



Validation of Quantum – Means by which quantum may be proved or demonstrated

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Introduction

This paper is intended to assist CILA students in being able to gain a good level of knowledge as to the issues around determination of quantum where physical evidence may be compromised or non-existent, for whatever reason. This is with particular reference to the syllabus for the CILA Advanced Diploma, AD1 – Application of the Principles of Insurance. Reference is made to other papers and documents that the reader may well find of additional benefit – these can be found in the [CILA Technical Library](#).

As a general principle it should be remembered that the onus of proof of loss rests with the insured. So, not only is it for the insured to demonstrate loss or damage has arisen from the operation of an insured event; it is also a requirement of the insured to demonstrate the extent and value of such loss. This can create difficulties where loss is due to theft as, by definition, the subject matter of that event is no longer there to see. Equally situations arise where damage is so extensive virtually all visible evidence is destroyed and it is not uncommon in such circumstances that most or all relevant documentation on site is destroyed as well – or becomes irretrievable or inaccessible. A good example of this type of situation is a major blaze in a market hall or shopping centre where many





separate, tenanted units or stalls are destroyed and the overall devastation precludes safe access to those areas most seriously affected.

Given the onus of proof rests with the insured, it would be easy to leave an insured to come up with a means of proving their loss – which many would find very difficult. In the interests of treating customers fairly, however, we have a responsibility as adjusters to provide all possible guidance and assistance to an insured in meeting their obligations. It may not be possible to ever precisely determine the extent of quantum on some losses but a point will be reached where a judgment is required, one way or another. Indeed with many total loss type scenarios involving smaller businesses, it can relatively quickly become clear a sum insured is exhausted so there becomes little point in trying to pursue an accurate assessment of the true loss. In all cases we need to maintain a balance between what is required, necessary, practical and realistic in the given circumstances.

Moving on to practical issues and potential solutions, we can look further at the position under the usual sections of a Property Policy.

Buildings

Demonstrating and proving quantum on Buildings losses should, in theory, be the most straightforward. This is probably true in terms of establishing the damage and the cost of rectifying it but that is not necessarily the loss actually suffered by the insured in question.

Where there is damage, the repairs can be quantified either by estimates or invoices. Where there is total destruction, it is nearly always the case there is still sufficient remaining to determine what was there before. Google Earth, as a last resort, will more than likely provide aerial views and street views of the building and plans are likely to exist, either with Land Registry or elsewhere. Establishing what was there and what it was constructed from should therefore be relatively simple, but that leaves the question of the actual quantum of the insured's loss.

Issues to consider are:-

- Did the insured own the building?
- What do they intend to do after the loss, in terms of repair or rebuild?
- Did they have any intentions before the loss – for example was the building for sale? It is always a good idea to check the Local Authority planning portal as well, so see if any relevant application has been made, perhaps for re-development.





- Are they tenants?
- If they are tenants, what documentation is available to determine their level of responsibility?

The answers to the above questions will have a significant bearing on the extent of the insured's loss. Reference should be made to several CILA papers in this respect – particularly:-

- *Tenants Fixtures and Fittings – Mike Weatherhead 03/06/02*
- *Reinstatement Basis of Settlement – Practical Problems in Adjusting Losses – Property SIG 01/05/14*
- *Indemnity Basis of Settlement – Practical Problems in Adjusting Losses – Property SIG 01/06/15*
- *Commercial Leases and Insurance claims – Property SIG 02/05/16*

In summary, it is necessary to firstly establish the extent of the damage to a building (which should generally be possible from site inspection, followed by a little research) but the key is in establishing what the financial loss to the insured may actually be of that damage. This may range from nothing through to the incurred costs of rebuilding, with all possibilities in between. A good knowledge of the issues covered in the above recommended papers will be invaluable in this respect.

