



# values

**Values** is an informational newsletter for attorneys who assist clients in answering valuation questions and claims adjusters who work to pay the proper amount of a claim.

*The mythical English detective Sherlock Holmes was reputed to be the greatest detective of all time. Holmes' success was sometimes the result of his vast knowledge of history, science and literature and his uncanny skills in memorization, disguise, language and psychology. However, Holmes was most famous for his method of deductive reasoning. He was able to solve unsolvable mysteries by applying a process to his detective work, uncovering details that others overlooked or considered insignificant (see our sidebar for a list of Holmes' secrets to solving a case).*

Maybe it's a stretch to compare forensic accounting to the brilliant tales of Sherlock Holmes. Nobody has asked us to write a book (much less a series) on the "cases" Cremers Holtzbauer & Nearmyer, P.C. have helped "solve". And, while we like to think we share many of the same characteristics of the great detective – charm, wit, wisdom and rugged good looks – our investigative process, "The Three Os," is probably our closest connection with him.



We thought we'd share how this process works in a practical sense by using a real-life case study:

Just before the new plant comes online, fire destroys the new facility and some of the old. Fortunately, the company is adequately insured for its plant and equipment and can continue partial operations. The biggest challenge is how to determine lost sales due to the reconstruction time.

## The Case of the Product Mix Mix-Up

### Observational Information

### The situation:

An equipment manufacturing company is struggling to claw its way out of debt. A polished venture capital group with excellent financial management skills has big plans to turn the company around – and takes the first step by earning several significant OEM contracts. The increased orders lead to the need for expansion – and a new production facility is slated to go online to meet the higher demand.

In this case, we started by looking at the observational information. The fire damaged all of the new structure and a portion of the old production facilities. It was obvious that the fire had caused damage to the insured property and inventory – all of which were insured. But the more difficult thing to determine was how the fire would impact the company's production and sales in the short term.

The facilities were in their final stages of construction and were about ready to go online. And, it was also obvious that the new facilities were designed for better manufacturing efficiency. To determine the actual economic loss, it was obvious we would need to gather additional information.

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### ***Sherlock Holmes' Seven Lessons of Investigation***

1: "One should always look for a possible alternative and provide against it. It is the first rule of criminal investigation."

2: "I never guess. It is a capital mistake to theorize before one has data. Insensibly one begins to twist facts to suit theories, instead of theories to suit facts."

3: "Use your time sparingly. Determine what you have. Then determine what you need. Then look for what you need in the place where it must be."

4: "There is nothing so important as trifles. Never trust general impressions, but concentrate yourself upon details."

5: "Singularity is almost invariably a clue."

6: "It is a mistake to confound strangeness with mystery. The most commonplace crime is often the most mysterious, because it presents no new or special features from which deductions may be drawn."

7: "When you have eliminated the impossible, whatever remains, however improbable, must be the truth."

### **Organizational Information**

Fortunately, the insured company kept excellent detailed records. In fact, every year, the company went through a detailed sales planning process that helped them determine what production levels would be needed to meet sales demand. Based on several years worth of records, it was easy to determine that the company's production and sales forecasts were very accurate.

To help determine what the economic loss would be, the company provided production and sales projections for the current year. Based on these projections and the contracts the insured company estimated that their loss due to business interruption would be a little more than a half-million dollars. Analysis of sales records showed that the company was indeed on track to meet their unit sales forecast. However, these figures didn't

match when we looked at the sales projections in *dollars*.

### **Outside Experience**

Taking a broader look at the company and the outside economic forces helped us understand that part of the new ownership's strategy to turn the company around was to pursue new OEM business. The company was successful at doing this. But their success also changed the business' product mix – and profitability.

In previous years, nearly two-thirds of the company's production and sales were its own branded product compared to OEM sales. However, this equation in the year of the loss was the exact opposite after the change in strategy to pursue more OEM business – and sales forecasts and production were actually for two-thirds to come from OEM business – at a lower profit margin.

*Without following all three of the "Three Os" of information gathering, it is likely that the insurer would have reimbursed the insured for more than the actual economic loss experienced by the manufacturer. In the end, we were able to explain to both the insured and the insurer why the actual economic loss was a quarter of a million dollars less than what was originally estimated. More importantly, both the insurer and the insured agreed with the assessment – and continue to maintain a positive working relationship.*

**Much like Holmes used his experience and keen sense of deductive reasoning to solve cases, Cremers, Holtzbauer & Nearmyer also has a time-tested process of investigation in cases where forensic accounting is needed.**

**Any good forensic accounting firm uses elements from each of "the Three O's". But in our experience, even cases that seem simple and straightforward on the surface aren't always the same when applying our process. And while the difference between an initial claim and the actual economic loss aren't always obvious - they can often be significant.**

### **Can We Help You?**

Dale Cremers, Bob Holtzbauer and Roger Nearmyer have experience to help you address questions about forensic accounting. Please call for more information at 515-274-4804 or e-mail us at [info@chncpa.com](mailto:info@chncpa.com).

