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Continuing Expenses: Continuing Confusion

How often have you heard things like these from a business owner in the course of adjusting a business income loss:

(1) *"Yes my business is completely shut down, but I still have plenty of bills coming in, so I have a lot of continuing expenses that need to be paid."*

(2) *"I know my business was operating near breakeven before the fire, so why can't you just pay me my continuing expenses."*

(3) *"My salary increased after the loss. That's all part of continuing expenses according to my policy."*

Much confusion stems from the way that business income is typically described. Most policies parallel the ISO CP-00-30 form:

Coverage. We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration."

In the subsequent paragraph, business income is then defined as:

Business Income. Business income means the: (a) Net income (Net Profit or Loss before income taxes) that would have been earned or incurred; and (b) Continuing normal operating expenses incurred, including payroll.

However, this needs to be



read in conjunction with the section on resumption of operations that appears several pages later:

Resumption of Operations. We will reduce the amount of your Business Income loss ... to the extent you can resume your "operations", in whole or in part, by using damaged or undamaged property (including merchandise or stock) at the described premises or elsewhere.

Thus, when operations

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No Fault Corner Tax Returns – The First Step

The basis for determining the appropriate wage loss benefit is the underlying documentation that reflect a claimant's income. The type of documentation available will depend on such things as the type of business, length of time the business has operated and the specific documents maintained by the

claimant.

A good source of information that can serve as a starting point is the income tax return. There are various types of tax returns depending upon the type of business entity. The most common of all tax returns is the personal income tax re-

turn, Form 1040.

The Form 1040 serves as a road map that identifies an individual's sources of income that can include wages, self-employment income, ownership in a corporation or partnership and farm income. The Form 1040 is also

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Continuing Expenses: Continuing Confusion

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are resumed during the period of restoration, this reduces the loss of business income accordingly. While “business income” may mean “net income plus continuing expenses,” the *loss* of business income cannot be determined without taking into account the revenue that is generated during the period of restoration. If one wanted to reduce it to a formula it would be:

$$\begin{aligned} & \pm [\text{Net income/(loss) that would} \\ & \quad \text{have been earned or incurred}] \\ & + [\text{Normal operating expenses} \\ & \quad \text{that continue}] \\ & - [\text{Actual Sales Achieved}] \\ & = [\text{Loss of Business Income}] \end{aligned}$$

With these things in mind, let's return to question (1). Business income coverage is defined in terms that are allied with accrual basis accounting where expenses are recorded when they are incurred. The policy language specifies “*net income*” as a starting point. This is not a term of art, but is specifically defined by the accounting profession as being derived from accrual basis accounting. The policy lan-

guage also indicates coverage of continuing normal operating expenses that are “*incurred*” during the period of restoration. However, most small business owners are focused on cash flow and think in terms of cash basis accounting where expenses are recorded in the period when they are paid. Question (1) often arises when the insured is receiving bills and invoices after the date of loss for goods and services that were actually purchased (incurred) prior to the date of loss. If the insured pays these invoices during the period of restoration, it is only the extinguishment of debt (trade accounts payable) for goods and services that were purchased prior to the date of loss, not a continuing normal operating expense incurred during the period of restoration.

In response to question (2), there are two reasons that continuing expenses should not be viewed in isolation. First, even if the insured's historical net income or loss appears to have been minimal in the previous year, it is the net income or loss that would have been earned or incurred during the period of restoration that is relevant.

This could be significantly different from the historical amounts. Second, if the insured continues operations to any degree, then the actual sales achieved during the period of restoration must also be considered. In addition, as in the previous example, care must be taken to verify that the “continuing expenses” were actually incurred during the period of restoration.

Now and then, as in question (3), an insured may be under the impression that raising the owner's salary after the loss will somehow increase the business income loss. However, increasing the owner's salary after the loss also decreases the *net income that would have been earned or incurred* during the period of restoration by the same amount. For the owner to argue otherwise, he or she would have to present the increase in salary as an extra expense. Would this be a “*necessary*” extra expense “*to avoid or minimize the suspension of business*” under your policy?

As always, a thoughtful reading of the policy will resolve many of the “difficult” questions that arise.

No Fault Corner Tax Returns – The First Step

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useful in determining if an individual received unemployment, retirement or disability benefits. Become familiar with line descriptions rather than line numbers because the IRS does change forms from time to time. Currently, an individual with W-2 wages would reflect this type of income on line 7. A self-employed individual would report their income on an attached Schedule C and it would be reflected on line 12. Earnings from an S-

corporation or partnership would be reflected on line 17.

From time to time the tax returns that are provided may be questioned as to their validity, or in some cases an individual may have misplaced their tax returns and cannot seem to locate them. This is not a problem. Form 4506 serves as an authorization to obtain tax returns directly from the IRS. Of course there is a charge (currently \$39 per year requested), but it does prove useful in certain circumstances. If you would like a copy of

a Form 4506 please contact our office.

While the tax return is not the only documentation used in analyzing a claim, it is a useful source of information and a great place to start.

Notice:

The No-Fault statutory maximum increased on October 1, 2005 to \$4,400 per 30-days.

Golf and Good Times Second Annual KJA Memorial Golf Outing

We want to thank everyone involved with the Second Annual KJA Memorial Golf Outing. As many of you know, the first event was held in 2004 in memory of our friend and partner Kevin Antonishen and to provide for a college fund for his children.



This year's event was held on August 22nd at Pine Lake Country Club and was well attended. Although the day was cloudy, the summer heat and humidity had receded making for a comfortable round of golf. Dinner followed on the lakeside veranda, providing a relaxing setting for an evening of fun.

of Black, Duggan and Moss. Mike was the lucky winner of the 50/50 raffle and graciously donated his winnings back to the KJA Education Trust.

We hope that you will join us in August 2006 for the Third Annual KJA Memorial Golf Outing.



A special thank you to Mike Black



Event Calendar

December 1 - The Detroit Puddle Blue Goose Holiday Season Party will be held at 11:00 a.m. at Burton Manor in Livonia. Attendees are asked to bring one new, unwrapped toy for donation to charity. For ticket information, call Linda Spence at 734-994-7790.

December 7 - The Grand Rapids Puddle Blue Goose Holiday Season Party will be held in the evening at Quail Ridge Golf Club. For ticket information call Joe Lothschutz at 616-575-1122.

April 2-5, 2006 - PLRB Claims Conference in Nashville. Bob Walworth will be presenting a seminar on the Broad Evidence Rule with attorney Gregory Meter of Braun, Kendrick, & Finkbeiner and Larry Miller, CPCU, of Frankenmuth Mutual.

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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 com-

panies 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.

Firm News

The recent hurricanes have meant more travel for us as for many of you. Mark Stephanic has been in New Orleans and other parts of Louisiana recently for Hurricane Katrina claims and Paul Donnan was in the Cayman Islands earlier this year for a lengthy construction accounting project stemming from Hurricane Ivan from last year.

Gary Nayh and Greg Wood recently presented two training seminars on Excess Wage Loss for adjusters at State Farm on November 8th and 9th that were well received. We realize the importance of continuing education and frequently provide seminars at client's offices. The advantage of in-house seminars is that they can be tailored to your

specific needs. In the past we have presented seminars on Understanding Tax Returns, Business Interruption Losses, Theft Claims and No-Fault Wage and Survivors Losses. If you are interested in having a training seminar at your office, please phone or e-mail Anne Moceri (see contact information above) to make the arrangements.