Contents

The most frequent problems regarding proof of loss probably arise in domestic theft claims. As the items have been stolen, then clearly proving their prior existence is a problem. Equally, whilst the insured may be able to prove they had the item, what evidence is there to show it has actually been stolen, and isn't still tucked away in a bedroom drawer? The writer recalls a claim for an expensive watch, alleged stolen, where the insured had lots of proof of purchase and ownership and it was only good fortune our consultant jeweller, to whom we referred for a replacement cost, had been asked by the very same insured to sell the watch for him after the alleged theft.

In reality, much about proof of loss on domestic claims, and especially thefts, will come down to the adjuster's judgement of the honesty and integrity of the insured. Typically the following would be reasonable proof of ownership/possession:-

- Receipts
- Warranties





- Photos where item(s) can be seen
- Videos – wedding for example with jewellery shown being worn
- Bank or credit card statements
- Instruction manuals
- Original boxes or packaging

Such evidence is all very useful, but what if none of these can be produced? Indeed, too much proof can be a fraud indicator in itself, implying pre-preparation.

The reasonable approach to this is to take the time for detailed discussions of the items with the insured. Explore possible documentation and if it is not available, why? Is the reason credible? Is the insured overly vague about a description and where the item came from? Does the item fit with lifestyle and apparent means? All these things build a picture and, in reality, the secret is to gauge the honesty of the insured and look for any inconsistencies or potential fraud indicators. At the end of the day, it remains the case the onus of proof rests with the insured and the FOS has a track-record of not supporting claims where no proper proof can be produced. Nevertheless, most insurers will not thank you for upsetting and/or alienating their loyal and previously claim-free policyholder by taking a difficult approach to a claim without there being reasonable ground for suspicion.

Moving on to commercial losses, the position is a little clearer as it is far more reasonable to expect a business to have and retain records of items purchased going back a good few years – typically at least 6 years. So, for stolen items you can reasonably expect to ask for, and be provided with, the original purchase invoices. These will possibly give sufficient details on model, specification, etc., but also a point of contact for enquiries as to current replacement – in terms of cost and any improved features. Additionally, you can expect to be able to get a detailed description. Equipment in commercial risks is generally regularly in use and someone should have a detailed knowledge of it. Items in the claim should therefore be listed by the insured, original purchase documents provided (or an explanation given as to why not available) and replacement invoices or estimates included.

Where things get more difficult is in a serious fire, where much of the business's equipment is destroyed, along with the offices and records. If faced with this scenario, the first judgement to make is whether what the insured says (i.e. all records were destroyed) is in fact correct. It is surprising how often documents in, for example, a filing cabinet can survive a fire: they may get wet but they can still be readable. Careful examination of the scene is therefore the first step.





If indeed records are gone, then enquire as to any off-site records – for example what does the insured’s accountant have?

A detailed sketch done with the help of the insured is very useful. Walking around a devastated building with the insured, noting the remains in the debris and annotating a lay-out plan of what was where is a very useful exercise. Not only does it enable valuable and contemporaneous information to be recorded, but it is also a good opportunity to form an opinion of the insured’s honesty and openness. As with the domestic losses mentioned above, it remains the case that the adjuster’s judgement of the insured is a key factor in determining the extent to which the insured might be put to proof – vagueness and obstructive behaviour after a loss are always things to raise doubts.

For significant items, if the insured have lost original documents, they may well be able to obtain copies from the suppliers – or you can approach the suppliers yourself (ideally with the Insured’s prior approval).

The value of forensics should not be overlooked. No matter what the level of devastation in a fire, it is more than likely some evidence will remain in the debris of any items of significance. Careful excavation of debris where an insured says something was in position before the fire may well prove it one way or another. If there is little or no visible evidence when you visit site, this may be a route to follow. Most equipment contains metal, often a metal frame or chassis, and the odds are that will be in the debris, if it was ever there.

