

# WALWORTH & NAYH, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

VOLUME 3, ISSUE 3

FALL 2009

## Forensic Accounting Services

- Property & Casualty Insurance Claims Consulting
- No-Fault / Wage Loss Claims Consulting
- Litigation Support
- Training and Seminars for insurance, legal and accounting industry professionals

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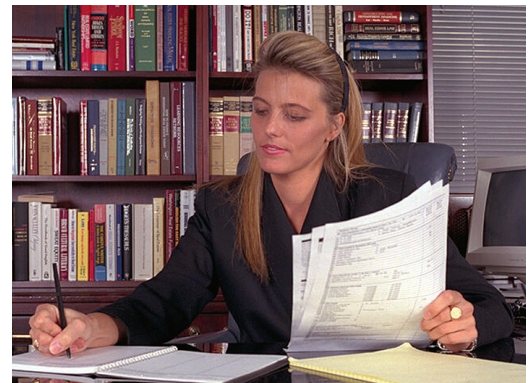
## DOCUMENT REQUESTS IN BUSINESS INCOME CLAIMS

Determining what documents to request and for what time period is often a challenge in business income claims. Policyholders sometimes object to the scope of requests and question their necessity. This is often due to a lack of understanding as to why certain records are needed and their duties under the policy. Informing the insured about these matters early in the adjustment process may help. The provisions contained within the ISO CP-00-30 form are typical of most business income forms. Under the *Loss Conditions* section, the relevant *Duties In The Event Of Loss* include:

- *“As often as may be reasonably required, permit us to ... examine your books and records. Also permit us to ... make copies from your books and records.”*
- *“We may examine any insured under oath ... about any matter relating to this insurance or the claim, including an insured’s books and records.”*
- *“Cooperate with us in the investigation or settlement of the claim.”*

Note that these provisions do not indicate any restriction on the scope of the books and records that the insurer may request. Neither do they contain any provision which would provide the insured with a basis to refuse to provide certain records.

The *Loss Determination* section states that, *“The amount of Business Income loss will be determined based on: (1) The Net Income of the business before the direct physical loss or damage occurred; (2) The likely Net Income of the business if no physical loss or damage had occurred, (3) The operating expenses, including payroll expenses, necessary to resume ‘operations’ with the same quality of service that existed just before the direct physical loss or damage; and (4) Other relevant sources of information, including: (a) Your financial records and accounting procedures; (b) Bills, invoices and other vouchers; and (c) Deeds, liens or contracts.”* (emphasis added)



Obviously, the loss cannot be determined in an information vacuum. If the listed items are relevant to the loss determination, then the documents and records (such as tax returns, financial statements, etc.) that provide information about them are clearly relevant. Since, in simple terms, net income is the difference between sales and expenses, various records concerning the detail of sales and expenses may also be relevant and necessary. A patient and tactful explanation of the insured’s duties and the overall reasons (“we know you want a fair and accurate adjustment of the loss just as we do”) for a document request will generally overcome most objections.

### Factors to Consider

The following are some of the more important factors that influence the nature and extent of the documents to request:

- Likely duration of the interruption. This is one of the most important factors. A short period of interruption (days to weeks) will generally require fewer and different documents than a longer period.
- Magnitude of the potential exposure. The greater the potential exposure, the greater the need for a solid, factual basis for loss calculations. When the exposure is large, it is unlikely that either party will entertain a settlement based on undocumented

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estimates and “back of the envelope” calculations. On the other hand, where there is minimal exposure, estimates may be preferable to gathering and analyzing appropriate documentation as the cost of doing so may far exceed the benefit of greater accuracy.

- **Nature of the business.** How will the loss affect operations? Will the insured be able to operate from a temporary location? Will there be a partial or total suspension? Where there is a partial suspension (i.e. the insured is able to continue some operations at the loss location), or a continuation of operations at a temporary location, it becomes more important to obtain actual postloss financial statements and other records to accurately measure the extent of mitigation of the business income loss.
- **Number of locations.** If the insured has multiple locations under the same policy, it may also be desirable to request records by location. For example, if a retailer has other stores that are relatively close to the loss location, they may experience an offsetting increase in sales from customers coming from the area of the loss location. If they are far away, then the financial performance at unaffected stores may provide a good indicator of the likely net income at the loss location if no damage had occurred.
- **Length of time in business.** Obviously, if the insured has only been in business for six months, their books and records won't go back any further. However, this is another instance where records from other locations may be useful if they have been in operation longer.
- **Basis of accounting.** The principal issue is timing differences between when revenue is recorded (recognized) on the books and when it is actually considered as earned under Generally Accepted Accounting Principles (which determines Net Income). If the insured is on the accrual basis, then the financial statements and underlying books and records should already be stated in a way that is conducive to a business income analysis. However, if the insured maintains their books on the cash basis of accounting, it may be necessary to request additional records to properly analyze sales and expenses in a way that is consistent with business income coverage.
- **Fiscal year.** If the insured uses a fiscal year that is other than a calendar year (e.g. a fiscal year ending January 31), this can lead to misunderstandings when requesting various records. For example, when requesting “2008 financial statements” you might end up receiving financial statements for the fiscal year ended January 31, 2008 when you thought you would be getting calendar year 2008.
- **Occupancy status.** Does the insured own the building, or are they a tenant? If they are a tenant, is the building owned by a related entity, or an unrelated third party? These factors may determine the extent to which rent and building related expenses continue during the loss period.

