

Filing a Business Interruption Claim: Properly Calculating the Business Income Loss

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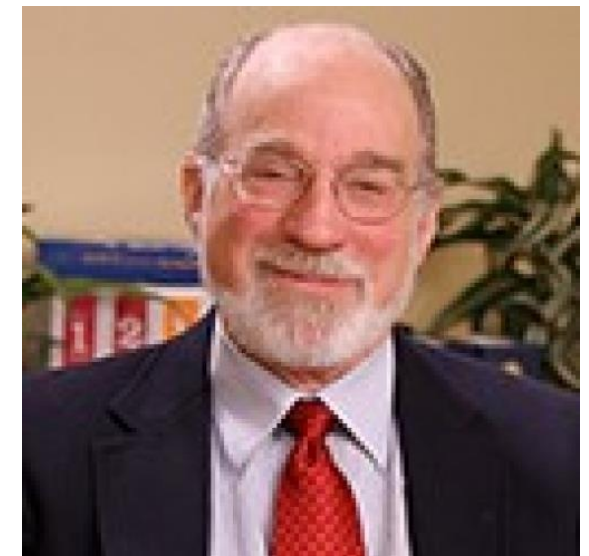


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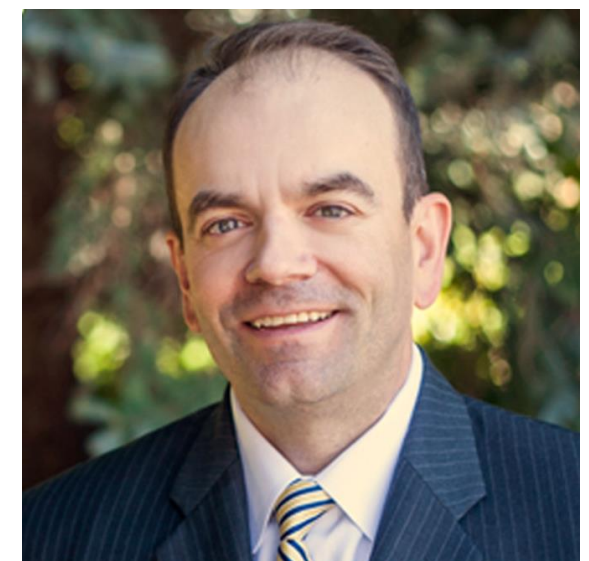
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Learning Objectives

