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SANDERFORD & ASSOCIATES, P.A.
Certified Public Accountants

Newsletter

INTRODUCTION

From the Staff of Sanderford & Associates

We hope your holidays were all that you wished for and we look forward to a great new year. We would like to thank those of you who have responded to our first newsletter. We will try to incorporate your suggestions into future articles.

This issue's technical topic continues with the business interruption explanation, Cost of Sales & Gross Profit.

Please continue to let us know what you think of our newsletter and include your e-mail address for future mailings.

Thank you for your support.

OUR FIRM

Sanderford & Associates, P.A. was founded September 1996. Our accounting staff has over fifty years of combined forensic accounting experience. Our accounting staff is dedicated to thorough and accurate claim evaluations in a timely manner. We are committed to providing forensic accounting services to the insurance community. We limit our forensic accounting practice to insurance companies and insurance defense law firms. All assignments are handled with integrity and professionalism to meet our clients' needs.

For more information on our firm please visit our web site at www.sanderfordcpa.com

BUSINESS INTERRUPTION / LOSS OF INCOME

We will present an explanation of the Business Interruption Calculation in six articles:

1. SALES PROJECTION
2. COST OF SALES & GROSS PROFIT
3. OPERATING EXPENSES & NET INCOME (LOSS)
4. CONTINUING & NON-CONTINUING EXPENSES
5. LOSS OF INCOME CALCULATIONS
6. EXTRA EXPENSES
7. CO-INSURANCE FACTORS

In Volume 1, Issue 1, we discussed the general methodology of projecting sales for the loss of income calculation. This article continues the explanation of the business interruption calculation and discusses the cost of sales and gross profit.

The second step is to project the cost of sales and gross profit associated with the projected lost sales.

Cost of Sales & Gross Profit.

The **Cost of Sales** includes the beginning inventory, the ending inventory, total cost of the product purchased for resale / wholesale or the total cost of the product manufactured during the reporting period. These costs include, direct costs of the product, direct labor and overhead expenses. Overhead expenses may include, but are not limited to indirect costs such as labor, utilities, depreciation of building and equipment, insurance, rental expenses and miscellaneous supplies.

The cost of sales is calculated by adding purchases or the cost of the manufactured product to the beginning inventory and subtracting the

Cost of Sales & Gross Profit

ending inventory. The change in accounts payable should also be considered in the cost of sales calculation. The ending inventory should be based on a physical inventory.

Gross profit equals sales minus the cost of sales. The gross profit percentage usually remains consistent from year to year, but could increase or decrease, as discussed below.

The actual components of the cost of sales are determined by the company's size and type of business. If the company is a manufacturing operation, it could have some or all of the cost of sales components. If the company is a retailer or distributor of products and merchandise, the cost of sales may only include the cost of the merchandise sold.

The cost of sales generally increases or decreases in proportion to the amount of sales. Therefore, one should analyze the company's historic cost of sales percentages (cost of sales divided by sales). The percentages could be calculated for each cost of sales item or in total depending on the actual components. The percentages are then multiplied by the projected lost sales to arrive at the cost of sales associated with the projected lost sales.

Once the insured's cost of sales associated with the projected lost sales is calculated, you subtract the result from the projected lost sales to arrive at the gross profit associated with the projected lost sales. One method of calculating the projected cost of sales and projected gross profit is to add the cost of sales associated with the lost projected sales and lost projected gross profit to the actual cost of sales and actual gross profit.

The cost of sales and gross profit percentages may be compared to the industry standards to determine if they are consistent with the industry. If not, one should inquire as to why there is a difference and what effect the difference may have on the loss of income calculation.

Other Factors—Cost of Sales & Gross Profit

There are other more complex issues that could affect the cost of sales and gross profit. For example, the insured could have made one or more of the following changes to the its business operations:

- The insured installed new equipment that increases productivity.
- The insured purchased a vendor company that supplies materials to the company
- The insured added a new product line or service, that affects the gross profit.
- Some of the components of the cost of sales could be fixed and do not necessarily increase or decrease with sales.
- The insured's supplier may have raised prices and the insured can not raise his sales price because of the competition.
- The insured raised its sales price and its costs remained the same.

Any of the above changes could increase or decrease the insured's cost of sales and gross profit accordingly. These issues if present should be reviewed and analyzed to determine how the changes affect the loss of income calculation.

In summary, there are several factors that could affect the projection of cost of sales and gross profit. Therefore, it is important to investigate and identify these areas.

Other Factors—Cost of Sales & Gross Profit

The above information is not intended to be all-inclusive. Furthermore, the above information is presented as a learning tool and is general in nature. The insured's policy of insurance and all related coverage's should be considered when measuring loss of income.

Tax Tips

Now is the time to review and organize your tax records. This could save you time and money.

The following is a list of items that may help you with your year-end tax planning.

1. Be sure that your business travel and entertainment expenses are properly supported with receipts and or a log / diary.

Tax Tips—continued

2. Organize your itemized deductions and determine that all items have adequate support.

   Medical & Dental Expenses

   Taxes Paid

   Gifts to Charity

   Casualty and Theft Losses

   Job & Miscellaneous Deductions

The tax tips provided in this newsletter are for informational purposes only. You should contact your personal tax professional to determine the appropriate tax advice for your situation.

SEMINARS

Ron Sanderford participated as a panel member at the annual Florida Advisory Committee on Arson Prevention on the types of records available in an Arson for Profit case.

Ron Sanderford will be presenting Loss of Income / Business Interruption and Extra Expense issues at the Windstorm Insurance Conference February 6, 2004, in New Orleans, Louisiana.

OUR SERVICES

Business Interruption
- Net Income (Loss) & Continuing Expenses
- Gross Earnings Calculations
- Loss of Rental Income
- Loss of Individual Earnings
- Extra Expenses

Property Damage
- Business Personal Property
- Building Loss
- Values at Risk / Coinsurance Analysis

Inventory / Stock Loss
- In Sight / Out of Sight
- Obsolescence

Employee Dishonesty
- Fidelity Bond Loss

Fraud / Arson Loss
- Financial Motive
- Arson for Profit
- Concealment Analysis
- Analysis of Financial Condition

Third Party Liability
- Personal Injury
- Loss of Income
- Wrongful Death

Environmental Claims
- Damage Measurement

Worker's Compensation
- Income Verification

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