss incurred before the balance sheet date and should be reflected in the financial statements.

Examples of events that provide additional information about conditions that existed as of the balance sheet date and therefore should be accounted for as recognized subsequent events include the following:

- An unfavorable court ruling in a lawsuit. The company had previously determined that the likelihood of an unfavorable outcome would be remote or reasonably possible but now considers it probable.

- A litigation settlement that indicates a loss amount different from that previously recognized in the financial statements.
- The identification of asset misappropriation that occurred on or before the balance sheet date for which no loss had previously been recognized.

If events constitute additional information that an asset had been impaired or a liability had been incurred as of the balance sheet date, but the amount of the loss cannot be reasonably estimated before the financial statements are issued or are available to be issued, the entity should consider whether disclosures are provided in accordance with [Section 5.2.6.1](#).

A loss should be recognized only when events confirm that an asset had been impaired or a liability existed as of the balance sheet date. If a loss contingency that did not exist as of the balance sheet date occurs after the balance sheet date but before the financial statements are issued or are available to be issued, the entity would not recognize the loss as of the balance sheet date but may need to disclose it as a subsequent event to keep the financial statements from being misleading.

The enactment of a law that gives rise to a liability after the balance sheet date but before the financial statements are issued or are available to be issued is a nonrecognized subsequent event. The newly enacted law does not provide evidence of conditions that existed as of the balance sheet date. However, the entity should consider whether it is required to disclose the event to keep the financial statements from being misleading. For additional information on the enactment of a law or legislation, see [Chapter 2](#) of Deloitte's Roadmap *Contingencies, Loss Recoveries, and Guarantees*.

Example 5-7

Legislation Enacted After the Balance Sheet Date

Company A, a public entity with a December 31, 20X1, year-end, operates in the health tech industry and is subject to proposed legislation that will impose an excise tax on software-related revenue transactions commencing on or after June 30, 20X1. The legislation is expected to be enacted after year-end but before the issuance of the financial statements. Company A believes that because the legislation is probable and is related to revenue transactions for the year ended December 31, 20X1, a liability should be accrued. However, the obligating event in this case is the enactment of the legislation, before which A did not incur a liability even though a tax is expected to be assessed on 20X1 sales; thus, no liability should be accrued as of December 31, 20X1. Instead, the impact of the new legislation is a nonrecognized subsequent event, and A should consider whether it is required to disclose the event to keep the financial statements from being misleading.

If a recognized contingent liability is settled after the balance sheet date but before the financial statements are issued or are available to be issued, a contingent liability should be reversed as of the balance sheet date to the extent that the recognized liability exceeds the settlement amount. The settlement constitutes additional evidence of conditions that existed as of the balance sheet date and would be considered a recognized subsequent event.

5.3 Gain Contingencies

The standard for recognition of gain contingencies is substantially higher than that for recognition of loss contingencies. ASC 450-30 indicates that a gain contingency should usually not be recognized before realization.

ASC 450-30

25-1 A contingency that might result in a gain usually should not be reflected in the financial statements because to do so might be to recognize revenue before its realization.

A gain contingency should not be recognized even if realization is considered probable. The notion of “probable” is relevant in accounting for a loss contingency, but it is not relevant in accounting for a gain contingency.

5.3.1 Scope

All gain contingencies should be evaluated under ASC 450-30-25-1 unless another source of authoritative literature specifically prescribes a different accounting model. The table below provides a nonexhaustive list of examples of uncertainties related to the timing or amounts of future cash flows to be received that are within the scope of other literature.

ASC 606	Seller’s estimation and constraint of estimates of the transaction price related to variable consideration (including a sale with a right of return) promised in a contract with a customer. (ASC 450-10-60-3)
ASC 610-20	Seller’s estimation and constraint of estimates of the transaction price in a contract for the sale of a nonfinancial asset or in-substance nonfinancial asset in a contract with a party other than a customer. (ASC 450-10-60-3)
ASC 720-20	“[R]ecognition of insurance recoveries by an entity insured through a purchased retroactive insurance contract,” other than for core insurance operations of an insurance entity. (ASC 450-30-60-4)
ASC 805-20	Indemnification assets acquired as part of a business combination. If an acquirer cannot determine the acquisition-date fair value of a contingency during the measurement period, it recognizes the contingency at its estimated amount if (1) “it is probable that an asset existed or that a liability had been incurred at the acquisition date” and (2) “[t]he amount of the asset or liability can be reasonably estimated.” These requirements are similar to those in ASC 450 related to loss contingencies. (ASC 805-20-25-20)
ASC 805-30	Contingent consideration related to the receipt of previously transferred consideration for the purchase of a business.
ASC 815	Contingent consideration arrangements accounted for as a derivative.
ASC 842-30	Lessor accounting for variable lease payments for sales-type leases, direct financing leases, or operating leases. (ASC 450-30-60-5)
Section F.3.4 of Deloitte’s Roadmap Consolidation — Identifying a Controlling Financial Interest	Contingent consideration accounting by the seller upon a subsidiary’s deconsolidation or derecognition of a group of assets that is a business.

5.3.2 Application of the Gain Contingency Model

ASC 450-30-25-1 indicates that a gain contingency should not be recognized “before its realization.” The realization of a gain occurs at the earlier of when the gain is realized or when it is realizable.

This view is based on paragraph 83 of [FASB Concepts Statement 5](#) (codified in ASC 450), which states, in part:

Revenues and gains of an enterprise during a period are generally measured by the exchange values of the assets (goods or services) or liabilities involved, and recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration.

- a. *Realized or realizable.* Revenues and gains generally are not recognized until realized or realizable. Revenues and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Readily convertible assets have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price. [Footnote omitted]

Recognition of a gain contingency occurs at the earlier of when:

The gain has been realized

The gain is realizable

An entity must often use significant judgment to determine when realization of a gain has occurred. Substantially all uncertainties about the realization of a gain contingency should be resolved before the gain contingency is considered realized or realizable and recognized in the financial statements. A gain is realized when cash or a claim to cash has been received and the cash (or claim to cash) is not subject to refund or clawback. A claim to cash supporting realization of a gain will often be in the form of a receivable. Such receivables may arise through (1) legally binding contractual arrangements detailing payment terms or (2) evidence provided by an insurer that all contingencies have been resolved and that the insurer will pay the insured party's claim with no right to repayment. It may be appropriate to recognize a gain contingency when it is realizable, although we would generally not expect this to be a common occurrence. A gain is realizable when assets received or held are readily convertible to a known amount of cash (or claim to cash).

An entity must thoroughly analyze all relevant facts and circumstances related to the gain contingency to support a conclusion that (1) a gain has been realized or (2) assets are readily convertible to cash in a known amount and the gain is therefore realizable. For an entity to recognize a gain contingency, the claim to cash must meet the definition of an asset in paragraphs E16 and E17 of [FASB Concepts Statement 8, Chapter 4](#). Paragraph E17 states, in part:

An asset has the following two essential characteristics:

- a. It is a present right.
- b. The right is to an economic benefit.



Connecting the Dots

Upon a litigation settlement determined by the courts or other authoritative bodies, an agreement often is executed that outlines the payments to be made by one or both of the parties and the timing thereof. In these situations, there is no longer a gain contingency because the agreement represents a claim to cash and the gain therefore has been realized. The executed agreement represents a contractual receivable since no contingencies remain. The party with the right to receive cash proceeds would assess the contractual receivable for impairment.