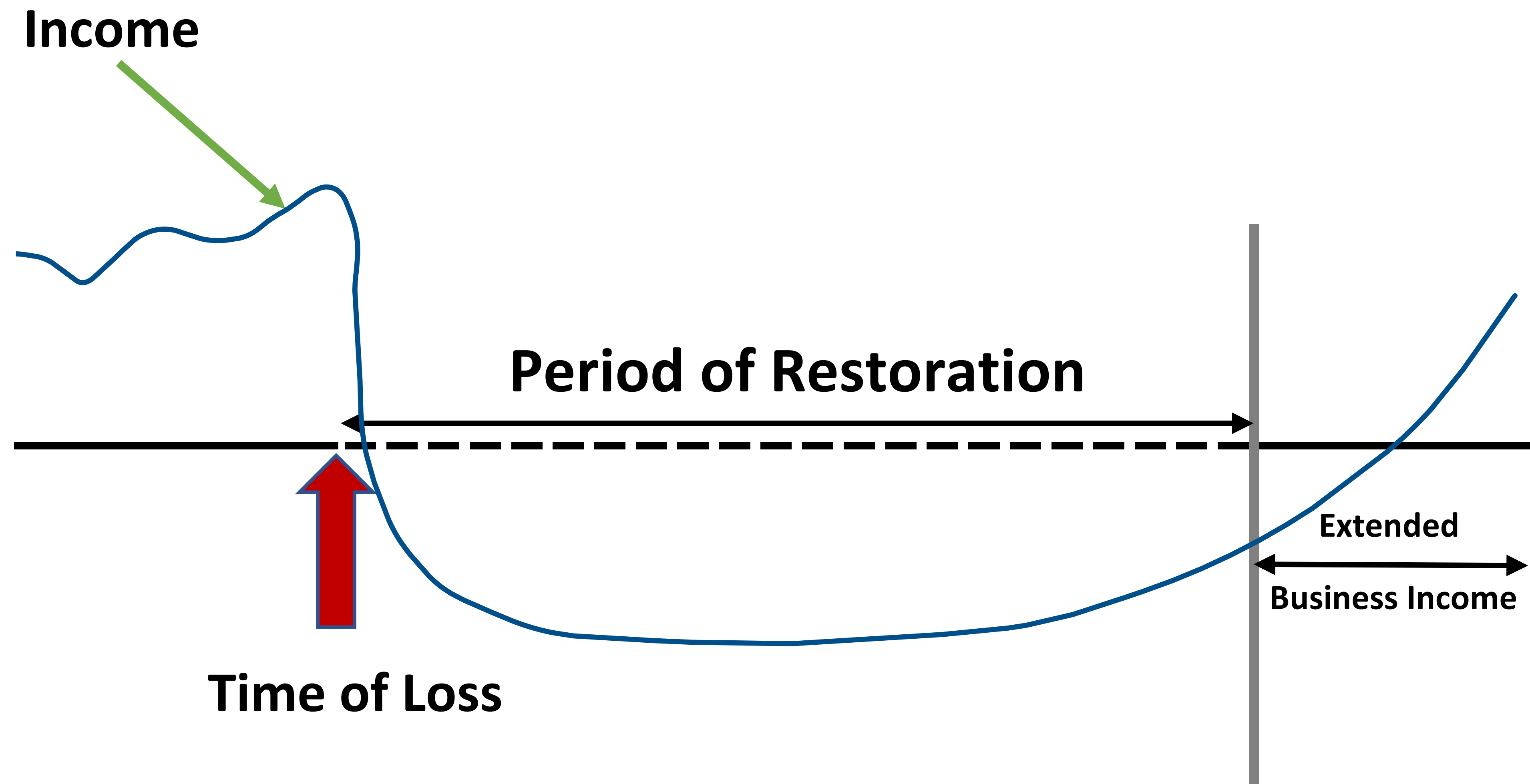
- 1 Define certain policy terms
- 2 Learn the basics of a proper calculation of “business income” and the two approaches to loss calculation
- 3 Identify relevant supporting documents

Coverage Triggers

- “Covered Cause of Loss”
- At an insured location
- For an incident that occurred during the policy period



Timeline



What the Insurer Will Pay

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**". The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss....

(Per ISO Policy CP 00 30)

What the Insurer Will Pay (continued)

- The purpose is to make the insured whole, by...
- Determining how much revenue would have been generated and what expenses would have been incurred but for the event



Terms to Define (per ISO Policy CP 0030)

Business
Income

Operations

Period of
Restoration
("POR")

Extra
Expense

Extended
Business
Income

Limits of
Insurance

Appraisal

Loss
Determination

Business Income

Business Income (And Extra Expense) Coverage Form

Various provisions in this policy restrict coverage, what is and is not covered.

Throughout this policy the words "you" and "your" refer to the insured, "we", "us" and "our" refer to the Company providing coverage.

Other words and phrases that appear in quotation marks are defined in the policy.

A. Coverage

1. 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.

For manufacturing risks, Net Income includes the net sales value of production.

Coverage is provided as described and limited to the actual amount of loss sustained by the insured, which the described premises are located.

1. 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.

For manufacturing risks, Net Income includes the net sales value of production.

Operations

F. Definitions

1. "Finished stock" means stock you have manufactured.

"Finished stock" also includes whiskey and alcoholic products being aged, unless there is a Coinsurance percentage shown on the Business Income in the Declarations.

"Finished stock" does not include stock you have manufactured that is held for sale on the premises of any retail outlet insured under the Coverage Part.

2. "Operations" means:

- a. Your business activities occurring at the described premises; and
- b. The tenantability of the described premises, if coverage for Business Income Including "Rental Value" or "Rental Value" applies.

3. "Period of restoration" means the period of time that:

- a. Begins:

(1) To the extent of the actual cash value of the property damaged;

- (2) Requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of "pollutants".

