BIG "I" VIRTUAL UNIVERSITY

Risk & Reality Report

BUSINESS INCOME:

Are You Sure You Protected ALL the Insurable Income?

BIG i VIRTUAL UNIVERSITY

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This Risk & Reality Report is a transcript of a webinar presented by the Big "I" Virtual University. Although minor edits have been made, the editors have not undertaken to change the presentation to comply with any style manual. This is the presenter speaking directly to you.

INTRODUCTION

Today we're delving into everybody's favorite topic and a topic that seems to scare a whole lot of people – business income. I did a business income webinar a couple of months ago – available here if you're interested – where I made the comment that, to me, business income is the most important property coverage out there.

Being underinsured on the building is bad, I totally agree, but being uninsured or underinsured on the business income – to make money and the reason the business exists – is catastrophic. It will put you out of business. Being underinsured on the building, OK, fine. You may be able to get a loan to rebuild. If you have no money coming in and it's not insured, you don't have a business anymore. That's what makes business income is the most important property coverage so let's jump into this and look at our topics.

We're going to start by reviewing three key business income concepts that we need to keep in mind any time we discuss business income. We'll be using these concepts as we go through the topic. From there, we're going to move to the most fun part of this discussion. We're going to focus much of our time on conquering the business income worksheet – the six-paged CP 15 15 that makes the people run scared and hide in a corner. OK, that's a bit of a hyperbole, I realize, but a lot of people are scared by that form. That's why we're going to spend a majority of our time today detailing that form. We're going to go step-by-step through that form. By the time you've completed this document, you will be extremely well educated on how to use the form and how to explain it. It's not the form itself that causes trouble; it's explaining the form that people seem to be the most worried about.

Then we'll talk about an unusual topic, something that many don't consider when talking about business income. It's the difference between insurable and compensable business income. There is a difference between what you develop when you do the worksheet, the insurable business income, and how much you get paid after the loss occurs, and we'll talk about that briefly.

As we move towards the end of our discussion, we need to discuss the fact that there are actually two loss periods – two periods of time during which the insured is losing money which means that we need to introduce and discuss the second loss period, the extended business income loss period, the extended business income coverage.

To end our conversation today, we're going to talk about a business income exposure that a lot of us tend to ignore. Nearly every insured has this exposure. We're talking about dependent property coverage, the fact that your insured's business depends on something else or somebody else in order to continue to operate. And with that, let's begin.

THREE KEY CONCEPTS FOR BUSINESS INCOME

Let's jump right into and review our three key business income concepts. These are concepts that any time you're talking about business income, any time you're discussing business income, any time that you are planning a business income coverage, these are the concepts that you need to keep in your head and make sure that you understand the meaning of these terms.

- Business Income
- Period of Restoration
- "Time Doctrine"

Business Income

So what is business income? We buy business income coverage, but what is business income? Business income is net income which means net profit or loss...Yes, you can insure a business for business income that is operating at a loss because when a fire or something else occurs, even though they were operating at a loss, then they would be operating at an even greater loss. We're trying to make up the difference between where they would've been and where they ended up being because of the fire or whatever the situation arose. So net income, net profit or loss, before income taxes that would have been earned or incurred plus continuing normal operating expenses including payroll.

Now remember, when we're talking about manufacturing risks – and we're going to spend a lot of time on this topic as we're going through the worksheet – the definition of business income includes the sales value of production, the potential income of goods that were manufactured but not sold. They're still sitting on the floor waiting to be sold, if you will, and that's specific to manufacturing operations. That's what business income is.

Period of Restoration

Period of restoration might be the most important concept in business income because upon the concept of period restoration or in conjunction with the period of restoration rests everything else that has to do with business income and the business income

concept. It's defined as the time period beginning after the direct physical loss or damage and ending on the earliest of the date the property should be – not is but should be – repaired, rebuilt, or replaced with reasonable speed and similar quality.

I make a big deal out of the fact that it says "should be repaired or replaced," not necessarily when it actually is. If it should be replaced with reasonable speed and similar quality within 12 months but it takes 15 months, the business income, the period of restoration, ends at 12 months because that's when it should be, not when it is. Big difference.

Ending the earlier of the date the property should be repaired, rebuilt, or replaced with reasonable speed and similar quality or the date when the business is resumed at a new, permanent location – not a temporary location, not if they have part of the business operating at a temporary location. The period of restoration only ends when either they're back up and running where they were, or they find a new permanent location. "Hey, we love it here. We don't want to go back where we were. We're going to set up operations here moving forward." So they set up a new, permanent location.

Remember, when we're talking about period of restoration and coverage under business income, we're dealing with a time deductible, generally 72 hours, which can be endorsed down. So, we have business income, period of restoration, and then our last concept that I want you to keep in mind is called the time doctrine.

“Time Doctrine”

Now, the time doctrine is not anything you'll find in the policy. This is something that I developed a few years ago that says all business income losses are settled based on the coverage limits purchased. An accurate business income coverage limit calculation depends on the legitimate estimation of a worst-case period of restoration. We'll talk about that again in a bit but estimating the worst-case period of restoration necessitates understanding the time required to accomplish the 10 steps within the four period of restoration objectives. The key to business income is the correct estimation of time.

You have to understand when we're going through the business income report and worksheet, we're going to be developing the 12-month business income exposure. That's not what we're talking about. We're just talking about the exposure, the 12-month exposure. We're not talking about how long it's going to take to rebuild the building following a worst-case scenario or loss. Period of restoration is what is the worst-case scenario loss. Yes, over a 12-month period we might have a million dollars’ worth of the business income, but because of the realities of rebuilding, the realities of the loss adjustment processes, the realities around business, it might take 16-18 months before we're back up and running and have reached operational capability.

Thus the 12-month business income exposure is just our starting point. We'll talk about that again in just a couple of minutes. That's just our starting point. We apply that to the worst-case period of restoration to come up with our limit of insurance. Essentially, the time doctrine is if the 12-month business income exposure is correctly estimated, and the time required to return to operational capability, the period of restoration, following a worst-case scenario loss is legitimately calculated.

Again, keeping in mind the realities of business, the realities of the fact that you have to get the loss settled, the fact that you have to get plans drawn, the fact that you have to get approval from the city or county or whomever is in charge of the building – all the factors that go into before a building can be rebuilt.

In our last business income webinar a couple months back, we talked about the fact that you can spend six months and haven't even dug a hole yet to rebuild the building. So, you have to have your 12-month business income exposure. You have to have a legitimate estimation of your worst-case scenario. If you have that and you apply those properly – we'll talk about how to develop a 12-month business income exposure – if you develop those correctly and you apply a legitimate period of restoration, the insured really in all honesty should suffer little or no business income loss, the profit they expected to earn, and the continuing normal operating expenses.

Those are the concepts we need to remember. We need to remember what business income is, the fact of what period of restoration actually looks like, the realities of the period of restoration, and how that all works together in the time doctrine.

