

Welcome!



You have successfully logged in for:
Solving the Mystery of the Business Income
Worksheet
Web Seminar

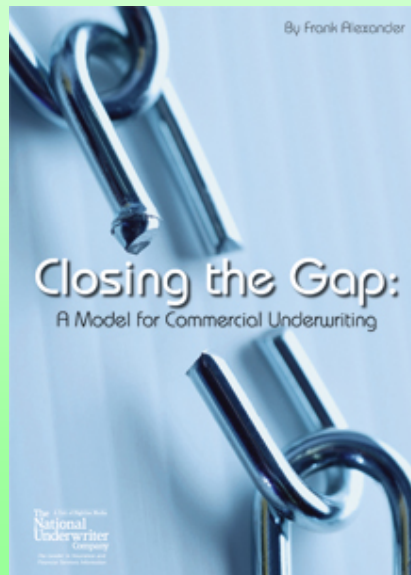
The seminar will begin promptly at 2:00 eastern standard time.



Our special presenter today: Frank S. D. Alexander

**Commercial Lines Training Consultant
and Motivational Speaker**

**Author of:
Closing the Gap: A Model for Commercial
Underwriting**



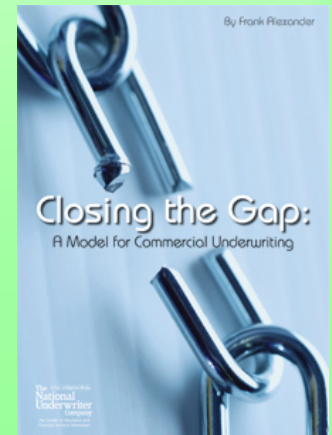
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Business Income Worksheet

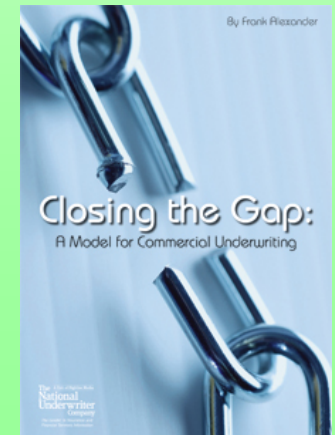
Its importance in establishing:

- Insurable Values
- Coinsurance Requirements



Objective

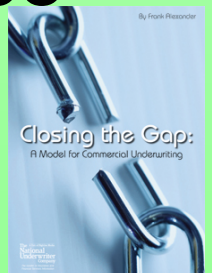
- Learn how to complete the Business Income Worksheet using financial data in order to establish insurable Business Income values



AGENDA

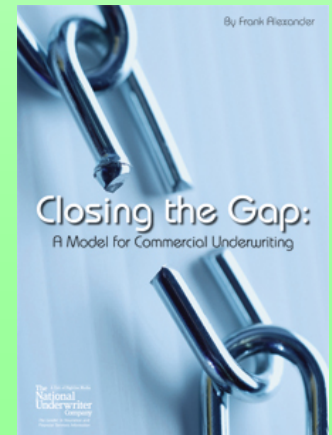


1. Introduction
2. Beyond the Numbers
3. The purpose of Business Income coverage
4. Coverage and Payment under Business Income
5. Challenges in establishing limits
6. Three ways to minimize underinsurance



AGENDA Cont'd

7. Coinsurance Requirement
8. Some Worksheet Definitions
9. Worksheet Walkthrough
10. Financial Statements for ABC
Manufacturing & ABC Mercantile
11. Translating financial data into worksheet
information
12. Review
13. Q & A

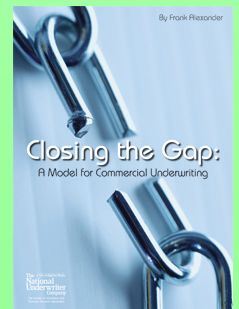


Introduction

Three Standard Forms:

1. Business Income (and Extra Expense)
2. Business Income (without Extra Expense)
3. Extra Expense

***Our focus Today will be: Business
Income (without Extra Expense)**

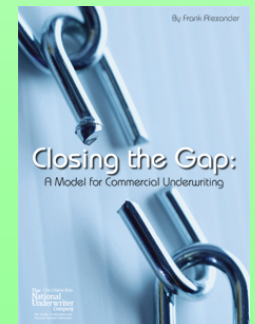




Beyond the Numbers

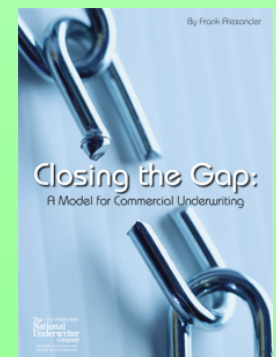


The Importance of Understanding
the Customer's Business &
Industry



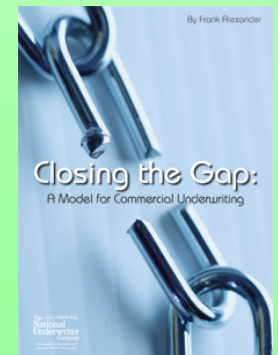
Understanding the Customer's Business & Industry

