Forensic Accountants Society of North America

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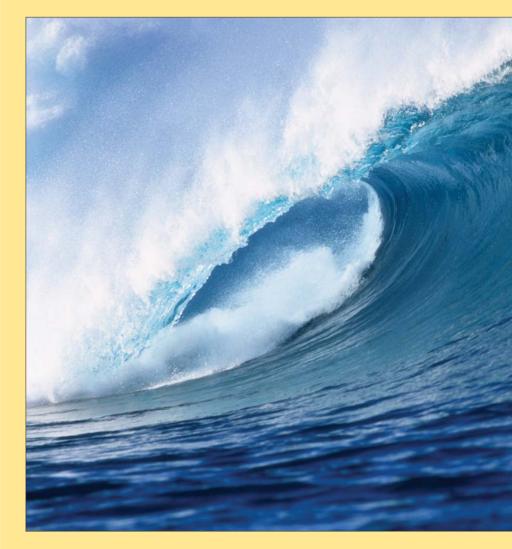
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Riding the Waves of Time

by Roger D. Nearmyer, CPA, FASNA Member

n a perfect world, business would be easy. Sales would be steady and predictable month after month with a constant rate of growth. That would make it easy to know when to hire new employees, buy new property or equipment and purchase inventory. Cash flow would never be an issue. And we'd all retire at 65, take a cruise in the Bahamas, play bad golf and not really care. ▶











CASEWORK EXPERIENCE

FASNA member casework includes, but is not limited to, cases involving:

- Inventory/property loss
- Employee dishonesty
- Business income loss
- Personal injury or wrongful death claims
- Truth in lending/truth in leasing
- Post judgement matters/ calculations
- Loss of income/earnings
- Divorce and fidelity claims
- Business valuation
- Expert testimony
- Fraud

INDUSTRY EXPERIENCE

FASNA member experience includes, but is not limited to cases involving:

- Auto dealerships and transportation
- Colleges and universities
- Construction, contracting, and engineering
- Financial/money management, trust, and estate
- Healthcare
- State and Indian tribal government
- Insurance claims
- Manufacturing
- Real estate
- Restaurant and hotel industries
- Retailing/wholesale

Unfortunately, business doesn't work that way. It's filled with ups and downs. Taxes. Employees who come and go. Double digit health insurance rate increases. Politics. And shipping expenses affected by the cost of oil controlled by the whim of a handful of people a half world away. And, believe it or not, in some way or another, all of these things – and more – can affect how you calculate an insurance claim. And that, in a nutshell, is a big part of the reason why forensic accountants exist.

One of the most important, yet confusing factors we consider when we are called in to determine the actual loss in a loss of business income claim is the "period". Every industry and every business within an industry has a different "period". Take for example a marine accessories company that we analyzed a claim for not long ago. As you can imagine, the boating industry took it on the chin when the economy turned sour a couple years ago. Boating is a luxury – and people just don't buy boats when they aren't making good money.

On the surface, if you were looking at a loss of business claim for a company like this, you might just look at their sales from the past couple years, multiply it by an industry standard based on lower sales trends over the past year and, cha-ching! Here's the loss.

But if you look a little deeper, that simple view might be naïve. Here are just a few factors that can affect a business income claim based specifically on the time period. ▶

Experienced forensic accountants take the period of recovery into special account when determining actual economic loss in business income claims. Businesses recovering from recessions often show higher margins because they have trimmed unnecessary fat. That means claims for business income loss are often higher than typically expected in normal economic times.

Cutting the Fat

Companies coming out of a recession have usually cut much of the "fat" that they were able to carry when things were better. They've eliminated marginal employees and ridded themselves of unnecessary expenses – maybe a country club membership, for example. In general, they run lean. That means when sales pick back up, they generally show a significantly higher profit margin.

In general, while sales may still be lower as the company comes out of the recession, the loss of business income claims are often higher than you might expect because profit margin is higher.

Graded Inventory

In the case of the marine accessories company, they grade their income based on movement. Maybe contrary to what you'd think, boat motors and accessories don't necessarily see the downturn that the general industry sees. Why? Because in a bad economy, boat owners often still want to boat, they just don't want to buy new boats – so they are more likely to repair and replace parts for what they already own. If you only looked at general industry sales trends and didn't account for the spike in repair and accessories-type business, your loss calculations would be wrong.

Mother Nature (and other outside influences)

Outside influences like weather can have different affects as well. Weather conditions that keep people from boating can also affect how much (and what type) of maintenance may be required of a boat owner. Bad conditions may mean lower motor repair business, but when the weather is good, this usually means higher sales for on-board accessories and repairs that may have been damaged from use of older equipment. It's important to consider these factors when calculating an actual loss of business income.

Competition Changes

In a tough economy, weaker companies often have to close. For those that do survive in the same market, this is a positive – as it creates the opportunity to pick up new business. Depending on the number of competitors left in the market, it can also mean a company can demand a higher margin on the products they are selling. Trends towards higher margins and higher sales definitely have an effect on a loss of business income claim.

Business income claims are complicated. There are many variables that can affect the outcome. An experienced forensic accountant can be a huge ally in determining factors that can affect the actual economic loss – especially when making reasonable determinations based on factors that are affected by the period of recovery.

The type and turnover of inventory can be significantly affected – both positively or negatively when the economy is in transition.



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