The books and records can be divided into two general classes: those that are typically necessary in almost any business income loss and those that are more likely to be necessary in specific situations.

### **Basic Requests Common to Most Losses**

- **Income tax returns.** For a short-period loss, the tax return for the most recent tax year preceding the date of loss is usually sufficient. When the loss period extends for several months or more, it is usually advisable to request three prior years. When the exposure is large and the loss period could approach 12 months or more, five years of history may be desirable.
- **Annual financial statements.** It is advisable to request both the tax returns and annual financial statements, as one source may provide essential information that is not contained in the other. The insured may object that they are “the same thing.” While in some cases they may be very similar, in many cases they are not and you won't know unless you have access to both.
- **Interim preloss financial statements.** “Interim” simply means any financial statement that covers a period of less than one fiscal year. The insured may normally prepare them on a monthly or quarterly basis, or not at all. If the last fiscal year ended some months before the date of loss, then it is usually advisable to request interim financial statements from the end of the last fiscal year up to the date of loss.
- **Interim postloss financial statements.** Depending on the factors discussed above, it may be advisable to request postloss monthly or quarterly financial statements. Obviously, the purpose is to analyze the actual sales and expenses reported for the loss period.
- **Preloss sales history.** Periodic sales reports should be requested that summarize total sales by time period over a time span that will allow for a reasonable assessment of the insured's sales trends prior to the loss. The choice of units of time (daily, weekly, or monthly) to be summarized in the reports depends on the length of the loss period. For a loss period of a few days, daily sales reports would normally be requested. For a period that could run several months, monthly sales reports would typically be requested. The time span encompassed by the request would also be dependent on the probable length of the loss period. For a loss period of a few days, daily sales reports are typically requested for a period of two or three weeks preloss through two or three weeks postloss. At the other end of the spectrum, a loss period extending for several months and having sufficient exposure would likely require a 36-month preloss sales history, plus postloss monthly reports if there is some continuation of operations.
- **Payroll journals.** For anything other than a minimal exposure, it is usually desirable to have preloss and postloss payroll journals (a report of pay and hours by employee for each pay period) to analyze and assess the reasonableness of any continuing payroll. Again, the time span to request will be a function of the probable duration of the loss period and the overall exposure.
- **Building lease.** This is often overlooked in an initial document request. Frequently, commercial leases will provide that the rent abates in the event of a fire or other casualty. The lease may also contain important information about the respective responsibilities of the landlord and tenant for payment of building related expenses.

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# The Current Pulse of the Economy

If you have read a newspaper, watched television or listened to the radio, you are well aware of the current economic crisis we are experiencing in our state. The automobile companies have scaled back operations, downsized and eliminated thousands of jobs. This has resulted in an economic crisis, the likes that have not been seen in many decades. Did you know (as of August 2009)?

- That Michigan has the highest unemployment rate in the entire country at 15.3%; the national average rate is 9.8%
- Of the 83 counties in Michigan the highest unemployment rate is in Baraga County (U.P.) with 23.8%, while the lowest rate is in Mackinac County (U.P.) at 5.3%.
- The local metropolitan tri-county unemployment rates are: Oakland (14.9%); Macomb (18.0%); and Wayne (18.2%)
- The City of Detroit unemployment rate is at an astounding rate of 28.9%.
- Michigan is 5th in the nation in households in foreclosure, with 1 in every 234 households in foreclosure.

The only other states experiencing greater foreclosure rates are Nevada, Florida, California and Arizona.

- By the close of trading on the last day of 2008, \$6.9 trillion dollars in stock market wealth had been wiped out.

All of the above have had a significant impact on wage loss claims. This has resulted in a substantial increase in the number of unemployed individuals, decreasing business trends, and an increase in fraudulent claims. Stay tuned, as future articles will discuss some of these topics in greater detail.