- Impact of Political, Economic and other factors
- The impact of competition or lack of competition
- Industry business cycles
- Their importance in projecting future sales



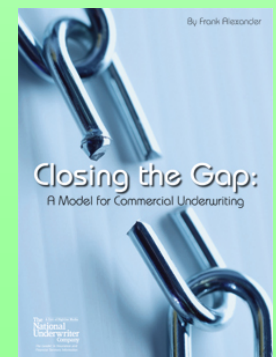
The Purpose of Business Income Coverage

Why the Need?



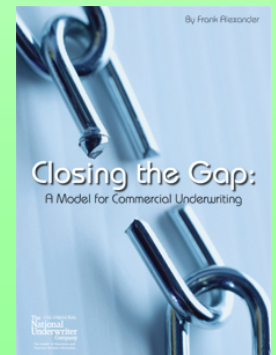
Purpose of Business Income

- To provide the owners of a business with the earnings that the business would normally provide, except for a loss
- Contributes to normal profit and ongoing insured expenses, proportionate to the sales lost
- Reimburses expenses to reduce loss



Business Income Without Extra Expense

Coverage Summary



Coverage Summary



A. Coverage

1. Business Income

Business Income means the:

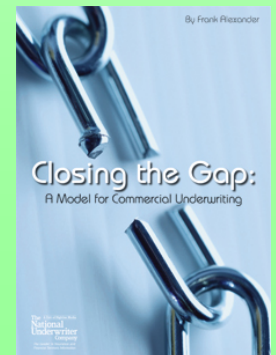
- a. Net Income [Net Profit or Loss before income taxes] that would have been earned or incurred; and
- b. Continuing normal operating expenses incurred, including payroll.

For manufacturing risks, Net Income includes the net Sales Value of production



Coverage Options

- a. Business Income including “Rental Value”
- b. Business Income other than “Rental Value”
- c. “Rental Value”

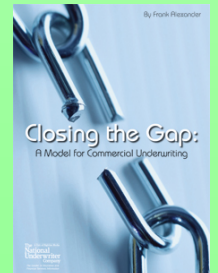


Payment Under Business Income



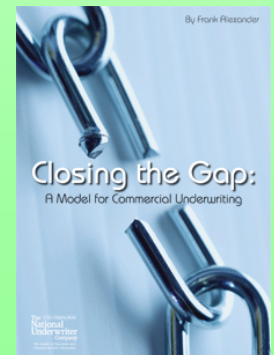
We will pay for the actual loss of Business Income you sustain due to the necessary “suspension” of your “operations” during the “period of restoration”.

The “suspension” must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income limit of insurance is shown in the Declarations.



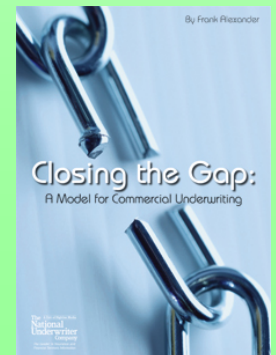
Challenges in Establishing Limits

What the Insured Faces



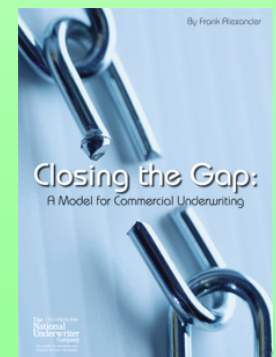
Challenges for the Insured

1. Using Financial Results from a previous year
 2. To establish limits in the current year
 3. Where losses could occur the following year
- *In establishing insurable values, think two years ahead



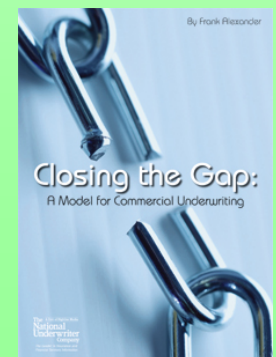
Three Ways to Minimize Underinsurance

- The Premium Adjustment Endorsement Form
- The Business Income Worksheet
 - Agreed Value Coverage