In concluding that a gain has been realized or is realizable, an entity should consider the nonexhaustive list of factors in the illustration below.



Besides the factors identified above, the entity should consider additional facts and circumstances, the nature of the agreement, and consultation with accounting advisers, as further discussed below.

Additional Facts and Circumstances	An entity that meets all of the above criteria should consider its individual facts and circumstances to determine whether any additional factors indicate that realization or realizability has not yet occurred.
Nature of the Agreement	An oral agreement may be legally binding in certain situations. For example, to recognize revenue within the scope of ASC 606, an entity must have a contract with a customer that is agreed to “in writing, orally, or in accordance with other customary business practices.” This requirement is based on the FASB’s conclusion that a revenue contract must be enforceable by law for an entity to recognize the rights and obligations arising from the contract. Because gain contingencies, by their nature, are generally expected to occur less frequently than revenue transactions, it is considerably less likely that oral evidence of, or a history of establishing, a customary business practice would be sufficient for the agreement to constitute a legally binding contract. Therefore, a written agreement would generally need to be in place for a gain contingency to be recognized.
Consultation With Accounting Advisers	Given the high threshold for recognizing a gain contingency, entities may determine that consultation with their accounting advisers is warranted when evaluating exactly when realization or realizability of a gain contingency has occurred. For example, while the realization principle described above does not mandate that cash be received before realization is considered to have occurred, the timing of receipt of cash often may coincide with the resolution of all remaining uncertainties associated with the gain contingency.

5.3.3 Legal Disputes and Legislative or Regulatory Approval

Because of the number of uncertainties inherent in a litigation proceeding, gain contingencies resulting from favorable legal settlements generally cannot be recognized in income until cash or other forms of payment are received. Gain recognition is not appropriate when a favorable legal settlement remains subject to appeal or other potential reversals. Often, gain contingency recognition will be deferred even after a court rules in favor of a plaintiff.

Example 5-8

Legal Dispute — Declaration of Award

Company W, a drug manufacturer, has a dispute with Company O, a third party it engaged to perform clinical research services. Company O ceases the work before its completion, and W subsequently declares the contract canceled because of various issues concerning O’s performance of its obligations under the contract. Company W files a claim against O, and the parties enter into arbitration. The arbitrator declares that O is to pay W \$4 million. The arbitrator’s judgment may be appealed to a higher court. Because there is no direct linkage between the arbitration award granted and the costs W previously incurred under the contract with O, the arbitration award is a gain contingency rather than the recovery of a previously incurred loss, and W should not recognize the \$4 million award before its realization or when it is considered realizable.



Connecting the Dots

In the example above, Company W should not recognize the \$4 million gain contingency award because all possible appeals have not yet been exhausted and W’s gain contingency therefore is not considered realized or realizable. This threshold for recognizing a gain contingency is higher than the “probable and reasonably estimable” threshold required for recognition of a loss contingency (see [Section 5.2](#)) or a loss recovery (see [Section 5.4](#)).

Separately, Company O would recognize a loss contingency after the arbitrator's judgment because the criteria in ASC 450-20 have been met. The arbitrator's ruling is significant objective evidence of the probability that O has incurred a liability, and O concludes that it does not have sufficient evidence to counterbalance this adverse ruling. Further, the \$4 million that O will pay to W for settlement of the dispute is reasonably estimable on the basis of the arbitrator's ruling. Because the thresholds for recognition of gain contingencies differ from those for recognition of loss contingencies or loss recoveries, it is not uncommon for one party in a dispute to recognize a loss contingency while the counterparty does not recognize the gain contingency.

Although an entity may be certain that it will receive proceeds from a legal settlement because there is no possibility of additional appeals, there may still be other uncertainties that indicate that the gain has not yet been realized. The examples below illustrate contrasting scenarios in which the ultimate amount to be received is not estimable in one case and is known in the other.

Example 5-9

Legal Dispute — Cash Is Received in Escrow: Amount Not Estimable

Company R is a plaintiff in a class action lawsuit against several drug manufacturers. After a lengthy appeals process, a final settlement is reached. The drug manufacturers place the funds in an escrow account because there is no agreement on how to allocate the settlement among the attorneys and each respective plaintiff. Because R does not know the amount of cash to be received, gain recognition is inappropriate.

Example 5-10

Legal Dispute — Cash Is Received in Escrow: Amount Known

Assume the same facts as in the example above except that the amount to be paid to Company R and to all other plaintiffs is known. In addition, the cash has already been placed in escrow and will be paid by the court-appointed escrow holder after it performs various administrative tasks (i.e., preparing and processing the wire payments to plaintiffs). None of the other plaintiffs are contesting the outcome or allocation of the settlement. The cash is nonrefundable, and there is no potential for appeal or reversal. Company R has not identified any additional facts or circumstances related to this gain contingency that call into question whether the gain has been realized. After consulting with its accounting advisers, R concludes that gain recognition is appropriate if sufficient disclosure is provided about the status of realization. Company R's realized claim to payment, as detailed in the agreement, would represent a contractual receivable subject to an impairment assessment.

If a legal settlement is reached but is pending regulatory or legislative approval, gain recognition is not appropriate until all required levels of regulatory and legislative approval have been obtained. This is the case even if the entity can demonstrate that the settlement meets all criteria that are evaluated by a regulatory body when it is determining whether to grant approval.

5.3.4 Settling Litigation by Entering Into an Ongoing Business Relationship

An entity may recognize gains related to the settlement of litigation achieved by entering into an ongoing business relationship when the revenue recognition criteria for such a relationship have been met. Such a situation may exist when a litigation settlement agreement includes past obligations and disputes and modifies the ongoing contractual terms of the business relationship. When the contractual relationship is with a customer, the entity should apply ASC 606; otherwise, the entity may find it appropriate to apply ASC 610-20. In accounting for a litigation settlement that also includes a revenue element, an entity should consider bifurcating the settlement into its different elements, as described in an SEC staff [speech](#) at the 2007 AICPA Conference on Current SEC and PCAOB Developments (see [Section 5.2.1.2](#) for further discussion).

In addition, regarding classification of the settlement, entities should consider the guidance in ASC 606 when making payments to a customer and in ASC 705-20 when receiving payments from a vendor. See [Section 5.2.1.3](#) for further discussion.

5.3.5 Gain Realization Contingent on Future Performance Requirements

An entity's realization of a gain may be contingent on whether the entity meets a future performance requirement. Alternatively, realization of a gain may be contingent on future events outside the entity's control. In both cases, uncertainty remains and recognition of the gain contingency is not appropriate.

Other Codification topics (e.g., ASC 718) prescribe different accounting treatment when uncertainty or contingent events are outside or within the entity's control. As long as the uncertainty is within the scope of the gain contingency guidance in ASC 450-30, the entity should not analogize to other areas of guidance in U.S. GAAP when evaluating the appropriateness of recognizing a gain contingency.

5.3.6 Gain Contingency Disclosures

ASC 450-30

50-1 Adequate disclosure shall be made of a contingency that might result in a gain, but care shall be exercised to avoid misleading implications as to the likelihood of realization.