**Effective October 1, 2009 through September 30, 2010, the No-fault statutory maximum limit has changed to \$4,878 per 30-day period. This is the first time that the statutory maximum limit has ever decreased from the prior year.**

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## **For Additional Detail and/or Specific Situations**

In a brief article, it is only possible to touch on some of the books and records which may be necessary under particular circumstances. Some of the more common types include:

- Detail general ledger. It contains the next level of detail supporting the amounts reported in the financial statements and tax returns. It, in turn, may be supported by underlying journals recording individual transactions and finally, the source documents of individual transactions (checks, invoices, etc.). In some cases, the information in the general ledger is sufficient to answer questions that arise in analyzing the financial statements and tax returns. In other cases, access to the lower-level documents will be needed.
- Where there may be issues with the timing of revenue recognition (i.e. cash vs. accrual basis accounting for sales), any or all of the following elements of the books and records may be pertinent:
  - o Accounts receivable reports.
  - o Sales journals.
  - o Cash receipts journals.
  - o Bank statements.
  - o Sales invoices.
  - o Purchase orders from customers.
  - o Sales order forms.
  - o Sales order logs.
  - o Documentation of orders canceled or refused after a loss.
  - o Formal sales forecasts and projections if they were prepared by the insured prior to the loss in the normal course of business.
- Where there may be similar issues with respect to the time period in which expenses should be recognized, any of the following may be needed:
  - o Accounts payable reports.
  - o Purchases journals.
  - o Canceled checks.
  - o Purchase invoices.
  - o Purchase orders issued to vendors.
- Particular industries and types of businesses typically have specialized records that may be necessary to the analysis:
  - o Production records summarizing output by time period may be needed for manufacturing risks.
  - o Cost accounting summaries and reports (which provide a breakdown of the normal labor, materials and other costs per unit of product) may also be needed where the insured is a manufacturer.
  - o Occupancy reports are often essential in analyzing losses of motels, hotels, nursing homes and similar businesses.
  - o Rent rolls (which record rental obligations and payments of tenants) may be required where the insured is the landlord of multi-unit properties such as apartment buildings, strip malls, office buildings, or mobile home parks.

Formulating the right document request for the circumstances is sometimes simple, sometimes not. As many of you know from past experience, we are always available to assist. Even if you have a small loss where you don't have the leeway to retain an accountant, we are happy to serve as an informal sounding board and offer practical suggestions. Help is only a phone call away.

**FORENSIC ACCOUNTING FOCUS****Main Office**

17800 Newburgh Rd.  
Suite 101  
Livonia, MI 48152

Phone: 734-464-8990  
Fax: 734-464-1951

**Grand Rapids Office**

3033 Orchard Vista Drive SE  
Suite 306  
Grand Rapids, MI 49546

Phone: 616-575-1122  
Fax: 616-575-1951

**Toledo Office**

5660 Southwyck Blvd.  
Suite 200-Q  
Toledo, OH 43614

Phone: 419-867-8180  
Fax: 734-464-1951

**Traverse City Office**

880 Munson  
Suite E-1  
Traverse City, MI 49686

Phone: 231-947-8990  
Fax: 734-464-1951

E-mail: [amoceri@walnay.com](mailto:amoceri@walnay.com)

## On the web: [www.walnay.com](http://www.walnay.com)

*At Walworth & Nayh, P.C., we specialize in Forensic Accounting Services, including Insurance Loss Accounting and Litigation Support.*

*We regularly provide expert testimony in deposition, trial and alternative dispute resolution venues. Our forensic specialists apply their knowledge of accounting, finance, information technology, and business to the investigation of specific issues related to insurance claims and litigation matters. Opinions are developed by thorough analysis combined with judgment and experience.*

*Our clients include insurance companies and their adjusters, private companies who have experienced a loss, and attorneys representing both plaintiffs and defendants involved in business disputes.*

*Unlike traditional accounting firms, we are exclusively devoted to helping clients resolve disputes by providing technical expertise in the relevant accounting and damages issues.*

*For further information, we invite you to contact one of our partners at the numbers listed above, or by e-mail at [amoceri@walnay.com](mailto:amoceri@walnay.com).*

## Firm News

During the months of August, September and October 2009, Walworth & Nayh presented business income seminars on "Business Documents and Document Requests" at all of the Auto-Owners Michigan Claims Branch offices.

On September 22, 2009, the Michigan Chapter of NSPII presented their annual half-day seminar at the MSU Management Center in Troy, MI. Bob Walworth is on the Executive Board of the NSPII Michigan Chapter, and was involved in all aspects of the planning of this important and informative event.

On October 14, 2009, Greg Wood and Gary Nayh were presenters at the annual IASIU Fall Conference. The topic was Wage Loss Claims in the Current Michigan Economy.

## EVENT CALENDAR

On November 3, 2009, Walworth & Nayh will be co-sponsoring a half-day educational seminar with Hopkins Yeager & Smith at the Lansing Center in Lansing, Michigan. Bob Walworth and Phil Yeager will be co-presenting the General Session: "Recent Developments Involving Legal and Accounting Issues on First and Third Party Claims." Greg Wood and Gary Nayh will be co-presenting "Legal and Accounting Issues Regarding No Fault Wage Loss Claims" with Meigs Day.

On November 17, 2009, Bob Walworth and Kurt Meyer of Gregory & Meyer P.C. will be co-presenting "Business Interruption: Cooking the Books for Profit - The Detection, Investigation and Litigation of Fraudulent BI Claims" at the NSPII National Seminar in Columbus, Ohio.