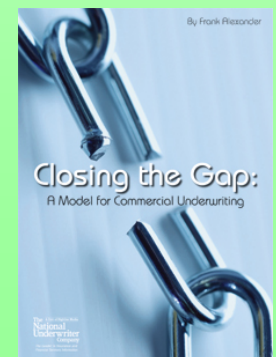
The Premium Adjustment Endorsement Form

- Converts the Business Income into a type of reporting form
- Allows the insured to carry higher limits than anticipated net income and expenses
- Insured receives return premium on any limits not used at end of year



The Business Income Worksheet

- Brings some precision in establishing limits
- Uses information from financial statements using “generally accepted accounting principles” [GAAP]



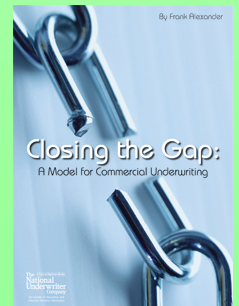
Agreed Value Coverage Option



- Replaces the coinsurance clause with a value agreed upon by insured and insurer

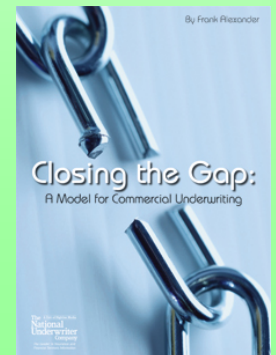
Note: When agreed value coverage option is chosen, the business income worksheet becomes a part of the policy

***Deliberate understatement of values could be viewed as material misrepresentation and void the entire policy**



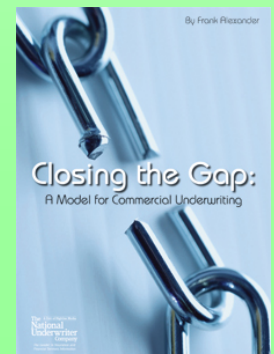
Coinsurance Requirements

Business income



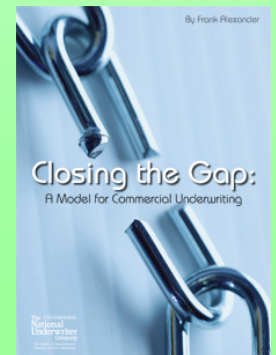
Coinsurance Requirements

- This clause requires that an amount of insurance be maintained equal to or greater than a specified percentage of the net income and operating expenses, including payroll, for the year after date of loss
- Failure to do so results in proportionate loss recovery from insurers



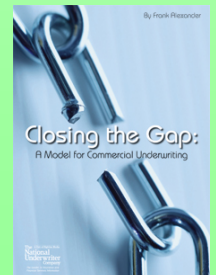
Calculating Coinsurance

Determining the right Percentage



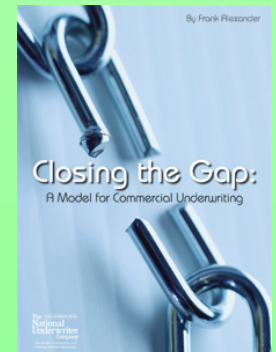
Calculating Coinsurance

1. Determine estimated Business Income exposure for 12 months, and additional expenses [Line 'J.1' or 'L' on worksheet]
2. Evaluate your period of restoration, e.g. 6 months = .5, 9 months = .75, 12 months = 1.0, etc.
3. Multiply line J.1 or L, by restoration factor = the minimum amount of Business Income Insurance
4. Divide the result in 3 above by line J.1 or L = Minimum Coinsurance percentage



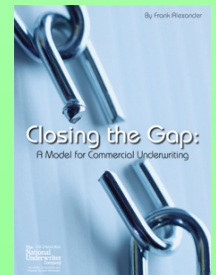
Example: Calculating Coinsurance

1. Estimated Business Income exposure for 12 months, and additional expenses [Line 'J.1' or 'L' on worksheet] = \$1,896,500
2. Period of restoration, e.g. 6 months = .5.
3. Multiply line J.1 or L, by restoration factor =
 $\$1,896,500 \times .5 = \$948,250$ = the minimum amount of Business Income Insurance
4. Divide the result in 3 above by line J.1 or L:
 $\$948,250 / \$1,896,500 = 50\%$ = Minimum Coinsurance percentage



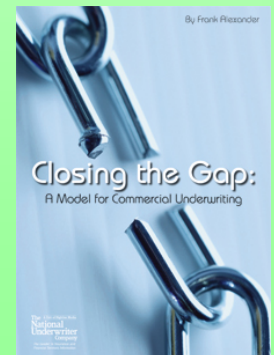
Other Considerations in Calculating Coinsurance

1. Consider specialized or custom-made equipment
2. Consider time of year- assume loss will occur at busiest time of year
3. Consider past business growth and any new factors
4. Assume the worst possible loss scenario