Even if insurance proceeds resulting in a gain or other gain contingencies are not recognized in the financial statements because of unresolved uncertainties, timely disclosure of the insurance gain contingency should be considered. Information disclosed might include (1) the nature of the gain contingency, including a description of any remaining uncertainties; (2) the parties involved; (3) the timeline of previous events; (4) an expected timeline for resolving the remaining uncertainties; and (5) the amount of the gain contingency, including consideration of uncertainties in the determination of the amount. If the entity is unable to determine the timeline for resolution or an estimate of the amount that will ultimately be realized, the entity may need to disclose the factors it considered in reaching these conclusions and update these disclosures in future financial statements as additional information becomes available.

The entity should take care to avoid providing misleading disclosures about the likelihood, timing, or amount of the potential gain contingency. Disclosures should also include the entity's accounting policy for recognizing recovery proceeds of previously recognized losses as well as proceeds expected to be received in excess of previously recognized losses.

For considerations related to gain contingency classification, see [Section 5.4.7](#).

5.3.7 Subsequent-Event Considerations

Entities should evaluate events that occur after the balance sheet date but before the financial statements are issued or are available to be issued to determine whether the events should be recognized in the current-period or subsequent-period financial statements.

The resolution of a gain contingency that results in a gain after the balance sheet date but before the financial statements are issued or are available to be issued generally should not be considered a recognized subsequent event. ASC 855-10-15-5(c) indicates that gain contingencies "are rarely recognized after the balance sheet date but before the financial statements are issued or are available to be issued" and provides a cross-reference to ASC 450-30-25-1, which states that "[a] contingency that might result in a gain usually should not be reflected in the financial statements because to do so might be to recognize revenue before its realization."

5.4 Loss Recoveries

5.4.1 Overview

Previous sections of this chapter address the accounting for loss and gain contingencies. This section addresses the accounting for recoveries pertaining to a previously recognized financial statement loss (e.g., an impairment of an asset or incurrence of a liability), as well as recoveries from business interruption insurance. Insured losses might result from partial or full destruction of an entity's property or equipment because of fire, earthquake, hurricane, or other natural disasters, as well as losses that arise from asbestos exposure or environmental matters. Insured losses can also take the form of insured director and officer costs and result from fraudulent activities undertaken by employees. Loss recoveries may be received from litigation settlements, insurance proceeds, or reimbursement of an employee's fraudulent activities through liquidation of the employee's assets.

An entity should consider four accounting models when determining the recognition and measurement of expected insurance or other proceeds related to a recovery: (1) the loss recovery model, (2) the gain contingency model, (3) a determinable mix of the loss recovery and gain contingency models, and (4) an indeterminable mix of the loss recovery and gain contingency models.

Loss recovery model	An asset for which realization is probable should be recognized only up to the amount of the previously recognized loss. The analysis of whether recovery is probable is consistent with the guidance on loss contingency recognition in Section 5.2 .
Gain contingency model	Recovery proceeds related to a loss that has not been recognized in the financial statements should be accounted for as a gain contingency as described in Section 5.3 .
Determinable mix of loss recovery and gain contingency models	A combination of the loss recovery and gain contingency models is applied when recovery proceeds are expected to exceed the amount of the previously recognized loss. The probable recovery proceeds equal to the amount of the recognized loss should be accounted for by using the loss recovery model. The expected proceeds in excess of the recognized loss should be accounted for by using the gain contingency model. For an entity to apply the determinable mix model, there must be a direct linkage between the recovery proceeds and the specifically identifiable recognized loss. See Section 5.4.4 for additional information.
Indeterminable mix of loss recovery and gain contingency models	An indeterminable mix of the loss recovery and gain contingency models results from a situation in which there is no clear evidence that the amount of the recovery proceeds is a recovery of previously recognized losses or costs (i.e., there is no direct linkage) or the amount of the loss or costs previously incurred is not objectively quantifiable (i.e., the losses or costs are not specific, incremental, identifiable costs or losses). Under these circumstances, the application of the gain contingency model would be appropriate for the entire amount of the recovery proceeds. See Section 5.4.4 for additional information.

These four models are based on the loss contingency model and the gain contingency model, both of which are codified in ASC 450. In addition, the accounting for recovery proceeds builds upon ASC 450, drawing from other parts of U.S. GAAP, including guidance on involuntary conversions (ASC 610-30); how to account for the impact of the September 11, 2001, terrorist attacks (EITF Issue 01-10); and environmental obligations (ASC 410-30). [Sections 5.4.2](#) and [5.4.3](#) describe how these additional sources of U.S. GAAP form the basis for the accounting for recovery proceeds.

5.4.2 Involuntary Conversions

Insurance is often maintained to mitigate losses in the event of property damage or casualty losses. The recognized loss and the associated recovery proceeds (through insurance proceeds or other sources of recovery) are treated as two separate events and therefore two separate units of account. The principle underlying this separation, which is the basis for the accounting models described in [Sections 5.4.3](#) and [5.4.4](#), is derived from the involuntary conversion guidance codified in ASC 610-30.

ASC 610-30

25-2 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. The conversion of a nonmonetary asset to monetary assets is a monetary transaction, whether the conversion is voluntary or involuntary, and such a conversion differs from exchange transactions that involve only nonmonetary assets. To the extent 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.

25-3 Involuntary conversions of nonmonetary assets to monetary assets are monetary transactions for which gain or loss shall be recognized even though an entity reinvests or is obligated to reinvest the monetary assets in replacement nonmonetary assets. However, the requirement of this Subtopic with respect to gain recognition does not apply to an involuntary conversion of a last-in, first-out (LIFO) inventory for which replacement is intended but not made by year-end and the taxpayer does not recognize gain for income tax reporting purposes. Paragraph 270-10-45-6(b) provides an exception for the liquidation of a LIFO inventory at an interim date if replacement is expected by year-end. Accordingly, that exception applies to an involuntary conversion of a LIFO inventory if replacement is expected by year-end.

25-4 In some cases, a nonmonetary asset may be destroyed or damaged in one accounting period, and the amount of monetary assets to be received is not determinable until a subsequent accounting period. In those cases, gain or loss shall be recognized in accordance with Topic 450.

When a nonmonetary asset (e.g., property) is involuntarily converted to a monetary asset (e.g., an insurance receivable), an entity must recognize the effects of the monetary transaction even if the proceeds are reinvested (voluntarily or by requirement) in the replacement or repair of the nonmonetary asset. The loss of a nonmonetary asset and subsequent monetary recovery through insurance are therefore accounted for as two separate units of account.

Example 5-11

Involuntary Conversion

A fire destroys Company X's operating plant. Company X must write off the plant, recognizing a loss, regardless of its decision or the insurance company's requirements to use any insurance proceeds to replace or repair the plant. If the property or equipment is destroyed or damaged in one period and the recovery proceeds are not recognizable (e.g., not determinable) until a subsequent period, X recognizes the loss when incurred without considering possible recognition of a monetary recovery (e.g., cash proceeds).

5.4.3 Loss Recovery and Gain Contingency Models

In determining whether an asset can be recognized for expected proceeds (e.g., proceeds from an insurance policy), an entity must first consider the amount of the expected proceeds in comparison to the related previously recognized loss, if any. This comparison is illustrated below in the context of the loss recovery and gain contingency models.

