



values

Values is an informational newsletter for attorneys who assist clients in answering valuation questions and claims adjusters who work to pay the proper amount of a claim.



Putting the Pieces of the Puzzle Together

Remember the Rubik's Cube? In 1980, it was introduced and quickly became a worldwide phenomenon, selling more than 300 million units. It was (and still is) one of the most popular toys in the history of the toy industry. Why were people so intrigued with this puzzle? Because on the surface, it seemed so simple. But after you actually got one in your hand, you realized that every move affected what you had already done. It was relatively easy to match up one colored face of the cube, but if you only looked to put one side of the puzzle together, it was unlikely that you were going to get the whole picture.

When we're asked to help solve business interruption claims, we often face some of the same challenges. Sure, it would be easy to just look at one side of a claim and come up with a figure, but often, business interruption claims are impacted by other factors that aren't always obvious, but can have a big impact on calculating the actual economic loss.

Seasonality

Seasonality can have a huge impact on a business interruption claim. By analyzing month-to-month sales reports (or in some cases ever shorter timeframes) we can often see trends that could impact how we calculate the insured's actual economic loss. For example, a fire at a waterpark hotel in the Wisconsin Dells would likely have a bigger economic loss during the middle of the summer than it would during the winter – because it is likely that 1) seasonality impacts the occupancy rates and type of guests

staying at the resort, and 2) summer room rates are usually higher, meaning the loss during the summer would be greater. If you were to calculate a loss strictly based on average monthly sales, your calculations could be considerably off from what the actual economic loss would be.

If you look at most businesses, you'll find some form of seasonality in their business. Some are more obvious –like a flower shop or bridal shop having a heavy spring sales period and shipping stores and toy retailers will likely see sales spikes closer to the holidays. Others, you may not expect. An advertising agency which specializes in agricultural business may have higher sales prior to planting season. A ritzy restaurant in downtown Des Moines may have higher sales during the Iowa Caucuses while media and candidate entourages are in town.

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Many factors can affect the actual economic loss in a business interruption claim. Our job as forensic accountants is to identify all of the pieces of the puzzle, then put them together so you can see the big picture.

Even things as simple as the type of business can have a big impact on how a business interruption claim is calculated. One of the biggest areas of misunderstanding in these types of claims is loss of business income. An experienced forensic accountant can help you calculate this part of the claim accurately.

Economic Shifts

Trends in the economy can also impact how we calculate economic loss. By looking at economic factors, we can sometimes find trends that would affect how an insured's claim would be affected.

For example, maybe a gas station is shut down for several months because of some sort of natural disaster. During the time of the shutdown, the cost – and therefore the price – of gasoline goes up. While the station would not necessarily generate a higher margin on the higher priced gas, the higher sales volume may push them into a higher sales volume rate used by the credit card company. This higher rate may have required the station to pay a higher transaction fee for every customer – reducing their profits. Depending on sales volume, fee rates and length of the shut down, the station's business interruption claim may have been higher *or* lower than expected.

Type of Business

Even the type of business an insured is running can significantly impact how its business interruption claim is calculated. Compare a dental practice to an HVAC contractor. Say both are similar in size and both generate gross profit around a half-million dollars per year. The dental office has very low direct costs (supplies, etc.) in relation to the HVAC contractor (material costs, installers, etc.).

An insurance claim due to a fire at both businesses could look very different. The HVAC contractor would likely be able to quickly resume operations because their work is done off site. Once they were able to find a temporary location for their offices and warehouse operations and access equipment and parts inventory, they could continue selling – so their business income claim for a six month period would be significantly reduced from the continued sales.

In the case of the dental office, they would not be able to quickly resume normal business in a temporary location because their offices would require a sanitary, private office space. The result is that, depending on the business interruption coverage, it is likely that the dental office's claim will include significant business income reimbursement – whereas the HVAC company would not.

Our job as forensic accountants is to take a look at the whole puzzle from every angle, then put the pieces together to determine actual economic loss. By having the experience of working with many different kinds of companies and situations, we can often identify factors that are not always obvious, but that could significantly affect a business insurance claim. Having that kind of expertise can be invaluable in determining the actual economic loss in a business interruption claim.

Can We Help You?

Dale Cremers, Bob Holtzbauer & Roger Nearmyer have the experience to help you address questions about forensic accounting. Please call for more information at 515-274-4804 or e-mail us at info@chncpa.com.