Some Worksheet Definitions

Their Meaning and Importance in
Establishing Insurable Values

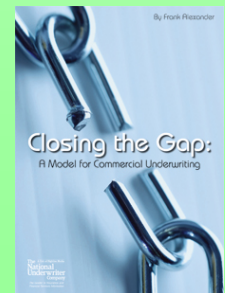


Accrual Basis



- Income and expenses must be shown for the time period in which they are incurred, as opposed to the time period in which the cash is actually transferred

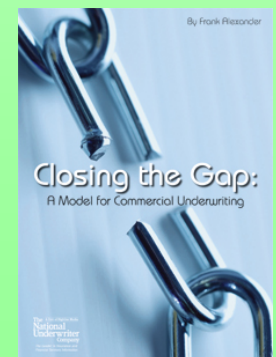
e.g. If a product were sold during the last week of the policy period, the income from that sale would be shown on the business income worksheet as being received during the expiring policy year, **NOT** the new policy year, when the cash would probably be received



Valuation Methods



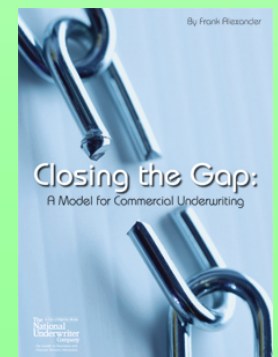
- First-in, first-out (FIFO): Assumes the first items purchased or manufactured are the first ones used or sold. During times of rising prices, the lower priced items are sold or used first, making income appear larger
- Last-in, first-out (LIFO): Assumes that the last items purchased or manufactured are the first ones used or sold. During inflationary periods LIFO will make income appear smaller



A. Gross Sales

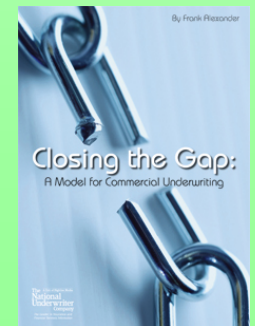


- Total sales revenue for the 12 months immediately preceding the inception date of the policy. Income taxes are not to be deducted, but sales taxes can be if they were shown separately from the sales price of the product.



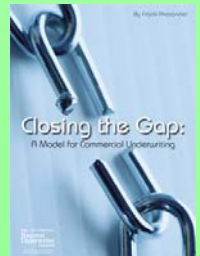
B. Finished Stock Inventory (at sales value) at Beginning

- Inventory at the beginning of the year preceding the policy. This refers to finished stock already in existence at the beginning of the year, valued at the sales price that existed at that time.
- The policy is intended to insure the sales value of production that occurred during the year in question, while this stock was produced **before** the year in question



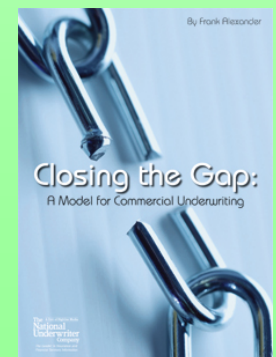
C. Finished Stock Inventory (at sales value) at End

- Inventory at end of year preceding the policy.
- Since finished stock inventory on hand at the beginning of the year has been taken out of the equation, this unsold inventory must have been manufactured during the year, and so is part of insured value of production that occurred during the year.



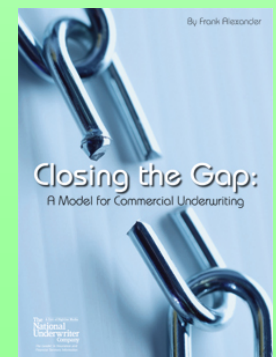
D. Gross Sales value of Production

- The value of the actual revenue stream that was produced during the year, before certain sales and production costs are deducted
- Defined as: Gross sales **less** the inventory at the beginning of the period **plus** inventory at the end of the period



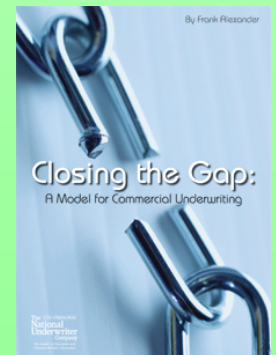
E. Prepaid Freight, Returns, Discounts, Bad Debts, etc.

