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SANDERFORD & ASSOCIATES, P.A.

Certified Public Accountants

Newsletter

INTRODUCTION

This issue's technical topic concludes our two part discussion on inventory. This newsletter will discuss Automatic Seasonal Increases. **Our past newsletters on Inventory / Loss of Inventory Calculation and Loss of Income (Business Interruption) 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 loss measurement calculations, consulting and litigation matters throughout the Southeast. For more information on our firm please visit our website at **www.sanderfordcpa.com**

AUTOMATIC SEASONAL INCREASE ANALYSIS

Documents to Request

1. **Federal Income Tax Returns for the prior 2 years including a copy of the Asset Listing (Form 4562) or a listing of assets with description, basis and the date each asset was placed into service.**
2. **A copy of the General Ledger for the 12 months preceding the date of loss, monthly purchases summaries or copies of purchase invoices for the 12 months preceding the date of loss.**
3. **Sales Information (sales & use tax returns, monthly sales summaries, receipts, invoices, daily sales, etc) for the 12 months preceding the date of loss.**

What is Automatic Seasonal Increase?

Automatic Seasonal Increase addresses the fluctuating values of business personal property and provides for seasonal variations in inventory by providing a percentage increase (usually 25%) to the Business Personal Property limits. This increase applies if the Business Personal Property limits of insurance are at least 100% of the average monthly values during the lesser of the 12 months immediately preceding the date of loss or the time period the insured has been in business prior to the date of loss. In other words, the average Business Personal Property values at risk for the 12 months immediately preceding the date of loss or the time period the insured has been in business must be less than the policy limits in order for the insured to qualify for the Automatic Seasonal Increase.

How are the Average Monthly Values Calculated?

Physical Assets other than Inventory — Determine the useful life assigned to the asset and multiply the number of years in the asset's useful life by 12 months to arrive at the useful life of the asset in months. Beginning with the date that the asset was placed into service, divide the beginning asset balance by the number of months in the assets useful life. This results in the straight line depreciation amount for the respective month assuming that there is no salvage value associated with the asset at the end of its useful life. Subtract the monthly depreciation amount from the asset balance to calculate the depreciated value each month. Multiply the depreciated value by the monthly change in the Consumer Price Index Percentage (http://www.bls.gov/cpi) to arrive at the current depreciated asset balance. Adding the monthly change from the Consumer Price Index to the depreciated value results in the calculated actual cash value. This amount becomes the beginning asset balance for the next month. This calculation

AUTOMATIC SEASONAL INCREASE ANALYSIS

is repeated monthly based on the number of remaining months in the assets useful life and the change in asset balance. Continue with this calculation each month through the month preceding the date of loss.

Inventory — If the insured utilizes a perpetual inventory system, obtain the ending inventory for each of the 12 months preceding the date of loss.

If the insured does not maintain a perpetual inventory system, the inventory will need to be calculated based upon the records available. If the inventory available for sale as of the date of loss has been determined then the inventory calculation can be worked in reverse for the 12 months preceding the date of loss. Begin with the inventory available at the date of loss and subtract the purchases during the month of the loss but prior to the date of loss. Adding the cost of goods sold from the beginning of the loss month through the date of loss results in the beginning inventory. This beginning inventory then becomes the ending inventory for the month before the date of loss. Repeat these steps for the 12 months preceding the date of loss or until the date that the insured began operations, which ever is less.

If the available inventory on the date of loss has not been determined, then the inventory calculation begins with the ending inventory from a physical inventory or you can utilize the ending inventory listed on the Federal Income Tax Return. The beginning inventory needs to be at least 12 months prior to the date of loss or the date the insured began operations, whichever is less. The inventory is calculated by adding the purchases for the month to the beginning inventory resulting in the goods available for sale. Subtracting the cost of goods sold for the month results in the ending inventory. Repeat this calculation for each month through the month preceding the date of loss.

Average Monthly Values — For each of the 12 months preceding the date of loss, add the monthly ending inventory amount to the actual cash value of the assets for the corresponding month. Add the 12 monthly amounts and calculate the average monthly value of the assets. Compare the calculated average amount to the Business Personal Property policy limits. If the calculated average value is equal to or less than the policy limits, then the insured qualifies for the automatic seasonal increase and the increased coverage would apply.

SUMMARY

Inventory calculations can involve many variables and are dependant on the records maintained by the insured. 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.