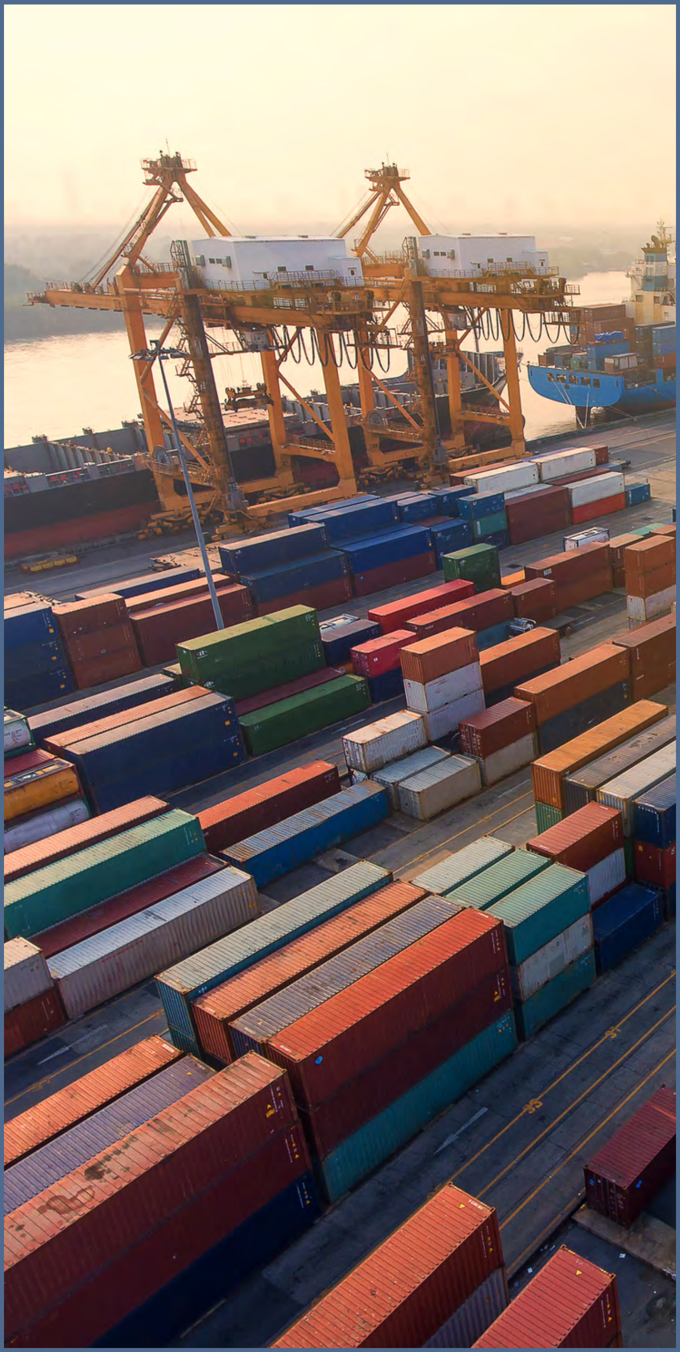

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PERSPECTIVES

Forensic Accounting In Marine Claims & Cargo Losses

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

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INTRODUCTION

Since the COVID-19 pandemic began, the logistical challenges, delays, and risks to the global marine supply chain have been well documented on both TV and the internet. While ships continue to sit at ports for extended periods of time, sales backlogs and other intangible reputational damages have mounted when companies cannot ship goods to customers as intended. While the delays in cargo shipments is generally not insurable, physical damages or loss to cargo may be. Additionally, the risks of physical damage or theft can be much greater the longer ships are backlogged and the longer cargo either is not in transit or is being stored at less secure locations at ports. Perils such as explosions, fires, floods, hurricanes, earthquakes, and even tornadoes could threaten the cargo while in storage. All of these issues amount to great concern for insurers as the risk for a major loss can occur at any moment.

Forensic accountants assist in Marine Insurance cases in a variety of ways, regardless of the cause of loss or type of damages. The purpose of this paper is to discuss a variety of different marine and cargo losses that forensic accountants can be involved in and how their insight can be pivotal to the claims process.

OPEN CARGO STOCK THROUGH PUT (INVENTORY)

Cargo Stored in Warehouses (Static Losses)

One of the most common marine insurance claims is associated with inventory stored in warehouses. These losses occur due to perils such as natural disasters, structural collapses, equipment failures, and other physical damage events.

Imagine a scenario in which a large warehouse and distribution center for wine and spirits suffers storm damage. In this scenario, the facility quickly returns to full operations; however, the building repairs take significantly longer as they are carried out in a manner that will lessen the impact on operations. During the initial storm, portions of the collapsed roof destroy bottles, cases, and pallets of inventory, making a physical count of the damaged goods impossible.

