



**AIMU INSURANCE DAY  
SEPTEMBER 30, 2011**

**FORENSIC ACCOUNTING**

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New York

Boston

Chicago

Tampa

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- Overview of Forensic Accounting
- Delay Claims
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# BIOGRAPHICAL INFORMATION – LOUIS D. MAGNAN

## Licensing:

- Certified Public Accountant - State of New York, Florida and Illinois
- Certified in Financial Forensics - CFF
- Forensic CPA – FCPA



## Credentials include:

- The resident senior partner of the New York office of Magnan Graizzaro & Associates CPA's, LLC (MG&A).
- His experience includes auditing complex domestic and international property and marine claims over the past 35 years with engagements covering six continents.
- In the January 2010 annual meeting of the Loss Executives Association (LEA), Mr. Magnan was awarded the Stephen P. Cronin, Jr. Memorial Award in recognition of his dedicated service in contributing to the professional, educational and ethical development of members of the property claims profession.
- Media appearance on CNN Newscast - February 23, 1993 regarding the largest cash theft in the United States.
- An active member of the house and dinner committees for the Columbus Citizens Foundation and is participating in the upcoming Gala for the Columbus Day Parade.
- Has provided expert witness testimony in both federal and state jurisdictions.
- This is my 47<sup>th</sup> presentation as a speaker or panelist on educational matters.

# Overview of Forensic Accounting

- Fact Finding/Advocacy
  - Forensic accountants generally work from a pre-determined paradigm
  - In the case of forensic accountants working on behalf of Insurers or in the litigation arenas, their contributions occur after a claim for damages is submitted or is in dispute
- Support
  - Generally operating within the framework of due diligence
  - Draw from their experience to identify issues not readily apparent
  - Use a well defined “**skill set**” to drill down and get “**behind the numbers**”

## The Adjusting Team:

- Insurers
- Surveyors
- Adjusters
- Engineering and Forensic Experts
- Outside Counsel/Litigation

# DELAY CLAIMS

- Delay Claims were restricted to the property loss arenas in the form of Builder's Risk property policies.
- Historically, Marine Underwriters have provided CBI or BI on manufacturing risks. Marine Underwriters have now expanded these coverages to some of the Global Project Cargo Risks which is commonly referred to as Delay in Start Up (DSU).





宮城県 名取市

時速約30キロのスピードで数分後には仙台空港にも到達。滑走路が水没して飛行機の離着陸は全て停止。空港の建物内には乗客や職員、避難した付近住民ら約1100人が取り残された=3月11日



【撮影時間】 16:05

一瞬のうちに  
孤島と化した仙台空港

マグニチュード9.0の巨大地震は本に甚大な被害をもたらしたが、とりわけ悲惨に襲来した大津波は東北・關方の太平洋沿岸に大きな爪痕を残し、津波による浸水域は、国土地理院の調査によると、宮城県東松島市で約100平方キロメートル、同県南三陸町と岩手県で約52%が浸水被害を受けた。宮城県名取市内を流れる旧北上は、河口から内陸8キロまでの流域水した。

津波の高さも記録的で、岩手県宮城で7.8メートル、同県大船渡市で7.9メートルとされるが、機庫所の津波破壊されたため、実際には海上で僅メートルを超える高さだったと推定されている。被災した建物や、陸地の斜到達から割り出した現地調査で、波は宮古市の田巻地区で37.9メートル、大船渡市の鏡里で23.6メートルに達していたことが確認されている。









宮城県  
気仙沼市

上は3月24日撮影、下は2003年8月撮影



福島県  
相馬市

上は3月28日撮影の相馬市尾浜地区、下は2010年8月撮影



## MARINE CONSEQUENTIAL / DELAY OF START UP (DSU)

### *Insuring Clause*

- *“...the loss of standing charges, debt service or profit ascertained in the manner hereinafter provided, during the indemnity period, due to the production during such period falling short of the standard production (hereinafter defined) as a result of loss of or damage to or delay in the delivery of the property as described in the schedule hereto (or any part thereof).”*

## *Duration*

- *Addressing “Loss Caused by” shall operate **from** the time the property leaves the premises of the manufacturers in the country of origin, continue during the ordinary course of transit and where specifically agreed, during storage, if any, **and until** the property is delivered to the insured destination, which could be at a port or inland.*