- These are items that, to this point, are included in the gross sales value of production, but do not contribute to ultimate revenues – **therefore are deducted** from Gross Sales value of Production



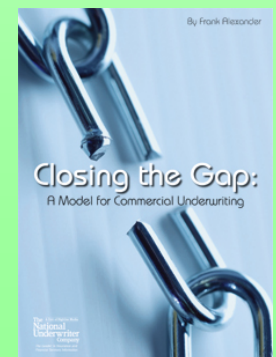
F. Net Sales

- The amount of sales generated by a company after deduction of returns, allowances, discounts, etc.
- The result of subtracting the expenses in step E of the worksheet from Gross Sales (step A) for **non-manufacturing or mercantile companies**
- Net sales gives a more accurate picture of the actual sales generated by the company



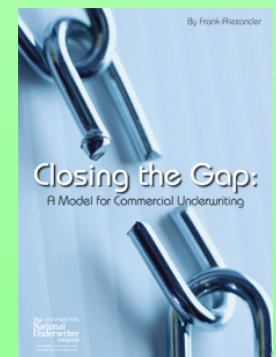
F. Net Sales value of production

- The result of subtracting the expenses in step E of the worksheet from Gross sales value of Production **for manufacturing companies**



G. Other Earnings

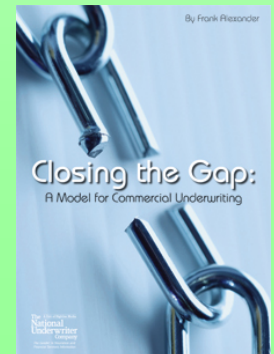
- Including commissions, or rents (if portions of the insured property are rented) not rents from other properties
- These are other earnings that derive directly from the operations being insured and that would be interrupted by an insured peril



H. Total Revenues

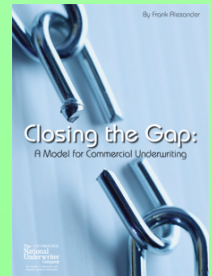


- The sum of F, net sales and G, other earnings
- This figure represents all income from the insured operation from which is deducted some of the costs of producing (or of buying merchandise in the case of mercantile operations) the goods that are sold



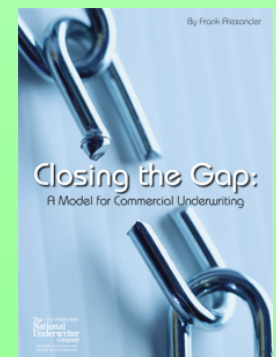
I. Deduct: Cost of Goods Sold

- The direct costs attributable to the production of the goods sold by a company – the sum of all material costs that the worksheet allows to be subtracted from the total revenues calculated on page 1.
- Cost of goods sold = inventory at beginning **plus** cost of raw stock **plus** cost of factory supplies consumed **plus** cost of merchandise sold **plus** cost of other supplies consumed **less** inventory at end of year



I. Deduct: Services Purchased

- Deduct the cost of services purchased from outsiders. E.g. a manufacturer who contracts out parts assembly, or a store that contracts out installation of appliances



I. Deduct:



Power, Heat & Refrigeration



→ Expenses that do not continue

All Ordinary Payroll Expenses

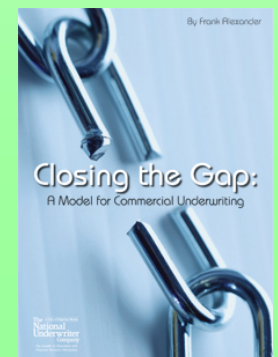


→ If ordinary payroll excluded [if CP 1510 is attached]

Special Deductions for Mining Properties



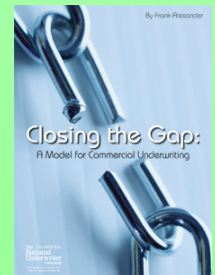
→ If applicable



J.1. Business Income Exposure for

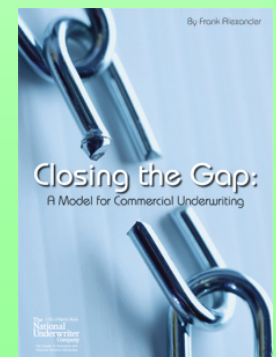
12 Months

- The figures in J.1. represent 100% of the actual and estimated business income exposure for 12 months
- J.2 for firms engaged in both manufacturing and non-manufacturing operations = 100% of Business Income Exposure
- If additional expenses: $J. + K = L = 100\%$ of Business Income Exposure