CONQUERING THE BUSINESS INCOME WORKSHEET – THE CP 15 15

Now that we have established an understanding of the three key business income concepts, we're going to tackle the part of the business income that, as I said earlier, everyone is kind of scared of. We're going to focus on conquering the business income worksheet, the CP 15 15.

But first, let's answer two questions in regard to the worksheet. First, why do underwriters need the CP 15 15? And then, what do they do with it?

Before we answer these questions, I'm going to mention one more thing. The business income worksheet is really – and I know you may not believe it now, but hopefully when this is over you'll believe it – it's really very simple and easy to understand and explain because you're going to have to explain it to the insured and/or their accountants. Again, as I said, after you read through this document, you'll know more than 99 percent of the agents out there, 99 percent of the agents you are competing against. If you use this

information correctly, you will have a major competitive advantage over those with whom you're competing.

I know of an agent in my home state, his goal is to win accounts using business income as his lead. Some agents use workers' comp, some agents use other tactics. He uses business income as his lead because he has taken the time to learn the business income report and worksheet and how to explain it in such a way that is very simplistic. You can actually use this as a lead to bringing in new clients. This can be your competitive advantage. Now let's get back and answer those questions.

1. Why do underwriters need the CP 15 15? And,
2. What do they do with it?

The time element, the CP 15 15, is the time element equivalent of the commercial property schedule. When you write a property coverage, the underwriter, if you have several properties, they ask for a property schedule to list the building limits and the contents limits and all the information about COPE and everything else. That's all the CP 15 15 is. It's the business income equivalent of the property schedule. It's nothing more than a starting point in the business income underwriting process. Once the insured has calculated the 12-month business income exposure with the form, the hard part of developing the business income limit is what is next by estimating the worst-case period of restoration and applying that to the limit.

This is just a starting point when you complete the business income report worksheet. There's wording in the form that basically tells you this information. That's your starting point. You've come up to a limit, start here, and apply the estimated worst-case period of restoration to this number to come up with the business income limit that you're going to purchase.

Lastly, as we just stated, the form is designed to help the insured and the agent develop the 12-month estimated business income exposure. Now, one of the things that you have to be very careful of as an against – we're going to talk about this more – do not confuse the completion of the business income worksheet with the settlement of a claim. We're going to talk about how there is a difference between insurable business income, which is what we're developing with the worksheet, and compensable business income, that's the part that's paid after loss.

Do not confuse the completion of a CP 15 15 with the settlement of a claim. In fact, the claims adjuster may, and probably never will, see the CP 15 15 in this situation.

Now let's start diving into the form.

POLICY NUMBER:

COMMERCIAL PROPERTY
CP 15 15 10 12

BUSINESS INCOME REPORT/WORKSHEET

Date:	
Your Name	**Location**

This worksheet must be completed on an accrual basis.

The beginning and ending inventories in all calculations should be based on the same valuation method.

Applicable When The Agreed Value Coverage Option Applies:
I certify that this is a true and correct report of values as required under this policy for the periods indicated and that the Agreed Value for the period of coverage is $, based on a Coinsurance percentage of %.
Signature: **Official Title:**

Applicable When The Premium Adjustment Form Applies:
I certify that this is a true and correct report of values as required under this policy for the 12 months ended: **Signature:** **Official Title:** **Agent Or Broker:** **Mailing Address:**

BUSINESS INCOME REPORT/WORKSHEET
FINANCIAL ANALYSIS

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
A.	Gross Sales	$	$	$	$
B.	Deduct:				
	Finished Stock Inventory (at sales value) At Beginning	–		–	
C.	Add:				
	Finished Stock Inventory (at sales value) At End	+		+	
D.	Gross Sales Value Of Production	$		$	
E.	Deduct:				
	Prepaid Freight – Outgoing	–	–	–	–
	Returns And Allowances	–	–	–	–
	Discounts	–	–	–	–
	Bad Debts	–	–	–	–
	Collection Expenses	–	–	–	–
F.	Net Sales		$		$
	Net Sales Value Of Production	$		$	
G.	Add:				
	Other Earnings From Your Business Operations (not investment income or rents from other properties):				
	Commissions Or Rents	+	+	+	+
	Cash Discounts Received	+	+	+	+
	Other	+	+	+	+
H.	Total Revenues	$	$	$	$

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line **H.** from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
K. Additional Expenses:				
1. Extra Expenses – Form CP 00 30 Only (expenses incurred to avoid or minimize suspension of business and to continue operations)			$	$
2. Extended Business Income and Extended Period Of Indemnity – Form CP 00 30 Or CP 00 32 (loss of Business Income following resumption of operations for up to 60 days or the number of days selected under Extended Period Of Indemnity option)			+	+
3. Combined (all amounts in **K.1.** and **K.2.**)			$	
L. Total Of **J.** And **K.**			"Estimated" Column $	

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.

Supplementary Information				
	12-Month Period Ending:		Estimated For 12-Month Period Beginning:	
Calculation Of Cost Of Goods Sold	**Manufacturing**	**Non-Manufacturing**	**Manufacturing**	**Non-Manufacturing**
Inventory At Beginning Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	$	$	$	$
Add: The Following Purchase Costs: Cost Of Raw Stock (including transportation charges)	+		+	
Cost Of Factory Supplies Consumed	+		+	
Cost Of Merchandise Sold Including Transportation Charges (for manufacturing risks, means cost of merchandise sold but not manufactured by you)	+	+	+	+
Cost Of Other Supplies Consumed (including transportation charges)	+	+	+	+
Cost Of Goods Available For Sale	$	$	$	$
Deduct: Inventory At End Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	–	–	–	–
Cost Of Goods Sold (Enter this figure in Item **I.** on page 3.)	$	$	$	$

Supplementary Information		
Calculation Of Special Deductions – Mining Properties		
	12-Month Period Ending: _	**Estimated For 12-Month Period Beginning: _**
Royalties, Unless Specifically Included In Coverage	$	$
Actual Depletion, Commonly Known As Unit Or Cost Depletion (not percentage depletion)	+	+
Welfare And Retirement Fund Charges Based On Tonnage	+	+
Hired Trucks	+	+
Enter This Figure In Item **I.** On Page 3.	$	$

If you're not used to using it or if you've never used it, it might look a little scary. If you have used it, it might not be so intimidating, but yeah, I know it can look a little scary because you see all these different lines. You have four columns and everything that needs to be filled out, but it's really not that scary at all. It's really fairly easy to understand. That's my goal in this section here is to get you over the fear of the form so you can use the worksheet to your advantage.

As you can see, there are four columns on it. There are two columns for manufacturing and two columns for nonmanufacturing. In general, only two of these columns apply to any particular insured and only the applicable columns need to be completed. If it's a manufacturing operation, you complete the two for the manufacturing. If it's a nonmanufacturing, you complete the two for the nonmanufacturing. I know…duh. Nut really, the only time that all four columns have to be filled out if it's a dual-income situation where you have manufacturing and nonmanufacturing income with the same insured. That's when you do have to complete all four columns.

