The subrogation process can help businesses improve their bottom line.

Work Like an Insurance Company to Save Money

BY JOSEPH A. GERBER AND ELLIOTT R. FELDMAN

EXECUTIVE SUMMARY

■ **IN BUDGET-CONSCIOUS TIMES MANY COMPANIES MISS** the opportunity to recover hundreds and thousands of dollars each year through the subrogation process—filing claims against third parties responsible for causing damage or injury to companies and their assets when these losses are uninsured or fall below the policy deductible. In these instances the company has to take the steps the insurer would if it was involved.

■ **THERE ARE SEVERAL STEPS CPAs CAN TAKE TO HELP** minimize the financial impact of property losses. The first is to immediately activate an investigation team to preserve evidence and inform the authorities and any potentially adverse parties of the company's loss.

■ **THE SECOND STEP AFTER A LOSS IS TO DEVELOP** the claim. Primary responsibility for this lies with the company's insurance or legal department, but CPAs will need to calculate the dollar amount of damages in terms of lost production days, delays and lost business opportunities. The accounting department also likely has copies of contracts, service agreements and guarantees related to the work that caused the damage.

■ **THE THIRD STEP INVOLVES EVALUATING DAMAGES** the company suffered to its building and interior contents, and business interruption due

to lost or delayed business. The company may want to hire an adjuster to help with this process.

■ **CPAs SHOULD HELP COMPANIES CREATE AN ACTION** plan they can implement when a loss takes place. The plan should identify the employees within the organization's engineering, risk management, accounting and legal departments who will respond to a new loss. Managers should be trained in how to identify, preserve and protect potentially valuable evidence of a loss.

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In these days of corporate belt-tightening, companies are understandably concerned with dollars that drop to the bottom line. Yet, there is one largely unnoticed area of operations that could deliver hundreds of thousands of dollars each year: subrogation and recovery. Subrogation is a legal process that permits an insurance company—after paying a policyholder's claim—to sue one or more third parties responsible for causing the damage or injury to the policyholder. The goal is to recoup the insurance payments, plus the policyholder's deductible. Even when an insurance company isn't involved in the loss, CFOs and CPA financial managers at many types of companies can use the same practices and procedures to recover lost profits.

With the significant increase in property and casualty insurance premiums, companies have been raising their policy deductibles or the amount they self-insure—the loss the company will absorb that's not covered by insurance. Typically the larger the deductible or self-insurance amount, the lower the premium.

When a property or casualty loss is less than the deductible amount or is not covered by insurance, CPAs can help companies recoup some of these losses by putting a team and a process in place to immediately investigate the loss and pursue recovery in court against the responsible parties. This article describes how to assemble such a team and what it should do to get maximum recovery.

Subrogation

A legal term, the literal meaning is "standing in the shoes of." In an insurance context, subrogation involves the substitution of one party (the insurer) for another (the insured) to pursue any legal rights the latter may have against a third party liable for an insurance-reimbursed loss the insured suffered.

A CASE IN POINT

Consider a situation that happens time and again. An outside contractor, perhaps a plumber or an electrician, comes onto a commercial property to repair a minor leak or replace an electrical fixture. While the technician is working, or shortly thereafter, a problem causes significant water or fire damage to the company's property.

Typically, despite the damage to the building and its contents and the potential interruption of business, the total loss doesn't exceed the deductible on the company's property insurance policy (which may be as high as $500,000 or more). So the company promptly repairs the damages at its own expense and resumes operations.

Most companies don't think about filing a claim or lawsuit against the party responsible for the loss to regain the company's repair and downtime costs. If the damages had exceeded the deductible, the insurance company would have pursued recovery against the wrongdoer; why shouldn't the company's financial management team do the same thing on the company's behalf?

How much can a business expect to recover? Companies with aggressive subrogation programs can expect to recover upwards of 5% to 20% of the losses they sustain. In virtually all companies, a certain percentage of losses ultimately will be attributable to the actions of the company's own employees without any third-party responsibility.