Loss Recovery Model



* The ultimate net income statement effect of the recognized loss and the insurance proceeds directly related to the recognized loss to the income statement is zero; however, the period in which the loss and the insurance proceeds are recognized may differ.

Gain Contingency Model



Although not codified, paragraph 16 of EITF Issue 01-10 notes that a gain is “a recovery of a loss not yet recognized in the financial statements or an amount recovered in excess of a loss recognized in the financial statements.” Consequently, a loss recovery could be defined as the inverse: recovery proceeds up to the amount of the financial statement loss incurred. The recognition threshold for a loss recovery is that it is probable, as indicated by ASC 410-30-35-8, which states, in part, that “an asset relating to the recovery shall be recognized only when realization of the claim for recovery is deemed probable.”

An asset related to a recovery should be recognized for a previously recognized financial statement loss when the recovery is probable. The amount greater than the previously recognized loss or a recovery of a loss not yet recognized in the financial statements should be treated as a gain contingency.

ASC 410-30 addresses the accounting for recovery proceeds related to environmental remediation liabilities. Although that guidance is specific to environmental matters, an entity should apply the recognition and measurement principles in ASC 410-30-35-8 and 35-9 when determining the appropriate recognition of other loss recoveries unrelated to environmental matters.

ASC 410-30

35-8 . . . The amount of an environmental remediation liability should be determined independently from any potential claim for recovery, and an asset relating to the recovery shall be recognized only when realization of the claim for recovery is deemed probable. The term *probable* is used in this Subtopic with the specific technical meaning in paragraph 450-20-25-1.

35-9 If the claim is the subject of litigation, a rebuttable presumption exists that realization of the claim is not probable.

An entity that incurs a loss attributable to impairment of an asset or incurrence of a liability and expects to recover all or a portion of that loss by filing a claim with an insurance carrier or a claim against other third parties should record an asset for the amount for which the recovery from the claim (not to exceed the amount of the total losses recognized) is considered probable. Amounts greater than an amount for which recovery from the claim was initially considered probable should be subsequently recognized only to the extent that they do not exceed actual additional covered losses or direct, incremental costs incurred to obtain the recovery. Any expected recovery that is greater than covered losses or direct, incremental costs incurred represents a gain contingency; therefore, a higher recognition threshold is required for such a recovery, as described throughout this section.

A conclusion that a potential recovery is probable may involve significant judgment and should be based on all relevant facts and circumstances. Claim proceeds that will result in a gain should be recognized at the earlier of when the proceeds are realized or realizable. For example, insurance proceeds may be considered realized when the insurance carrier settles the claim and no longer contests payment. Payment alone does not mean that realization has occurred if such payment is made but is being contested or is subject to refund. Recognition of the proceeds may be appropriate after consideration of the conditions outlined in [Section 5.3.2](#). Further, an entity should analyze proceeds accounted for as a loss recovery by applying the “probable” criterion used to determine a loss contingency (whether an asset has been impaired or a liability has been incurred), as outlined in [Section 5.2.2.1.1](#).

When recognizing potential loss recoveries from insurance carriers or other third parties, entities should consider both internal and external evidence related to the claim, including:

- Direct confirmation from the insurance carrier or other third parties that they would agree with the claim.
- In the absence of direct evidence from the insurance carrier or other third parties that they would agree with the claim, an opinion from legal counsel that it is “probable,” as that term is used in ASC 450, that:
 - The claim under the policy is enforceable.
 - Any loss events are covered.

Before recognizing a potential loss recovery, entities should consider the guidance in ASC 410-30-35-9, which indicates that “[i]f the claim is the subject of litigation, a rebuttable presumption exists that realization of the claim is not probable.”



SEC Considerations

The guidance in ASC 410-30-35-9 is consistent with the SEC staff’s interpretive guidance in Question 2 of [SAB Topic 5.Y](#) (codified in ASC 450-20-S99-1). However, additional disclosure requirements are included in footnote 49 of that guidance, which addresses uncertainties regarding the legal sufficiency of claims filed against insurance carriers or other third parties and the solvency of such insurance carriers and other third parties:

The staff believes there is a rebuttable presumption that no asset should be recognized for a claim for recovery from a party that is asserting that it is not liable to indemnify the registrant. Registrants that overcome that presumption should disclose the amount of recorded recoveries that are being contested and discuss the reasons for concluding that the amounts are probable of recovery.

It is likely that in determining whether it is probable that an entity will receive a recovery, the entity will need to understand, among other factors, the solvency of the insurance carrier or other third parties and have sufficient dialogue and historical experience with the insurance carrier or other third parties related to the type of claim in question to assess the likelihood of payment.

Example 5-12**Insurance Recovery of Replacement Cost**

A fire destroys Company H's main operating plant. Immediately after the fire, H recognizes a loss for the net book value of the plant and meets with the insurance adjuster to evaluate the loss and expedite the claim. Given a similar fire loss three years earlier, both parties are familiar with H's plant and the process by which the adjuster will determine H's claim settlement amount.

Because H is constructing a similar plant, H and the adjuster are also familiar with the replacement cost of the plant. Accordingly, the adjuster is able to quickly estimate the minimum property damage claim and implement appropriate procedures to process the claim and establish a schedule of reimbursements. The adjuster computes and the insurance carrier approves (settles) a minimum reimbursement for the cost of replacement; the amount is greater than the net book value of the old plant. Company H appropriately recognizes a gain for the excess of the minimum reimbursement over the net book value of the property since the amount was considered realized when the insurance carrier settled the claim and no longer contested the payment to be made to H. The recognition of the excess as a gain is consistent with the guidance in ASC 610-30 on involuntary conversions. It would not be appropriate for H to recognize the excess as a reduction of the cost basis of the replacement plant.

**Connecting the Dots**

Some incurred losses may be related to past events spanning multiple years or decades, such as losses that arise from asbestos exposure or environmental matters. In these situations, the losses may span periods covered by several insurance carriers, some of which may no longer be solvent, or various policies. Therefore, it may be challenging for an entity to determine whether the incurred loss is a covered event, whether because of vague language used in prior insurance policies or the number of policies or insurance carriers that may have existed at any given time. The entity should consider these potential limitations and factor them into its calculation of the probability that it will receive an insurance recovery for losses spanning multiple years.

5.4.4 Determinable and Indeterminable Mix of Loss Recovery and Gain Contingency Models

Under the determinable mix model, the probable recovery proceeds equal to the amount of the recognized loss should be accounted for by using the loss recovery model. Any expected proceeds in excess of the recognized loss should be accounted for as a gain contingency. When there is no clear evidence that the amount of the proceeds is a recovery of previously recognized losses or incremental costs (i.e., there is no direct linkage) or the amount of the loss or costs previously incurred is not objectively quantifiable (i.e., specifically identifiable), the gain contingency model would be applied to the entire amount of the recovery proceeds (also referred to as the indeterminable mix model). The determinable mix model, which encompasses both the loss recovery model and the gain contingency model, and the indeterminable mix model, which results in the application of the gain contingency model to probable recovery proceeds, are further illustrated below.