2. "Operations" means:

- a. Your business activities occurring at the described premises; and
- b. The tenantability of the described premises, if coverage for Business Income Including "Rental Value" or "Rental Value" applies.

- b. Continuing normal operating expenses

Period of Restoration (“POR”)

- The time period for which the insurer will pay Business Income and Extra Expense
- Seasonality – effect on sales forecast
- The time required to rebuild, repair or replace the damaged or destroyed property
- Cannot exceed 12 months

3. "Period of restoration" means the period of time that:
 - a. Begins:
 - (1) 72 hours after the time of direct physical loss or damage for Business Income Coverage; or
 - (2) Immediately after the time of direct physical loss or damage for Extra Expense Coverage;caused by or resulting from any Covered Cause of Loss at the described premises; and
 - b. Ends on the earlier of:
 - (1) The date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality; or
 - (2) The date when business is resumed at a new permanent location.

Extra Expense

“Necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss.”

Will be paid if such extra expense reduces the business income loss by shortening the period of interruption, increasing revenue, or reducing costs.

Examples:

- Construction
- Overtime
- Lease for temporary location
- Equipment rental
- Advertising for temporary location
- Legal

Extended Business Income (Extended Period of Indemnity)

“(1) Business Income Other Than "Rental Value”

If the necessary suspension of your "operations" produces a Business Income loss payable under this policy, we will pay for the actual loss of Business Income you incur during the period that:

- (a) Begins on the date property is actually repaired, rebuilt or replaced and "operations" are resumed; and
- (b) Ends on the earlier of:
 - (i) The date you could restore your "operations" with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage occurred; or
 - (ii) 30 consecutive days after the date determined in (1)(a) above.”

Limits of Insurance

“The most we will pay for loss in any one occurrence is the applicable Limit of Insurance shown in the Declarations.”

For Example:

- Actual loss sustained – 12 months
- Actual loss sustained – 12 months + (30 to 60 days)
- Monthly limit of indemnity – capped monthly amount
- Agreed value – predetermined loss coverage

Appraisal

“If we and you disagree on the amount of Net Income and operating expense or the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser.

The two appraisers will select an umpire. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the amount of Net Income and operating expense or amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding. Each party will:

- a. Pay its chosen appraiser; and
- b. Bear the other expenses of the appraisal and umpire equally.

If there is an appraisal, we will still retain our right to deny the claim.”

Loss Determination

“The amount of Business Income loss will be determined based on:

- (1) The Net Income of the business before the direct physical loss or damage occurred;
- (2) The likely Net Income of the business if no loss or damage had occurred, but not including any Net Income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses;
- (3) The operating expenses, including payroll expenses, necessary to resume "operations" with the same quality of service that existed just before the direct physical loss or damage; and
- (4) Other relevant sources of information, including:
 - (a) Your financial records and accounting procedures;
 - (b) Bills, invoices and other vouchers; and
 - (c) Deeds, liens or contracts.”

Loss Determination (continued)

c. Resumption Of Operations

We will reduce the amount of your:

- (1) Business Income loss, other than Extra Expense, 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.
- (2) Extra Expense loss to the extent you can return "operations" to normal and discontinue such Extra Expense.

- d. If you do not resume "operations", or do not resume "operations" as quickly as possible, we will pay based on the length of time it would have taken to resume "operations" as quickly as possible.

prompt notice of the direct loss or damage. Include a description of the property involved.

As possible, give us a description of how, when, and where the physical loss or damage occurred.

Reasonable steps to protect the property from further damage. Keep a record of your actions necessary to protect the property, for consideration in the event of the claim. This will not reduce the Limit of Insurance. We will not pay for any loss or damage resulting from a cause of loss that is not a Covered Cause of Loss. Also, if you do not resume the damaged property in the best possible order, we may be reasonably

is may be reasonably

3. Loss Determination

- a. The amount of Business Income loss will be determined based on:
- (1) The Net Income of the business before the direct physical loss or damage occurred;
 - (2) The likely Net Income of the business if no physical loss or damage had occurred, but not including any Net Income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses;
 - (3) The operating expenses, including payroll expenses, necessary to resume "operations" with the same quality of service that existed just before the direct physical loss or damage; and

Insured's Duties in the Event of Loss include:

- “(1) Notify the police if a law may have been broken.
- (2) Give us prompt notice of the direct physical loss or damage. Include a description of the property involved.
- (3) As soon as possible, give us a description of how, when, and where the direct physical loss or damage occurred.
- (4) Take all reasonable steps to protect the Covered Property from further damage and keep a record of your expenses necessary to protect the Covered Property, for consideration in the settlement of the claim....

