

BUSINESS INTERRUPTION INSURANCE 101



BUSINESS INTERRUPTION CONCEPTS

Business Interruption (BI) claims can be complicated and are often misunderstood. In general, the purpose of Business Interruption coverage is to put the business in the same financial position it would have been in “but for” the event or loss. Simply put, this coverage will help to replace the cash flow that would have been generated in order to cover the operating expenses of the business and paying out the net profit, if the business is profitable.

It is a common misconception that Business Interruption insurance covers a business’ lost revenues. This is rarely the case. The expenses of the business need to also be considered. Variable (non-continuing) expenses such as costs of goods sold and utilities are not going to be reimbursed by insurance due to the fact that these expenses are not incurred during a loss. Fixed (continuing) expenses such as rent and insurance will be reimbursed by insurance. The following page shows an example of a simple BI calculation for a manufacturing facility which illustrates these concepts.

BI EXAMPLE ANALYSIS

SAMPLE BUSINESS FINANCIAL INFORMATION			
Sales Price per Unit	\$	1.00	
Units Produced per Year	10,000,000		
Annual Sales	\$	10,000,000	
Annual Expenses			
	\$	Per Unit	% of Sales
Raw Materials	\$ 2,000,000	\$ 0.20	20.00%
Overhead Expenses	\$ 6,000,000	\$ 0.60	60.00%
Total Expenses	\$ 8,000,000	\$ 0.80	80.00%
Net Income (Margin)	\$ 2,000,000	\$ 0.20	20.00%

\$ 0.20	Raw Materials	
\$ 0.60	Overhead Expenses	(Certain labor costs, rent, taxes)
\$ 0.20	Margin	(Profit)
\$ 1.00		

For each unit sold, 20 cents covers raw materials and 60 cents covers overhead costs which leaves a margin of 20 cents (20%)

During a typical business interruption, if the business is shutdown and not producing, they are not incurring raw material costs. We assume overhead costs continue.

BUSINESS INTERRUPTION SIMULATION		
Months shut down	6	
Lost Production	5,000,000	(Half of annual production)
Lost Sales	\$ 5,000,000	
Less: Saved Raw Material Costs	\$ (1,000,000)	\$0.20 per unit or 20% of Sales
Business Interruption Loss	\$ 4,000,000	\$0.80 per unit or 80% of Sales
Less: Overhead Expenses	\$ (3,000,000)	\$0.60 per unit or 60% of Sales
Net Income (Margin)	\$ 1,000,000	\$0.20 per unit or 20% of Sales

A Business Interruption Loss is typically equal to the lost net income plus the continuing expenses (overhead) of the business

GENERAL INFORMATION & DOCUMENT REQUESTS

While each Business Interruption loss is different and unique, there are key pieces of information and certain documents that are almost always required to evaluate the financial impact of an event on a business. The following list includes some of these:

Business Interruption (Due to Property Damage)

1. Timeline and description of the property damage and how each location was impacted including photos or video (if possible). Please include dates, times and specific details.
2. Monthly Profit & Loss statements for 24 months prior to the loss.
3. Budgeted/Forecasted Revenues for 24 months prior to the loss as well as the next 12 months.
4. Daily sales/production records.
5. Payroll Records for 3-6 months prior to the loss.
6. Federal, State, Sales & Use Tax Returns.
7. Copies of specific cancelled sales, bookings, events, contracts, etc.
8. Schedule of maintenance/planned shutdowns for the current year.

In addition, the following events/perils may have a financial impact on the business and may result in a recoverable BI loss:

- a. Power outage
- b. Civil authority – provide a copy of the official order of evacuation and when the order is formally lifted.
- c. Ingress/Egress – include distance from the location and when access was restored
- d. Looting
- e. Contingent Business Interruption (“CBI”) – Damage to key customers or suppliers

In general, the more detail and information available, the easier it will be to quantify and present a business interruption claim. Should you require any additional assistance, please do not hesitate to contact Procor Solutions + Consulting today.



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