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Business Interruption Claims: Should a Forensic Accountant be Retained?

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Most business owners buy insurance that covers the eventuality of some event happening that prevents the business to operate for either a short time or permanently. Examples include fire, earthquake, floods, etc. Unfortunately, when such a disaster occurs there usually follows an attempt by the insurance company to pay as little as possible. While this is somewhat expected, the vehemence and stubbornness of the insurance adjustors to revise their findings can be downright shocking. Most business owners give up and accept the insurance payment as full compensation. Others choose to hire a law firm to deal with the insurance company.

In simple terms an insurance claim for business interruption is an attempt by the insurance company to replace "what would have been" but for the disaster. There is a period for which business is interrupted (usually limited in the contract to a number of months). For that period the insurance company is theoretically to replace the profits that would have been earned. If there is a disagreement between the insured and the insurance company it is usually in how that lost profit number is calculated.

Before a lawyer is hired, consideration should be given to retaining a forensic accountant who has experience in such matters. Forensic accountants are accustomed to reading insurance contracts, understanding the definitions in the contract, and applying them to the facts of the case. This is almost always money well-spent because the insurance companies usually hire CPAs to do the damage calculations – or effectively be the insurance adjustor. Having your expert (accountant) sit across from the insurance company's expert can assist with a settlement at best. At worst, the result is that you have identified the areas of disagreement and the lawyer can then assist in evaluating whether it is worth your time and money to pursue the matter.

Case in Point

The following is an example of the benefit of this type of process. A fast growth financial services business was completely destroyed in a fire that started in an adjoining business. Since a financial services business is highly dependent on computers and paper, a fire brings the business to a complete stop. It was an extraordinary effort to recreate the work that was in process, much less re-establishing the ongoing business operation.

In this case, the insurance company calculated losses over the correct period but at significantly reduced amounts. The adjustor effectively ignored the historic growth rates of the company and calculated projected growth based on industry growth rates rather than on the historic growth of the subject company. Additionally, the adjustor made some calculation errors that resulted in a lost profits amount that was less than were pre-disaster profits. Regardless, the insurance company had essentially taken the position that this was their best offer and that they weren't going to budge.

In this case, the law firm was retained first. After spending a lot in discovery fees and costs the policy holder hired their own accountants to review the adjustor's (CPA) work. After the review and analysis was complete, the insurance adjustor agreed to meet with the policy holders and their expert. The result was an acknowledgment of the mathematical errors and a "line in the sand" disagreement on growth projections. Once the issue had been narrowed to that single question, a settlement conference was held. It took most of a day but the case settled for hundreds of thousands of dollars more than the original settlement offered by the insurance company. All parties acknowledged it was a fair agreement – the insurance company thought it was a little high, the business felt it could have been more. The attorneys were pleased that the matter resolved in their clients favor without extended litigation required.

The conclusion then is two-fold:

- Business owners should understand what they are buying when they pay for business interruption insurance. The policy benefits in the event of a disaster may in fact not be worth the cost.
- In the event of a disaster, a business owner who feels they are not being fairly compensated should enlist the help of an accounting expert who can do an independent analysis of the settlement. As in the case cited above the investment can pay off many times over.

About the author:

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