Insured's Duties in the Event of Loss include (continued):

- (5) As often as may be reasonably required, permit us to inspect the property proving the loss or damage **and examine your books and records.** Also permit us to take samples of damaged and undamaged property for inspection, testing and analysis, and **permit us to make copies from your books and records.**
- (6) Send us a signed, sworn proof of loss containing the information we request to investigate the claim. You must do this within 60 days after our request. We will supply you with the necessary forms.
- (7) **Cooperate with us in the investigation or settlement of the claim.**
- (8) If you intend to continue your business, you must resume all or part of your 'operations' as quickly as possible."

Relevant Documents and Information for Loss Calculation: Understand the Business and its Operations and the Nature of Extra Expenses

Insurance
Policy

Financial
Statements

Tax Returns

Sales &
Expense
Projections and
Budgets

Source
Documents like
Invoices,
Receipts &
Contracts

Interviews
with Owners
& Employees

Accounting
System
Reports

Industry &
Economic
Research

Two Methods of Calculating a Business Interruption Loss: Same Result

Bottom Up Approach :

Net Income (Forecast)
+ Continuing Expenses
+ Extra Expenses

Top Down Approach :

Revenue/Sales not Made
- Non-continuing Variable Expenses
+ Extra Expenses

Policy language requires the Bottom Up Approach, but....

Two Methods of Calculating a Business Interruption Loss, continued

Bottom Up Approach:

- Usually for longer periods of interruption – months or quarters
- More detailed (forecasting)
- Review every expense during the POR
- Review cash disbursements to determine what expenses were actually incurred and paid

Top Down Approach:

- Usually for shorter periods of interruption – days or weeks
- What level of revenue would have been achieved (forecasting)
- Determine fixed v. variable expenses
- What level of variable expenses would have been incurred (regression analysis)

CASE STUDY

BUSINESS INTERRUPTION LOSS CALCULATION

Required Professional Skills and Expertise

Ability to efficiently obtain an understanding of the business and the industry

Interpret the business financial statements and develop appropriate financial forecasts

Apply accepted methodologies to prove Business Income and Extra Expenses

Communicate often with retaining counsel, claim representative or public adjuster

Case Study

Business:

The ABC Hardware Store
Augusta, Maine

Period of Interruption:

February 9, 2011 through July 31, 2011
(approximately 6 months)

CASE STUDY

2010 Results of Operations (Profit & Loss)

STATEMENT OF LOSS THE ABC HARDWARE STORE AUGUSTA, MAINE FIRE - FEBRUARY 8, 2011 OUR FILE NO. XXXX.XX		
	2010 HISTORICAL	
	\$	%
GROSS RECEIPTS	\$ 1,009,803	102.2%
LESS:		
RETURNS AND ALLOWANCES	1,977	0.2%
BAD DEBTS	99	0.0%
SALES TAX	19,800	2.0%
	21,876	2.2%
NET SALES	987,927	100.0%
LESS:		
COST OF MERCHANDISE SOLD	718,245	72.7%
FREIGHT IN	5,013	0.5%
CONSUMABLE SUPPLIES	504	0.1%
	723,762	73.3%
DEDUCT PURCHASE DISCOUNT	8,106	0.8%
COST OF GOODS SOLD	715,656	72.4%
GROSS PROFIT	272,271	27.6%
OPERATING EXPENSES		
Salaries	50,000	5.1%
Payroll	60,000	6.1%
Payroll taxes	12,100	1.2%
Group Insurances	4,000	0.4%
Advertising	15,000	1.5%
Repairs and maintenance	3,500	0.4%
Depreciation	8,000	0.8%
Professional fees	6,000	0.6%
Telephone	4,000	0.4%
Utilities	5,600	0.6%
Licenses and dues	2,200	0.2%
Travel	3,200	0.3%
Meals and entertainment	1,800	0.2%
Rent	28,800	2.9%
Postage	2,400	0.2%
Auto expense	1,950	0.2%
Interest	5,200	0.5%
Computer supplies	2,200	0.2%
Insurance	3,800	0.4%
Total operating expenses	219,750	22.2%
NET INCOME	\$ 52,521	5.3%