## *Indemnity Period*

- **Begins** *on the day on which, but for the contingency, the property would have been put into use or operation and **ending** not later than twelve months thereafter during which the period the production reasonably expected to be achieved by the property is affected in consequence of the contingency.*



## *Measure of Indemnity*

- *The sum payable as an indemnity under this insurance shall be:*
  - *In respect of loss of **Gross Profit**: the sum produced by applying the rate of Gross Profit by which the production during the indemnity period shall in consequence of one or more of the occurrences above fall short of the standard production.*
  - *In respect of **standing charges**: the sum of expenses based upon the Rate of Standing Charges incurred by the insured project which are not affected by any change in the output of the insured project.*

## *Deductible*

- Usually in the form of a “\$” value or X days of indemnity (i.e. 30 days)*

- In respect of **increase in cost of working**: the additional expenditure reasonably and necessarily incurred by the assured for the sole purpose of avoiding or diminishing the reduction in production.
- If the sum insured is less than the sum obtained by applying to the annual production either the rate of gross profits or the rate of standing charges, as applicable, the amount shall be reduced proportionately.

## *Sue and Labour*

- *It is agreed that in **case of actual or imminent loss, damage, cost or expense**, it shall be lawful and necessary for the assured, their factors and assigns, to sue, labour and travel for in and about the defence, safeguard and recovery of the interested insured hereunder, or any part thereof, or to incur such other expenses as are reasonable and/or necessary **for the purpose of reducing or attempting to reduce any potential loss or liability** under this policy without prejudice to this insurance, and subject always to the terms, conditions, limitations and exclusions of this insurance, the charges thereof shall be borne by the Underwriters. Etc.*



## GLOSSARY OF TERMS:

- *Gross Profit*
  - *The sum produced by adding to the expected net profit amount of all standing charges appertaining to the property, or if there be no expected net profit the amount of all such standing charges less any net trading loss.*
  
- *Expected Net Profit*
  - *The net trading profit (exclusive of all capital receipts and accretions and all outlay properly chargeable to capital) as is reasonably expected to result from the operation of the property after due provision has been made for all standing and other charges appertaining to the property.*
  
- *Standing Charges*
  - *All charges of the Assured's trade which are not affected by any change in the output of the business and which remain to be paid in full, such as rent, taxes, interest and debt service, depreciation to buildings, machinery and other plant.*

- *Production*
  - *The revenue of the goods produced or to be produced by the property.*
  
- *Rate of Gross Profit*
  - *The rate of gross profit that would have been earned on the standard production to be brought about by the property but for the contingency.*
  
- *Standard Production*
  - *The revenue of the goods as they were reasonably expected to be produced during the Indemnity Period but for the contingency.*
  
- *Annual Production*
  - *The anticipated production during the twelve months immediately following the commencement of production.*
  
- *Rate of Standing Charges*
  - *The proportion expressed as a percentage of standing charges to the annual production.*

## Adjustment Team Tasks

- Underwriting and pre-loss planning
  - Know your policy and customer
  - Understand the equipment and its expected contribution to the project
  - Policy review and coverage issues
  - Adjustment team/providing direction
  - Important documents
    - Manufacturing records documenting equipment dates of production
    - Evidence documenting movement of equipment to ocean going vessel
    - Examination of physically damaged goods and nature of loss determination. Identification of other possible contributing parties
- Time to influence adjustment
- Preservation of evidence and records
- Possible mitigation measures

## Measurement

- Requires determining two important dates:
  - The date the equipment in transit would have been received had no loss occurred
  - The amount of delay caused by the loss
- Losses typically measure the period of delay, less any reduction to the period of indemnity.



- The key to understanding the length of a delay caused by the loss lies in understanding the delay period of the property impacted by the loss or damage.