In general, there are just two columns to be completed. Basically, the form can be divided into two halves. You draw a line down the middle of the page. The first two columns on the left request information about the year ENDING. That's the basis for what you're going to be doing for the coming year which are the two columns on the right. Those columns on the right request information about the upcoming year, estimated data for the upcoming year. Basically, the right-hand columns, that's what the insured is budgeting or expecting for the coming year, in other words the year that's being insured.

That's the most important side, the estimated columns, the ones on the right. This is the information about the insured's upcoming year or the estimated information about the insured's upcoming year. You don't pick limits based on what happened the last year.

Keep that in mind, the left side is just the basics. That's where you start. The right side is where you're purchasing the coverage off of those limits. That's what's expected to happen, that's what the insured is expecting for the next year, the year coverage is in force, because that's the year the insured is insuring.

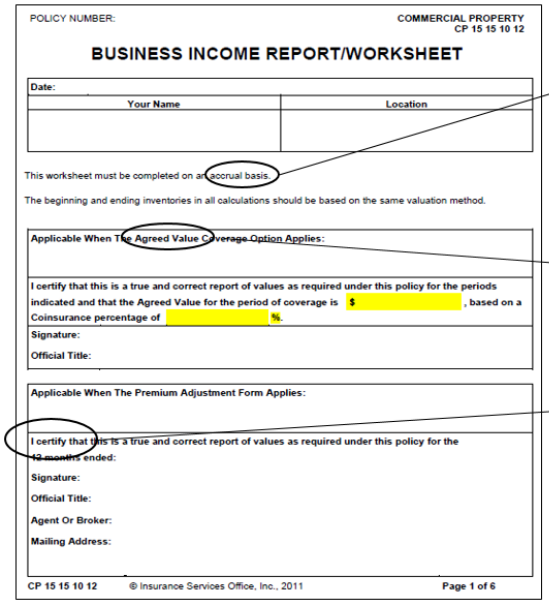
It's kind of a duh statement I realize, but I'm trying to make the point obviously that the right columns, the estimated columns, those are the more important columns to fill out, not the previous year. Yeah, you have to put it down because that's the basis of what you're going to build to get to the estimated, but the estimated columns are the ones that need to be closer to reality when it's all said and done. Most of the information for completing the worksheet can be found in the insured's yearend income statement. However – there's always that however in insurance – some of the information may have to be manually developed.

One key is the sales value of production, which we'll discuss in detail in just a couple of minutes, or the values of goods in various phases of production which becomes an important part of the sales value of production and the cost of goods sold.

The last point I want to make about the CP 15 15 which is what scares a lot of people, especially somebody who has an accounting background, is that the CP 15 15 does not always follow generally accepted accounting principles or GAAP. ISO, the form is developed differently than the development of income calculation is in generally accepted accounting principles. That's why you can't simply hand it to the insured or their accountant and say, "Here, fill this out and give it back to me," because there are differences that you have to be able to explain.

Let's jump into it. Over the next several pages, we're going to detail the CP 15 15 step-by-step and point-by-point. We're going to go through nearly every line of this form so that you can completely understand it. It's tedious but when we're done, as I said, you'll no longer fear the form and you'll also know how better to explain the form. I almost want to say you'll be excited about using the form, but I realize that's a bit of hyperbole. That's a little too far. I can't go that far. So I'll just say that you will no longer be bothered by the form or scared by the form. That's the most important part of this, being able to go to the insurer and say, "Here's exactly what we're asking for and here's how you get it."

Let's start our step-by-step information page. On page one of the form, there are three key elements on the very first page of the form I that I want you to notice.



POLICY NUMBER: COMMERCIAL PROPERTY CP 15 15 10 12

BUSINESS INCOME REPORT/WORKSHEET

Date:

Your Name	Location

This worksheet must be completed on an accrual basis.

The beginning and ending inventories in all calculations should be based on the same valuation method.

Applicable When The Agreed Value Coverage Option Applies:

I certify that this is a true and correct report of values as required under this policy for the periods indicated and that the Agreed Value for the period of coverage is $, based on a Coinsurance percentage of %.

Signature:

Official Title:

Applicable When The Premium Adjustment Form Applies:

I certify that this is a true and correct report of values as required under this policy for the 12 months ended:

Signature:

Official Title:

Agent Or Broker:

Mailing Address:

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- **Accrual Basis**: The BI worksheet is to be completed using the accrual basis of accounting. If the insured uses Cash Basis, the data must be converted to accrual basis.
- **Agreed Value**: If the Agreed Value coverage option has been chosen, the insured must provide requested info and sign.
- **BI Premium Adjustment** (CP 15 20): If this endorsement is used, the insured must certify the information provided in the form. Makes it a type of Reporting Form.

The first one, the top section of the form, where it says accrual basis. It says, "The business income worksheet is to be completed using the accrual basis of accounting." Now, accrual basis of accounting, income and expenses, are reported in the year earned or incurred, regardless of when realized or paid. If it was sold in fiscal year 2017, but I didn't get the money until fiscal year 2018, it's recorded in 2017. It's recorded in the year incurred or earned, not necessarily when it was realized or paid. I got the bill in 2017. I didn't pay it until 2018. In accrual basis, everything is done in the year it is incurred or earned. It matches the income and expenses to the correct year.

One of the issues of that is that if the insured does their accounting on a cash basis, which means they don't record it until they receive it and they don't record it until they actually pay it, regardless of when it was earned or regardless of when it was incurred, they have to convert to accrual basis to complete the form. The form has to be done on an accrual basis.

The good thing is, most business already conduct their accounting on an accrual basis anyway. This probably won't be an issue very often. It is something you have to know and the insured has to be on an accrual basis. If not, you have to explain to them that they have to transition the information to an accrual basis to properly complete the form.

That's the first thing we need to know about the business income and reporting worksheet. It's an accrual basis form. The second thing, you have a couple of options that take away the coinsurance requirement, which scares a lot of people. One of them is the agreed value option.

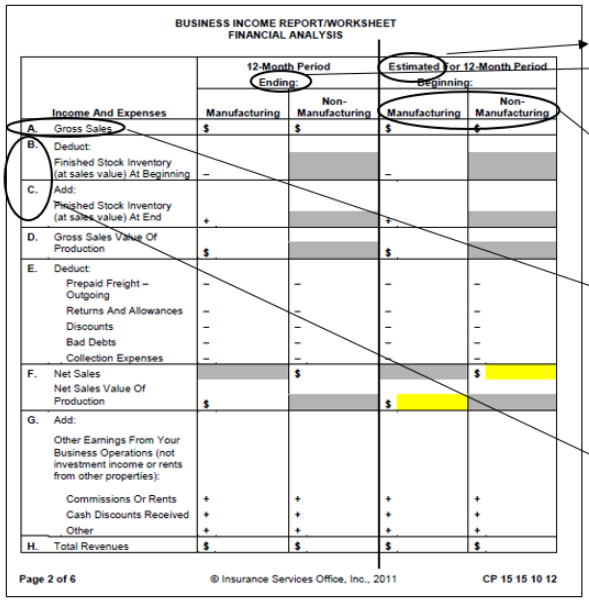
If the insured chooses agreed value – which, again, does away with the coinsurance requirement for one year – the insured must provide the requested information in the report worksheet, and they sign the form. Basically, when the insured says, "We're going to do agreed value," which negates the coinsurance calculation if there's a loss, they're going to do agreed value, they have to sign the form filling out the specific information that's highlighted on your form, then certify. They have to sign and certify it that they're doing it on agreed value basis. They're certifying the information is correct. There's no endorsement to do agreed value. You just check the application that says, "We're going to do this on an agreed value basis." If they write coverage on an agreed value basis, it increases the premium by about 10 percent, but it avoids any coinsurance calculation if there are any doubts. That's the second section of the very first page of the form.

