

Liability audit

Carrying out this simple audit helps you get business protection to the forefront of your client's mind.



Getting business protection on the agenda

Businesses often don't consider how they would cope financially if a key worker in their business fell ill or died unexpectedly. Over 100,000 UK businesses fail each year because the owners haven't adequately planned for the future or protected against the unexpected, and thousands more face real financial hardship*.

A liability audit gives you the ideal opportunity to take a professional, straightforward approach to getting business protection on your client's agenda. It's quick, easy and effective. By asking just a few questions, you can help your client realise the importance of having cover in place to protect their business. It will give your client the ideal starting point to help them arrive at a comprehensive business protection solution.

Who should consider the audit?

It's a worthwhile exercise for any business to carry out. Regardless of whether your client is a sole trader, partner, shareholder or director, this audit will raise the question of business protection in a positive way.

Carrying out an audit doesn't give your client all the answers straight away, but it does clearly show the need for having business protection in place.

What can the liability audit achieve?

Carrying out the audit is just the starting point. If your client takes the correct action afterwards, they can ensure that:

- any business loans are repaid
- there's enough money if a key person dies, becomes critically or even temporarily ill, or is totally and permanently disabled, to:
 - recruit a replacement person
 - cover the short-term loss of profit
 - allow the business to continue paying and employing someone who's unable to work

*MORI Succession Survey, November 2006



Helping you with the liability audit

These notes give you a few pointers and things you should think about when completing the audit form.

Names – List here the names of the people who are key to your business. This could include business owners and people who have a major influence or impact on profit, for example individuals who may have specialist skills or unique relationships with third parties. Anyone who would put the business at risk if they were to become ill unexpectedly or even die.

Liabilities to third parties – List here any loans and regularly used overdraft facilities. If you're auditing a sole trader's business you should consider any personal debts they have.

Liabilities to owners – Where the business owner is a partner, member of a limited liability partnership, shareholder or director, they may have made loans to the business which will need to be repaid to them if they die or become critically ill. This could be a credit balance on a loan account, capital or current account.

Loss of profits x term to recovery – To get the information you need for this section, you could ask:

- What is the net profit of the business?
- How much of that can be attributed to the business owners?
- How much profit can be attributed to another key person, for example a top sales person or someone with specialist skills or knowledge?
- How long would it take the business to recover on the loss of that particular key person?

One-off expenses – Even if it's only on a short-term basis, you should consider any recruitment costs to replace a key person. These may include advertising, agency fees and training costs.

Total – The need for cover will be apparent when you arrive at a total. This figure could also be indicative of sums assured.

Next steps

Carrying out the liability audit is just the starting point – the important point is that the protection need has been highlighted. The next step would be to think about what a comprehensive business protection solution would look like, the type of policy, the level and cover basis that would be appropriate. The liability audit demonstrates the need for cover and a financial adviser would be able help make sure that all aspects of the business are protected by recommending a solution to meet the needs of the individual business.

Liability audit form

This form will help you get one step closer to identifying your business protection needs and putting measures in place to plan for the future well-being of the business if the worst happens. You can use it for partnerships, limited liability partnerships, companies or sole traders to identify the need for cover.

Names				
	Amount	Amount	Amount	Amount
Liabilities to third parties	£	£	£	£
	+	+	+	+
Liabilities to owners	£	£	£	£
	+	+	+	+
Loss of profit x term to recovery	£	£	£	£
	+	+	+	+
One-off expenses	£	£	£	£
= Total	£	£	£	£

Case study

This case study takes you through an example of the process of carrying out an audit.

Company details

Company name – Johnstone and Pearson Ltd

Last year's net profit – £1.25 million

Directors – Bill Johnstone and Harry Pearson

Salesman – John Crosbie

Overview of responsibilities – Both Bill and Harry are equally key. Bill is the brains behind the business and Harry is responsible for sales. Harry recruited John Crosbie 18 months ago and appointed him as senior salesman. The recruitment process took 12 months. When John joined he brought with him a valuable list of contacts, which has allowed him to make a substantial contribution to overall profit.

What are the liabilities to third parties?

- Business bank loan A: £250,000
- Business bank loan B: £150,000
- Overdraft facility: £100,000 – always fully used

What are the liabilities to owners?

Both have outstanding directors' credit loan accounts:

- Bill: £120,000
- Harry: £100,000

Loss of profit cover

- What is the net profit of the business?
£1.25 million.
- How much of that can be attributed to the business owners?
Bill & Harry estimate £240,000 each.
- How much profit can be attributed to another key person, for example a top sales person or someone with specialist skills or knowledge?
John Crosbie, senior salesman, contributes £120,000.
- How long would it take the business to recover on the loss of these key people?
They estimate if Bill or Harry were to fall ill or die unexpectedly it would take 18 months for the business to fully recover and 12 months if anything should happen to John.

What other expenses are there?

Recruitment costs for each director of £50,000 and £25,000 for John.

Johnstone and Pearson Ltd's liability audit form

Names	Bill Johnstone	Harry Pearson	John Crosbie	
	Amount	Amount	Amount	Amount
Liabilities to third parties	£ 250,000	£ 250,000	£ 0.00	£ - - - -
	+	+	+	+
Liabilities to owners	£ 120,000	£ 100,000	£ 0.00	£ - - - -
	+	+	+	+
Loss of profit x term to recovery	£ 360,000*	£ 360,000*	£ 120,000	£ - - - -
	+	+	+	+
One-off expenses	£ 50,000	£ 50,000	£ 25,000	£ - - - -
= Total	£ 780,000	£ 760,000	£ 145,000	£ - - - -

*Loss of profit calculated as £240,000 contribution for the year X 1.5 as estimated it would take the business 18 months to fully recover. They would also need to ensure John's contribution to their profit was covered if he became ill or died suddenly.

Summary

At this stage, the audit on Johnstone and Pearson Ltd has simply highlighted that there's a need for business protection – particularly to cover Bill and Harry's business loans and overdrafts. These third party liabilities may be split equally between them but consideration should be given as to whether the bank's lending is on a joint and several liability basis where the requirement is that the loan be fully repaid on the death or illness of either of them. They would also need to

ensure John's contribution to the business was covered if he became ill or died suddenly.

More thought would need to be given to the type of policy that would best meet their needs and how long they would need cover for, but the important thing is that business protection is now on their agenda and they can put business continuity plans in place to protect them against the unexpected.

Our protection solution

Third party, fire and theft or fully comprehensive cover?

Many loan and key person policies are written for life cover only but, while this is vital cover, does it meet the clients' needs fully?

A fully comprehensive cover solution to consider for Bill, Harry and John should include life cover, critical illness cover, total and permanent disability cover and key person income protection. Any existing cover should be taken into account and assessed as to its suitability.

In respect of the loan cover, is there a requirement from the bank that Bill and Harry are joint and severally liable? This will affect how the policies are written. The loan policies should cover the amount and duration of the loan. The term for the loss of profits cover will depend on individual circumstances, but a five-year term is typical.

You can find out more about AEGON Scottish Equitable's Business Protection proposition by visiting our online toolkit at:

www.businessprotection.aegonse.co.uk

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