THREE STEPS TO RECOVERY

To assist companies with their recovery efforts and thus help minimize property and casualty losses, CPAs should understand three steps insurance companies typically take in cases of property damage.

Step 1: ***Begin an immediate investigation.*** Since the first step in any successful recovery is proving responsibility for the loss, CPAs should immediately activate an investigation team to preserve evidence. In addition to the company's corporate accounting department or CPA firm, players assembled or waiting in the wings should include in-house counsel or the company's outside law firm, forensic consultants, insurance adjusters (even for self-insured losses which must be "adjusted" for accounting and tax purposes) and experienced recovery counsel who can lead the team's overall efforts. The adjusting process involves determining the cause and amount of a loss, the indemnity recoverable by the insured and the amount to be paid under the terms of the policy.

The team should inform authorities and the potentially adverse parties (the individual or business suspected of causing the damages) of the circumstances of the company's loss. Depending on the facts and circumstances and whether any personal injuries or exposure to toxic materials occurred, interested local, state or federal authorities might include the Occupational Safety and Health Administration (OSHA), the state department of labor and industry or the appropriate environmental protection agencies. Potential adverse parties might include the general contractor on the job at the time of the loss; subcontractors such as plumbers, electricians or HVAC providers; and the manufacturer, seller or installer of any defective product that caused or compounded the loss. To help begin its investigation, the company should ask these parties to provide all relevant information about their product or service. Without a rapid response, crucial physical evidence may be lost or destroyed in the cleanup process. This will hamper and possibly negate the company's recovery efforts. Working with experienced forensic consultants and attorneys skilled in recognizing and preserving physical evidence, the company should

- Photograph evidence in place.
- Carefully tag or otherwise identify it.
- Remove the evidence and secure it to prevent intentional or negligent destruction.

Step 2: ***Developing the claim.*** Although primary responsibility for putting together the claim rests with either the company's insurance or legal department, CFOs and CPAs will play a significant role in helping to analyze and finalize the damages. Although initially such damages may be categorized as lost production days, delays in production or even lost business opportunities, CFOs and CPAs will be responsible for converting the losses into dollars and cents and for providing that information to either the insurance or legal department.

Depending on how a company is organized, the accounting department may have documents critical to the underlying theories of liability, including service agreements and contracts, guarantees and warranties or other documents that relate to work performed (or not performed) by a potential adverse party. The company's risk management and legal departments will need to see these contracts and related materials as they will significantly facilitate any claims.

Step 3: ***Establishing damages.*** Even when losses fall within the company's deductible or self-insurance amount, CPAs still should calculate the loss amount for accounting and tax purposes. Companies frequently overlook this step or dismiss it as insignificant. Either the in-house risk management team or an outside adjuster should assess the damages as accurately and thoroughly as possible and gather all supporting documentation required to prove the claim. (For losses that trigger coverage above the deductible or self-insured limit, the property insurer typically will assign a staff or independent adjuster.) The investigation and recovery team should work with the adjuster to ensure a quick and fair resolution to the damage claim.

To establish damages CPAs should help the adjuster evaluate losses such as

- *Building damages.* Includes damage to a structure and its component parts including walls, floors, ceilings and roof, as well as electrical, plumbing and HVAC.

- *Interior contents.* Ranges from furnishings and fixtures to equipment and machinery.

- *Business interruption.* Covers financial losses the company sustained from the partial or total disruption of its operations.

■ *Other.* Includes other damages that reasonably arise from the property loss, such as lost business opportunities or market share or other economic impairments.

What an Investigative Team Should Look Like

The investigative and recovery team should include

■ ***The company's own CFO or CPA*** to calculate the loss in terms of dollars, lost production time or other measurements potentially relevant to the company in connection with its quarterly or annual performance and any tax losses attributable to casualty claims. The CFO or CPA investigative team leaders must coordinate their investigative efforts with company executives and public-sector authorities, including local, state and federal representatives (as in police departments, fire marshals and OSHA) and give notice to potentially adverse parties (manufacturer, seller or installer of a faulty product) that may be responsible for the cause or origin of the loss.

