



STRICTLY PRIVATE & CONFIDENTIAL
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The Chartered Institute of Loss Adjusters
Associateship Examination 2016 (October)
Paper C3 Business Interruption

3½ Hours

Maximum Marks 200

Answer ALL questions in Part 1 and 2 questions from Part 2
Where appropriate, answers should make reference to relevant case law or statute.

PLEASE ENSURE THAT QUESTION NUMBERS ARE ENTERED CLEARLY AND IN FULL ON THE COVER OF YOUR ANSWER BOOK AND IN YOUR ANSWER BOOK.

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PART 1
ANSWER ALL QUESTIONS

QUESTION 1

- A. You are appointed by Insurers to deal with a claim for moderate fire damage which has occurred to a café in a town centre location. The café provides the usual range of non-alcoholic beverages, light meals, sandwiches and cakes etc and has seating for thirty customers. It is open between 8.00 am to 5.30 pm each day except Sundays.

Your Principals' Policy covers all Trade Contents and Stock together with Business Interruption. The latter covers Loss of Gross Profit on a Sum Insured Basis - £150,000.00 - with a twelve month indemnity period. There are no specific extensions and the policy wording is typical for a small business. The building is separately insured by the Landlord.

The precise cause of the fire is not determined but there is no evidence that it was other than accidental. Policy liability has been accepted by your Principals (and by the Landlord's Insurers) and you have already agreed the material damage element of the claim. To allow for the repair/replacement of damaged equipment, acquisition of new stock and repair of the building damage, it is estimated that it will be approximately eight weeks before the Insured can resume trading. Due to the nature of the business, it is accepted that it will not be feasible to consider partial reopening whilst building repairs and other remediation are ongoing.

- i) At the time of your initial visit, what advice generally should you provide to the Insured regarding the Business Interruption element of the claim?
- ii) What information and documentation should you require to enable you to verify the loss of turnover during the interruption period and to calculate the Rate of Gross Profit?
- iii) How should you determine whether the Sum Insured against Gross Profit is adequate or otherwise? If it is not adequate, how might this impact upon the claim?

(20 Marks)

- B. Discuss the circumstances under which it might be appropriate to evaluate a stock loss using the stock reconciliation method and also comment on any potential disadvantages of using this method of validation. Explain how the loss would be calculated on this basis (figures need not be included).

(12 Marks)



- C. In the context of an insurance claim, what do you understand by the term “Salvage” and how would you deal with this if identified during the course of the claim?

(8 Marks)

40 MARKS

QUESTION 2

1. Explain briefly the term “Warranty” when applied to a policy of Insurance.

(4 Marks)

2. Specify two warranties that might apply to each of the following:

- a) Takeaway fish and chip shop
- b) Vehicle repairer.

(4 Marks)

3. In a typical Commercial Policy covering both material damage and business interruption, what is meant by the following terms:

- a) Reinstatement Memorandum
- b) Public Authorities Clause
- c) Loss of Attraction
- d) Departmental Clause.

(12 Marks)

4. In dealing with claims for building damage, discuss briefly the possible advantages and disadvantages of instructing, on behalf of insurers, their network building contractors to carry out the necessary repairs. Draft a letter to explain this procedure to a Policyholder who would prefer to use the services of his/her preferred local contractor and who is concerned that the appointment of a network contractor may impact upon the quality and standard of the work with a view to minimising Insurers’ expenditure. The Policyholder also requires advice as to who will guarantee the work and the procedure for remedying any subsequent defects should the network contractor cease trading or be removed from the network. NB Your own name must not appear in this draft letter.

(15 Marks)

5. Calculate the amounts payable by each policy, on the basis of each Insurers’ independent liability, for the costs of Alternative Accommodation as follows:



Sum Insured - Buildings Policy - £50,000.00

Sum Insured - Contents Policy - £15,000.00

Total cost of Alternative Accommodation - £18,000.00

NB All arithmetical workings must be shown.

(5 Marks)

40 MARKS

QUESTION 3

You are instructed to deal with a claim for fire damage to a terraced, two storey, three bedroomed, tenanted private dwelling. Your Principals provide buildings cover to the landlord and the tenants have separate cover for their own contents with other Insurers. The tenancy agreement stipulates, amongst other things, that the landlord will arrange the necessary buildings insurance and also includes a cessor of rent clause in the event of the dwelling or any part being rendered uninhabitable due to fire or other insured damage.

Preliminary enquiries have shown that the fire was probably caused by a carelessly discarded cigarette end in the kitchen waste bin. The tenants do not smoke but admit that their daughter's boyfriend, who had been at the house on the day of the fire, is a smoker. Extensive damage was caused to the kitchen by the direct effect of the fire and to the remainder of the internal accommodation by the effects of heat and smoke contamination. The house will not be fit for normal occupation until the necessary repairs are complete.

Explain how you would deal with the following items of claim that have been presented to your Principals and the various issues listed. For the purposes of this question, assume that the Policy provides typical cover, that the Sum Insured is adequate and that Policy Liability is admitted.