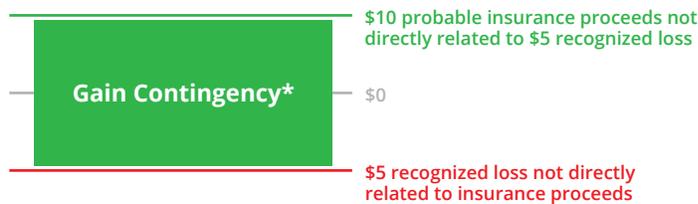
Determinable Mix Model



* Gain contingency model for \$5 proceeds in excess of \$5 recognized loss.

** Loss recovery model for \$5 proceeds up to \$5 recognized loss.

Indeterminable Mix Model



* Gain contingency model for all probable proceeds.

The examples below illustrate the application of the determinable mix model and the indeterminable mix model.

Example 5-13

Determinable Mix Model

An earthquake destroys Company R's corporate headquarters. At the time of the earthquake, the net book value of the corporate headquarters is \$350,000. Company R's insurance policy covers fair market value of the property, and R has a \$50,000 deductible. In accordance with the insurance policy, the fair market value of the corporate headquarters is based on a third-party appraisal before the earthquake. Company R carefully analyzes the provisions of the insurance policy regarding the deductible. Using an external expert, R determines that the fair value of the corporate headquarters before the earthquake was \$500,000.

In the same period as the earthquake, the insurance adjuster communicates to R that once the fair value is determined, an amount equal to the fair market value of the property, reduced by the deductible, will be paid to R, and the amount will not be subject to refund. Because this is a determinable mix of a loss recovery and a gain contingency, in the current period in which the earthquake occurs, R recognizes a loss of \$350,000 for the net book value of the destroyed corporate headquarters and a corresponding insurance recovery receivable of \$350,000. The loss recovery receivable is recognized because R concludes that it is probable that the insurance recovery will be realized.

Because it is probable that the insurance recovery will be realized and the fair value of the facility was determined to be well above the net book value of the corporate headquarters, we believe that it would be appropriate for R to recognize the entire \$350,000 loss recovery in the period in which the loss on the property is recognized. In a scenario in which there is sufficient evidence to support the insurance payment (in this case, \$450,000, which represents the \$500,000 fair market value of the property reduced by the \$50,000 deductible) will exceed the amount of recognized loss (in this case, \$350,000), it would be appropriate for R to recognize an insurance recovery receivable in an amount of \$350,000 and apply the deductible to the deferred gain, which represents the excess amount of fair market value over the net book value of the property.

Example 5-13 (continued)

The deferred gain is the \$100,000 difference between (1) the expected insurance proceeds of \$450,000 and (2) the \$350,000 recognized recovery receivable. Such a gain contingency should not be recognized until all contingencies are resolved and the insurance proceeds are realized. In this example, R may conclude that the \$100,000 is realized once the adjuster pays or confirms the related covered amount (the fair value of the corporate headquarters) and the amount is no longer contested or subject to refund.

Evidence to Support Probable Receipt of \$350,000 Insurance Proceeds

To recognize the \$350,000 recovery receivable, R considered whether it had sufficient evidence to support recognition of the full amount of the loss recovery receivable. If, for example, the external expert had determined the fair value of the corporate headquarters to be \$400,000 rather than \$500,000, it may have been more difficult for R to conclude that the full \$350,000 loss recovery asset would have been received because there would have been no excess (i.e., cushion) of fair value over the net book value of the property. In these situations, an entity could consider consulting with its accounting advisers.

Example 5-14**Indeterminable Mix Model**

Company T joins a class action lawsuit against Wholesaler Y because Y has overcharged for various service fee transactions over the past 10 years. Wholesaler Y and T enter into a settlement agreement, subject to the final approval of the claims administrator, for an estimated amount of \$35 million payable to T over the next 5 years. Company T concludes that it is probable that T will receive at least \$35 million from the settlement. The settlement agreement includes the recovery of actual and estimated overcharges, punitive damages, payment to avoid further cost of litigation, and payment to restore a collaborative business relationship.

The recovery of the overcharges amount is based on actual and estimated overcharges over the past 10 years. Company T is unable to determine a direct linkage between (1) what represents cost recovery of the previously recognized overcharges and (2) punitive damages. Further, Y contends in all legal proceedings that the lawsuit is without merit and that T has not previously incurred any losses. From Y's perspective, it is settling the lawsuit to restore a collaborative business relationship rather than to repay T's incurred losses. Accordingly, the amount of the loss previously incurred is not objectively quantifiable.

For T to characterize an amount as a loss recovery, the amount should represent the reimbursement of specific, incremental, identifiable costs previously incurred. Company T determines that it is unable to objectively determine how much of the settlement represents recovery of previously recognized overcharges. Therefore, T applies the gain contingency model to the entire amount of the settlement. Uncertainties remain regarding the settlement's approval; therefore, T should defer recognition of the gain until sufficient information is available for T to conclude that the gain is realized or realizable.

5.4.5 Business Interruption Insurance

ASC 220-30-20 defines business interruption insurance as “[i]nsurance 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.” ASC 220-30-05-2 describes the types of costs and losses that business interruption insurance covers.

ASC 220-30

- 05-2** 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, and so forth).

The guidance in [Section 5.4.3](#) on loss recoveries and gain contingencies applies to the accounting for business interruption insurance. That is, certain fixed costs incurred during the interruption period may be analogous to losses from property damage; accordingly, it may be appropriate to recognize a receivable (not to exceed the amount of costs incurred) for amounts whose recovery is considered probable. A recovery receivable should be recognized into income when the direct and incremental losses are incurred if the entity concludes that receipt of the recovery proceeds is probable. A recovery receivable should be recognized only up to the amount of the financial statement loss incurred (e.g., the fixed costs incurred). The possible recovery of lost profit margin should be considered a gain contingency since the absence of expected profit margin would not be considered a previously recognized financial statement loss. Therefore, the recovery of lost profit margin should be recognized into income when the gain contingency is resolved (i.e., the proceeds are realized or realizable). Because of the usually complex and uncertain nature of the settlement negotiations process, recognition of the lost profit margin (i.e., the gain contingency) may occur at the time of final settlement or when nonrefundable cash advances are made.

Because business interruption insurance may be paid in a lump-sum amount to the insured, including reimbursement for both property damage and lost profit margin, it may be difficult to determine whether the recovery is for losses previously recognized in the financial statements (i.e., whether the recovery should be considered a determinable mix or an indeterminable mix of loss recovery and gain contingency). We encourage entities to consult with their independent accountants when evaluating whether a receivable may be recognized for expected insurance recoveries associated with fixed costs incurred during the interruption period.



Connecting the Dots

There may be situations in which business interruption insurance is paid as an advance, lump-sum, nonrefundable final settlement amount for both future estimated fixed costs (e.g., continued labor, utilities) and estimated future lost profit margin for a claim period that covers future reporting periods. Under these circumstances, the amount received in advance related to future estimated fixed costs or future estimated lost profit margin is treated as a gain contingency. Therefore, because the advance payment is final and nonrefundable, the gain is considered realized even though the future fixed costs or lost profit margin has not yet occurred. There is no remaining contingency; the gain is therefore recognized in the financial statements given that there is no basis for deferring and amortizing the insurance proceeds over the future anticipated periods of continuing fixed costs or lost profit margin.

ASC 220-30-45-1 addresses the income statement presentation related to business interruption insurance and allows an entity to “choose how to classify business interruption insurance recoveries in the statement of operations, as long as that classification is not contrary to existing generally accepted accounting principles (GAAP).” In addition, in a period in which business interruption insurance recoveries are recognized, ASC 220-30-50-1 requires further disclosures in the notes to financial statements.

