



PERSPECTIVES

Insurance Claims & Fraud Investigations: Where Forensic Accountants Bring Value

Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

INTRODUCTION

Forensic accountants are independent, highly specialized accountants with strict confidentiality policies who are involved in investigating financial information to assist attorneys, insurance companies, businesses, government, law enforcement, IT experts, and individual clients. They assist in criminal investigations, various insurance claims (personal injury, employee dishonesty, cyber, time element, and builder's risk), business valuations, shareholder disputes, divorce cases, and much more. Forensic accountants can also aid in depositions and mediations, as well as provide expert testimony in all the above cases.

The purpose of this paper is to discuss some of the major work forensic accountants focus on and how they bring unique value to the process.

FORENSIC ACCOUNTING: FRAUD INVESTIGATIONS

As it concerns fraud, forensic accounting services fall within three major categories:

- Prevention
- Detection
- Response

Prevention

Considering the average loss for a business (annually) due to employee theft is \$1.13 million (Hiscox, 2017), the value of preventative measures is high. Forensic accountants work with clients to develop controls and systems to protect businesses from such losses before those losses occur.

As an example, forensic accountants can help businesses address and improve where internal controls may be lacking. When there is little to no segregation of duties, fraud is more likely to occur. Small businesses usually depend on one employee or a bookkeeper to perform all accounting functions including authorization, execution, custody, and posting of transactions. These processes should be segregated among different individuals, the individuals performing the above tasks should be rotated periodically,

or the business should consider an outside CPA to review the financial statements.

Detection

However, risks are not always apparent, and losses are not always noticed even as they are underway. In these situations, forensic accountants can, for example, identify the red flags potentially related to fraud simply by looking at ratios in profit and loss statements or by digging deeper into specific transactions. Detection can make a big difference, and in fact, 27% of executives say that real-time insights into the accounting areas of heightened risk and internal controls are one of the most critical benefits that are available because of forensic accounting (Brandon Gaille, 2019).

Response

Forensic accounting also involves the work of responding to fraud that has already occurred. Once fraud has been detected, forensic accountants are often called upon to assist in investigating the matter, finding and analyzing evidence, calculating damages, and, if needed, providing litigation support as expert witnesses. It should be noted that fraud hotlines have been shown to facilitate the work of detection and response, as 47% of companies with hotlines received tips that helped lead forensic accountants to successful interventions (Brandon Gaille, 2019).

FORENSIC ACCOUNTING: INSURANCE CLAIMS – BUSINESS INTERRUPTION

There is more to forensic accounting than just looking at tax returns and “the bottom line.”

By looking at the bottom line, you may see variations in net income. A forensic accountant's role is to determine what is causing those variations and ask whether there is an impact on revenues, whether costs of goods sold changes, and whether there are fixed or variable expenses that began or discontinued.

Ultimately, in an insurance claim, forensic accountants determine if these changes are correlated to the covered peril.

FORENSIC ACCOUNTING: INSURANCE CLAIMS – BUILDER’S RISK

Forensic accountants assist in quantifying the damages relating to soft costs and delay in startup in builder’s risk claims. Accountants help track the incurred hard costs associated with the project during the period of restoration. They also work hand in hand with the building consultants, delay experts, and carrier to determine costs associated with the delay in startup period. Additionally, forensic accountants will determine any business interruption loss associated with the delay. It is important that the accountant is involved in all aspects of the builder’s risk claim—to confirm that no costs are paid as a hard or soft cost—and that they are also involved in the delay calculations.

FORENSIC ACCOUNTING: INSURANCE CLAIMS – PROPERTY DAMAGE & BUSINESS PERSONAL PROPERTY

Forensic accountants work on more than just the business interruption loss.

For property damage, they schedule, review, and clerically analyze invoices and corresponding support. They summarize these items in a concise manner for the insured, carrier, and other experts to review.

For inventory damages, they calculate the valuation of the inventory at either selling price or cost. For out of site inventory, they review records to verify the quantities that can no longer be counted.

On many occasions, the carrier and the insured also look to forensic accountants to show all the categories of the loss. They summarize all the claimed and reviewed amounts and reconcile any discrepancies or items for discussion.

Calculating Losses Using Industry Data

Something forensic accountants hear from time to time is, “We don’t have that data.”