1. Damage to fitted kitchen units and appliances. The tenants had replaced the original units in place at the start of the tenancy with better quality units and had also supplied a free-standing cooker. These items were installed by the tenants at their expense with the approval of the landlord. The replacement kitchen appliances include an integral washing machine, dryer and a fitted oven and hob.
2. Vinyl floor covering in the kitchen, again installed by the tenants with the landlord's approval.
3. Light fittings in the ground floor accommodation, again installed at the tenants' expense but without notification to the landlord.



4. Decorations throughout. These include areas where the tenants have applied upgraded wall coverings, again with the landlord's approval.
5. At the time of the fire, the tenants were in the process of redecorating part of the first floor accommodation. They had purchased rolls of wallpaper which had not yet been used but are now worthless due to the effects of smoke. Their purchase cost was £350.00 and your Insured has included this amount within the claim so that they can be reimbursed.
6. Fitted floor coverings. These were provided by the tenant.
7. Replacement of a number of double-glazed windows in the ground floor accommodation. However, you learn from your discussions with the tenant that the landlord had already agreed to replace two of these windows as their seals were defective.
8. Alternative accommodation requested by the tenant until the building is fit for habitation.
9. Your Principals' policy is subject to a £500.00 excess. As it appears that the fire was caused by a carelessly discarded cigarette, the landlord seeks your advice as to whether you will be pursuing recovery against the tenants and, if so, whether he can include the excess within this procedure. This is on the basis that, in the terms of the tenancy agreement, the tenants agree that they will not smoke, or permit smoking, within the premises.

40 MARKS



PART 2
ANSWER TWO QUESTIONS ONLY

QUESTION BI 1

Insurers have appointed you to deal with the business interruption loss following a fire at a home entertainment system retailer. The entire stock was destroyed in the fire as were the premises. The incident occurred on 1 January 2015.

Liability has been accepted under the Material Damage cover.

Under normal circumstances, products are imported in container loads from China with lead times of up to three months. In order to mitigate the loss, smaller temporary premises were sought and some stock was purchased locally at greater unit cost.

Turnover for the financial year ending 31 December 2012 was £4,305,226.

Turnover for the financial year ending 31 December 2013 was £4,735,749.

Turnover for the financial year ending 31 December 2014 was £5,209,324.

The directors advise that the forecasted turnover for the financial year ending 31 December 2015 was £6,250,000.

Historic turnover is analysed thus:

	2014 (actual)	2015 (forecast)	2015 (actual)
Jan	£ 196,115	£ 378,434	£ 0
Feb	£ 229,533	£ 204,372	£ 0
Mar	£ 534,741	£ 526,867	£ 31,123
Apr	£ 352,708	£ 483,941	£ 108,631
May	£ 382,523	£ 527,030	£ 151,966
Jun	£ 374,830	£ 462,179	£ 200,637
Jul	£ 319,144	£ 447,202	£ 250,727



Aug	£ 467,955	£ 510,546	£ 300,011
Sep	£ 393,763	£ 473,841	£ 359,752
Oct	£ 402,790	£ 565,916	£ 507,856
Nov	£ 715,432	£ 799,773	£ 680,914
Dec	<u>£ 839,790</u>	<u>£ 869,899</u>	<u>£ 695,040</u>
Total	£5,209,324	£6,250,000	£3,286,657

The accounts for the financial year ending 31 December 2014 are as follows:

Turnover	£5,209,324
Cost of Sales:	
Opening stock	£ 456,911
Purchases	£3,216,506
Shop wages	£ 360,530
Agency labour	£ 53,000
Depreciation	£ 35,000
Closing stock	(£ 500,104)
Total Cost of Sales	<hr/> £3,621,843
Gross Profit	£1,587,481
Expenses:	
Staff salaries	£ 100,035
Directors' salaries	£ 200,516
Carriage	£ 468,717
Packaging	£ 90,743
IT costs	£ 50,000
Advertising	£ 195,290
Repairs and renewals	£ 26,225
Telephone costs	£ 2,400
Energy costs	£ 23,609
Stationery/postage	£ 17,045
Sundry	£ 1,000
Audit fees	£ 25,000
Legal fees	£ 15,000
Credit card charges	£ 104,186
Bad debts	£ 3,410
Bank charges	£ 19,008
	<hr/> £1,342,184



Net profit £ 245,297

The policy is declaration linked with an Estimated Gross Profit of £1,000,000 and a Maximum Indemnity Period of 12 months. Uninsured Working Expenses are purchases (including stock movement), carriage, packing and freight, and bad debts.

The Increased Cost of Working claim was presented thus:

Fit-out works at temporary premises	£105,000
Dilapidations on temporary premises	£ 25,000
Rent for temporary premises	£135,000
Temporary storage	£150,000
Purchase of a delivery vehicle	£ 14,000
Additional advertising	£ 50,000
Premiums paid for stock purchases locally	£450,000
Overtime	£ 25,000
Directors' time handling claim etc	£ 20,000
Wages whilst unable to trade	£ 80,000

1. Based on the above information, calculate:
 - a) The Rate of Gross Profit.
 - b) A proposal for settlement of the Gross Profit loss to include a discussion surrounding any trend that is incorporated.
 - c) A proposal for settlement of the Increased Cost of Working claim, with an explanation of the reasons for their inclusion or exclusion.
 - d) A proposal for what categories of cost could constitute savings, with your explanations as to the reasoning behind their inclusion as a savings item.
 - e) If the stock loss was settled under a Contract Price Clause, how would this affect your consideration of the Gross Profit loss?
 - f) Comment on the adequacy of the Declared Gross Profit and what remedies insurers have in relation to Gross Profit that has been under-declared.