The bottom section deals with the business income premium adjustment endorsement, the CP 15 20. If this endorsement is used, the insured, sort of like the agreed value, has to certify the information being provided in the form. When you use the business income premium adjustment endorsement, the CP 15 20, basically, the business income policy, the business income form becomes a type of reporting form coverage. You report at the

beginning of the policy period, pay a premium based on what you said your business income exposure is for however long, 12 months, 9 months, 16 months, whatever period of time, and at the end of the policy period, you complete the business income report and worksheet again for the previous policy period.

If you paid too much, if you overestimated what your business income exposure was during that previous policy period, you get a return premium. In all reality, it's better to use this endorsement, over report, that way, just in case you're wrong and you underestimated how long the period of restoration was going to be, you're still OK. So use the endorsement, over report. At the end of the policy period, you fill it out again for the previous policy period and then they do a premium correction on that. Most agents do not know that this endorsement exists. It is a very good endorsement, if you can convince the insured and you want to deal with having to fill it out twice for the same policy period. For what it gets you and the ability to pay the correct premium for the actual exposure and not be underinsured at a particular situation, I think it's worth the time spent doing it if you can explain it to the insured.

Now let's move to page two of the business income worksheet and look at the income and expense calculation.



BUSINESS INCOME REPORT/WORKSHEET
FINANCIAL ANALYSIS

Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
A. Gross Sales	$	$	$	$
B. Deduct: Finished Stock Inventory (at sales value) At Beginning	–		–	
C. Add: Finished Stock Inventory (at sales value) At End	+		+	
D. Gross Sales Value Of Production	$		$	
E. Deduct:				
Prepaid Freight – Outgoing	–	–	–	–
Returns And Allowances	–	–	–	–
Discounts	–	–	–	–
Bad Debts	–	–	–	–
Collection Expenses	–	–	–	–
F. Net Sales		$		$
Net Sales Value Of Production	$		$	
G. Add:				
Other Earnings From Your Business Operations (not investment income or rents from other properties):				
Commissions Or Rents	+	+	+	+
Cash Discounts Received	+	+	+	+
Other	+	+	+	+
H. Total Revenues	$	$	$	$

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- **"Ending" and "Estimated"**: The more important of the two is "Estimated."
- **Manufacturing and Non-Manufacturing**: Only two columns must be completed.
- **"A" Gross Sales**: Applies to both manufacturing and non-manufacturing operations.
- **"B" & "C" Finished Stock Inventory**: Only Applies to Manufacturing Risk.

Now we start getting to the numbers. I want you to notice a couple of key words at the top of the form that I've got circled for you – ending and estimated. Ending is the prior policy period information, or the prior year information. That's a duh statement. Estimated is the upcoming policy period, the policy period for which we are writing coverage.

As I said already, the more important of the two is the estimated. That's what we're buying insurance on, the estimated amount for the coming policy term. If you notice the term beginning, beginning at the beginning of the policy period. That's the beginning. The policy period is being insured. This is the more important column. I know I said that 14 times already, but I want you to remember. Estimated is the one you want to make sure, and the insured wants to make sure, is correct. Ending is on the left. Estimated is on the right. You want the right side to be right.

There are a couple other terms that I've circled for you – manufacturing and nonmanufacturing. We already talked about this, the fact that this form, if you're a manufacturing operation, only the manufacturing columns need to be completed. If you're a nonmanufacturing operation, only the nonmanufacturing columns need to be completed. Not everything, unless you are a dual operation, manufacturing with a retail operation as well. With that behind us, let's begin our calculations.

Let's start looking at the numbers. Row A, gross sales. Gross sales applies to both manufacturing and nonmanufacturing operations. Gross sales equals the total invoiced amount before any deductions. Total invoiced amount before any deductions. Remember, on accrual basis, this doesn't mean you've necessarily received the money. You've invoiced it. On accrual basis, you record it in that year. Total invoiced amount before any deductions. Gross sales is row A. Then we have row B and C.

Row B and C apply only to manufacturing operations, only to manufacturing risk. You'll notice that it's blocked out for nonmanufacturing operations. You know that if you're writing a manufacturing operation, you have to complete B and C. We'll detail B and C next because this is one of those more complicated sections of the form. This is one of those areas that you are going to have to explain.

Gross sales is pretty easy. When we start talking about finished stock inventory and the value of finished stock inventory, this gets a little bit more involved. This is one of those times where you're going to have to explain it to the insured.

If we look at row B, row B begins with the word "deduct." Deduct means subtract. We're going to subtract this amount from gross sales. We're going to subtract the sales value of finished stock on hand at the beginning of the policy period.

BUSINESS INCOME REPORT/WORKSHEET
FINANCIAL ANALYSIS

Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
A. Gross Sales	$	$	$	$
B. Deduct: Finished Stock Inventory (at sales value) At Beginning	–		–	
C. Add: Finished Stock Inventory (at sales value) At End	+		+	
D. Gross Sales Value Of Production	$		$	
E. Deduct:				
Prepaid Freight – Outgoing	–	–	–	–
Returns And Allowances	–	–	–	–
Discounts	–	–	–	–
Bad Debts	–	–	–	–
Collection Expenses	–	–	–	–
F. Net Sales		$		$
Net Sales Value Of Production	$		$	
G. Add:				
Other Earnings From Your Business Operations (not investment income or rents from other properties):				
Commissions Or Rents	+	+	+	+
Cash Discounts Received	+	+	+	+
Other	+	+	+	+
H. Total Revenues	$	$	$	$

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"**B**" – **Deduct** the Sales Value of Finished Stock at the **Beginning** of the Period

"**C**" – **Add** the Sales Value of Finished Stock at the **End** of the Period

To Develop the **Finished Stock Value**:

- Divide inventory into its three component parts:
  - Cost of Raw Material
  - Cost of Stock in Process
  - Cost of Finished Stock (Internal Cost)
- Apply one of two Methods to Arrive at the Sales Value
  - "Mark Up" (Margin) Method
  - "Percentage-of-Net-Sales" (Percentage) Method

The sales value of finished stock on hand. That's what we're going to have to develop. This is the explanation that you're going to have to learn to be able to explain how you come up with the sales value of production. Row B, we're going to deduct the sales value of finished stock on hand at the beginning of the policy period. We subtract the sales value on hand because we're only concerned with realized and potential income during the policy year as if everything was sold. If it was on hand at the beginning of the policy period, last day of the previous policy period or last day before you took out the coverage if you're taking out for the first time, you deduct the sales value of that stock, finished stock, on hand. You're not going to carry that over to the next year. Just a reminder before we keep moving forward on that.