ASC 220-30

50-1 The following information shall be disclosed in the notes to financial statements in the period(s) in which business interruption insurance recoveries are recognized:

- a. The nature of the event resulting in business interruption losses
- b. 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.

5.4.6 Balance Sheet Presentation — Offsetting

ASC 210-20-20 defines a right of setoff as “a debtor’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor.” A right of setoff exists when all of the criteria in ASC 210-20-45-1 are met.

ASC 210-20

45-1 A right of setoff exists when all of the following conditions are met:

- a. Each of two parties owes the other determinable amounts.
- b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
- c. The reporting party intends to set off.
- d. The right of setoff is enforceable at law.

An entity that purchases insurance from a third-party insurer generally remains primarily obligated for insured liabilities; however, the entity should carefully evaluate the insurance contract and applicable laws. Under U.S. GAAP, it is only appropriate to offset assets and liabilities when the four above conditions in ASC 210-20-45-1 for the existence of a right of setoff are met.

It is not appropriate to offset a receivable for a probable insurance recovery against a contingent liability unless the requirements of ASC 210-20 are met. In such circumstances, the conditions for offsetting would typically not be met because an insurance receivable and claim liability generally would be with different counterparties. For example, insurance proceeds received by the reporting entity are usually from a third-party insurer, whereas the contingent liability related to claim liabilities would be to a party other than the third-party insurer.

5.4.7 Income Statement Classification of Loss Recoveries and Gain Contingencies

ASC 220-30-45-1 addresses the income statement presentation related to business interruption insurance and allows an entity to “choose how to classify business interruption insurance recoveries in the statement of operations, as long as that classification is not contrary to existing generally accepted accounting principles (GAAP).” Further, ASC 410-30 provides guidance on the income statement presentation of environmental remediation costs and related recoveries, such as insurance recoveries. ASC 410-30-45-4 states, in part, that “environmental remediation-related expenses shall be reported as a component of operating income in income statements that classify items as operating or nonoperating. Credits arising from recoveries of environmental losses from other parties shall be reflected in the same income statement line.”

Although authoritative income statement classification guidance does not exist for many other types of loss recoveries, such as involuntary conversions, in practice, entities have generally applied the guidance in ASC 410-30 by analogy when determining the appropriate classification of other loss recoveries.

For recoveries in which the recovery proceeds exceed the incurred loss, resulting in a gain, an entity should consider other authoritative literature, including applicable SEC regulations (e.g., SEC Regulation S-X), when determining whether it is appropriate to classify the gain within the related income statement line item as the loss recovery. Depending on the nature of the gain, entities should consider whether it is appropriate to classify the gain as operating or nonoperating. In determining whether it is appropriate to classify a loss, a loss recovery, or a gain as operating or nonoperating, entities may consider SEC Regulation S-X, Rule 5-03. Although Rule 5-03 does not define items that should be classified as operating, it does provide examples of items that should be classified as nonoperating.

Entities should provide sufficient disclosure, if material, to enable financial statement users to determine in which financial statement line item the gain has been recognized.

5.4.8 Subsequent-Event Considerations

Entities should evaluate events that occur after the balance sheet date but before the financial statements are issued or are available to be issued to determine whether the events should be recognized in the current-period financial statements or in the subsequent-period financial statements.

The recognition, measurement, and disclosure principles related to loss recoveries that are described in this chapter apply to the period after the balance sheet date but before the financial statements are issued or are available to be issued.

After the balance sheet date, there may be a recovery of a loss that exceeds the amount of a loss previously recognized on or before the balance sheet date, resulting in a gain after the balance sheet date. The recovery should be treated as two separate units of account:

- *Loss recovery* — The amount of the recovery equal to the previously recognized loss.
- *Gain contingency* — The amount of the recovery in excess of the previously recognized loss.

The recognition of these two units of account will differ in a manner that is consistent with the different loss recovery models described in this chapter. A recovery asset (e.g., a receivable) for the amount of the recovery equal to the previously recognized loss should be accounted for as a recognized or nonrecognized subsequent event in a manner that is consistent with the recognition threshold for loss contingencies.

If an event occurs after the balance sheet date but before the financial statements are issued or are available to be issued, and the event indicates that a loss recovery is probable (or the loss recovery has been received) for a loss incurred on or before the balance sheet date, the event provides additional evidence of the recovery and should be accounted for as a recognized subsequent event. Examples might include (1) the probable receipt of insurance proceeds equaling the loss incurred related to a plant that was destroyed on or before the balance sheet date or (2) proceeds from a lawsuit settlement in the amount of a previous loss incurred for litigation that arose on or before the balance sheet date.

The amount of the recovery in excess of the previously recognized loss would be accounted for as a nonrecognized subsequent event because to realize the gain recovery would be to recognize income before it is realized, as described in ASC 450-30-25-1. Accounting for the two units of account by using separate recognition thresholds is consistent with the subsequent-event treatment of loss contingencies and gain contingencies discussed earlier in this chapter. Further, the treatment of the loss recovery and the gain contingency as two separate units of account is consistent with the involuntary conversion guidance in [Section 5.4.2](#).

5.5 SEC Comment Letter Themes Related to Contingencies

The SEC staff continues to closely monitor registrants' contingency disclosures, and it comments when such disclosures do not comply with U.S. GAAP or SEC rules and regulations.

The staff frequently comments on:

- Lack of specificity regarding the nature of the matter.
- Lack of quantification of amounts accrued, if any, and possible loss or range of loss and/or disclosure about why such an estimate cannot be made.
- Insufficient detail about judgments and assumptions underlying significant accruals.
- Unclear language in disclosures (e.g., not using terms that are consistent with accounting literature, such as "probable" or "reasonably possible") and failure to consider the disclosure requirements of ASC 450, SAB Topic 5.Y, and SEC Regulation S-K, Item 103.
- Lack of disclosure of an accounting policy related to accounting for legal costs (when material) and uncertainties in loss contingency recoveries, including (1) whether ranges of reasonably possible losses are disclosed gross or net of anticipated recoveries from third parties, (2) risks regarding the collectibility of anticipated recoveries, and (3) the accounting policy for uncertain recoveries.
- Unclear disclosures regarding the reason or rationale for the release of a loss provision.

Below are examples of certain SEC staff comments that registrants in the life sciences industry and other industries have received regarding their accounting for contingencies. For more information about SEC comment letter themes that are relevant to the life sciences industry, see Deloitte's Roadmap [SEC Comment Letter Considerations, Including Industry Insights](#).

5.5.1 Loss Contingencies

Examples of SEC Comments

- Please tell us and quantify the methods and key assumptions underlying the change in estimate for legal contingencies of \$[X million] that reduced the liability for accrued legal contingencies to \$[Y million] as of [the end of the fiscal quarter]. In particular, explain how the [appellate] court's decision vacating the . . . judgment and remanding this case back to the [lower court] supported your release of this litigation loss provision. Refer us to the technical guidance upon which you relied and revise your disclosure accordingly.
- We note your disclosure that there can be no assurance that your legal proceedings, either individually or in the aggregate, will not have a material adverse effect on your business, results of operations, financial condition or cash flows. To the extent it is reasonably possible you will incur losses in excess of recorded accruals related to your contingencies, please provide the applicable disclosures required by ASC 450-20-50-3 through -4, including the amount or range of reasonably possible losses in excess of recorded amounts. . . . Although we recognize that there are a number of uncertainties and potential outcomes associated with loss contingencies, please note that ASC 450 does not require estimation of a reasonably possible range of loss with precision or certainty.

