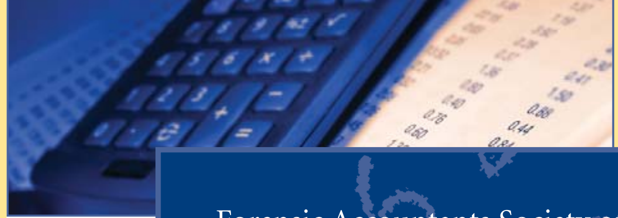

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Forensic Accountants Society of North America
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A Case History

by Michelle Tucker, Sterling & Tucker, Inc., FASNA Member

Our firm was retained by an insurance adjuster to review the claim of an automobile dealership. The dealership experienced a business interruption when a fire destroyed the parts and service departments of the building, and smoke and water resulting from the fire damaged the sales department. While the sales department was only closed for three business days, the parts and service departments, suffering an almost complete loss of inventory and tools and equipment, were down entirely for approximately one week. Determination of an exact restoration period was complicated because the insured continued operating in the damaged location by way of trailers and tents until construction of a new facility was completed several weeks later. The goal of our calculations was to determine when and if the impact of the fire on gross profit was noticeable.

The insured rallied its employees and set up operations in the parking lot, and actually did one heck of a job in recovering from the loss. Therein lays the first predicament encountered by the claimant. Did the insured do too good a job in recovering from the loss?

The second quandary the insured ran into revolved around the co-insurance clause contained in the insurance policy and a resulting deficiency in coverage. Was the claimant properly informed of the co-insurance requirement when the policy was purchased?

The insured's claim consisted of lost gross profit of $130,000 company-wide over a period of approximately one month. In addition, the insured claimed extra expenses for temporary accommodations erected in an attempt to minimize lost revenues. In order to verify lost gross profit, we examined the monthly financial statements for the three years preceding the loss. This analysis revealed a consistent increase in revenues and related costs of goods sold. The trend percentage was reasonably applied in an effort to project gross profits for the restoration period. Consequently, a comparison of actual activity to this projection seemed to indicate that no loss of gross profits had actually occurred. In fact actual gross profits exceeded our projections. And while we were not engaged to verify the extra expense portion of the claim, it would appear that the insured incurred said expenses

as were necessary to reduce or eliminate the business income loss that otherwise would have been incurred.

We extended our calculations to further to consider only the loss experienced by the parts and service department. Analysis of actual activity compared to our projections for the parts and service department did in fact reveal a loss of gross profits amounting to $43,000. So while the sales department recovered fully from the fire by setting up temporary operations and even achieved gross profits significant enough to cover the loss incurred by the parts and service department, it stands to reason that a loss still occurred.

CONTINUED ON PAGE 3

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CASEWORK EXPERIENCE

FASNA member casework includes, but is not limited to, cases involving:

- Inventory/property loss
- Employee dishonesty
- Business income loss
- Personal injury or wrongful death claims
- Truth in lending/truth in leasing
- Post judgement matters/ calculations
- Loss of income/earnings
- Divorce and fidelity claims
- Business valuation
- Expert testimony
- Fraud

INDUSTRY EXPERIENCE

FASNA member experience includes, but is not limited to cases involving:

- Auto dealerships and transportation
- Colleges and universities
- Construction, contracting, and engineering
- Financial/money management, trust, and estate
- Healthcare
- State and Indian tribal government
- Insurance claims
- Manufacturing
- Real estate
- Restaurant and hotel industries
- Retailing/wholesale

The "Flashing Lights" of Forensic Accounting

How to Know When You Need a Forensic Accountant

by Dale E. Cremers, Cremers, Holtzbauer & Nearmyer, P.C., FASNA Member

In this era of technology, we live in a world where flashing lights control how we respond. These lights warn us, educate us and help us make decisions. Flashing lights on your car's dashboard? Time to take the car into the shop. Flashing lights on your computer? Time to save your files. Flashing lights in your tractor cab? You need to steer straighter. Flashing lights flashing behind you in the car? Well, hopefully that doesn't happen too often.

So, what do flashing lights have to do with forensic accounting? Well, that's just it. There aren't any. It would be easy if there were flashing lights at the top of every insurance claim that indicated the need for the expertise and experience of a forensic accountant. So, how do you know when bringing a forensic accountant into a claim makes sense? What are the flashing lights of forensic accounting?

While there are no hard and fast rules, there are times when it makes a lot of sense to bring in an experienced forensic accountant. Following are a few "flashing lights" of forensic accounting.

Inventory

Different companies handle similar inventory in very different ways. How those inventories are handled can sometimes make a big difference in determining the actual economic loss.

Something as simple as calculating the value of a company's inventory can get confusing. For example, say "Big Bear Animal Company" sells stuffed animals in a strip mall. A fire destroys their building and everything in it. In their claim, the company lists 700 stuffed bears in their inventory at a retail price of ten dollars each.

Under most insurance coverages, the company would not claim a $7,000 loss in inventory. The loss would be calculated based on the company's wholesale price - what they actually paid for the inventory. Any additional claim would be considered a loss of business income claim - and would need to be calculated accordingly.