Finally plant and equipment registers are often available. Most sizeable companies have these, listing all items on a particular date, usually with subsequent additions and disposals. Whilst often there is a lower limit for individual items to be listed this may be quite low – say £50 – so a minor concern. Anything of significance in the claim should be on the register: if not, questions need to be asked.

Having established the existence and loss/ destruction of any items, along with repair or replacement costs, there is still a need to address how that translates into the loss to the insured. Items may be on lease – so the terms of any lease need to be considered, along with to what extent that places a financial responsibility on the insured. Reference to some of the papers mentioned above under the Buildings section is also recommended to enable a proper indemnity to be established, in the given circumstances.





Stock

It is probably fairly obvious that the best way to verify the quantum of a stock loss is to count it. This is not always as easy as it sounds, however. Thefts make it impossible to actually count what has gone and many stock losses through fire or water damage render the debris either unrecognisable or make it impossible to count individual items. Equally the sheer quantities that can be involved may make a counting exercise impractical.

Thankfully there are other options. It is a good idea, where it is possible, to use more than one method of checking stock as different approaches can be used as a cross-check or a sense-check. In many cases, the available method may not be capable of producing an entirely accurate result, so looking at things in different ways may establish a more likely level of loss than other methods might suggest.

In many cases, it is possible for the insured to produce a list of what they consider lost or damaged. If it is possible, it will usually suffice to make some spot-checks of the list, rather than having to check every item. If a sufficiently wide sample is checked and proves accurate, then it may be reasonable to assume the rest is also accurate.

If there is a list but nothing to physically check (after a theft for example) then the first enquiry is to ask the insured how they have produced the list. On smaller losses, this will usually be from memory or knowing what stock was where, and what has gone. You can check this to an extent. For example after a theft at a corner shop, all the cigarettes may have been stolen from the behind the counter display. What the insured says was there can be checked by measuring the areas in question and working out whether the number of packets of cigarettes claimed will actually fit in the spaces. Usually different sections will be labelled for different brands, so that can be checked. Discrepancies cast doubt on the accuracy of the list. Equally if garments have been stolen you can look at where they were said to be and see if there are gaps (depending on how long ago the theft occurred) or if the numbers would fit on the rails or shelves identified.

Volumetric or quantitative analysis can be used on many types of stock loss. It is inaccurate to some extent as it tends to establish the maximum loss, rather than necessarily the actual loss, but it is nevertheless a valuable cross-check. It may actually be the only way of estimating a loss in some situations – for example produce losses in farm fires. Bales of hay require a certain minimum space





so establishing the cubic capacity of the storage area in question enables an estimate to be made of the maximum quantity that could have fitted in there.

Another method is a stock reconciliation. This is effectively an accounting exercise to determine, from the company's records, what the stock was at the time of the incident. Deducting what is still there and undamaged determines the loss. There is a CILA paper on stock reconciliations within the CILA Technical Library and whilst this was published in 2000 the principles are still relevant today:-

- *An Adjusters Guide to Stock Reconciliations – JRM Ball 01/03/00.*

The paper makes reference to the method being used in non-manufacturing situations but it can readily be used for manufacturing concerns – it is just more complex in view of the need to deal with work in progress.

A point to make here is the accuracy of the stock reconciliation depends on the accuracy of the trading records and the post-loss count of remaining stock. The latter can be checked, and should be: the former may be a little more difficult. Be wary of some small traders who operate 2 sets of accounts. One for "official" purposes and one set that reflects the correct position. You need to be sure you have correct figures and also that you are not assisting an insured in tax or VAT avoidance. Taking the "official" accounts may be the correct answer.

More common these days are highly sophisticated, computerised stock control systems. These are now controlling the stock in quite small business, as well as major retailers, wholesalers and manufacturers. At the press of a button or two, a detailed stock report can be produced, identifying missing or destroyed items. These systems are excellent in terms of establishing the extent of a loss, but it would not be good practice simply to accept the result. Checks are required.