Forensic accountants can analyze records to determine if the inventory was in storage or in transit as the status of the inventory may have different policy provisions. In the above situation in particular, a forensic accountant can create detailed schedules and databases by product which identify the quantity of goods lost and the associated purchase costs, selling prices, taxes, etc. to determine the quantum of the damaged goods at the valuation basis afforded in the policy. These databases would also be pivotal in ascertaining the amount of excise tax for each product that was not incurred as the product was not ultimately sold.

Cargo in Transit

Goods are frequently damaged in transit and often represent large custom-made equipment that does not make the journey intact or even fungible goods delivered on a truck or container that is not delivered in the same condition as when it was originally shipped. In relation to the custom-made equipment, analysis is commonly focused on the costs incurred to repair the damaged equipment. When this occurs in certain industries, the inhouse repair costs may include the application of potentially unique labor burdens that are not common in most industries.

In these instances, forensic accountants can assist in the measurement of the costs incurred as allowed under the policy. These losses can also include business interruption, extra expenses, or contingent business interruption (as discussed later). In other instances, goods damaged in transit may be easily replaced from inventory, such as with manufacturers or retailers, or they can be purchased on the open market such as for commodities. Supply chain problems have recently complicated the replacement cost issue.

Cargo on the Water

Cargo damaged on the water can have an added level of complexity if a portion of the shipment was damaged and/or that damage has impacted the volume or weight of the commodity. In these instances, forensic accountants use every available resource to correctly determine the volume or weight of the damaged goods and the afforded valuation as allowed under the policy.

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Theft, Missing Goods, or Unknown Disappearance

Marine claims that are ultimately deemed theft, missing goods, or unknown disappearance can present themselves in different forms. A forensic accountant can be retained to augment the Adjuster's investigation by facilitating the gathering of the necessary financial data and combing through the data and records to simplify and summarize the results.

When a theft has occurred, forensic accountants analyze various records, inventory purchases, sales, shipping records, pre- and post-loss physical inventory counts and other available data to quantify the amounts that are missing and may have been stolen. It is important that the accountant understands what the records represent and how they are relevant to the claimed goods. The records provided may include other locations outside of the loss location; therefore, those records would not support the assertion that the goods were at the loss location at the time of claimed loss. Whenever possible, a post-loss physical inventory count should be performed to determine exactly what remained.

By abridging the transactional data, the forensic accountant facilitates the Adjuster's review of causation. Through collaboration between the forensic accountant and the Adjuster, the most accurate quantum of the loss afforded under the policy is ascertained.

TIME ELEMENT

Business Interruption and Extra Expense

As previously mentioned, business interruption and extra expense claims also arise in marine losses. Consider a case wherein a vessel collides with various docks at a marine terminal where ships regularly load and/or unload cargo. Business interruption and extra expense losses ensue since the damaged dock is unable to accept product and customers are unable to transport and store product at their dedicated storage location. For example, the insured might not be able to accept deliveries of refined or residual fuel oil to be stored in dedicated storage tanks, thereby generating a multi-year restoration period.

Customer contracts and financial books and records are analyzed to evaluate the actual business loss sustained by the terminal owner. Key accounting-related interrogatories may be critical in projecting revenue for the business interruption calculation. If the file is in litigation, the interrogatories may also assist Counsel in the deposition of both the expert who prepared the claim and key management of the Insured. The responses may also be pivotal in preparing an expert Rebuttal Report.

Contingent Business Interruption and Delays

Sales losses can occur not only because of physical damages to business operations but also the delay in the shipment of goods. Consider a scenario wherein forensic accountants are retained to evaluate the sales loss sustained to a domestic apparel company caused by the delay in the arrival of goods due to a fire that occurred on a vessel in transit.

But for the loss, the vessel was scheduled to deliver the goods to the port, and from there the goods would be transported to a distribution warehouse to be sold. However, the goods are delayed in excess of the policy's defined number of delay days. As a result, the goods are never sold during their intended season, causing the goods to be liquidated at a lower price which is considered an offset to the lost sales.

This case also presents a unique set of circumstances as the policyholder switches insurance providers at the same time the vessel catches fire, and the goods subject to the delay are covered by two separate parties. To accurately apportion the total loss amongst the two insurance providers, a meticulous review of the unique variables included within the bills of lading is required. To measure the lost sales of the delayed goods, a separate analysis of the anticipated net sales to be earned at the retail locations vs. net sales earned online and/or through wholesalers is needed. The situation also requires a review to determine whether the specific goods were deemed to be "seasonal." That determination relates to analyzing whether the goods could only be sold during a particular period of time, whether any repeat styles could be sold in a later period, or whether substitute inventory on-hand could have been sold to mitigate the sales loss.

Finally, forensic accountants would trace the salvage sales prices of each of the liquidated goods to properly reduce

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the measurement and consider the proper sales loss measurement for each of the insurance providers.