When we're dealing with manufacturing operations, I've said this a couple times already, when we're dealing with manufacturing operations, not only are we concerned with establishing our business income limit on how much sales we had in that year where we actually sold it, we're also insuring the potential income of what we manufactured but didn't sell. We're looking at it as if everything that we manufactured was sold during that policy period. That's why we deduct what is already on the floor, because that was realized and accounted for on business income in the previous policy period. All we're looking for is the money collected during this policy period and the potential money collected during this policy period if we sold everything manufactured during the year.

We deduct the sales value of finished stock on hand at the beginning of the policy period from the prior year. Again, based on an accrual basis. Basically, again, if it's sitting on the floor on the first day of the policy period and it was manufactured before the end of the last year, you don't count the sales value of that stock. We deduct that.

Row C, add. We got a plus here. We deduct row B, but then we're going to add back the sales value of finished stock on hand at the end of the current period, the period that we're calculating. This is the potential income of finished stock on hand at the end of the year. We deduct what was on hand before the beginning of the policy period. We add what is on hand on the last day of the policy period in C. Finished stock, not sold; it’s just sitting on the floor waiting to be sold. We're going to deduct what was there the day before the policy period started. We're going to add the amount of sales value of production sitting on the floor on the last day of the policy period. Again, because we're including potential income, had it been sold during the policy period.

Remember, in B and C, we are focused on the finished stock. We're focused on the sales value of finished stock. We're going to deduct what was there the day before the policy period began, and we're going to add the sales value of finished stock sitting on the floor on the last day of the policy period. We're focused on the sales value of finished stock.

What we've got to talk about is how we develop the sales value of finished stock. Hang with me on this one. This is one that we get lost before we even get into the form. In order to develop the sales value of finished stock, we have to divide inventory into its three component parts.

1. Cost of raw materials
2. Cost of stock in process such as goods halfway through the production line
3. Cost of finished stock.

The key term here is cost. What did it cost us for the raw materials? What is the cost, our internal cost, my cost, of the stock in process? What is my cost, the manufacturer's cost, of the finished stock sitting on the floor?

The internal cost, the accountant should know what that is. Each one of these widgets costs $3,000 or whatever it might be to make. They should know what their internal cost is of that finished stock on hand because that's how they come up with how much they're going to sell it for. We divide that number into the three component parts -- the cost of raw materials, the cost of stock in process, and the cost of finished stock. Again, the internal cost. The first two, the cost of raw materials on site and the cost of stock in process, are used as we develop this information and it's used again when we talk about the cost of goods sold. The cost of finished stock, the internal cost of there, is only used in calculating B and C. You're going to have to do this for the cost of goods sold anyway. You do it once and you have it in the two places that you need it.

Once you have it divided out into its component parts, the cost of raw materials, cost of stock in process, and cost of finished stock, then the insured needs to apply one of two methods to arrive at the sales value of production.

- "Mark Up" (Margin) Method

Cost x (1 + Profit Margin) = Sales Value of Production

- "Percentage of Net Sales" (Percentage) Method

Traditional COGS / Net Sales = Cost of Goods Sold Ratio (COGSR)
Cost / COGSR = Sales Value of Production

We have what's called the markup method or margin method, and we have the percentage of net sales method or percentage method. My recommendation is to use both and take the average if the numbers are different because they come at it from two different perspectives.

Let's look closer at what we're talking about here. There are two ways to develop the sales value of production. We take the cost, the internal cost, of the finished goods and we develop the sales value of production. Again, you have to be able to explain this to the insured and their accountant.

The first method that we mentioned is the markup or margin method. For this, basically, you use the internal cost of finished stock and how much the insured plans to make, the desired profit margin in the form of a percentage. The calculation for the margin method, the markup method, is internal cost times one plus the profit margin equals the sales value of production.

For the sake of the example, if the insured plans a 50 percent margin, a 50 percent markup, a 50 percent profit, it's the internal cost of that product times one plus 0.50as seen in the graphic above. If the cost is $1,000 times 1.50, that means the sales value of production for that one machine, that one product, is $1,500. Basically, you're just taking the internal cost and you're applying your markup to it to get your sales value of production. That's one method.

The second method is the percentage of net sales method. The percentage of net sales method is a two-step process. It uses the cost of goods sold and the net sales as the basis for developing the sales value of production. The first step is you take the traditional cost of goods sold. The reason I say traditional cost of goods sold is because it's not the same calculation as the CP 15 15, the business income report and worksheet development of cost of goods sold. It's the traditional, generally accepted accounting principle which is beginning inventory plus purchases plus freight plus direct labor plus indirect expenses minus ending inventory. That's the traditional cost of goods sold divided by net sales. Net sales is gross sales minus returns, allowances, and discounts. You take the traditional cost of goods sold, you divide that by the net sales and that gives you your cost of goods sold ratio.

With the cost of goods sold ratio you take the cost, the internal cost of the goods, the manufactured product, the finished products, and you divide it by the cost of goods sold ratio, the COGSR. You take your internal cost and divide it by the cost of goods sold ratio and that gives you your sales value of production.

To me the markup method is easier, but the percentage of net sales method is using historical data, historical margins, so it might be more exact.

My recommendation – because it's coming at it from two different angles – the markup method, again, coming at it from the desired, planned profit margin, if you will, and the percentage method is based on actual historic data. Because it is based on what the insured has actually done in the past. I recommend taking both and calculating both, and taking the average. That's probably going to be closest to what your actual sales value of production is. When you fill in lines B and C, you deduct what was there on the day before the policy began, you add what was there on the last day of the policy period, and you take A minus B plus C. That gives you the gross sales value of production, which is line D.

BUSINESS INCOME REPORT/WORKSHEET
FINANCIAL ANALYSIS

		12-Month Period Ending:		Estimated For 12-Month Period Beginning:	
	Income And Expenses	Manufacturing	Non-Manufacturing	Manufacturing	Non-Manufacturing
A.	Gross Sales	$	$	$	$
B.	Deduct:				
	Finished Stock Inventory (at sales value) At Beginning	–		–	
C.	Add:				
	Finished Stock Inventory (at sales value) At End	+		+	
D.	Gross Sales Value Of Production	$		$	
E.	Deduct:				
	Prepaid Freight – Outgoing	–	–	–	–
	Returns And Allowances	–	–	–	–
	Discounts	–	–	–	–
	Bad Debts	–	–	–	–
	Collection Expenses	–	–	–	–
F.	Net Sales		$		$
	Net Sales Value Of Production	$		$	
G.	Add:				
	Other Earnings From Your Business Operations (not investment income or rents from other properties):				
	Commissions Or Rents	+	+	+	+
	Cash Discounts Received	+	+	+	+
	Other	+	+	+	+
H.	Total Revenues	$	$	$	$

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"D" - Gross Sales Value of Production: Applies only to manufacturing risks.

