



Newsletter

INTRODUCTION

This issue's technical topic continues with the business interruption explanation, Coinsurance Factors. Our past newsletters can be downloaded from our website at www.sanderfordcpa.com

Please send us your e-mail address so that we can provide you a copy of our newsletter in a more efficient manner.

OUR FIRM

Sanderford & Associates, P.A. is celebrating its tenth year of 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

BUSINESS INTERRUPTION / COINSURANCE FACTORS

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

1. SALES PROJECTION
2. COST OF SALES & GROSS PROFIT
3. OPERATING EXPENSES & NET INCOME (LOSS)
4. CONTINUING & NONCONTINUING EXPENSES
5. LOSS OF INCOME CALCULATION
6. EXTRA EXPENSE
7. **COINSURANCE FACTORS**

This article continues the business interruption explanation and discusses Coinsurance.

What is coinsurance?

Coinsurance is a provision in many insurance policies which requires the insured to carry a limit of insurance equal to a certain percentage of the total value of the insured property. If the insured fails to meet the coinsurance requirements, the insurance company requires the insured to participate in a prorated share of the loss. Coinsurance encourages the insured not to purchase an undervalued policy in an attempt to pay lower premiums without risking reduced loss payments.

How is coinsurance calculated?

For Business Interruption Insurance, we must first establish the appropriate net income (loss) and operating expense. To determine net income (loss) and operating expenses we use, "The net income and operating expenses for the 12 months following the policy inception, or last previous anniversary date." Under some policies there are certain operating expenses which are excluded such as prepaid outgoing freight, returns and allowances, discounts, bad debts, collection expenses and cost of merchandise sold. If a policy has a March 1 anniversary date and a date of loss of December 1, we would use the actual net income (loss) and operating expenses from March 1 through November 30 and project the net income (loss) and operating expenses for December 1 through February 28. For this reason, it is important for the insured to revisit their policy annually and revise the limits as necessary. For coinsurance purposes, the values at risk are calculated by →



Business Interruption / Coinsurance Factors

Coinsurance Continued

multiplying the coinsurance percentage by the sum of the net income (loss) and operating expenses during the above referenced 12 month period.

Assume that a policy contains an 80% coinsurance percentage and the insured's combined net income and operating expenses total \$100,000.00. The values at risk totals \$80,000.00. Under this scenario the insured's policy must have a loss of income limit of at least \$80,000.00 to collect 100% of their loss.

For this example, assume the insured's loss of income policy limit is \$60,000.00. To calculate the collectable percentage, we divide the policy limit, \$60,000.00 by the values at risk, \$80,000.00. The collectable percentage equals 75%. Therefore, the insured will collect 75% of the actual loss of income sustained.

To determine the insured's collectable loss of income, we multiply the actual loss of income by the collectable percentage. We will assume that the

insured's actual loss of income totals \$20,000.00. Therefore, the insured's collectable loss of income is calculated by multiplying the collectable percentage, 75%, by the actual loss of income, \$20,000.00. Under these circumstances, the insured will be entitled to collect \$15,000.00. The insured's prorated share as a result of the coinsurance clause totals \$5,000.00.

SUMMARY

Coinsurance is an attempt to influence the insured to purchase a policy with reasonable coverage limits or risk reduced payments for under reporting the values at risk.

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 prior newsletters can be downloaded from our website at www.sanderfordcpa.com.

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

Environmental Claims

- Measurement & Verification

Arson & Fraud

- Financial Conditional Analysis (Motive)
- Concealment Analysis

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