HULL & MARINE LIABILITY

Repair and Rework to Insured Property

Unfortunately, accidents happen, and property gets damaged. Consider a situation in which forensic accountants must assist in the measurement of damages due to inefficiencies and delays caused by the damage to a vessel.

For example, the Insured had a vessel undergoing construction which was damaged while docked in their yard. As the shipyard must adhere to a tight schedule, it has limited time and physical space to work around a damaged vessel. In instances like these, a team of experts is assembled by the Underwriters to lend their knowledge and experiences to ascertain the damage calculations. For instance, an experienced marine surveyor and an expert in shipbuilding would collaborate to determine the period of restoration. Involve an experienced forensic accountant, and the result would be a measurement of the additional costs incurred during that period. In addition to quantifying the repair costs, forensic accountants are hired to evaluate the additional inhouse labor required to work around the damage and attempt to meet the contracted delivery dates, as well as to measure the costs related to additional vessels delayed due to the damaged vessel occupying space in the yard. Although large vessels may take years to build, shipbuilders often have numerous long-term government or commercial contracts underway. As such, the accountants provide an analysis regarding the effect and projected economic impact of the loss event for years to come associated with the damaged vessel and the other impacted vessels.

Review of Salvage Recovery Costs

In the event of an unforeseen natural disaster due to heavy winds, strong seas, rising tides, and other weather-related events that may occur, experienced marine surveyors and salvors are often retained or deployed to assist in the salvage recovery process. Natural disasters can cause significant physical damage to insured marine contracts- in-progress; they may also potentially trigger liability obligations to third parties. While the benefit of retaining a marine surveyor with previous experience in negotiating salvors' contract terms and rates is paramount to protecting the interests of Underwriters, the forensic accountant may be added to the adjustment team to facilitate the gathering of the necessary financial data, to review and evaluate the scope of work, and to track and apportion costs to key coverages identified. This will assist in achieving common objectives of securing the necessary accounting information to mitigate a protracted exchange of Requests for Information (RFIs).

The continuous monitoring of insured barge and equipment values on marine projects in-progress may be necessary as well. Current replacement and insured values should be tested to avoid the possibility of vessels being declared Constructive Total Losses ("CTLs") as this may trigger the movement of an Insured vessel(s) from the Hull Policy to the Protection and Indemnity ("P&I") policy (as a wreck removal). While hull policies may protect vessels against physical damage and/or collision liability and P&I policies generally protect other maritime liability risks related to the operation of the vessel, policies will differ from company to company.

In addition to monitoring salvage recovery costs, the forensic accountant can account for estimated and actual repair costs incurred and evaluated by the surveyor, as well as residual values generated from the sale of insured vessels before or after final repairs are consummated. Analyzing and organizing daily or hourly scope of work details of salvage and property costs incurred may also compliment the average adjuster, surveyor, or property adjuster and will likely provide added value to the overall adjustment process.

Depending on the size and complexity of the engagement, forensic accountants may be added to the adjusting/surveyor team to assist in the monitoring and allocation of costs to sue and labor, hull and machinery policy, contractor's equipment, P&I coverage, or possibly other coverages. Overall, it's imperative the forensic accountant maintains accurate workpapers that report the necessary information in a concise, informative, and accurate manner.

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CONCLUSION

Retaining a forensic accountant early can provide tremendous value to the claims review process. Given their unique skill sets and experience handling large or small marine and cargo claims globally, they can prove to be invaluable resources for insurance companies, attorneys, Third-Party Administrators, or even governmental authorities.

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Deborah Ford is a Vice President in J.S. Held's Forensic Accounting – Insurance Services Practice. Deborah specializes in forensic accounting and the analysis of economic damages. With nearly 20 years of experience, she provides expert forensic accounting services for insurers, adjusters, and attorneys in the U.S. and overseas. She specializes in the financial evaluation of damages for diversified matters dealing with quantifying business interruption, extra expense, cargo/marine, subrogation, and insurance defense. She has been involved in over 750 cases, including claims of up to $500 million. Her industry experience includes, but is not limited to aerospace, apartments, casinos, construction, distribution, gaming, government, health services, hospitality, hospitals, life sciences, manufacturing, professional services, restaurants, retail, and warehousing. She has testified as an expert witness in California, Delaware, and federal courts.

Contact Deborah Ford at dford@jsheld.com or
+1 949 390 7473

Louis Magnan Jr. is a Vice President in J.S. Held's Forensic Accounting – Insurance Services Practice. He is a forensic accounting consultant providing investigative accounting and litigation support services for commercial damage claims. He specializes in computing economic damages related to business interruption, builders' risk, inventory and stock losses, extra expense, and property damage losses for insurers. He has also provided various litigation support services for attorneys, law firms, and other parties related to damage claims assessments, alternative dispute resolutions and accounting-related interrogatories.

Contact Louis Magnan Jr. at magnanld@jsheld.com or
+1 917 779 0147

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