The forensic accountant needs to confirm that they are speaking with the appropriate parties within the insured to determine what documentation is available and to confirm a proper understanding of the documentation. For example, the accountant may ask for profit and loss statements. However, the insured may state that they don’t have profit and loss statements, but they do have a report that shows revenue and expenses each month. In other instances, the documentation may have been destroyed during the event. If the data really isn’t available, what can be used? The insured knows their records and their business best. The forensic accountant should explain to the insured what they are trying to achieve with the records so the insured can provide what may be readily available. If the records aren’t available, then the insured and the forensic accountant can brainstorm third party documentation that may be used to support the claim.

On other occasions, the data the insured can provide doesn’t tell the entire story, or maybe there were other outside factors. For example, what if the insured just began operations? In these instances, forensic accountants can turn to industry data. Consider the hotel industry, which has Smith Travel Research (STR) reports. These reports show how the insured location is operating in respect to a “competitive set” of hotels nearby.

Arson Investigations

Forensic accountants can play a key role in an arson investigation, and the three key elements that are normally required in order to prove arson are incendiary origin, opportunity, and motive.

A forensic accountant will perform the appropriate analysis to determine if there may have been a financial motive for arson. Their skills are often utilized to analyze the defendant’s financial records and provide an opinion on the existence

of financial circumstances that assist in assessing financial motive. Arson motives come in many forms, but are mainly categorized into five distinct groups:

- **Emotions**—revenge, jealousy, hatred, terminal illness
- **Egocentric**—recognition, social status
- **Ideological**—superior cause, terrorism, feeling exploited
- **Psychotic**—pyromaniac, confidence game
- **Economic**—profit oriented, eliminate losses, replace outdated assets

Analysis of financial condition requires consideration of assets, liabilities, income, expenses, and net cash inflow or outflow. It also requires consideration of other unusually significant financial needs. Often, cash inflows and outflows are a key consideration.

Forensic accounts will review both business and personal finances. If they can successfully show that a property owner's business was suffering financial difficulties, but it's also learned that the individual has a trust fund that makes a million dollars available to them each year, the ability to prove a financial motive becomes more difficult. Therefore, it is imperative that a financial motive review encompasses all known sources of income, both business and personal.

The key questions a forensic accountant will ask are:

- What changes occurred in financial condition prior to the date of the fire?
- What was the financial condition at the date of the fire?
- What was the future financial picture if there had not been a fire?
- Was there a potential financial benefit from the fire?

To mount an effective arson case, the accountant must work hand in hand with the attorney and the cause and origin expert to maximize results. To this end, the accountant should be able to provide the attorney with both generic and specific documents to request and questions to ask from the insured during the course of the investigation.

Personal Injury, Wrongful Death & Disability

Forensic accountants are often asked to assist attorneys and insurance companies in the quantification of economic

losses resulting from personal injury, wrongful death, or lost employment. They must consider an individual's assets, which can generate current and future earnings. Factors such as age, education/training, geographic location, gender, race, occupation, industry, union membership, and health can impact this future stream.

However, each state's law needs to be well understood. For instance, California prohibits the reduction of personal injury and wrongful death awards on the basis of race, ethnicity, or gender—consideration of these as factors in determining earning capacity are prohibited.

The longer someone works or lives, the longer they are expected to work or live?

One may think that a person who is injured at age 66 has no future lost earnings, but if a woman was working at the time of her accident, she has a work-life expectancy of 2.5 – 5.5 years, depending upon her level of education. Likewise, a man who has survived to age 88 has a life expectancy of 4.7 years.

Earnings of decedents are reduced by “personal consumption” or the amount of their own income they would have spent on themselves. Personal consumption is inversely related to household size and earnings. The greater the earnings, the smaller the percentage of earnings that would be spent on the decedent. The larger the household, the smaller the percentage of earnings that would have been spent on the decedent. Single, low earning decedents have the highest rates of personal consumption of income, sometimes exceeding 100%.

CONCLUSION

Due to their specialized skill sets, ability to work on the smallest or largest cases, and flexibility in working in many settings and across many industries, forensic accountants are excellent resources regarding a variety of claims and litigation. They are not restricted to business interruption, and in fact provide valuable services in the area of fraud as well as in the realm of insurance claims.

Today, especially as the prevalence of cybercrime increases and financial markets become more complex and sophisticated (Herjavec Group, 2019), forensic accounting will only become more visible and in-demand. Because they are bound by the

AICPA's Code of Professional Conduct and required to be independent—maintaining the highest level of ethical and professional diligence—forensic accountants will continue to be an invaluable asset to clients in need of expert assistance.

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