Examples of SEC Comments (continued)

- To the extent it is reasonably possible you will incur losses in excess of amounts recorded related to both your litigation and non-income related tax matters, please revise to disclose an estimate of the reasonably possible losses or range of loss or state that such an estimate cannot be made. Refer to ASC 450-20-50-3 through 50-4.
- We note your disclosure . . . that the amount of your asbestos litigation liability and its effect on the company could differ materially from current estimates. Please address the following comments related to your asbestos litigation:
 - To the extent it is reasonably possible you will incur losses in excess of the amount accrued, provide the applicable disclosures required by ASC 450-20-50-3 through -4, including the amount or range of reasonably possible losses in excess of recorded amounts. Alternatively, if no amount of loss in excess of recorded accruals is believed to be reasonably possible, please state this in your disclosure.
 - If you conclude that you cannot estimate the reasonably possible additional loss or range of loss, please explain to us in sufficient detail the reasons for your determination. Although we recognize that there are a number of uncertainties and potential outcomes associated with loss contingencies, ASC 450 does not require estimation of a reasonably possible range of loss with precision or certainty. An effort should be made to develop estimates for purposes of disclosure, including determining which of the potential outcomes are reasonably possible and what the reasonably possible range of losses would be for those reasonably possible outcomes.
- With respect to the cyber-security incident and related assessments and litigation, please tell us your consideration of the requirement in ASC 450-20-50-4.b. to disclose an estimate of the possible loss or range of loss or to disclose that such an estimate cannot be made.

The SEC staff often asks about estimates of reasonably possible losses or comments when a registrant omits disclosure of a loss or range of losses because its estimates lack precision and confidence. If an estimate of the loss or range of losses cannot be made, the staff expects registrants to (1) disclose, in accordance with ASC 450-20-50-4, that such an estimate cannot be made and (2) demonstrate that they at least attempted to estimate the loss or range of losses before concluding that an estimate cannot be made. In such cases, the staff has commented that registrants should disclose the specific factors that limited their ability to reasonably estimate the loss or range of losses and has asked about registrants' quarterly procedures related to such estimates. The factors disclosed should be specific to the loss contingency in question and could include representations that (1) claims do not specify an amount of damages, (2) there are a large number of plaintiffs, or (3) the case is in its early stages.

If a registrant discusses a potential contingency in its earnings calls, the SEC staff is likely to seek more information about the contingency and to inquire about whether the related disclosures are appropriate. The staff encourages registrants to clearly disclose the "full story" regarding their loss contingencies because recognition of such contingencies requires a high degree of professional judgment.

Further, the SEC staff has noted that disclosures related to loss contingencies should be continually evaluated over time as facts and circumstances change. As stated in [Section 5.2.6.1](#), in addition to being required to provide the primary disclosures under ASC 450-20, an entity must provide certain additional disclosures under ASC 275 when it is reasonably possible that a change in estimate will occur in the near term. For discussion of the disclosure requirements of ASC 450-20 and ASC 275, see [Section 2.8.1](#) of Deloitte's Roadmap [Contingencies, Loss Recoveries, and Guarantees](#).

The SEC staff may also ask about (1) the basis for a registrant's accrual (e.g., factors supporting an accrual, such as trends in claims received and rejected), (2) the timing of a loss contingency's recognition, (3) adjustments to the loss reserve, and (4) the disclosure of a loss contingency. In addition, when a material settlement is disclosed during the period, the staff may review prior-period disclosures to determine whether such disclosures were appropriate (i.e., whether the registrant should have provided early-warning disclosures about the possibility of incurring or settling a loss in future periods to help financial statement users understand these risks and how they could potentially affect the financial statements) or whether an accrual should have been recognized in a prior period.

5.5.2 Litigation Contingencies

In addition to complying with ASC 450, when disclosing litigation matters, public entities must separately meet the requirements of SEC Regulation S-K, Item 103, because while those requirements are similar to the requirements of ASC 450, they are not identical. Item 103 requires disclosure of an environmental proceeding to which the government is a party if the proceeding is generally expected to result in sanctions of \$300,000 or more. However, a registrant may elect an alternative higher threshold if the registrant determines that such threshold is more reasonably designed to result in the disclosure of material environmental proceedings. If so, the alternative threshold is limited to the lesser of \$1 million or 1 percent of the current assets of the registrant and its subsidiaries on a consolidated basis. A registrant must disclose this alternative threshold in each annual and quarterly report. Also, to address potential concerns related to a registrant's assertion that providing too much information may be detrimental to litigation or settlement efforts, the SEC staff has indicated that registrants do not need to separately disclose each asserted claim; rather, asserted claims may be aggregated in a logical manner as long as the disclosure complies with ASC 450.



Connecting the Dots

SEC rules and regulations permit the use of hyperlinks or cross-references to disclosures about legal proceedings that were included elsewhere in the document (e.g., in the financial statement footnotes). However, registrants may not make reference from the financial statements (e.g., the financial statement footnotes) to other areas outside of the financial statements (e.g., Item 103) to satisfy financial statement disclosure requirements (unless permitted by the SEC's rules or the applicable accounting standards).

Appendix B — Titles of Standards and Other Literature

AICPA Literature

Accounting and Valuation Guides

Assets Acquired to Be Used in Research and Development Activities

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Clarified Statements on Auditing Standards

AU-C Section 501, "Audit Evidence — Specific Considerations for Selected Items"

AU-C Section 620, "Using the Work of an Auditor's Specialist"

FASB Literature

ASC Topics

ASC 105, *Generally Accepted Accounting Principles*

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 270, *Interim Reporting*

ASC 275, *Risks and Uncertainties*

ASC 280, *Segment Reporting*

ASC 310, *Receivables*

ASC 320, *Investments — Debt Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 340, *Other Assets and Deferred Costs*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 405, *Liabilities*

ASC 410, *Asset Retirement and Environmental Obligations*

ASC 420, *Exit or Disposal Cost Obligations*

ASC 440, *Commitments*

ASC 450, *Contingencies*

ASC 460, *Guarantees*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 705, *Cost of Sales and Services*

ASC 710, *Compensation — General*

ASC 712, *Compensation — Nonretirement Postemployment Benefits*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 830, *Foreign Currency Matters*

ASC 832, *Government Assistance*

ASC 835, *Interest*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 845, *Nonmonetary Transactions*

ASC 848, *Reference Rate Reform*

ASC 852, *Reorganizations*

ASC 855, *Subsequent Events*

ASC 860, *Transfers and Servicing*

ASC 905, *Agriculture*

ASC 915, *Development Stage Entities*

ASC 930, *Extractive Activities — Mining*

ASC 944, *Financial Services — Insurance*

ASC 946, *Financial Services — Investment Companies*

ASC 954, *Health Care Entities*

ASC 958, *Not-for-Profit Entities*

ASC 960, *Plan Accounting — Defined Benefit Pension Plans*

ASC 962, *Plan Accounting — Defined Contribution Pension Plans*

ASC 965, *Plan Accounting — Health and Welfare Benefit Plans*

ASC 970, *Real Estate — General*

ASC 985, *Software*

ASUs

ASU 2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers — a consensus of the FASB Emerging Issues Task Force*