The accuracy of a stock control system can be determined by firstly understanding the details of how it works. When are purchases added? When and how are sales deducted? What happens to damaged items and how is "shrinkage" (shop-lifting; pilfering by staff; past sell-by date goods) addressed? What is the frequency of physical checks to verify the computerised record, and what is the historic accuracy of such physical checks? Having looked into the theory, you can then check the reality. Select a category or line of unaffected items, establish what quantity the systems states exists and go and physically count it. Repeat this until you are satisfied as to the degree of accuracy. Discrepancies are a concern so need explaining, or reflecting as an overall margin of error on the claim.





Where a premises is totally destroyed, there may be the option to check the system at another location. Supermarket chains use the same system across their estate, so checking at another branch will at least give some comfort the system works.

All of the above help to verify the quantities. There is then the question of attributing a value to those quantities. For purchased items, this generally involves checking purchase invoices. If they have been destroyed, current prices can be obtained from suppliers. Where large quantities are involved, again the practical method is spot-checks. This equally applies to computerised systems. You need to understand how pricing in the system is done, and check against recent invoices. Often such systems are not updated in “real-time” as it is a major task so corrections might be required for price changes, currency fluctuations, etc. Again, however, pragmatism needs to be shown as many systems use the last received invoice as their price point so there will be ups and downs, depending on the frequency of purchasing and sales of the items checked, as well as the items actually included in the loss.

For further guidance regarding the establishment of the actual value of stock for a claim, refer to the paper mentioned earlier - *Indemnity Basis of Settlement – Practical Problems in Adjusting Losses – Property SIG 01/06/15*.

One final point to consider in the context of the valuation of stock is the possible inclusion of a **Contract Price Clause**. This provides a level of additional cover in terms of the valuation of some finished stock, essentially covering it on the basis of selling price, rather than cost price. Contract Price clauses come in a variety of forms – sometimes an automatic inclusion in a policy and sometimes as a policy extension, either offered as standard or on request. In its simplest form is a wording from a Commercial Combined policy where it appears under the section detailing the basis of settlement. For Stock, an example simply states settlement will be based on:-

- a. *The replacement cost at the time of the DAMAGE as raw materials or*
- b. *Goods sold but not delivered for which the insured is responsible at contract price.*

A more comprehensive specific extension wording is as follows:-

In respect only of goods sold but not delivered for which the Insured is responsible subject to a sale contract which following DAMAGE is cancelled by reason of its conditions wholly or to the extent of the DAMAGE the liability of the insurers shall be based on the contract price.





For the purpose of this insurance the value of all the goods to which this clause could apply in the event of DAMAGE shall also be ascertained on this basis.

As can be seen, there is quite a difference between the two versions of cover but the overall principle is that where goods sold but not delivered are destroyed, payment will reflect the invoiced value, or selling price, rather than the cost price.

The simpler version clearly provides quite wide cover, in that it is only necessary to show the goods had been sold but not delivered, and remained the insured's responsibility. This should be capable of being established from a sales invoice and the insured's terms of business. It is however unlikely a supplier would not be responsible for goods sold but still in their possession, unless the items were call-off stock or the like.

The more detailed clause is actually considerably more restrictive, as it contains more hurdles to cross before the cover operates. Note also it contains a requirement to judge the stock value at risk on the same basis – something which is absent from the simpler version, albeit arguably implicit.

As always, careful consideration of the actual wording applying to cover for sold stock is required to ensure the requirements are met and can be documented. If stock is allowable on a selling price basis, then it is important to recognise any duplication with a related BI claim, and address this under the BI calculations.

As well as being required to establish the quantum of the stock loss, it is also necessary to verify the value at risk for Average purposes. All of the above tools are equally useful for this exercise and indeed potentially more accurate for VAR purposes than actually determining the extent of a loss, given there is some unavoidable inaccuracy, the effects of which diminish with bigger scale.

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