This all makes sense when you remember which policy insures what:

Property/Value	CPP	BI
• Raw Materials	X	
• Stock in Process	X	
• Cost of Finished Product	X	
• Sales Values of Finished Stock Sold but not delivered	X	
• Sales Value of Finished Stock not yet sold		X

That's how you get to that line, the gross sales value of production, which again applies only to manufacturing risks. This accounts for the actual sales during the policy period, plus potential sales of finished products that have not yet been sold during the period of production. Remember, when we're doing the business income report and worksheet for manufacturers, we're not only estimating or calculating actual income, realized income. We are also calculating and using potential income from production during the policy period.

Doing this method that we just talked about – gross sales minus the finished inventory, the sales value of finished inventory at the beginning of the policy period, and adding back the finished value, the value of production during the policy period, the sales value of finished production – we get the gross sales value of production. Again, because the business income policy covers all income, realized or not, associated with the sales and production during the policy period. Again, basically the policy assumes that everything completed during the policy period is or could be sold, and on an accrual basis.

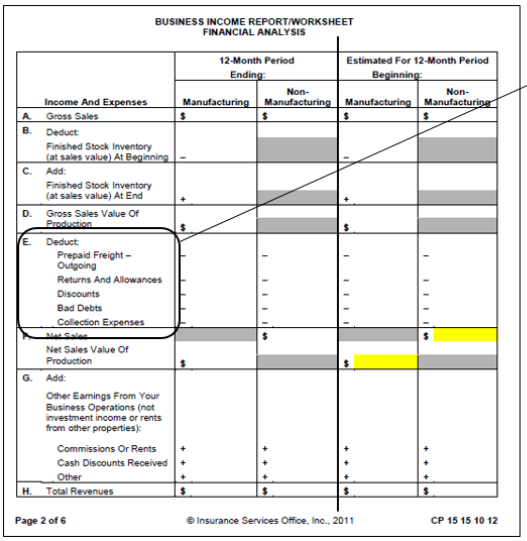
This all makes sense when you consider and remember which policy insures what. Remember, we broke down the component parts. The value of the raw materials are covered by the commercial property policy. The stock in process is also covered by the commercial property policy. The cost of the finished product is also covered by the commercial property policy. We're not talking about the income. We're talking about the value of it sitting on the floor. That's why we take this out. That's why we're not considering the raw materials and the goods in process, because that's covered under the commercial property policy. It's not yet finished to be sold, there's no income that can come from that yet. It's just there. The cost of the finished product, as I said, is also covered by the commercial property policy. The sales value of finished stock sold but not yet delivered, that's also covered by the commercial property policy. If you sold it and it's still sitting on the floor waiting to be delivered, the commercial property policy pays the amount that you sold it for.

The sales value of finished stock not yet sold is covered by the business income policy. This makes sense when you start remembering which policy pays what part of a loss. Remember, you're combining the commercial property policy with the business income policy.

So we've developed our gross sales value. Now we have to start making some deduction. I'm going to say this about 17 times today. When you're considering, and when you're doing a business income coverage, and when you're completing a business income report and worksheet, the only deductions that you consider, the only thing that you deduct and subtract from these numbers, from these gross sales value is what is on the form.

You do not discuss at this point, nor do you care, about which expenses will continue or will not continue or will be reduced after the loss occurs. That is irrelevant when you're completing the form. The only thing you consider when you are developing the business income exposure, the 12-month business income exposure, is what is on the form. That's it. Don't think about everything that might or might not continue after the loss occurs. It does not matter at this point. All we're talking about is what the form asks for. You don't have to have that conversation with the insured when you're completing the form.

Now let's look at our deductions in box E.



BUSINESS INCOME REPORT/WORKSHEET
FINANCIAL ANALYSIS

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
A.	Gross Sales	$	$	$	$
B.	Deduct:				
	Finished Stock Inventory (at sales value) At Beginning	–		–	
C.	Add:				
	Finished Stock Inventory (at sales value) At End	+		+	
D.	Gross Sales Value Of Production	$		$	
E.	Deduct:				
	Prepaid Freight – Outgoing	–	–	–	–
	Returns And Allowances	–	–	–	–
	Discounts	–	–	–	–
	Bad Debts	–	–	–	–
	Collection Expenses	–	–	–	–
F.	Net Sales		$		$
	Net Sales Value Of Production	$		$	
G.	Add:				
	Other Earnings From Your Business Operations (not investment income or rents from other properties):				
	Commissions Or Rents	+	+	+	+
	Cash Discounts Received	+	+	+	+
	Other	+	+	+	+
H.	Total Revenues	$	$	$	$

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"E" – Deduct Cost of Sales, Unrealized Income & Collection Expenses

Cost of Sales:

- Prepaid Freight – Outgoing
- Returns & Allowances
- Discounts

Bad Debts. Any spike will likely be considered a part of business income.

Collection Expenses. Any increase in collection expenses will likely be paid either as Business Income or as an "Extra Expense" (discussed in a later session).

We're going to deduct the cost of sales, unrealized income, and collection expenses. Basically, there are two types of deductions that we're making in box E – the cost of sales and business risk costs. If you'll notice, box E applies to both manufacturing and nonmanufacturing risks.

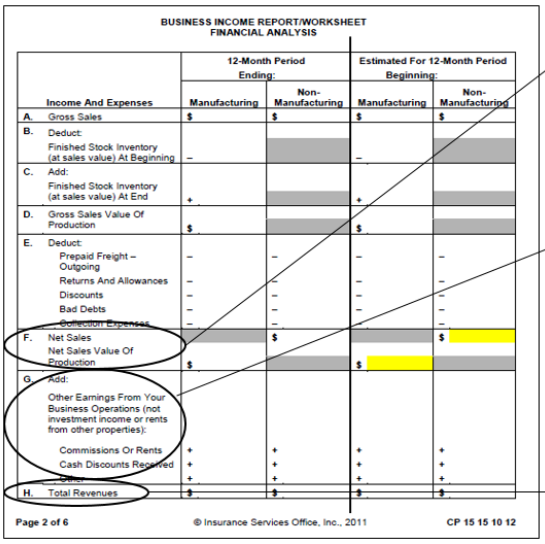
The three cost of sales deductions that we're making are the cost of prepaid freight – outgoing, returns and allowances, and discounts. Essentially, if you're not operating, you're not incurring these expenses. Those are our three cost of sales deductions that we're making.

There are also two business risk deductions that we're going to be making at this point – bad debts and collection expenses. The business income policy deducts bad debts. Coverage is excluded. Limits are excluded for normal bad debt expense. I use the phrase normal bad debt expense on purpose, because if the insured has any spike in bad debts after the loss, that might be considered part of the business income loss.

For example, if the insured's normal bad debt was two percent, two percent of their sales they can't collect, their normal bad debt is two percent. But after the loss, for some reason, people think they don't have to pay them because they're closed down for however long a period. If it was 2 percent normal bad debt, but after loss it jumps up to 10 percent, the additional 8 percent might be part of – it's subject to conversation and debate – but I tend to believe that that falls under the business income exposure and the business income loss because the increase would not have occurred apart from the business closing loss. People think that they can't pay because the business is temporarily closed.