Claims involving inventory can be complicated by a number of factors, including how the inventory is used (is it for resale or is it a component of a final product), who owns it, how it is recorded in company records and where it is stored. Believe it or not, we have helped investigate claims where the inventory that was claimed would not physically fit in the location where the loss was reported to have taken place.

Business Income

Determining loss of business income can be one of the more complicated matters. We've seen many business income claims drag on through the legal system for years. So many factors go into determining a company's loss of business income that it almost always makes sense to involve a forensic accountant.

For example, a storm blows through town and damages the hotel. Contractors determine it will take three months to rebuild the building. The hotel's claim for lost income seems high, but they are able to produce records showing that those three months were their highest occupancy rate the year before. However, closer examination turns up the fact that the occupancy rate was much higher than at any other time - as the result of the town's only competitor hotel being closed during that time for remodeling. Most recent sales figures show a steady decline of occupancy and sales starting immediately after the re-opening of the other hotel. As in this case, outside factors can have a significant impact on a loss of business income - but without the expertise to know what to look for, outside factors can often be missed.

Volatile Markets

In some cases, the volatility of an industry or market can itself make a difference. Knowing how those changes affect a company's business is important when a loss occurs.

The oil industry, for example, has been very volatile over the past two years. Gas prices have increased significantly. How could this volatility affect an insurance claim? Say a gas station refilled their underground tanks - with higher priced gas. You might suspect that their profits would increase proportionally with the percentage increase. However, in this industry, that is not true. The margin stays the same regardless of the price. A claim based on factoring a percentage increase in sales would be inaccurate. Knowing this can have a big effect on an insurance claim. Historically, volatility has hit steel, sugar, and computer chips.

Geography

Even though an industry's market is changing, it doesn't mean a localized part of that market will automatically follow suit. By understanding both the effects of a broader market - and the localized market - a forensic accountant can often calculate a more accurate loss.

For example, a local farm coop's grain bin collapses in a windstorm. They can't store grain at harvest - so they obviously have a loss of business income. A simple calculation multiplies the grain margin the coop would have earned by the number of bushels the bin would hold. Seems simple, right? If you didn't know that a new ethanol plant had just gone online five miles from the coop, you may not have investigated the effects the new plant might have on the need for grain storage in the area. Since more farmers were delivering grain directly to the plant - bypassing the coop - the coop had less volume going through it. An economic analysis could show that the coop might not be entitled to a payment based on the same volume of grain going through it as the previous year.

Data Recovery

Sometimes - as in the case of a natural disaster - it takes a deeper level of analysis to be able to piece back what a company looked like before the disaster. Being able to resurrect a company's books based on tax returns, bank statements and other outside documentation is often necessary. This can often be done most efficiently and accurately using the services of an experienced forensic accountant.

A law office is destroyed by a tornado that rips through town. Files are lost. Computers are destroyed. The firms accounting records are nowhere to be found. A good forensic accountant can work with the firm's bank, the IRS, suppliers and client records to help determine what the firm looked like (in terms of assets and finances) before the disaster took place - enabling the firm to make an accurate claim for their insurance, provided they may even have had a loss of gross income, or just extra expenses.

Fraud

There are many kinds of fraud - ranging from employee dishonesty to inflated or fictional insurance claims to intentional damage (such as arson) designed to collect on insurance claims. The motives can be many - and well hidden. Gambling. Drug addiction. Business failure. Divorce.

A good forensic accountant knows many of the warning signals that could point to fraudulent activities. Through experience, we understand what questions to ask - and who to ask - to help determine if fraud could be taking place. Whenever there are suspicious or unexplained issues relating to a claim, it often makes sense to bring in the expertise of an experienced forensic accountant.

A Case Study…
continued from cover

As mentioned previously, a co-insurance clause existed in this particular insurance policy. The insured was required to be 90% co-insured, meaning their limit of insurance needed to fall below 90% of the net income plus operating expenses that would have occurred if but for the fire during the 12-month policy period. A calculation of the required coverage indicated the claimant was underinsured by $525,000 and could only recover 30% of the loss incurred by the parts and service department. Thus, of the original claimed loss of $130,000, only $43,000 in lost gross profits was deemed to be actually lost and further still only $13,000 was actually recoverable by the insured. Presumably, the insured was also able to recover a portion, if not all, of the extra expense loss.

Two important points can be gleaned from this particular case. It is vital that the insured have a thorough understanding of the insurance policy and its requirements. In this situation, the insured fell far below the limit of coverage needed for their level of business activity. A thorough calculation of the required coverage should be done before a policy is purchased and should be revisited on policy anniversary dates to ensure adequate coverage is in place at all times. Secondly, it makes good business sense for a claimant to forge ahead in the face of a business interruption loss. The insured could have complacently stood by as business suffered waiting for the insurance proceeds. The policy in this case stated that "if you intend to continue your business, you must resume all or part of your 'operations' as quickly as possible." The insured did just that. One might envision the goodwill created from witnessing the dedication a company has toward its customers; the drive of a company to continue servicing customers despite the obstacles presented by fire damage.