



# BUSINESS INTERRUPTION CLAIMS

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## A STEP-BY-STEP GUIDE



Business Strategy | Expert Witness | Valuations

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## Future Economic Loss - Some Practical Considerations for Self-Employed Persons in a Post-COVID-19 Environment.

### OVERVIEW

It may very well be that pre-COVID-19 or post-COVID-19, the outcome for the plaintiff may not vary materially. It could be that the advice received, or calculations provided (say, in January 2020) may be very different to the one made today or even in six to twelve months' time.

The takeaway is that obtaining up-to-date legal and accounting advice is more important than ever in today's environment.

### NEED HELP?

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## Future Economic Loss - Some Practical Considerations for Self-Employed Persons in a Post-COVID-19 Environment.

### WHO OR WHAT IS INVOLVED?

Forensic Accountants are commonly engaged by Lawyers to assess the fair market value of small, owner-managed businesses (SMEs). As well as to determine the foregone income derived by the plaintiff but for their injury.

Business valuation concepts can be critical for the proper quantification of personal injury damages, particularly in the context of self-employed individuals.

Self-employed plaintiffs represent a particular problem and bring an extra level of complexity for personal injury litigation and economic loss claims; doubly so when the business's cash flow has shown times of difficulty. The COVID-19 pandemic and the resulting economic consequences present a new set of challenges for forensic accountants, lawyers and plaintiffs alike.

Each business possesses its own set of challenges and every compensation claim has to be framed to tell a story that translates the complexities of any scenario into layman's terms to allow an equitable resolution to the matter.

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### DETERMINE THE FACTS

Understanding how the plaintiff's accident has affected their business is paramount in estimating their economic loss.

There may be a number of separate but interrelated matters to consider.

Economic loss may occur within business entities, and like a lot of small businesses, the financial reporting of the business is likely framed in a manner that seeks to minimise personal tax payable.

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### DETERMINE THE FACTS

In some cases, the loss could be hidden amongst a number of different entities.

As a first step, a forensic accountant will interrogate the financial statements to establish what lies behind the numbers.

The types of economic loss in a self-employed case may then be separated (but not always) into the following categories:

- 1.Reduction in Revenue
- 2.Increase in Expenses
- 3.Resulting Loss of Profits
- 4.Replacement Labour
- 5.Capital Losses
- 6.Goodwill

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### DETERMINE THE FACTS

It is imperative to have an academic discussion around the complexities of the above.

Some self-employed individuals earn income from a number of different types of assets. The return on these assets will be unequally impacted by a personal injury.

While the business owner's capacity to earn personal exertion income will clearly be impacted, the impact of the injury on the business' return and its business goodwill may be negligible. Even when the returns on these other assets are affected, a much different discount factor will need to be used in discounting these losses.

There are a number of legal principles and regulations around this.

What I do want to discuss (and this also applies to Family Law Matters) is how the valuation process for SMEs may need to be adapted to deal with the challenges we are facing today and its potential impact on a personal injury claim. Job keeper payments, grants, reduction in PAYG payments etc, all impact the bottom line of the business and may in fact reduce the loss suffered... but every business needs to be assessed based upon its own circumstances.

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### CONFIRM THE OBJECTIVE

The objective of the Forensic Accountant is to comply with the instructions of the client.

But what about lawyers?

They need to provide an independent valuation report that complies with our professional accounting standards, APES 215 Forensic Accounting Services and APES 225 Valuation Services and to apply independent professional judgement and skill to the facts and information provided to facilitate an outcome in accordance with legal principles.

There is no one-size-fits-all.

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### MAIN OBSTACLE

When predicting the future, it is important to know that what worked in the past may not work in the future.

In the vast majority of SME business valuations, the capitalisation of earnings approach is used. This requires an assessment of the future maintainable earnings (FME) of the business and the application of an appropriate multiple.

Even where there was a lack of forecast information, there is usually some information present. It may have been historical trading performance and/or sales multiples that provided guidance to the value.

The economic fallout of COVID-19 and surrounding economic uncertainty has seen a more introspective use and review of the appropriate capitalisation rates.

Simply put, there is much uncertainty. This increases risk and decreases value.

Valuation theory indicates that the most technically correct valuation approach is the discounted cash flow (DCF) methodology. This approach assesses value based on future cash flows. Using this approach, the Valuer could attempt to model the financial impacts of COVID-19 on the business.

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### MAIN OBSTACLE

While the approach is sound, its application has some extra considerations.

Key considerations for such an approach would include:

- How long and to what extent will revenues be reduced due to COVID-19?
- What are the impediments the business may face converting debtors, work in progress and stock to cash?
- What cost savings/deferral might be available during the downturn?
- When and what government assistance will be available?
- After the restrictions from COVID-19 have lifted, how long will it take for economic activity and the business financial performance to return to normal, if ever?
- What opportunities exist for the business during and after the COVID-19 restrictions?

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**So how do we overcome these obstacles?**

**This question can be answered in two parts:**

- Firstly, the exercise of sound judgement and expertise by the forensic accountant.
- Secondly, access to reliable information from the business being valued, as well as what is happening in the economy more broadly.

All of this will assist in building a model of a business's future cash flows.

However, that is not to throw the baby out with the bathwater.

The FME approach still has a significant role to play and it could be in today's environment that the best approach may be to undertake both.

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### DEVELOP A LIST

Envision Forensics has developed a checklist of the documents and other types of information required. This assists with forming an opinion on the value of the business for a personal injury matter, and for most matters where a Business Valuation is required.

This checklist has been updated to include questions and considerations around the impact of COVID-19 on the business.

It is noteworthy that a similar checklist can help us assist those businesses that are in financial trouble at the moment, and who may require guidance on steps available to them to mitigate their current risks.

The checklist can be found on the [website](#).

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