40 MARKS



QUESTION BI 2

The Insured operate a successful business, Grundy, Wong & Horrobin International, which imports and distributes seasonal foods to a variety of customers in the UK.

On 1 April 2015, the Insured's premises were seriously affected by fire in which the warehouse building was badly damaged and all the stock within was destroyed.

Temporary premises were considered, but the only suitable location could not be leased until November 2015, by which time the trade in the run-up to Christmas and New Year would have been lost. Mr Grundy advises that a material damage policy was in force and Loss Adjusters Archer, Snell and Titchener have agreed that the policy will operate to cover the material damage.

The Business Interruption aspect is insured on an Estimated Gross Profit basis in the sum of £1,000,000 with a Maximum Indemnity Period of 12 months. Uninsured Working Expenses are purchases (including stock movement), carriage and packaging.

You have been instructed by Insurers to adjust the loss on the basis of the information provided. No claim has been presented by the Insured for loss of gross profit, but a schedule of costs incurred has been provided as part of the Increased Cost of Working claim for your consideration as follows:

Costs incurred:

Wages during closure period	£ 205,000
Staff overtime upon re-opening	£ 7,500
Insurance costs during closure	£ 14,000
Temporary additional security	£ 15,000
Installation of intruder alarm/CCTV after flood	£ 35,000
Installation of flood defence systems	£ 50,000
Advertising campaign for re-opening	£ 25,000
Director's bonus upon re-opening	£ 5,000

Turnover details have been provided as follows:



Sales (£)	2012/13	2013/14	2014/15	2015/16
Apr	173,652	143,848	137,809	0
May	163,371	142,754	90,116	0
Jun	109,857	93,430	112,285	0
Jul	79,242	58,324	91,016	0
Aug	79,496	63,001	77,215	0
Sep	147,594	116,095	127,022	0
Oct	192,576	122,526	92,884	0
Nov	208,531	204,646	199,159	0
Dec	120,455	99,293	101,933	0
Jan	46,574	66,534	50,635	0
Feb	86,101	111,022	131,191	115,675
Mar	201,737	166,577	156,984	140,702
Total	1,609,186	1,388,050	1,368,249	256,377

The Insured's last set of accounts have been provided for your information.

Sales		1,388,050
Opening stock	129,400	
Direct wages	253,767	
Purchases	800,845	
Closing stock	(135,200)	
Cost of Sales		<u>1,048,812</u>
Gross Profit		<u>339,238</u>
Carriage	60,177	
Packaging	10,000	
Rent	38,000	
Rates	10,000	
Insurance	16,500	
Electricity	6,000	
Heat and light	7,998	
Repairs	4,532	
Motor expenses	7,630	



Telephones	3,653	
Printing, postage and stationery	6,550	
Bank charges	550	
Invoice discounting charges	6,272	
Accountancy/professional fees	3,000	
Directors' remuneration	23,000	
Depreciation	2,000	
Overheads		<hr/> 205,862
Net Profit		<hr/> 133,376

1. Calculate the Loss of Gross Profit, to include a discussion on trend, Increase in Cost of Working and potential Savings. Give your reasons for including or excluding costs as Increase in Cost of Working/Savings.
2. What do the following terms mean?
 - a) Standard Turnover
 - b) Annual Turnover
 - c) Uninsured Standing Charges clause
 - d) Departmental clause
 - e) Estimated Gross Profit
 - f) Accumulated Stocks clause

40 MARKS

QUESTION BI 3

Insurers have instructed you to attend the first meeting at a ceramic tile and mosaic art business following the total destruction of the Insured's buildings, machinery/plant/contents and stock. The business, Kinnear Ceramics Ltd, has three shareholder directors (Sally Kinnear-Webster, Patricia Cheung and Abhilasha Malhotra), 50 permanent staff and 25 agency staff.



The company own and insure the buildings, machinery, contents and stock.

Customers have the choice of substitute products in the marketplace and will look to utilise other suppliers if the Insured cannot provide a business plan to customers soon.

At the meeting, the Insured's Operations Director, Abhilasha Malhotra, looks to you to recommend as many options as possible at this stage so that a formal mitigation strategy can be agreed upon in due course.

Abhilasha was about to take a six month sabbatical and is now concerned that she may need to cancel her "holiday of a lifetime" and incur substantial personal costs.

It is anticipated that reinstatement of the building and machinery could take in excess of 12 months, but the Maximum Indemnity Period is only 12 months. The declared Gross Profit is adequate at the time of the loss. The policy includes Additional Increase in Cost of Working expenditure.

Explain what actions might be taken to mitigate the Insured's potential losses, the benefit and drawbacks of each option and any problems that you may foresee with any of the mitigation options.

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