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LITTLE MISTAKES... BIG DIFFERENCES

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In the year 1173, construction began on what today is probably one of the most famous mistakes in history - the Leaning Tower of Pisa. The architects and builders of the tower failed to recognize the weak, unstable subsoil underneath its foundation until the tower's third story was under construction. Over several years, one side of the tower gradually sank, causing the tower to lean. Efforts in later years to attempt to straighten the structure only added to the problems.

What started as a single, simple miscalculation grew into a huge mistake.

The same thing can happen when calculating actual economic loss in a loss of business income claim - especially when calculating business interruption costs. Small miscalculations or overlooking minor details can end up becoming big differences. Here are just a few examples:

Common Mistake #1: Wrong Numbers

An insured business files a business interruption claim and measures the loss based on gross sales. Sure, if a business is shut down temporarily because of a fire, it may not have any sales until it can rebuild. But calculating the actual economic loss based on gross sales doesn't take into account the fact that the company also may not have costs associated with those sales - sales commissions, advertising, etc. The better starting point would be calculating gross profit (gross sales minus direct expenses and cost of sales).

Common Mistake #2: Double Dipping

A business is shut down due to a fire. The owner claims the company's employees as a continuing expense under the business interruption policy. The employer also retains the employees to help with the cleanup and submits this claim under the property coverage of the policy. Often, insurers will miss this case of double dipping and reimburse the employer twice for the employees' wages and benefits.

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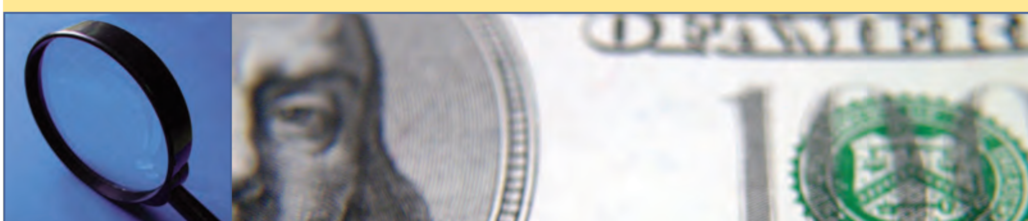

CASEWORK EXPERIENCE

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

Varying economic conditions like those we are experiencing now can have a big impact on calculating actual economic loss in a business insurance claim. It's important to consider the impact on the economy when making these calculations.

Common Mistake #3: Coinsurance Confusion

In some cases, a business will purchase a business interruption policy containing a co-insurance clause. In these cases, the insured is assuming a percentage of the risk associated with a loss. This is not a fixed deductible. Instead, it requires the insured to estimate the worst-case loss and purchase insurance to cover the percentage they want the insurer to cover. When a loss happens, the insurer must determine if the insured had adequate coverage based on the worst-case loss. If not, a further limit is imposed on the compensable loss. These policies are often misunderstood by the insureds - and can easily be miscalculated by the insurer as well if adequate annual financial information is not gathered.

Common Mistake #4: Customer Base Corrosion

Some business interruption policies will allow for extra expenses to help a business regain business from lost customers after a shut down covered by the policy. However, it is not uncommon for an insured's business to attempt to claim income loss even after resuming operations. It is rare for a policy to cover the permanent loss of customers. In fact, most coverage ends once the business resumes operations after the period of loss.

Common Mistake #5: Sales Seasonality

It's easy to take big, broad numbers like annual sales from accounting records and apply them to a short period of time that a business is not operational due to a disaster. That's not always wise. Most businesses have some kind of sales seasonality to

Even seemingly small details can often grow into large mistakes that can have a significant impact on how an insurance claim is paid.

them. For example, a midwestern tree nursery is likely to have higher sales in the spring than it does in December because of when landscaping projects typically take place. If, based on the insured's historical sales data, seasonality is identifiable, it stands to reason that a business interruption claim could be lower based on when the disaster and subsequent shut down takes place.

Common Mistake #6: Seeing the Trees, Not the Forest

Sometimes it's just smart to take a step back and take a look at the bigger picture. Is a business's owner having personal financial difficulty? Is the business environment better or worse compared to previous time periods? Can/did a big sale or loss of a large client recently affect the company? Are there subsidiaries or sister companies that should be considered? Are there industry trends or economic conditions that could impact a company? In economic times like the ones we are currently in, it is especially important to consider how bigger picture views affect an insured. For example, it would be pretty difficult for an insured window manufacturer to make a claim for loss of business income similar to what it could have just a year or two ago.

Common Mistake #7: Inventory Inconsistencies

A retailer that sells candy burns to the ground - a total loss. As part of its property loss claim, the company files a claim for its inventory. It also files a claim for business interruption for the time it will take to rebuild the company. Too often we see claims like these go through without a close look. The insured will claim the retail value of inventory instead of how much the inventory cost the retailer. By claiming the retail value, the insured would be getting paid twice for the inventory - once under the property claim and once under the business interruption claim. Realistically, any claim that involves a loss of inventory should be well scrutinized so the claim is consistent with how the company accounts for its inventory.

It's very easy to overlook details and miscalculation in business insurance claims. There are so many complicated variables that can affect a claim. Many times, hiring an experienced forensic accountant who understands how these different variables and details can affect a claim is a smart investment - especially when the economic environment is so different from what it was in the recent past. Our job is to analyze all of the details so we can help determine actual economic loss.

Now, if only those guys building that tower 800 years ago would have considered a few more details themselves...

FASNA members are dedicated to helping you resolve your most complicated claims. Call the member nearest you today.

Without knowing what to look for, calculating the actual economic loss in a business insurance claim can be difficult. The expertise that an experienced forensic accountant can offer is often a smart investment.

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