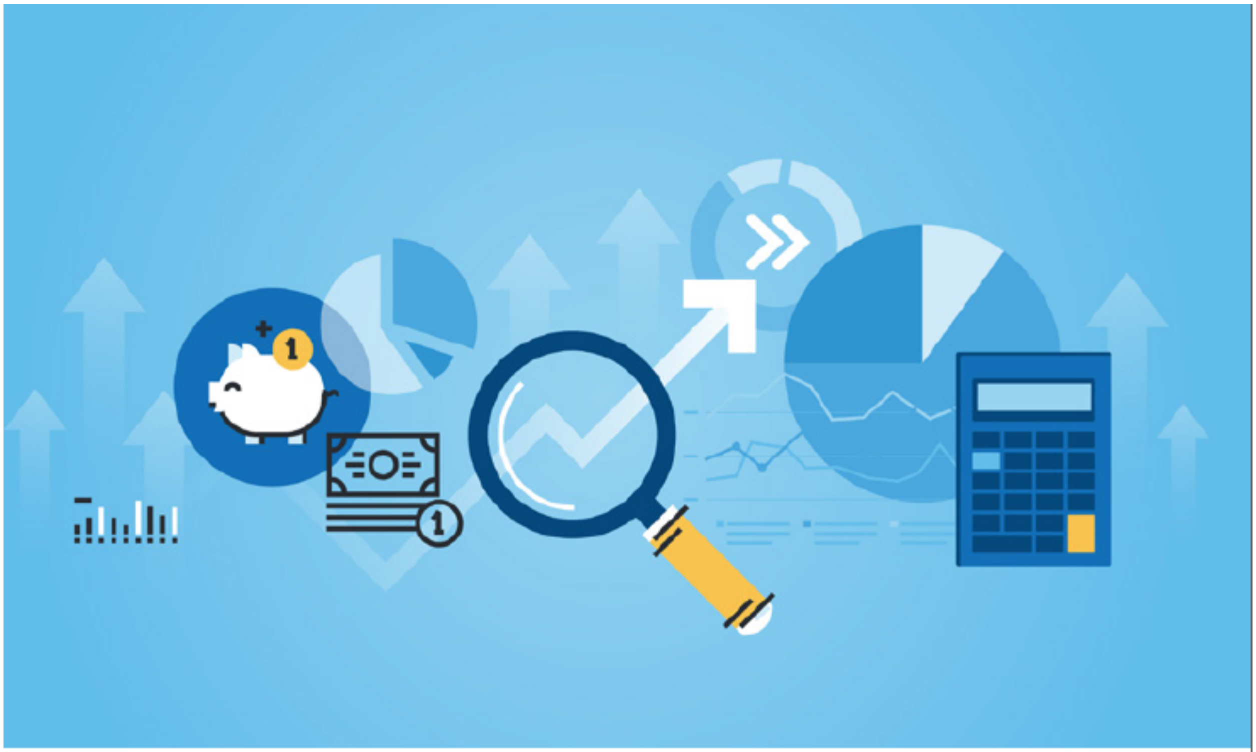

Forensic Accounting: Predicting the Future

Forensic accountants are often relied on to take a deep dive into insureds' financial records, particularly on commercial files that involve business interruption coverage. But did you know that part of their work involves imagining—with some very scientific calculations—how a business might have fared had a loss never happened?

"We try to predict the future in a way that works for all parties," says Crawford Forensic Accounting Services Managing Director Jay Strano.

"Primarily we get involved [in a claim] to value how much business was lost. We consult with the insured and go through historical financial records to understand their business and what would have happened if the interruption had not occurred."

When looking at long periods of a business shut-down, they examine outside factors like the economics of the area and what sort of things are going on outside of this business that would have affected sales, i.e. a recession or inflation.

More to forensic accounting than business interruption

In addition to their sought-after expertise in business interruption claims, forensic accountants are often called on to review repair costs, including contractors' hours, auditing fees and extra expenses claimed. They also apply the tools of their trade to employee fraud cases. Though they typically work with insurance companies, occasionally they're engaged by an individual to perform future income loss calculations due to a personal injury.

One of the hallmarks of this profession is communication. Typically, a forensic accountant submits a report to the adjuster, the insurance company and to the insured for a review. But their service doesn't always end there.

"We like to discuss a report with the insured afterwards," said Strano. "[The insured] sometimes sees a number they weren't expecting… but once we walk them through the numbers and they see how we got there, they understand."

Forensic accounting at Crawford Canada

Internal accounting has a long history in the UK and Australia. While new to North America, there is growth with more and more adjusting firms bringing forensic accounting in-house.

In 2012, Crawford Canada invested in its own in-house forensic accounting unit. The three-person team, which operates out of Toronto as part of Global Technical Services, is comprised of Strano, Stephen Dodd and Julia Vickers, with an assistant to help as needed.

The benefits of a select team within Crawford are as measurable as the work they do. Their proximity to internal files makes the process simple for everyone working on a claim.

Adjusters managing their own business interruption calculations can engage the Crawford team to get a quick verification of their numbers—or involve them in a file from the beginning. Strano says that when they're involved early in the process, the forensics team can help the insured understand calculations and some potential issues before the process moves into complicated territory.

"Adjusters managing their own business interruption calculations can engage the Crawford team to get a quick verification of their numbers—or involve them in a file from the beginning."

They can also speed up the adjusting process and come in at a lower cost. "We can turn around files much quicker than outside handling, so our services tend to be more reasonable [than outside resources]."

A common misconception in the industry is that a forensic accounting team working within an insurance company creates the conditions for a conflict of interest. Strano says that couldn't be further from the truth. "As part of our designation, we're legally bound to provide an unbiased report to every client. I have an obligation to provide an unbiased number and that in itself gets rid of the conflict issue."

When it comes to clients, Strano says his Crawford team has worked with most insurance companies on everything from small claims to ones totaling $750 million. They recently worked on an oil refinery loss in Houston, TX that totaled between $260 and $280 million.

Anatomy of a business interruption claim

When calculating the lost revenue of a business forced to close due to a loss, forensic accountants take into account a number of internal and external variables to come up with an equitable claim.

Internal factors that affect the revenue the business may have earned during a business interruption include:

Seasonality: Is there a drop-off in sales based on the season, i.e. ski resort, restaurant in summer/winter tourist town.

Location: Where is the business situated and how does this affect sales?

Capacity: Is the business operating near capacity due to fire regulations? E.g. is there a maximum number of people in restaurant at any given time?

Operating hours: Is the business open on Sundays? Does the business have Friday and Saturday night crowds and are open much longer than usual? Is the business closed at specific times during the year?

Leases: It's important to review the lease agreement (if the insureds rents space) to verify whether rent continues while the business is unable to open due to repairs.

Employees: If employees have to leave the business due to the loss, will they return once the business reopens? If they leave, what is the cost to train new employees?

External factors that affect lost sales

General economic conditions: What is the state of the economy? Has the area gone into a recession? Is the economy in a rapid rebound which could ignite inflation?

Competitors: Are there a number of competitors in the area where people will go to if the business is down for a period of time? Will people come back to the business once they are able to reopen?

Business life-cycle: What stage is the business in? Is it a relatively new entry into the industry? Is it established and growing? Has the business matured and have sales leveled? Is the business on the tail end of its life-cycle?