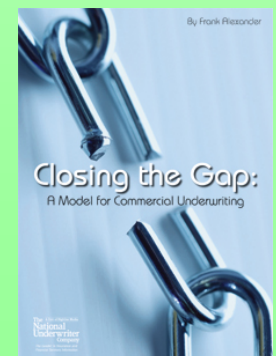
Financial Statements

ABC Manufacturing & ABC
Mercantile



ABC Manufacturing Company Inc. Year Ended December 31, 2007

Sales	<u>4,750,000</u>
Cost of sales	
Opening inventory	800,000
Merchandise purchased	2,200,000
Duty and freight	<u>330,000</u>
	3,330,000
Less closing inventory	<u>725,000</u>
	2,605,000
Gross margin	<u>2,145,000</u>
 Operating expenses	
Warehouse wages	440,000
Sales commissions	475,000
Warehouse rent	360,000
Office and Management salaries	340,000
Delivery charges	142,500
Management bonus	50,000
Business promotion	35,000
Travel	28,000
City Taxes	24,000
Utilities	15,000
Equipment amortization	22,000
Bad debts	16,000
Telephone and fax	12,000
Printing, postage and stationery	<u>14,000</u>
	<u>1,973,500</u>
Net income before income taxes	171,500
Income taxes	42,875
Net income for year	128,625



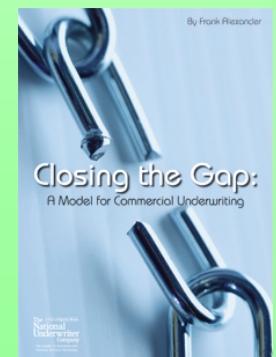
ABC Carpet Company Inc. Year Ended December 31, 2007

Sales	1,850,000
Cost of sales	
Cost of flooring sold	844,000
Installation labor	72,000
Sub-contract labor	55,000
	<u>971,000</u>
 Gross margin/Profit	 <u>879,000</u>
 Operating expenses	
Office and management salaries	200,000
Sales commissions	185,000
Rent	84,000
Sales Manager Salary	60,000
Vehicle	54,000
Cartage	37,000
Advertising	24,000
Bad debts	18,000
Repairs and maintenance	18,000
Utilities	15,000
Installation supplies	12,000
Insurance	9,000
Telephone and fax	8,000
City Taxes	5,000
Bank interest earned	-4,000
	<u>725,000</u>
Net income before income taxes	154,000
	<u>=====</u>



Worksheet Walk-through

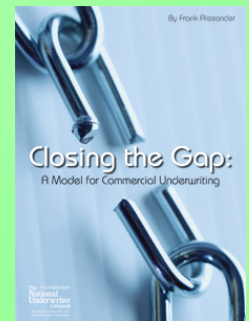
Step by Step Review
Manufacturing



12 month period
ending: _____

ESTIMATED for 12 month
beginning: _____

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
A. Gross Sales	\$4,750,000		\$ _____	\$ _____
B. DEDUCT:				
Finished stock				
Inv. (@sales value)				
@ beginning	-800,000	<u>XXXXXXXXXX</u>	- _____	<u>XXXXXXXXXX</u>
	_____	<u>XXXXXXXXXX</u>	_____	<u>XXXXXXXXXX</u>
C. ADD:				
Fin. Stock Inv. (@				
Sales value)at End	+725,000	<u>XXXXXXXXXX</u>	+ _____	<u>XXXXXXXXXX</u>
D. Gross sales value				
Of prod.	<u>\$4,675,000</u>	<u>XXXXXXXXXX</u>	\$ _____	<u>XXXXXXXXXX</u>



12 month period ending:

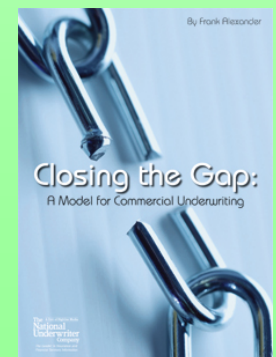
ESTIMATED for 12 month beginning:

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
E.DEDUCT				
Prepaid freight	-330,000		- _____	- _____
Returns/allow	-0		- _____	- _____
Discounts	-0		- _____	- _____
Bad Debts	-16,000		- _____	- _____
Collection exp.	-0		- _____	- _____
F. Net Sales:		\$ _____		_____
Net Sales value of prod.	<u>\$4,329,000</u>		\$ _____	
G. ADD: Other				
Earnings from bus. operations (not invest. or rents other prop.)				
Commissions on rents +0			+ _____	+ _____
Cash disc. Rec'd. +0			+ _____	+ _____
Other. Bank Interest +0			+ _____	+ _____
H. Total revenues	<u>\$4,329,000</u>	_____	\$ _____	\$ _____



Definition: Cost of Goods Sold

- Cost of goods sold = inventory at beginning **plus** cost of raw stock **plus** cost of factory supplies consumed **plus** cost of merchandise sold **plus** cost of other supplies consumed **less** inventory at end of year.



Example: Cost of Goods Sold

Beginning Inventory = \$800,000 + [incl.raw mat.]

Cost of raw stock = \$142,500 + [incl. Del.]

