

Managing Business Interruption Claims

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What Forensic Accountants Need to Avoid Doing

What do forensic accountants need to know when performing a business interruption loss engagement? What are some of the common errors and pitfalls that forensic accountants need to avoid? In this article, the author will answer these questions as well as walk through the process of performing a business interruption loss engagement.



Resources:

[Business Interruptions and Lost Profits](#)

When natural disasters or damages occur and business operations are interrupted, forensic accountants are an invaluable tool for both the insured and the insurance companies. Forensic accountants are engaged to calculate a fair and accurate “business income loss” amount that ensures that the business income lost during the period of restoration is paid

to the insured and that the analysis includes only amounts covered by the policy. What do forensic accountants need to know when performing a business interruption loss engagement? What are some of the common errors and pitfalls that forensic accountants need to avoid? In this article, the author will answer these questions as well as walk through the process of performing a business interruption loss engagement.

Accepting the Business Interruption Loss/Extra Expense Engagement

Your phone rings and you are talking to your local licensed public adjuster who wants to engage your services to calculate the business interruption loss and extra expenses for a restaurant that has been damaged as a result of the tornado that came through the area a few days prior.

You have just avoided an important error. It is a “must” that you work with a licensed public adjuster, attorney, or insurance company in business interruption loss engagements. Do not represent and work directly for the insured. Be sure to know your state’s laws regarding this issue as it can carry heavy penalties if you represent the insured directly.

What do you need to do on your initial phone call with the adjuster? You will need to get their contact information as well as the insured’s contact information. Before accepting the engagement, do not forget to run a conflict check. You need to know the date of the loss; this is important as many insurance policies will have a waiting period.

Understanding the Insurance Policy

One of the most important items you will want to obtain will be a copy of the insurance policy and the declaration page. It cannot be stressed enough that you read through the policy and be sure you understand the policy. Each policy is different, and it is critical that the forensic accountant fully understand what is covered, excluded, waiting periods, and any monetary or time limitations that are in the policy. If you have any questions, ask the adjuster, the insurance agent, or attorney you are working with, for clarification. The pitfall to avoid here is assuming that all insurance policies are the same for the same type of business. This is not true and can be a costly error.

There are two types of insurance policy formats: ISO Policy, which is a standard policy, and a Manuscript Policy, which is a customized policy that has negotiated terms.

There are three types of policy types: a Business Owner Policy, also known as a BOP Policy; a Commercial Property Policy in which there is a stated monetary limit and no time limit other than the period of restoration; and a Homeowner’s Policy with BI endorsement. which is an add-on to a policy and has limited dollar amounts.

It is important at this stage that you are familiar with and understand the definitions of the terminology in the policy. An important distinction to be aware of is the difference between

business interruption loss and extra expenses. Be aware of the waiting period; the period of time before the insurance policy starts coverage, usually 24–72 hours from the date of the loss.

Understanding cause and effect, both direct and indirect, must be established at the beginning phase of the engagement. If other experts are needed in order to distinguish damage from more than one event, do not step outside your area of expertise, call in an expert in the field that is needed.

Contact With the Insured

At this point of the engagement, usually within the few first days of accepting the engagement, you will need to contact the insured. I start with a phone call to introduce myself and put the insured at ease as well as set a time to meet in person. If possible, I like to meet with the insured, in person, at the loss site. I find that being at the loss site not only gives me a better understanding of the damage but also helps the insured give a more detailed and complete history of the business. Seeing things in person can trigger details that might otherwise be overlooked or forgotten. Non-financial data is just as important as financial data. Be sure to ask about any plans to expand, projects in the works, business cycles, types of customers, competitors, economic conditions that impact their business, as well as other questions that you feel are appropriate for this specific business and industry.

At this meeting, bring a list of financial documents that are needed from the insured, which include: at least three years of financial statements, budgets, projections, sales reports, inventory reports, and other data that is appropriate for that business. I also discuss the insurance policy with the insured to be sure that they have a correct understanding of what is covered, excluded, and any limits that are in the policy.

So what can you do if they lost all of their financial data? This does happen, especially with smaller businesses. In this case, bank statements and tax returns are requested so that financial statements can be re-created.

At this point, the insured needs to decide whether they are able to partially operate at the loss site or if they need to find a temporary location. There are many factors that go into making this decision, but it is important that it is made fairly quickly so that losses are mitigated. It is also a good time to stress to the insured the importance of segregating normal operating expenses and extra expenses.

