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SANDERFORD & ASSOCIATES, P.A.

Certified Public Accountants

Newsletter

INTRODUCTION

With the down turn in the economy we have been seeing more inventory theft and fire losses. This issue's topic is an overview inventory losses based on damaged on site inventory and missing out of sight inventory. **Our past newsletters include the steps and procedures necessary to calculate an inventory loss and can be downloaded from our website at www.sanderfordcpa.com**

OUR FIRM

Sanderford & Associates, P.A. has been doing business in the Tampa Bay area since 1996. Our practice is limited to providing forensic accounting services for the insurance industry including but not limited to the verification of insurance claims, alternative loss measurement calculations and expert testimony. Additional information is available at **www.sanderfordcpa.com**

Damaged on Site Inventory

Inventory quantities that have been damaged and are available to be inspected can be verified with a physical inventory count. From an accounting and auditing point of view a independent third party accountant, independent adjuster, or salver, should be utilized to count the physical inventory for verification. However, due to economic concerns small post loss inventories are usually taken by a representative of the insured. If the insured or its representative takes the physical inventory then the physical inventory should be test counted by a independent third party for accuracy. Once the quantities have been determined the next step is to verify the cost. Verifying the unit cost of the inventory items consist of determining the amount that the insured paid for the item from the insured's purchase invoices. The cost of the item should include freight costs, discounts, sales tax, etc. Once the unit costs, including freight, discounts and sales tax, have been determined then the unit costs are multiplied time the quantities. The results of this calculation is the value of the damage inventory.

Missing Out of Sight Inventory

The missing out of sight inventory can involve two types of calculations depending on the type of inventory system maintained by the insured. The first calculation can be utilized if the insured maintains a perpetual (book) inventory system. One needs to test the perpetual (book) inventory system or utilize analytical procedures to determine the accuracy of the perpetual (book) inventory system. If a perpetual (book) inventory system is maintained by the insured then a physical inventory of the remaining items can be compared to the perpetual (book) inventory to determine the missing items. The post loss physical inventory should be taken by an independent third party or if taken by the insured then it should be test counted by a independent third party. Once the missing quantities have been determined then the inventory can be extended at cost based on the insured's actual purchase invoices. The inventory costs should include freight costs, discounts, sales tax, etc. →

The second type inventory loss calculation, for missing out of sight inventory, is utilized when the insured does not maintain a perpetual (book) inventory. This calculation begins with a beginning physical inventory count prior to the date of loss. Some businesses only take one physical inventory per year usually at year end for tax purposes. The insured's Federal Income Tax Return should reflect a ending inventory which can be utilized at the beginning inventory for the inventory calculation. Once the beginning inventory has been determined then one has to add merchandise purchases from the date of the beginning physical inventory through the date of the post loss physical inventory. The merchandise purchases can be obtained from the actual purchases invoices, general ledger, or from the Statements of Income (Profit or Loss Statements) depending on how they account for the merchandise purchases. The inventory that has been sold has to be subtracted from the combined beginning inventory and merchandise purchases to arrive a the ending (book) inventory as of the date of the post loss physical inventory. Sales from the date of the beginning inventory through the date of the post loss physical inventory need to be considered. Once the sales have been identified then they need to be converted to costs. The insured's Federal Income Tax Return will reflect the cost of sales The cost of sales is calculated as a percentage of gross sales by dividing the cost of sales by gross sales. Keep in mind that the cost of sales may include labor which will need to be taken out of the cost of sales percentage calculation. After calculating the cost of sales percentage multiply the cost of sales percentage times the gross sales. This calculation results in the merchandise sold at cost. Subtract the cost of sales from the combined beginning inventory and merchandise purchases. This calculation will give you the inventory on hand as of the date of the post loss physical inventory. Once you have calculated the book inventory you will need to compare it to the remaining inventory items, if any. The post loss physical inventory should be taken as soon as possible after the date of loss. The post lost physical inventory should be counted by a independent third party or if taken by the insured test counted by a independent third party. Once the post loss physical inventory has been extended at cost then you compare the calculated (book) inventory to the post loss physical inventory to arrive a the lost (missing) inventory.

SUMMARY

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 Verification
- 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

Litigation Consulting

Expert Testimony

Third Party Liability

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

Environmental Claims

- Measurement & Verification

Arson & Fraud

- Financial Conditional Analysis (Motive)
- Concealment Analysis