Factory supplies = \$0 +

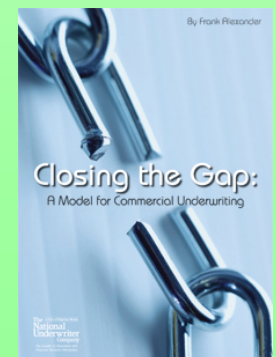
Merchandise sold = \$2,200,000 +

Supplies consumed = \$0 =

Cost of goods for sale = \$3,142,500 (-)

Closing inventory = (\$725,000) =

Cost of Goods Sold: \$2,417,500



12 month period ending:

ESTIMATED for 12 month beginning:

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
H. Total revenues	<u>\$4,329,000</u>	_____	\$ _____	\$ _____
I.DEDUCT				
Cost of goods sold	<u>-2,747,500</u>	-	- _____	- _____
Cost/services				
From outsiders				
(not empl) to resell				
& don't cont. under				
Contract	<u>-0</u>		- _____	- _____
Power, heat, fridge				
Expenses don't cont				
Under cont.(CP1511)	<u>-15,000</u>	<u>XXXXXXXXXX</u>	- _____	<u>XXXXXXXXXX</u>
Ordinary payroll or				
Excluded amt if				
CP 15 10 att.	<u>-0</u>		- _____	- _____
Spec. ded mining	<u>-0</u>		- _____	- _____
J1. Bus. Inc. 12 mo.	<u>\$1,566,500</u>	_____	_____	_____



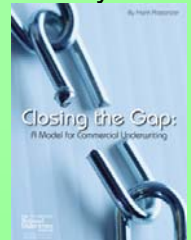
12 month period ending:

ESTIMATED for 12 month beginning:

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
J2. Combined (manu/non-manu) \$ _____		\$ _____		
Figures in J1 or J2 represent 100% of actual 12	_____	_____	_____	_____
K. Addt'l expenses:				
1. Extra exp. CP \$ _____		\$ _____		
2. Ext. bus.)	+ _____	+ _____		
3. Combined amounts in K1 & K2			\$ _____	
L. Total of J and K.			\$ _____	

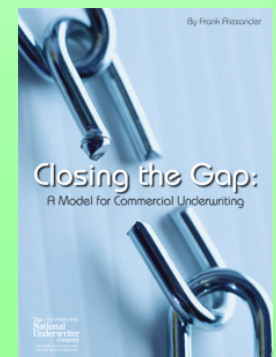
The figure in L. represents 100% of your estimated Business Income exposure for 12 months, and additional expenses. Using this figure as information, determine the approximate amount of insurance needed based on your evaluation of the number of months needed (may exceed 12 months) to replace your property, resume operations and restore the business to the condition that would have existed if no property damage had occurred.

Refer to the agent or Company for information on available Coinsurance levels and indemnity options. The Limit of Insurance you select will be shown in the Declarations of the policy.



Worksheet Walk-through

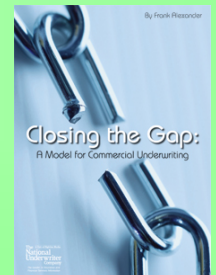
Step by Step Review
Mercantile



12 month period
ending: _____

ESTIMATED for 12 month
beginning: _____

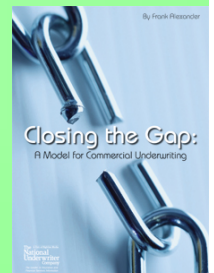
<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
A. Gross Sales	\$4,750,000	\$1,850,000	\$ _____	\$ _____
B. DEDUCT:				
Finished stock				
Inv. (@sales value)				
@ beginning	-800,000	<u>XXXXXXXXXX</u>	- _____	<u>XXXXXXXXXX</u>
	_____	<u>XXXXXXXXXX</u>	_____	<u>XXXXXXXXXX</u>
C. ADD:				
Fin. Stock Inv. (@				
Sales value)at End	+725,000	<u>XXXXXXXXXX</u>	+ _____	<u>XXXXXXXXXX</u>
D. Gross sales value				
Of prod.	<u>\$4,675,000</u>	<u>XXXXXXXXXX</u>	\$ _____	<u>XXXXXXXXXX</u>



12 month period ending:

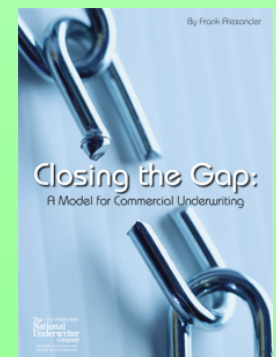
ESTIMATED for 12 month beginning:

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
E.DEDUCT				
Prepaid freight	-330,000	-0	- _____	- _____
Returns/allow	-0	-0	- _____	- _____
Discounts	-0	-0	- _____	- _____
Bad Debts	-16,000	-18,000	- _____	- _____
Collection exp.	-0	-0	- _____	- _____
F. Net Sales:		<u>\$1,832,000</u>		\$ _____
Net Sales value of prod.	<u>\$4,329,000</u>		\$ _____	
G. ADD: Other				
Earnings from bus. operations (not invest. or rents other prop.)				
Commissions on rents +0		+ 0	+ _____	+ _____
Cash disc. Rec'd. +0	+0	+ 0	+ _____	+ _____
Other. Bank Interest +0	+0	+4,000	+ _____	+ _____
H. Total revenues	<u>\$4,329,000</u>	<u>\$1,836,000</u>	\$ _____	\$ _____



Example: Cost of Goods Sold

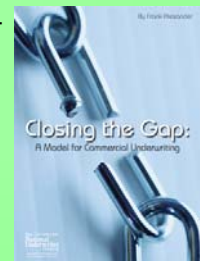
Cost of flooring sold = \$844,000 +
Sub-contract labor = \$55,000 +
Installation supplies = \$12,000 =
Merchandise sold = \$911,000



12 month period ending:

ESTIMATED for 12 month beginning:

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
H. Total revenues	<u>\$4,329,000</u>	<u>\$1,836,000</u>	\$ _____	\$ _____
I.DEDUCT				
Cost of goods sold	<u>-2,417,500</u>	<u>-911,000</u>	- _____	- _____
Cost/services				
From outsiders				
(not empl) to resell				
& don't cont. under				
Contract	<u>-0</u>	<u>-0</u>	- _____	- _____
Power, heat, fridge				
Expenses don't cont				
Under cont.(CP1511)	<u>-15,000</u>	<u>XXXXXXXXXX</u>	- _____	<u>XXXXXXXXXX</u>
Ordinary payroll or				
Excluded amt if				
CP 15 10 att.	<u>-0</u>	<u>-0</u>	- _____	- _____
Spec. ded mining	<u>-0</u>	<u>-0</u>	- _____	- _____
J1. Bus. Inc. 12 mo.	<u>\$1,566,500</u>	<u>925,000</u>	_____	_____



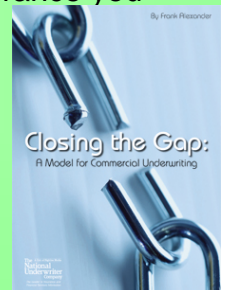
12 month period ending:

ESTIMATED for 12 month beginning:

<u>Inc. & Exp.</u>	<u>Manuf.</u>	<u>Non-Manu.</u>	<u>Manuf.</u>	<u>Non-manuf.</u>
J2. Combined (manu/non-manu) \$ _____		\$ _____	_____	_____
Figures in J1 or J2 represent 100% of actual 12	_____	_____	_____	_____
K. Addt'l expenses:				
1. Extra exp. CP \$ _____		\$ _____		
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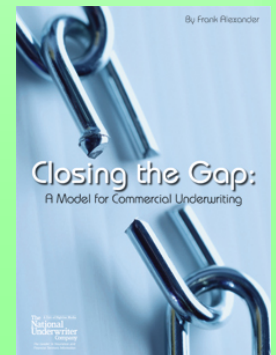
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What These Calculations Mean

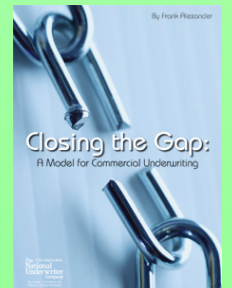
You Have Used The Latest Financial Statements
To Gauge Business Income & Expense For
Current Year

**You Now Take Those Numbers And Project
Them For The Next Policy Year**



REVIEW

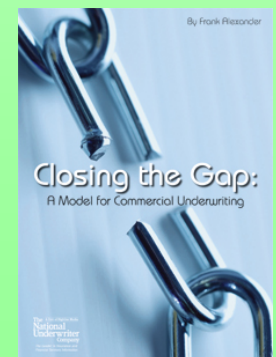
- Focus on Business income Worksheet without Extra Expense
- Beyond the Numbers
- Purpose of Business income coverage
- Coverage and Payment under Business Income form
- Challenges in establishing limits
- Three ways to minimize underinsurance



REVIEW



- Coinsurance requirement
- Some Worksheet definitions
- Worksheet walkthrough
- Financial Statements ABC Manufacturing & ABC Mercantile
- Translating financial data into Worksheet information



Q & A