Only the normal bad debt expense is excluded and is deducted at this point. Again, if it was two percent of sales, then that's normal bad debt expense, is excluded. Same thing with collection expenses. Normal collection expenses are deducted. If the insured's spending $50,000 a year on collection expenses, that is deducted here. You take out the normal collection expenses. However, again, if collection expenses increase following the loss, that might be – and I tend to believe – is covered under the business income because that becomes a continuing operating expense, or it might be paid out under the extra expense coverage.

Some way or another, any increase in expenses on bad debts and collection should be covered under the business income form, but ignore the ideas of the increased bad debt and collection expenses at this point. Just know that normal bad debt expenses and collection expenses are deducted from either gross sales or the gross sales value of production. The deduction in box E results in F, the net sales or the net sales value of production. You'll notice that there's two different things here.



BUSINESS INCOME REPORT/WORKSHEET
FINANCIAL ANALYSIS

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
A.	Gross Sales	$	$	$	$
B.	Deduct: Finished Stock Inventory (at sales value) At Beginning	–		–	
C.	Add: Finished Stock Inventory (at sales value) At End	+		+	
D.	Gross Sales Value Of Production	$		$	
E.	Deduct:				
	Prepaid Freight – Outgoing	–	–	–	–
	Returns And Allowances	–	–	–	–
	Discounts	–	–	–	–
	Bad Debts	–	–	–	–
	Collection Expenses	–	–	–	–
F.	Net Sales		$		$
	Net Sales Value Of Production	$		$	
G.	Add: Other Earnings From Your Business Operations (not investment income or rents from other properties):				
	Commissions Or Rents	+	+	+	+
	Cash Discounts Received	+	+	+	+
	Other	+	+	+	+
H.	Total Revenues	$	$	$	$

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"F" –Net Sales / Net Sales Value of Production

- **Net Sales** applies to non-manufacturing risks.
- **Net Sales Value of Production** applies to manufacturing risks.

"G" – Other Earnings

- Commissions or Rents
- Cash Discounts Received
- Other Income

Added to the amount in "F"

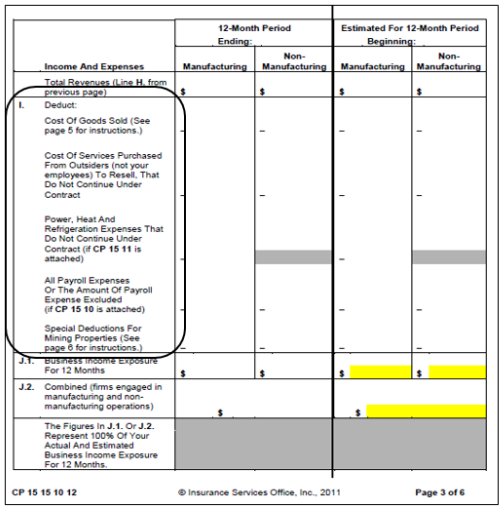
"H" – Total Revenues

After we subtract the cost of sales and the business risk expenses, you're left with either net sales, which applies to nonmanufacturing risks, or the net sales value of production, which applies to manufacturing risk because, remember, manufacturing risk is actual and potential income. On the manufacturing side, you start with gross sales, and you deduct and add, and have the gross sales value. You deduct again and you get the net sales value of production. On nonmanufacturing side, the only thing you do is you start with gross sales and you subtract everything in box E, to get your net sales.

Once you get to F, your net sales or your net sales value of production, depending on what type of operation it is, you add G, other earnings. It's other earnings that are derived at or from a specific location or business operation. If specific location, you're making commissions or rents, you add that. Cash discounts received, you add that, and/or other income. You have to be very careful with other income. Other income does not mean investment income. This means income that's assignable to a business location.

Investment income is, forgive the use of the term, an umbrella income. You're making it because the business has invested in something. We're not including investment income here. We're talking about something that can be attributable to that operation, one building or six buildings, or whatever, but it's attributable to the operation. It's not attributable to investments. Be very careful with that. Don't include investment income under that other earnings section. When you add F and G together, you get H, total insurable revenues. H, total insurable revenues, is carried over to the top of page three. Now let's move to page three of the form. We're going to start subtracting business and production-related expenses. We've subtracted five expenses already.

We're only going to subtract, potentially, five more – depending on the operation – more than likely, only two more, depending on what the insured does. When we get to box I here, we have five deductions that we have to deal with.



	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line H, from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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Five Deductions to Arrive at 12-Month Business Income

1. ***Cost of Goods Sold***: A Required Deduction (From page 5 of Worksheet)
2. ***Cost of Services Purchased and Resold*** (Required Deduction if Present)
3. ***Power, Heat and Refrigeration not Continuing Under Contract*** (Optional Deduction if Correct Endorsement)
4. ***Ordinary Payroll Expenses*** (Optional, Depending on Attachment of Endorsement)
5. ***Special Deductions for Mining Properties*** (Page 6 of Worksheet)

The cost of goods sold, which is a required deduction. We'll go to page five in just a couple seconds and discuss how to develop the cost of goods sold. You'll see the division of raw materials into its component parts again there. We deduct cost of goods sold, a required deduction; cost of services purchased and resold, another required deduction; power, heat and refrigeration not continuing under contract, an optional deduction; ordinary payroll expenses, another an optional deduction; and then special deductions for mining operations if you're writing a mining operation.

Since we're talking about the cost of goods sold, which is our very first required deduction, it doesn't matter if it's a manufacturing or nonmanufacturing risk. You have to deduct cost of goods sold. There's no choice in this. This is a required deduction of both manufacturing and nonmanufacturing operations. This again does not follow generally accepted accounting principle guidelines because it's not based on finished goods. Remember we took finished goods out to take it into the sales value of production. We've accounted for the sales value of finished products in the beginning part of the form, page two of the form. Now we're having to consider the things other than the sales value of the finished product. It's not generally accepted accounting principles when you're doing the cost of goods sold and in particular as it relates to the manufacturing operation.

The example that we're going to go over here for the next few minutes, we're going to look at it as if we were writing a manufacturing operation. Keep that in mind. I'm doing this from a manufacturing operational perspective, not nonmanufacturing because there are some things on the nonmanufacturing side that you don't have to deal with.

Let's talk about the cost of goods sold calculation. Again, it’s a required deduction. Here are our steps in the process, the beginning process of the cost of goods sold.

Supplementary Information

Calculation Of Cost Of Goods Sold	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
Inventory At Beginning Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	$	$	$	$
Add: The Following Purchase Costs: Cost Of Raw Stock (including transportation charges)	+		+	
Cost Of Factory Supplies Consumed	+		+	
Cost Of Merchandise Sold Including Transportation Charges (for manufacturing risks, means cost of merchandise sold but not manufactured by you)	+	+	+	+
Cost Of Other Supplies Consumed (including transportation charges)	+	+	+	+
Cost Of Goods Available For Sale	$	$	$	$
Deduct: Inventory At End Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	–	–	–	–
Cost Of Goods Sold (Enter this figure in Item I. on page 3.)	$	$	$	$

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Complete the Calculation for the Period Ending and the Upcoming Policy Period.