## Challenges

- Understanding the complex issues involved in planning, scheduling and implementing the construction project are critical
- Identifying all circumstances contributing to the delay in the delivery of the property
- Critical time constraints necessary to retain experts assisting in the mitigation of the potential delay period
- Project milestone
- Loss measurement

# WAREHOUSE LOSSES

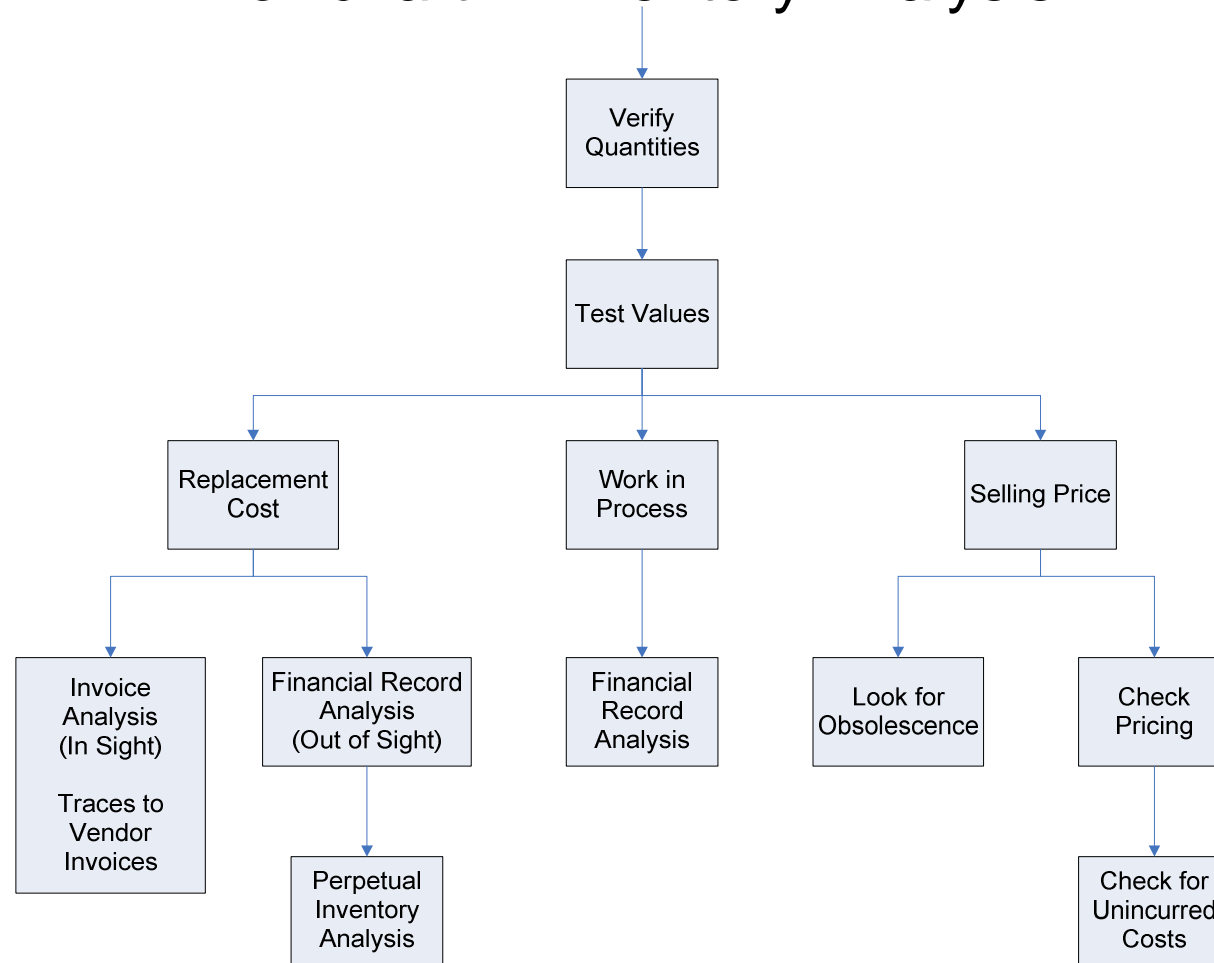
- The Investigation: The Adjusting Team
  - Company Adjuster, Surveyor or Independent Adjuster
  - Salvor
  - Building/Equipment Consultant
  - Engineering, Forensic Experts, Counsel, etc.

- Accounting Challenges
  - Gaining an understanding of the books and records
  - Developing a professional relationship with Insured, broker or other representatives
  - Pre-loss comparison of physical counts to perpetual inventories.
  - As to the quantum measurement when goods are entrusted to a third party (i.e. public warehouse).