Once the insured has a plan for operations during the period of restoration, a plan and timeline need to be made for repairs and resuming normal business operations. Once this has been determined, it is important that the adjustor and the insured are on the same page. One key take-away from this section of the article is communication. It cannot be

stressed enough how important timely communication with both the insured and the adjuster is in this type of engagement. If, for example, there will be a two-month delay in construction, communicating this with the adjuster can avoid problems, especially if there are time limitations. It is helpful to communicate in writing, but if you have phone conversations, it is important to follow up the conversation, with both the insured and the adjuster, with an e-mail recapping everything that was discussed. This is important so that there are no misunderstandings and you will not have any issues of "he said, she said". Following up with an e-mail assures that everything is documented and everyone involved is on the same page.

Period of Restoration

The period of restoration is defined as, "the length of time required to rebuild, repair, or replace the damaged or destroyed property. The period of restoration begins when the physical loss or damage occurs; it ends when the property should, with reasonable speed, be repaired or replaced." Expiration of the policy does not end the period of restoration. As long as the physical loss occurs during the policy period, the business income coverage will provide coverage for the duration of the period of restoration, even if the policy expires before the period of restoration ends.

Who determines the period of restoration? The period of restoration is determined by the carrier and the policy. It is important that both the insured and the adjuster are on the same page from the beginning of the engagement to avoid any issues as a result of timeframes and time limits causing repairs not to be covered.

What should the insured do during the period of restoration? The most important thing the insured needs to do during the period of restoration is to mitigate losses and attempt to limit the period of restoration.

The insured also needs to provide frequent updates to the adjuster. I have found that this is something that tends to fall through the cracks if left up to the insured. This is an area where we can play an important role. Keeping the adjuster informed about any delays and extra expenses is key in business interruption loss engagements.

Types of Business Interruption Calculations

Gross Profit Method (also known as Top Down Method):

Gross Sales

Less: Non-Continuing Expenses=

Business Interruption Loss

Plus: Extra Expenses (calculated separately from the business interruption loss)

The advantage of the Gross Profit Method is that it is a simple method, easy to calculate and easy to understand. Disadvantages of this method are that it ignores historical losses and can result in an overstated claim.

Net Income Method (also known as the Bottom Up Method):

Net Income (Loss Period) (before interest and depreciation)

Plus: Continuing Expenses =

Business Interruption Loss

Plus: Extra Expenses (calculated separately from the business interruption loss)

The best way to calculate the expenses is through a projection of the business's sales and expenses for the loss period based upon prior years. This step can often be very time consuming and it should be stressed that taking the time to address each line item to determine which expenses will be continued, partially continued, or not continued, is well worth the time. Taking the time to accurately calculate and document how you calculated the amount you project is crucial as these are the items that the adjuster will be focused on and can and/or will challenge.

What are extra expenses? Extra expenses are expenses that are necessary by the insured during the period of restoration that it would not have been subjected to if there had been no physical loss to real or personal property caused by covered peril. Examples are lease for a temporary location or lease for equipment.

Extra expenses are evaluated in conjunction with the business interruption claim but is a separate coverage, although they are often presented together.

One important error to avoid in the calculation phase of the engagement is not excluding expenses that were paid in the beginning of the period of restoration and excluding expenses that were incurred during the period of restoration, but not paid until after the end coverage. It is important to be sure to look carefully at the expenses at the beginning of the period of restoration to be sure that all expenses paid are expenses that were incurred after the loss date. It is equally important to make sure that all expenses incurred at the end of the period of restoration are included even though they were paid at a later date.

There are many types of natural disasters and damage causing events that can interrupt a business's operations. With the increased use of technology and private information being stored electronically, cyber losses have been rapidly increasing. This is such a new area of

loss that most business owner's policies do not cover them, intentionally exclude them, or have ambiguous coverage. Depending on where you live, you will see different types of events that trigger a business interruption claim.

No matter the event that caused the business interruption, the above information applies to all engagements. Just remember, do not act as a licensed public adjuster, clearly understand the insurance policy, and be in communication with the adjuster and the insured during every step of the engagement.

This article touches on important areas of managing a business interruption claim. For more in-depth information, please attend the [NACVA week-long webinar series](#) on this topic or attend the live presentation at the [NACVA Florida SuperConference, December 9-11, 2019](#), where Joe Epps and I will be hosting an interactive seminar on this topic.

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