■ ***Forensic consultants t***o assist in conducting the loss site examination, including interviewing witnesses, examining and collecting physical evidence, obtaining applicable plans and blueprints for the structure and ideally reaching a professional opinion as to the mechanism(s) responsible for the cause or origin of the loss.

■ ***Experienced outside recovery legal counsel*** to help coordinate all activities (especially inviting potentially responsible parties to retain adjusters to assess the property damage during their own investigations).

PLANNING FOR THE FUTURE

In addition to understanding the process of putting together a claim against responsible parties, it's important for CFOs and CPAs to work with other company executives in advance to create an action plan the company can implement when a property loss takes place. The plan should identify the employees in the company's engineering, risk management, accounting and legal departments who will respond to a new loss and assign specific duties and responsibilities for investigating the loss, recovering from it and assembling and presenting any claims the company makes to its insurance company or the third parties potentially responsible for causing the loss.

There are financial benefits to having such a plan in place. For example, one large national retailer maintains a proactive loss recovery program, relying heavily on members of its risk management, accounting and finance and legal departments. Additionally, outside counsel provides critical support following property losses.

Typically, these losses involve damages to company buildings by delivery trucks, leaking or ruptured sprinkler lines resulting in water damage, fires of all sizes in both warehouse and public retail space and occasional collapses of ceilings or displays.

Given the company's significant property insurance deductible of $500,000, many of these losses are less than that amount. Accordingly, the retailer's property insurer frequently is not involved in any loss investigation, adjustment, payment of claim or pursuit of third-party liability.

As the result of careful preplanning, the department store's parent company, working with its outside counsel,

■ Developed a list of available forensic investigators and experts. While companies don't typically keep these experts on retainer, it's a good idea to put together a preferred list in advance of a loss.

■ Educated its managers on the need to carefully investigate and document losses and to involve both outside counsel and outside forensic investigators. Special training programs using case studies will help an organization prepare its personnel for a loss. Interactive training of loss team members will enable the company to take a more coordinated approach following a real incident.

■ Trained its managers on how to identify, preserve and protect potentially valuable evidence.

■ Instructed its accounting department to carefully calculate any and all losses sustained including building damage, contents or merchandise damage, business interruption, lost sales, loss of business opportunity or any other damages attributable to the casualty.

As a result of this careful preparation, the department store chain is able to maintain evidence of a loss, evaluate and calculate damages and quickly notify and present a detailed claim to potential adverse parties. Because of its proactive approach, the retailer has improved its bottom line, collecting literally hundreds of thousands of dollars from third parties in connection with otherwise uninsured losses in recent years.

PRACTICAL TIPS TO REMEMBER

■ CPAs can help companies create an action plan they can implement when they suffer a loss. This involves identifying the individuals in their engineering, risk management, accounting and legal departments who will respond to a new loss.

■ In the event their company suffers a property or casualty loss, CPAs should immediately activate an investigation team to begin preserving critical evidence. Without such a rapid response, crucial physical evidence could be lost in the cleanup process.

■ CPAs play a significant role in developing a claim for damages against a third party by helping to convert losses into dollars and cents in terms of lost production days, production delays and lost business opportunities.

■ To establish a claim, CPAs should work closely with an insurance adjuster to evaluate potential losses due to damage to the building and its contents, the partial or total disruption of operations and any other economic losses.

WHAT'S NEXT?

Subrogation and recovery departments have become important revenue centers for both insurance companies and for their insured policyholders. As accountants, CFOs or risk managers for their employer or client, CPAs will be evaluated, at least in part, on the basis of the quality of the recovery programs they establish. By leading such efforts, CPAs can take advantage of the same opportunities that directly improve every insurance company's profit and loss statement. To do otherwise is to leave dollars in the pockets of the very entities responsible for causing losses rather than recovering them on behalf of the organizations that suffered the damages. ■