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SANDERFORD & ASSOCIATES, P.A.

Certified Public Accountants

Newsletter

INTRODUCTION

This issue's technical topic begins a two part discussion on inventory. This newsletter will discuss calculating Out of Sight Inventory Losses and the following newsletter will focus on Automatic Seasonal Increases. Our past newsletters on Loss of Income can be downloaded from our website at **www.sanderfordcpa.com**

Thank you for your continued support.

OUR FIRM

Sanderford & Associates, P.A. has over 24 years of experience providing forensic accounting services to the insurance industry. We have assisted our clients with the verification of insurance claims, alternative measurement calculations, consulting and litigation matters throughout the Southeast. For more information on our firm please visit our website at **www.sanderfordcpa.com**

INVENTORY / LOSS OF INVENTORY CALCULATION

Documents to Request

1. **A copy of the last physical count of the inventory prior to the date of loss.**
2. **All purchase invoices from the time of the last physical inventory count to the date of loss.**
3. **Sales Information (receipts, invoices, daily sales, etc) from the date of the last physical inventory count to the date of loss.**
4. **A post loss inventory count of the remaining inventory.**
5. **Salvage received, if any, from the inventory.**

This article begins our two part series on Inventory. This issue will discuss the calculation of out of sight inventory.

What is out of sight inventory?

Out of sight inventory is inventory that is not able to be seen whether it is from the destruction due to the loss, someone disposing of the inventory prior to your inspection, stolen inventory or it was never present before the loss.

What are the different types of Inventory Systems?

Perpetual— This type of inventory system record updates of the inventory as items are purchased and sold. A "perfect" system would add purchases immediately upon receipt and delete items immediately upon a sale. Unfortunately, there is no perfect system and there are adjustments that are needed to account for the difference between the physical count and the system's records. These differences can result from human input error, failure to enter purchases, delete sales, shoplifting, breakage, spoilage or theft .

Periodic—This type of inventory system is characterized by updates to the inventory only at select times such as monthly or quarterly. This system can suffer from the same problems as the perpetual inventory system described above.

No System—This is usually seen with the small businesses which does not use a electronic means of tracking inventory and does not take a physical inventory count but perhaps once a year if at all. Usually the only documentation of their inventory is from the Federal Income Tax Return which is sometimes estimated. The inventory balances on the Federal Income Tax Returns can be inaccurate and sometimes understated. Understating the beginning inventory means an understated calculated inventory loss. →

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INVENTORY / LOSS OF INVENTORY CALCULATION

The Steps In Determining Out of Sight Inventory Loss

Begin with the last physical count of inventory prior to the loss or the inventory from the Federal Income Tax Return. Add all the purchases from the date of the last inventory count to the date of loss. This amount is the Total Goods Available for Sale. Subtract the cost of goods sold. If sales are at retail, the cost of goods sold percentage can be utilized to calculate the cost of goods sold. Next subtract the post loss physical inventory count. This results in the loss of inventory. Finally, subtract salvage value of the inventory received by the insured (if any).

Other Considerations

Price Testing Inventory—If the post loss inventory is listed at retail then price testing of the inventory can utilized to reduce the inventory to cost. A sample of the inventory is selected and the items are matched to existing invoices. The total of the sample at cost is divided by the sample at retail to obtain the retail to cost percentage. This percentage can be applied to the post loss count at retail to provide an inventory at cost. This procedure can also be applied to Inventory Losses that are not out of sight.

Obsolete Inventory—When reviewing the purchases and inventory counts, obsolete inventory must be considered. Obsolete inventory is inventory that cannot be sold or utilized in other marketable products due to it being outdated or spoiled. Many companies carry obsolete inventory on the books because writing it off causes a decrease in overall earnings. If obsolete inventory is discovered then the obsolete goods should be subtracted from the inventory loss as they have little to no value.

SUMMARY

Inventory Loss calculations can involve many variables and are dependant on the records maintained by the insured. Prompt post loss inventory counts are essential in determining an accurate inventory loss. 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.

OUR SERVICES

Business Income Loss

- Net Income or (Loss) & Continuing Expenses
- Gross Earnings less Noncontinuing Expenses
- Loss of Rental Income
- Extra Expenses
- Coinsurance Analysis

Property Damage

- Business Personal Property
- Coinsurance Analysis

Inventory / Stock Loss

- Out of Sight Inventory Measurements
- Price Testing Verification & Obsolescence Analysis
- Physical Inventory Counts
- Automatic Seasonal Increase Analysis

Employee Dishonesty

Computer Data Recovery

Litigation Expert Services & Consulting

Third Party Liability

- Personal Injury
- Wrongful Death
- Loss of Income / Earnings Verification

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- Measurement & Verification

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- Financial Conditional Analysis (Motive)
- Concealment Analysis

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