



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.

Business insurance coverage often includes both property and business income. Roger Nearmyer of Cremers, Holtzbauer & Nearmyer, P.C., a certified public accounting firm, explains how a portion of a property loss would be appropriately determined.

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Calculating Property Loss

Large companies often have systems and staff in place to assist in loss valuation when necessary. In smaller organizations, outside forensic accounting resources are useful in finding answers.

The starting point for an inventory property loss valuation is usually a review of inventory management processes, according to Roger Nearmyer. "We want to evaluate the level of sophistication of the inventory system being used. Can it tell us what inventory was on hand on the date of the accident so that we can easily determine what was lost? If not, we begin with a physical inventory, which may be handled by an inventory specialist company. In cases where the perishable items still on hand will not be usable for long, we'll ask for a count of what is being discarded".

The job is more difficult when there is nothing left. "We can't count inventory that was destroyed by fire, of course, so we use forensic accounting to recreate the quantities from accounting records," says Nearmyer. The task is to look at all the purchases and sales since the last physical count, and work forward to the inventory quantities that should have been on hand on the day of the loss. Merchandise that has been rendered no longer salable may be

included even though it is actually still on hand. That is not to say that simple inventory valuation is always a clear-cut matter, according to Nearmyer. The value of the stale merchandise may no longer be equal to the original purchase price, particularly if items have been on hand for a period of time. Questions of fraud sometimes arise if claimants request replacement cost coverage for obsolete inventory, and insurers may reasonably ask for proof that the merchandise will actually be replaced. Otherwise, depending on policy coverages, the insurer will reimburse for actual cash value, usually the lower of cost or fair value.

When is it important to call in outside forensic expertise? When inventory is smoke- or water-damaged but not destroyed by fire, the insurer or salvage company can probably come up with accurate counts upon which to base a prop-erty loss valuation. But if an inventory value must be calculated by accounting methods rather than a physical count, it's wise to seek professional help.

Mistakes to Avoid in Property Loss Determination

Proper accounting treatment of damaged or destroyed inventory is a basic but avoidable error. The key is to match inventory losses with reimbursements received, effectively removing the inventory from the books. Adding the lost inventory to operating expenses results in "double-dipping," which is not an acceptable accounting practice.

How is a property loss typically determined? In the example of a fire at a large poultry farm, owners suffered the loss of buildings, equipment and grain elevators. The adjuster begins by obtaining photographs of the loss. Then, price quotes in the amount of approximately \$600,000 are secured for rebuilding the building and replacing the machinery. The adjuster's settlement offer is contingent upon the owners' decision to rebuild, as reimbursements for rebuilding are based on replacement value. Otherwise, insureds will receive the actual cash value of the loss.

Nearmyer notes that, in this case, a business income loss valuation was also involved. The fire destroyed equipment owners used to grind feed for their poultry farm as well as to resell, causing income loss along with the property loss; Nearmyer and other staff members assisted the insurer in determining the effect of the loss on net income and continuing expenses.

Why Call a Forensic Accountant?

Nearmyer says forensic accountants provide meaningful assistance to the insured's accountant or insurers in loss determination. "As outside professionals, we are not likely to get caught up in the emotion of the loss. It's our job to understand the

business and the loss and to determine whether or not payment is due under terms of the policy in force. Our role to be empathetic and provide professional assistance can be very helpful in stressful circumstances," he explains.

Forensic Accountants apply accepted accounting principles from a fresh and objective point of view. Matching revenue with costs of revenues, proper expense reporting, and evaluation of ongoing accounting practices in the business operation assure that loss determinations are appropriate and consistent with coverage limits.

"Sometimes we see situations in which owners have shifted expenses to a business income loss category when the property loss claims have reached the coverage maximum. We are going to be conversant on the coverages so that we can catch mistakes," says Nearmyer, who adds that such errors are more often a misunderstanding of coverage rather than an attempt to deceive.

For example: An adjuster may reimburse claimants under their property coverages for use of internal labor to aid in cleanup after an accident. If this occurs, the payroll cost must be excluded from reimbursement under business income coverage of continuing payroll.

Can We Help You?

Dale Cremers, Bob Holtzbauer and Roger Nearmyer have 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.