	2010 HISTORICAL	
	\$	%
GROSS RECEIPTS	\$ 1,009,803	102.2%
NET SALES	987,927	100.0%
LESS:		
COST OF MERCHANDISE SOLD	718,245	72.7%
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	723,762	73.3%
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OPERATING EXPENSES		
Total operating expenses	219,750	22.2%
NET INCOME	\$ 52,521	5.3%

CASE STUDY

Period of
Interruption:

Expected v.
Actual

Results of
Operations
(Profit & Loss)

THE ABC HARDWARE STORE AUGUSTA, MAINE FIRE - FEBRUARY 8, 2011 OUR FILE NO. _____				
Period of interruption determined to be 02/09/11-07/31/11				
	BEFORE FIRE EXPECTED INCOME STATEMENT		AFTER FIRE ACTUAL RESULTS TOTAL LOSS	PARTIAL LOSS
GROSS SALES	\$ 478,710		\$ -	\$287,226
LESS:				
RETURNS AND ALLOWANCES	936			
BAD DEBTS	48			
SALES TAX	9,387			
	10,371			
NET SALES	468,339			
LESS:				
COST OF MERCHANDISE SOLD	340,251			
FREIGHT IN	2,691			
CONSUMABLE SUPPLIES	240			
	343,182			
DEDUCT PURCHASE DISCOUNT	3,915			
COST OF GOODS SOLD	339,267			
GROSS PROFIT	129,072			
OPERATING EXPENSES				
Salaries	26,000			
Payroll	31,000			
Payroll taxes	6,270			
Group Insurances	2,050			
Advertising	8,000			
Repairs and maintenance	1,800			
Depreciation	4,100			
Professional fees	2,500			
Telephone	2,200			
Utilities	2,300			
Licenses and dues	1,000			
Travel	1,700			
Meals and entertainment	950			
Rent	14,500			
Postage	1,300			
Auto expense	975			
Interest	2,700			
Computer supplies	1,200			
Insurance	1,900			
	112,445			
Total operating expenses				
NET INCOME	\$ 16,627	\$		

	BEFORE FIRE EXPECTED INCOME STATEMENT		AFTER FIRE ACTUAL RESULTS TOTAL LOSS	PARTIAL LOSS
GROSS SALES	\$ 478,710		\$ -	\$287,226
NET SALES	468,339		-	281,003
LESS:				
COST OF MERCHANDISE SOLD	340,251		-	204,151
FREIGHT IN	2,691		-	1,615
CONSUMABLE SUPPLIES	240		-	144
	343,182		-	205,909
DEDUCT PURCHASE DISCOUNT	3,915		-	2,349
COST OF GOODS SOLD	339,267		-	203,560
GROSS PROFIT	129,072		-	77,443
Total operating expenses	112,445		32,360	91,971
NET INCOME	\$ 16,627	\$	(32,360)	(\$14,528)

CASE STUDY

Period of Interruption:

Amounts to Include in Claim

STATEMENT OF LOSS THE ABC HARDWARE STORE AUGUSTA, MAINE FIRE - FEBRUARY 8, 2011 OUR FILE NO. _____					
Period of interruption determined to be 02/09/11-07/31/11					
	A	B	C (A - B)	D	E (A - D)
	BEFORE FIRE PROJECTED INCOME STATEMENT		AFTER FIRE RESULT TOTAL LOSS CLAIM		AFTER FIRE RESULT PARTIAL LOSS CLAIM
GROSS SALES	\$ 4				
LESS:					
RETURNS AND ALLOWANCES					
BAD DEBTS					
SALES TAX					
NET SALES	4				
LESS:					
COST OF MERCHANDISE SOLD	3				
FREIGHT IN					
CONSUMABLE SUPPLIES					
DEDUCT PURCHASE DISCOUNT	3				
COST OF GOODS SOLD	3				
GROSS PROFIT	1				
OPERATING EXPENSES					
Salaries					
Payroll					
Payroll taxes					
Group Insurances					
Advertising					
Repairs and maintenance					
Depreciation					
Professional fees					
Telephone					
Utilities					
Licenses and dues					
Travel					
Meals and entertainment					
Rent					
Postage					
Auto expense					
Interest					
Computer supplies					
Insurance					
Total operating expenses	1				
NET INCOME	\$ 16,627	\$ (32,360)	\$ 48,987	\$ (14,528)	\$ 31,155

	A	B	C (A - B)	D	E (A - D)
	BEFORE FIRE PROJECTED INCOME STATEMENT		AFTER FIRE RESULT TOTAL LOSS CLAIM		AFTER FIRE RESULT PARTIAL LOSS CLAIM
GROSS SALES	\$ 478,710	\$ -	\$ 478,710	\$287,226	\$191,484
LESS:					
RETURNS AND ALLOWANCES	936	-	936	562	374
BAD DEBTS	48	-	48	29	19
SALES TAX	9,387	-	9,387	5,632	3,755
NET SALES	468,339	-	468,339	281,003	187,336
LESS:					
COST OF MERCHANDISE SOLD	340,251	-	340,251	204,151	136,100
FREIGHT IN	2,691	-	2,691	1,615	1,076
CONSUMABLE SUPPLIES	240	-	240	144	96
DEDUCT PURCHASE DISCOUNT	3,915	-	3,915	2,349	1,566
COST OF GOODS SOLD	339,267	-	339,267	203,560	135,707
GROSS PROFIT	129,072	-	129,072	77,443	51,629

CASE STUDY

Period of
Interruption:

Amounts to
Include in Claim,
continued

STATEMENT OF LOSS THE ABC HARDWARE STORE AUGUSTA, MAINE FIRE - FEBRUARY 8, 2011 OUR FILE NO. _____					
Period of interruption determined to be 02/09/11-07/31/11					
	A	B	C (A - B)	D	E (A - D)
	BEFORE FIRE PROJECTED INCOME STATEMENT		AFTER FIRE RESULT TOTAL LOSS CLAIM	AFTER FIRE	
GROSS SALES	\$ 478,710		\$ - \$ 478,7		
LESS:					
RETURNS AND ALLOWANCES	936	-	9		
BAD DEBTS	48	-			
SALES TAX	9,387	-	9,3		
	10,371	-	10,3		
NET SALES	468,339	-	468,3		
LESS:					
COST OF MERCHANDISE SOLD	340,251	-	340,2		
FREIGHT IN	2,691	-	2,6		
CONSUMABLE SUPPLIES	240	-	2		
	343,182	-	343,1		
DEDUCT PURCHASE DISCOUNT	3,915	-	3,9		
COST OF GOODS SOLD	339,267	-	339,2		
GROSS PROFIT	129,072	-	129,0		
OPERATING EXPENSES					
Salaries	26,000	26,000			
Payroll	31,000	-	31,0		
Payroll taxes	6,270	2,860	3,4		
Group Insurances	2,050	400	1,6		
Advertising	8,000	-	8,0		
Repairs and maintenance	1,800	-	1,8		
Depreciation	4,100	-	4,1		
Professional fees	2,500	500	2,0		
Telephone	2,200	-	2,2		
Utilities	2,300	-	2,3		
Licenses and dues	1,000	1,000			
Travel	1,700	-	1,7		
Meals and entertainment	950	-	9		
Rent	14,500	-	14,5		
Postage	1,300	200	1,1		
Auto expense	975	-	9		
Interest	2,700	1,000	1,7		
Computer supplies	1,200	-	1,2		
Insurance	1,900	400	1,5		
Total operating expenses	112,445	32,360	80,0		
NET INCOME	\$ 16,627	\$ (32,360)	\$ 48,987	\$ (14,528)	\$ 31,155