ASU 2011-06, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers — a consensus of the FASB Emerging Issues Task Force*

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2014-10, *Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation*

ASU 2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*

ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*

ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

ASU 2016-02, *Leases (Topic 842)*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*

ASU 2016-17, *Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control*

ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers*

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

ASU 2017-04, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*

ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

ASU 2018-10, *Codification Improvements to Topic 842, Leases*

ASU 2018-11, *Leases (Topic 842): Targeted Improvements*

ASU 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*

ASU 2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction Between Topic 808 and Topic 606*

ASU 2019-01, *Leases (Topic 842): Codification Improvements*

ASU 2019-10, *Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*

ASU 2020-02, *Financial Instruments — Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)*

ASU 2020-03, *Codification Improvements to Financial Instruments*

ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

ASU 2020-05, *Revenue From Contracts With Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*

ASU 2020-06, *Debt — Debt With Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*

ASU 2021-04, *Earnings per Share (Topic 260), Debt — Modifications and Extinguishments (Subtopic 470-50), Compensation — Stock Compensation (Topic 718), and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options* — a consensus of the FASB Emerging Issues Task Force

ASU 2021-05, *Leases (Topic 842): Lessors — Certain Leases With Variable Lease Payments*

ASU 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities From Contracts With Customers*

ASU 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*

ASU 2022-03, *Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*

ASU 2023-01, *Leases (Topic 842): Common Control Arrangements*

ASU 2023-05, *Business Combinations — Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*

ASU 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures*

ASU 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*

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ASU 2024-03, *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*

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Appendix C — Abbreviations

Abbreviation	Description
AETR	annual effective tax rate
AFSI	adjusted financial statement income
AI	artificial intelligence
AICPA	American Institute of Certified Public Accountants
AIN	AICPA Accounting Interpretation of an APB Opinion
AMT	alternative minimum tax
ANDA	abbreviated new drug application
AOCI	accumulated other comprehensive income
APB	Accounting Principles Board
API	active pharmaceutical ingredient
ARO	asset retirement obligation
ASC	FASB Accounting Standards Codification
ASR	accelerated share repurchase
ASU	FASB Accounting Standards Update
AUD	Australian dollar(s)
BC	Basis for Conclusions
BEAT	base erosion anti-abuse tax
BEMTA	base erosion minimum tax amount
BPD	branded prescription drug
C&DI	Compliance and Disclosure Interpretation
CAM	critical audit matter
CAQ	Center for Audit Quality
CARB	California Air Resources Board
CARES Act	Coronavirus Aid, Relief, and Economic Security Act

Abbreviation	Description
CFC	controlled foreign corporation
CIMA	Chartered Institute of Management Accountants
CMO	contract manufacturing organization
CMS	Centers for Medicare & Medicaid Services
CODM	chief operating decision maker
CPU	central processing unit
CRO	contract research organization
CSRD	Corporate Sustainability Reporting Directive
CYR	choose-your-rate
DD&A	depreciation, depletion, and amortization
DEI	deduction-eligible income
DISE	disaggregation of income statement expenses
DTA	deferred tax asset
DTL	deferred tax liability
EBITDA	earnings before interest, taxes, depreciation, and amortization
EC	European Commission
ED	exposure draft
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EFRAG	European Financial Reporting Advisory Group
EGC	emerging growth company
EITF	Emerging Issues Task Force
ELOC	equity line of credit
EPS	earnings per share

Abbreviation	Description
ESA	energy service agreement
ESPP	employee stock purchase plan
ESRS	European Sustainability Reporting Standards
E.U.	European Union
EUR	euros
EU Taxonomy	EU Taxonomy for Sustainable Activities
Exchange Act	Securities Exchange Act of 1934
FAQ	frequently asked question
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FDA	U.S. Food and Drug Administration
FDDEI	foreign-derived deduction-eligible income
FDII	foreign-derived intangible income
FinREC	AICPA Financial Reporting Executive Committee
FOB	free on board
FPI	foreign private issuer
FRM	SEC Division of Corporation Finance Financial Reporting Manual
FVO	fair value option
FVTOCI	fair value through other comprehensive income
GAAP	generally accepted accounting principles
GDP	gross domestic product
GHG	greenhouse gas
GILTI	global intangible low-taxed income
GloBE	Global anti-Base Erosion
GPO	group purchasing organization
GPU	graphics processing unit
GWP	global warming potential
HAFWP	how and for what purpose
HFI	held for investment

Abbreviation	Description
HFS	held for sale
HHS	U.S. Department of Health and Human Services
HVAC	heating, ventilation, and air conditioning
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IEEPA	International Emergency Economic Powers Act
IFRS	International Financial Reporting Standard
IIR	investigator-initiated research
IOSCO	International Organization of Securities Commissions
IP	intellectual property
IPCC	Intergovernmental Panel on Climate Change
IPO	initial public offering
IPR&D	in-process research and development
IRA	Inflation Reduction Act of 2022
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISO	incentive stock option
ISSB	International Sustainability Standards Board
IT	information technology
ITC	invitation to comment
JOBS Act	Jumpstart Our Business Startups Act
LCD	liquid-crystal display
LIBOR	London Interbank Offered Rate
LIFO	last in, first out
LLM	large language model
M&A	merger and acquisition

Abbreviation	Description
MD&A	Management's Discussion & Analysis
MFN	most-favored-nation
MNE	multinational enterprise
MSL	medical science liaison
NCTI	net CFC tested income
NDA	new drug application
NFP	not-for-profit (entity)
NIH	National Institutes of Health
NLP	natural language processing
NOL	net operating loss
NOPA	notice of proposed adjustment
NQSO or NSO	nonqualified stock option
OCA	SEC Office of the Chief Accountant
OCI	other comprehensive income
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturer
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PIE	public interest entity
PIK	paid-in-kind
PIPE	private investment in public equity
PP&E	property, plant, and equipment
PRV	priority review voucher
PTRS	probability of technical and regulatory success
Q&A	question and answer
QIP	qualified improvement property
R&D	research and development
R&E	research and experimental

Abbreviation	Description
RAM	random-access memory
REIT	real estate investment trust
REMS	risk evaluation and mitigation strategy
ROU	right-of-use
S&P 500	Standard & Poor's 500 Index
SaaS	software as a service
SAB	SEC Staff Accounting Bulletin
SAFE	simple agreement for future equity
SASB	Sustainability Accounting Standards Board
SEC	U.S. Securities and Exchange Commission
Securities Act	Securities Act of 1933
SEPA	standby equity purchase agreement
SG&A	selling, general, and administrative
SOX	Sarbanes-Oxley Act of 2002
SPAC	special-purpose acquisition company
SPPI	solely payments of principal and interest
SRC	smaller reporting company
TCFD	Task Force on Climate-Related Financial Disclosures
TD	Treasury Decision
TRG	transition resource group
TSA	transition services agreement
USD	U.S. dollar(s)
UTB	unrecognized tax benefit
VCO	voluntary carbon offset
VIE	variable interest entity
VWAP	volume-weighted average daily market price



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