- Records typically reviewed:
  - Warehouse contract (public or otherwise)
  - Warehouse invoicing
  - Tracking ins and outs to/from the warehouse
  - Perpetual inventory of insured
  - Warehouse inventory records
  - Receiving and shipping records
  - Periodic physical counts (i.e. y-e physical count)
  - Post loss physical count

# Flowchart – Inventory Analysis





# OCEAN CARGO POLICY

- *“The policy applies to all shipments on or after the inception of the policy and prior to the cancellation date or on the date of the expiration, whichever may occur first.”*
  - Historical valuation
    - Cost (vendor invoice cost, insurance and freight) or CIF + X % factor
    - Historically versions of policy valuation clauses included 10-20% add-on factors on top of CIF values





- Caution to current underwriting trends:
  - Endorsing 100% factors above CIF “**may**” result in indemnifying the Insured beyond selling price valuation
  - A comparison of the formula of CIF plus 100% (or other percentage factors) to net selling price should be made by Underwriters to properly understand the magnitude of loss exposure. (Refer to illustration that follows how percentage factors to a CIF Valuation could be viewed).
  - Current trend: possible movement to value “**unsold merchandise**” at net selling price, (valuation historically restricted to goods only sold)

## ILLUSTRATION OF POTENTIAL MARK-UP PERCENTAGE ABOVE FOR A LARGE RETAIL PUBLICLY TRADED COMPANY

	Amount in Thousand US Dollars				
	<u>Quarter Ended</u>				Mark-Up
	July 30, 2011	<u>Cost</u>		<u>Gross Margin</u>	<u>Percentage</u>
Net Sales	\$ 558,201				
Cost of Sales	251,400	<u>\$ 251,400</u>			
Gross Margin	<u>\$ 306,801</u>			<u>\$ 306,801</u>	<u>122.04%</u>
* Extrapolated from 10Q Filing with the SEC for Quarter Ended 7/30/11					

- Challenges of Replacement Cost and Net Selling Price Valuations
  - Historical cost and application to Balance Sheet GAAP accounting
  - Lower of cost or market application
  - Obsolescence
  - Shelf life of goods in offsite storage warehouses and application to policy valuation clause
  - Replacement cost - what does it mean?
  - Net selling price – must be properly defined in policy

- **Manufactured Goods**
  - In many cases, manufacturers frequently mark the date of production on goods held for resale. Surveyors, adjusters, salvors and CPAs should be vigilant as to this trend.
- **Shelf life and storage suggestions**
  - By way of example, the storage life for confectionary goods is limited. We extrapolated the following information posted to National Confectioners Association's (NCA) website, regarding the maximum shelf life of storing candy.

## *“Storing Candy for Maximum Shelf Life*

*Chocolate, Gum, Non-Chocolate*

*Storing away sweets is a great way to encourage moderation and ensure that Halloween candy lasts beyond a few weeks.*

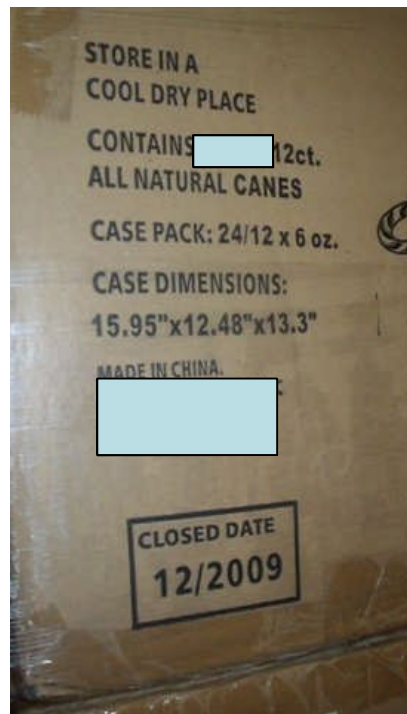
*But how long does candy last? And how can you make sure it stays fresh?*

## *Shelf Life and Storage Suggestions*

*Dark chocolate can be kept for 1 to 2 years if wrapped in foil and stored in a cool, dark and dry place. A pantry or basement is an ideal location. Milk and white chocolate have a more limited storage time – no more than 8 to 10 months.”*

# DOCUMENTARY EVIDENCE BY SURVEYOR

- Photograph of goods earmarked by date of production





- CPA should proceed with due diligence and gather external documentary evidence to support the foundation of his or her final opinions
- Challenging losses – Sometimes losses become contentious



# *Any Questions ?*

