

Business Income Claims: Simplified!

How to Document and Calculate Loss

By Robert M. Swift, CPCU, CIPA, CBCP

Business Income claims are the most frustrating part of insurance and cause the majority of E&O lawsuits. Business owners do not understand the coverage, so post loss they receive an education about their insurance policy language resulting in hard feelings and lawsuits. Insurance companies unnecessarily spend approximately \$2,500 per claim in loss adjustment expenses hiring forensic accountants to show the insured how to calculate and document their claim. Agents and brokers devote many hours of non-billable time hand-holding, talking to the adjuster, and explaining the policy to the insured. Undoubtedly, this unnecessary time and expense could be better utilized properly preparing and adequately protecting the insured which would eliminate nasty surprises.

The insured is responsible for calculating and submitting their claim to the insurance company. This is not a whimsical or unsubstantiated number, but a well-documented, calculated amount. To protect their interests, the business owner should hire an advocate for help determining their loss. Usually there is coverage to pay some of an expert's fees in the "Loss Settlement Fees" section of the property insurance policy. That way the business owner retains control of the claim process and any business considerations that should be addressed. It seems incongruous that the insurance company sends an accountant to the insured to determine how much the insurance company should pay. It is the insured's responsibility to tell the insurance company what was lost and how much they expect to be paid.

The biggest problem with business income claims is communication. The insured claims an unrealistic projection of lost sales and an inaccurate recovery period. The adjuster does not see it in the provided documentation and an adversarial situation develops. Both sides dig in their heels and a disruption of communication occurs. The insured needs to be educated so they know their responsibilities and have realistic expectations.

about the author

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insurance and risk management field, advising corporate executives about the benefits of properly preparing for disaster and helping them calculate their business income claims. Through his company, Business Interruption Consultants, Inc., he has developed a unique, Web-based business interruption resource, www.bisimplified.com with a section that includes templates, worksheets, and instructions on how to calculate and present a BI claim. Swift is a regular continuing education provider for business professionals of all levels, and is in demand by numerous professional organizations as a frequent public speaker.

He is a member of the CPCU Society, the Disaster Recovery Institute, the Risk and Insurance Management Society, the National Society of Insurance Premium Auditors, and a past member of the Insurance Institute of London.

Discontinuing expenses subtracted from the claim are another area of contention. Most forensic accountants use a computer model to calculate all the expenses as a percentage of sales and then arbitrarily subtract some of each line item. For example, if utilities are 4% of sales, a one month interruption would be 4% divided by twelve or 0.33%. This amount would be subtracted from lost sales as a discontinuing expense. However, the actual expenses need to be compared against the normal expenses to determine how much of a reduction is to be used.

When preparing a claim, the first step is to determine the growth of the business. This growth increase or decrease factor is then applied to the previous year's sales to determine what the sales should have been during the interruption period. Next, actual sales are subtracted from these projected sales to determine how much was really lost. To illustrate, if monthly sales prior to the loss are 10% higher than last year, the lost sales for the month of July, 2010 would be 10% higher than the month of July the previous year. For example, July, 2009: Sales were \$100,000. July, 2010: Projected sales would be 10% higher or \$110,000. However, if the actual sales for July, 2010 were \$80,000, there would be a loss of \$30,000. Look to the next several months, i.e. August, September, October to make certain the sales were not made up later. If they were, there would be no loss.

Next, subtract discontinuing expenses from projected lost sales because if the expense was not incurred, it will not be reimbursed. For example, July, 2009's expenses were \$1,000 for rent, \$1,000 for utilities, and \$1,000 in subcontracted costs that equals a total of \$3,000. So, \$30,000 in lost sales minus \$3,000 discontinuing expenses equals a business income claim of \$27,000.

The last piece is to add the extra expenses that were incurred to recover as quickly as possible to the business income amount. If the extra expenses were \$10,000, then the total claim would be \$27,000 plus \$10,000 or \$37,000. As you are aware, this explanation is simplified as most claims are trickier and include much more detail.

Remember, the common areas of dispute between the policyholder and the claim adjuster usually involve:

- **The period of recovery.** Sometimes the claim is cut-off before the business fully recovers. The machinery may be replaced in July, but takes another month to install and quality control the output and then an additional month to train the operators. Since there were two more months of restoration, the recovery period should be through the end of September, not July
- **The lost sales are projected too high.** If sales have been flat for two years, how could there be an increase in future sales?
- **The discontinuing expenses are too low.** Look at the expense ledger to compare actual expenses with expected expenses.

Business Interruption Consultants, Inc. has been asked to help with a large number of claims. During the claim process, a great deal of time was spent educating the insureds, agents, adjusters, and accountants on what the policy said and how the claim should be calculated. This repetitive situation led us to automate the claim submission process on our website, www.BISimplified.com. This organized, multi-level approach has simplified the claim documentation procedure and enables the parties to concentrate on the relevant issues: The recovery period, lost sales amount, and discontinuing expenses. Suffice it to say that thorough preparation goes a long way in reducing the negative impact of a business income loss and utilizing well-documented, concise communication should result in a smooth claim settlement.