

FORENSIC ACCOUNTING CASE STUDY

Forensic Evaluation of Lost Profits Damages Saved
New Jersey State Housing Agency \$6.5 Million in
Damage Dispute Damages with Contractor



DiGabriele, McNulty, Campanella & Co., LLC was retained by a New Jersey State housing agency to review financial claims brought against it by a housing contractor. The lawsuit alleged the agency's decision to prematurely terminate a contract for the development of a 75-unit housing project resulted in a loss to the contracting company of approximately \$7.5 million. An attorney representative for the agency engaged DMC, under the leadership of Dr. James DiGabriele, to utilize its decades of forensic accounting expertise to examine the methodology by which the contractor had made its financial calculations and, if necessary, dispute the overall amount in alleged damages.

The Approach

The first step included distinguishing between the contractor's calculations in five separate areas: lost profits, project damage for completed work, cost of redesign damages and financing, delay costs and interest. By breaking out the alleged damages, DMC could pinpoint specific areas of miscalculation and assumptions, and challenge areas where the firm believed the contractor had overstated its right to compensation.

The Findings

One of the most significant findings was that the amount of lost profit claimed by the plaintiff significantly exceeded the profits it stood to gain from the completed housing project.

DiGabriele also expressed doubt about the process by which the plaintiff reviewed similar contracts to determine what amount of negotiated direct costs it could claim from the terminated contract. He believed the plaintiff's review did not rely on sufficient data and, did not provide a sound basis for the costs it sought to recover.

The plaintiff's allegations of lost profits were based on the price for the entire contract, which was an incorrect calculation as the project was cancelled before its completion. The investigation found no reasonable financial basis for some general conditions and overhead costs alleged by the plaintiff.



The contractor also claimed \$1.1 million in damages incurred from architect and engineering service fees, insurance, mobilization, project site costs, equipment rentals and related costs for work that had already been completed. DiGabriele conducted a rigorous and detailed analysis of the plaintiff's schedule of damages and identified several costs that were actually associated with a separate housing contract. Other costs could not be verified due to a failure to receive invoices and checks from the plaintiff for verification purposes.



The Firm challenged the plaintiff's attempts to recover salary costs it claimed were associated with the contract due to vague employee timekeeping records. Other costs the contractor sought to recover had already been claimed in other areas of the plaintiff's schedule, resulting in the problem of "double dipping".

From two areas where the contractor sought additional financial compensation—charges it claimed to have accrued from project delays and \$2 million in interest charges—DiGabriele counterclaimed that such damages could not be claimed as a result of the terminated contract. The

charge amounts, the firm challenged, were also unreasonable and significantly less than those claimed by the plaintiff.

Conclusion

In summary, the forensic accountants pointed to a lack of factual and analytical basis for the plaintiff's alleged costs, identified calculation errors and unsupported assumptions rather than actual expenses, and highlighted an inconsistency with existing financial records, as well as calculations made on the basis of a completed contract rather than one that had been terminated early.

These issues, DiGabriele's team concluded, undermined the overall reliability of the costs the contractor sought to recover, resulting in a "substantial overstatement of the alleged damages due to the plaintiff."

The court agreed, saving the agency approximately \$6.5 million as a result of the team's work.

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