Financial information to support a claim for business interruption or other loss of profit claim

Following a fire or flood or other crucial event or factor that impacts trading, the accounting records may be the last thing on management's mind. Nevertheless, in order to achieve a quick resolution it is often most efficient to collate documentation from the start. Contemporaneous evidence is generally the most compelling, and sometimes it can be difficult to recreate details retrospectively.

We set out below some of the key accounting information we would ordinarily seek to support a claim for business interruption.

Loss of gross profit

A loss of gross profit arises from sales foregone during the period of the loss; usually because production/sales have been temporarily incapacitated or affected.

The starting point here is an assessment of lost sales. This is the difference between:

(i) The projected sales that would have been generated during the loss period (for an insured claim, the loss period would be the period of interruption, or the indemnity period under an insurance policy, whichever is the greater); and

(ii) The actual sales achieved during that period.

Perhaps rather predictably, the principal point of reference is generally the accounts of the business. The accounts may take two forms: the annual accounts required for statutory purposes, and the monthly or quarterly management accounts (presuming those are prepared).

In order to project sales, we would be looking at trends in performance. As the management accounts cover shorter discrete periods, these might be more useful in establishing trading patterns (particularly if the business is subject to seasonal fluctuations in activity). However, management accounts can be perceived as less reliable than the annual accounts, as they are not necessarily prepared under UK GAAP and with the same level of scrutiny. Ideally, the management accounts figures should be reconcilable to the annual accounts; this provides us with some comfort regarding their reliability.

To assist in projecting performance, it would also be useful to refer to any pre-interruption budgets or forecasts prepared that cover the loss period. Forecasts need to be reviewed carefully and sometimes set aside as they may reflect unrealistic growth expectations.

If the level of projected sales may be disputed, then it is often helpful to support the claim with evidence of lost orders or contracts.

Once the value of lost sales is established, we can then look at the profit that would have been earned on those sales. Expenses of a business can broadly be categorised as either variable (i.e. fluctuating in line with activity – such as the cost of materials used to make a product) or fixed. Fixed overheads typically include premises costs (such as rent and rates) and other costs relating to the infrastructure of the business. We would ordinarily expect to see variable (but not necessarily fixed) expenses to be saved as a consequence of a reduction in sales.

The classification of expenses between variable and fixed may be evident from the accounts. Often, variable expenses are treated as “cost of sales”. However, this is not a hard and fast rule. Moreover, most insurance policies include a definition of the composition of gross profit.

Increased costs of working

Increased costs of working can take a number of forms following a major incident. These might include:

- Overtime costs, or the costs of temporary staff – perhaps incurred in order to try and mitigate the sales that have been lost;
- Relocation costs;
- Replacement or rectification costs for items damaged (such as plant and machinery or stock);
- Costs of clearing the site and disposing of damaged or destroyed items;
- Additional security costs; and
- External advisers’ costs.

Again, to the extent that costs have increased, this might be evident from the management accounts. Some businesses capture these costs separately in their accounting records (and so the additional costs arising following a fire or flood are treated as “exceptional” expenses in the nominal ledger and management accounts, and reported as a separate line). This makes subsequent identification much simpler.

Of course, evidence should be retained to support each cost item. This would ordinarily include payroll records and purchase invoices.

The time expended by management can be a contentious area – as management are generally salaried and so their efforts in dealing with the interruption do not reflect an obvious incremental cost to the business. Whether this is claimable might be a matter of law. Nevertheless, if the time is significant and has diverting them from performing their normal duties, then we would recommend keeping a record of all time spent. This might be evidenced by diary records (including electronic diaries, such as in Outlook) or timesheets. Also, if the diversion of time has led to missed revenue-generating opportunities (for example, not attending a tradeshow), a note of this should be retained.

As a general point, it is best practice to keep minutes of all meetings held relating to the interruption incident, whether board minutes or meetings held by an “incident team”. This will help demonstrate the thought process and actions taken by management at the time. On occasions, the issue of whether a business has properly mitigated its loss is raised many months after the fire or flood. The recording of key decisions will help demonstrate that the management acted in good faith, based on the information then available to them.