A	B	C (A - B)	D	E (A - D)
BEFORE FIRE PROJECTED INCOME STATEMENT		AFTER FIRE RESULT TOTAL LOSS CLAIM		AFTER FIRE RESULT PARTIAL LOSS CLAIM
OPERATING EXPENSES				
Salaries	26,000	26,000 -	26,000	-
Payroll	31,000	- 31,000	18,600	12,400
Payroll taxes	6,270	2,860 3,410	4,906	1,364
Group Insurances	2,050	400 1,650	1,810	240
Advertising	8,000	- 8,000	4,800	3,200
Repairs and maintenance	1,800	- 1,800	1,080	720
Depreciation	4,100	- 4,100	4,100	-
Professional fees	2,500	500 2,000	2,000	500
Telephone	2,200	- 2,200	2,200	-
Utilities	2,300	- 2,300	1,800	500
Licenses and dues	1,000	1,000 -	1,000	-
Travel	1,700	- 1,700	1,500	200
Meals and entertainment	950	- 950	600	350
Rent	14,500	- 14,500	14,500	-
Postage	1,300	200 1,100	1,000	300
Auto expense	975	- 975	975	-
Interest	2,700	1,000 1,700	2,400	300
Computer supplies	1,200	- 1,200	1,000	200
Insurance	1,900	400 1,500	1,700	200
Total operating expenses	112,445	32,360 80,085	91,971	20,474
NET INCOME	\$ 16,627	\$ (32,360) \$ 48,987	\$ (14,528)	\$ 31,155

CASE STUDY

Business Income
Loss:

Bottom Up
Approach

CALCULATION OF ACTUAL LOSS SUSTAINED BOTTOM UP APPROACH		
TOTAL LOSS:		
NET INCOME AS PROJECTED	\$	16,627
CONTINUING EXPENSES DURING PERIOD OF INTERRUPTION		<u>32,360</u>
CLAIM FOR ACTUAL LOSS SUSTAINED	\$	<u><u>48,987</u></u>
PARTIAL LOSS:		
NET INCOME AS PROJECTED	\$	16,627
CONTINUING EXPENSES DURING PERIOD OF INTERRUPTION		<u>91,971</u>
		108,598
LESS GROSS PROFIT EARNED		<u>(77,443)</u>
CLAIM FOR ACTUAL LOSS SUSTAINED	\$	<u><u>31,155</u></u>

CASE STUDY

Business Income
Loss:

Top Down
Approach

CALCULATION OF ACTUAL LOSS SUSTAINED TOP DOWN APPROACH		
TOTAL LOSS:		
NET SALES DIFFERENCE	\$	468,339
LESS COST OF GOODS SOLD		
NOT INCURRED (SAVED)		<u>(339,267)</u>
		129,072
LESS SAVED OPERATING EXPENSES		<u>(80,085)</u>
CLAIM FOR ACTUAL LOSS SUSTAINED	\$	<u><u>48,987</u></u>
PARTIAL LOSS:		
NET SALES DIFFERENCE	\$	187,336
LESS COST OF GOODS SOLD		
NOT INCURRED (SAVED)		<u>(135,707)</u>
		51,629
LESS SAVED OPERATING EXPENSES		<u>(20,474)</u>
CLAIM FOR ACTUAL LOSS SUSTAINED	\$	<u><u>31,155</u></u>

CASE STUDY

The payment of the calculated Business Income loss makes ABC Hardware Store whole

RESTORATION OF THE INSURED		
TOTAL LOSS:		
PAYMENT TO THE INSURED	\$	48,987
PAY CONTINUING EXPENSES		<u>(32,360)</u>
NET INCOME AS EXPECTED	\$	<u><u>16,627</u></u>
PARTIAL LOSS:		
PAYMENT TO THE INSURED	\$	31,155
KEEP GROSS PROFIT EARNED		77,443
PAY CONTINUING EXPENSES		<u>(91,971)</u>
NET INCOME AS EXPECTED	\$	<u><u>16,627</u></u>

For questions and comments, please contact:

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