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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.*

In our last issue, we solicited article topics from some of our readers.

Kathleen suggested a tax related issue and suspicious signs to look for on tax returns during an investigation. She stated that most claims are accompanied by a claimant's tax return and she often wonders why a claimant has filed their return the way they have.

Please see the sidebar on page 2 for a preview to our next article.

Thanks Kathleen

CREMERS, HOLTZBAUER & NEARMYER, P.C.

6200 AURORA AVENUE
SUITE 600W
URBANDALE, IA 50322-2871

PHONE *515.274.4804*
FAX *515.274.4807*
E-MAIL *info@chncpa.com*
www.chncpa.com

The "*Flashing Lights*" of Forensic Accounting

How to Know When You Need a Forensic Accountant?

In this era of technology, we live in a world where flashing lights control how we respond. These lights warn us, educate us and help us make decisions. Flashing lights on your car's dashboard? Time to take the car into the shop. Flashing lights on your computer? Time to save your files. Flashing lights in your tractor cab? You need to steer straighter. Flashing lights flashing behind you in the car? Well, hopefully that doesn't happen too often.

So, what do flashing lights have to do with forensic accounting? Well, that's just it. There aren't any. It would be easy if there were flashing lights at the top of every insurance claim that indicated the need for the expertise and experience of a forensic accountant. So, how do you know when bringing a forensic accountant into a claim makes sense? What are the flashing lights of forensic accounting?

While there are no hard and fast rules, there are times when it makes a lot of sense to bring in an experienced forensic accountant. Following are a few "flashing lights" of forensic accounting.

Inventory
Different companies handle similar inventory in very different ways. How those inventories are handled can sometimes make a big difference in determining the actual economic loss.

Something as simple as calculating the value of a company's inventory can get confusing. For example, say "Big Bear Animal Company" sells stuffed animals in a strip mall. A fire destroys their building and everything in it. In their claim, the company lists 700 stuffed bears in their inventory at a retail price of ten dollars each.

Under most insurance coverages, the company would not claim a $7,000 loss in inventory. The loss would be calculated based on the company's wholesale price – what they actually paid for the inventory. Any additional claim would be considered a loss of business income claim – and would need to be calculated accordingly.

Claims involving inventory can be complicated by a number of factors, including how the inventory is used (is it for resale or is it a component of a final product), who owns it, how it is recorded in company records and where it is stored. Believe it or not, we have helped investigate claims where the inventory that was claimed would not physically fit in the location where the loss was reported to have taken place and inventory valued at suggested retail.

Business Income
Determining loss of business income can be one of the more complicated matters. We've seen many business income claims drag on through the legal system for years. So many factors go into determining a

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The *Case of the Disappearing Income* began when we were hired by an attorney to assist in defending a policyholder who had caused an accident, injuring a retirement-age man.

The injured plaintiff was self-employed in a commission-based sales capacity. He sued for loss of earnings in an amount of over $500,000, which he alleged was the result of the accident. He also claimed that, because he could no longer work, the lost income had caused serious financial difficulties, which forced him to liquidate income-producing assets.

Our firm initiated an examination of financial records and tax returns, which quickly confirmed a significant reduction in income. But the story had just begun.

Further investigation revealed that most of the significant real financial problems existed before the accident, and in fact, a number of the liquidated assets had been sold prior to the injury. Further examination of his sales and commissions revealed that while the plaintiff's income had been reduced, his wife's income went up.

Another issue in the plaintiff's claim was that the he could no longer sit for any prolonged periods. However, examination of his financial records and mortgage interest revealed a fairly recent purchase of a motor home.

...Our next Values will expand on all the indicators and "flashing lights" that led to a significantly reduced claim settlement, as well as what you should look for in financial statements and tax documents when reviewing a claim.

company's loss of business income that it almost always makes sense to involve a forensic accountant.

For example, a storm blows through town and damages the hotel. Contractors determine it will take three months to rebuild the building. The hotel's claim for lost income seems high, but they are able to produce records showing that those three months were their highest occupancy rate the year before. However, closer examination turns up the fact that the occupancy rate was much higher than at any other time – as the result of the town's only competitor hotel being closed during that time for remodeling. Most recent sales figures show a steady decline of occupancy and sales starting immediately after the re-opening of the other hotel. As in this case, outside factors can have a significant impact on a loss of business income – but without the expertise to know what to look for, outside factors can often be missed.

Volatile Markets

In some cases, the volatility of an industry or market can itself make a difference. Knowing how those changes affect a company's business is important when a loss occurs.

The oil industry, for example, has been very volatile over the past two years. Gas prices have increased significantly. How could this volatility affect an insurance claim? Say a gas station refilled their underground tanks – with higher priced gas. You might suspect that their profits would increase proportionally with the percentage increase. However, in this industry, that is not true. The margin stays the same regardless of the price. A claim based on factoring a percentage increase in sales would be inaccurate.

Knowing this can have a big effect on an insurance claim. Historically, volatility has hit steel, sugar, and computer chips.

Geography

Even though an industry's market is changing, it doesn't mean a localized part of that market will automatically follow suit. By understanding both the effects of a broader market – and the localized market – a forensic accountant can often calculate a more accurate loss.

For example, a local farm coop's grain bin collapses in a windstorm. They can't store grain at harvest – so they obviously have a loss of business income. A simple calculation multiplies the grain margin the coop would have earned by the number of bushels the bin would hold. Seems simple, right? If you didn't know that a new ethanol plant had just gone online five miles from the coop, you may not have investigated the effects the new plant might have on the need for grain storage in the area. Since more farmers were delivering grain directly to the plant – bypassing the coop – the coop had less volume going through it. An economic analysis could show that the coop might not be entitled to a payment based on the same volume of grain going through it as the previous year.

Lost Records and Fraud

Sometimes lost or inconsistent records are just the cover-up for potential fraud. The examples are endless, which is just the point of how and why an experienced forensic accountant can help.

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.