Steps in the Process

1. **Begin** w/Inventory at beginning of the year (this excludes finished stock as broken out earlier)
2. **Add**: Cost of Raw Stock purchased during the year (Mfg.)
3. **Add**: Cost of Factory Supplies Consumed during the year (Mfg.)
4. **Add**: Cost of Merchandise Sold
5. **Add**: Cost of Other Supplies Consumed

Equals: Cost of Goods Available for Sale

First of all, we begin with inventory at the beginning of the year, excluding the finished stock inventory because we already broke that out. We're going to begin with the inventory of the raw materials and the stock in process. That's the number we're putting in there. Forget finished stock. That's accounted for in a different place that we've already talked about.

On the cost of goods sold, raw material and stock in process at the beginning of the year, to that we add the cost of raw stock purchased during the year, raw stock only, and that applies only to the manufacturing. To that we add the cost of factory supplies consumed during the year, which applies again only to manufacturing operations. We add the cost of factory supplies consumed during the year. These are supplies that are used and made part of the finished product but essentially can't be traced or attached to a specific piece, like glue. You buy gallons and gallons and gallons of glue, but you can't assign a value of that glue to that one product necessarily. Or paint. You have gallons and gallons and gallons of paint, but you can't assign a value to that one piece of product.

You add the cost of factory supplies consumed. All the glue we consumed, the value of all the glue that is consumed, the value of all the paint that was consumed, and things like that.

This also is a little tricky because sometimes accountants don't always agree on what the definition of the factory supplies consumed is or it constitutes because some say this includes the supplies used for running the machinery, like oil and grease and things like that to lube the machines. Accountants might even have a different meaning on what this constitutes, which really doesn't matter because there's another addition that we're going to make in just a second that will pick it up anyway if it's not picked up under factory supplies consumed. To that we add the cost of merchandise sold.

When it says the cost of merchandise sold, it's the merchandise of outside suppliers sold as a product of the insured. The insured sells...I don't know the example you have. You have a boxed set of five different things, and one of the things in there is not made by the insured. They purchase it from an outside supplier, but they sell it in their package as their product. It's merchandise of an outside supplier sold by the insured, or as a product of the insured. You add the cost of merchandise sold, manufactured, or supplied by an outside supplier. To that, our last addition is the cost of other supplies consumed. We had the cost of factory supplies consumed. Now we have the cost of other supplies consumed.

Let’s look at gloves. The machine operators have to wear gloves. When the gloves wear out, you have to buy more gloves. Oil for the machines. We talked about that in our factory supplies consumed. It could go in either place, it doesn't matter. We're adding it,

we're picking it up, we're recognizing it. Safety glasses, earplugs, clipboards, whatever's being used as supplies in the manufacturing operation – other supplies consumed.

We have the cost of factory supplies consumed, but then we have the cost of other supplies consumed that apply to the process itself, which could apply to a manufacturing or a nonmanufacturing operation. I'm thinking if you go to a pharmacy or something, hopefully, they wear gloves when they're taking out the drugs and everything. All the gloves they throw away. My dad's been in the hospital a couple times. All the surgical gloves, and all the gloves that they have waiting in the room, everybody comes and puts on a set of gloves every time they come in the room. They leave the room, they take off those gloves, they come back in, they put more gloves on again.

I would love to have the glove concession to a hospital because of the millions of dollars I'm sure is spent on gloves. That's supplies consumed, and that's what we're talking about, the cost of supplies consumed. All that equals the cost of goods available for sale.

We begin with the inventory at the beginning of the year – raw materials and goods in process. That's it, not finished stock. Raw material and goods in process on the manufacturing side. Add the cost of raw stock. Add the cost of factory supplies consumed. Add the cost of merchandise sold, merchandise supplied by an outside supplier. Add the cost of other supplies consumed, and that equals the cost of goods available for sale.

When we get down to the cost of goods available for sale, now we subtract a little bit.

Supplementary Information				
	12-Month Period Ending:		Estimated For 12-Month Period Beginning:	
Calculation Of Cost Of Goods Sold	Manufacturing	Non-Manufacturing	Manufacturing	Non-Manufacturing
Inventory At Beginning Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	$	$	$	$
Add: The Following Purchase Costs: Cost Of Raw Stock (including transportation charges)	+		+	
Cost Of Factory Supplies Consumed	+		+	
Cost Of Merchandise Sold Including Transportation Charges (for manufacturing risks, means cost of merchandise sold but not manufactured by you)	+	+	+	+
Cost Of Other Supplies Consumed (including transportation charges)	+	+	+	+
Cost Of Goods Available For Sale	$	$	$	$
Deduct: Inventory At End Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	–	–	–	–
Cost Of Goods Sold (Enter this figure in Item I. on page 3.)	$	$	$	$

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From the: ***Cost of Goods Available for Sale***

- **Subtract**: Inventory on Hand at the End of the Year
- FINAL NUMBER: **Cost of Goods Sold**

From the cost of goods available for sale, we subtract the inventory on hand at the end of the year. Again, on the manufacturing side, remember, this does not include the value of

finished stock on hand at the end of the year, only the raw stock and the stock in process. Again, that only applies to manufacturing operations.

Supplementary Information				
	12-Month Period Ending:		Estimated For 12-Month Period Beginning:	
Calculation Of Cost Of Goods Sold	Manufacturing	Non-Manufacturing	Manufacturing	Non-Manufacturing
Inventory At Beginning Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	$	$	$	$
Add: The Following Purchase Costs: Cost Of Raw Stock (including transportation charges)	+		+	
Cost Of Factory Supplies Consumed	+		+	
Cost Of Merchandise Sold Including Transportation Charges (for manufacturing risks, means cost of merchandise sold but not manufactured by you)	+	+	+	+
Cost Of Other Supplies Consumed (including transportation charges)	+	+	+	+
Cost Of Goods Available For Sale	$	$	$	$
Deduct: Inventory At End Of Year (including raw material and stock in process, but not finished stock, for manufacturing risks)	–	–	–	–
Cost Of Goods Sold (Enter this figure in Item **I.** on page 3.)	$	$	$	$

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	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line **H.** from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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Nonmanufacturing operations, you include all stock. For manufacturing operation, only the value of raw stock and stock in process is considered in the cost of goods sold, which is why you cannot just give this to an accountant and say, "Fill this out." You have to explain the difference if you're dealing with a manufacturer.

Our final number is the cost of goods sold. All this calculation comes down to the cost of goods sold, which we'll see in just a second.

If you've dealt with accounting at all, one of the factors that's missing from the business income calculation of cost of goods sold that is included in the generally accepted accounting principles, the GAAP calculation is the cost of labor. You'll notice that's not on there anywhere.

Why is labor not considered in the business income ISO calculation of cost of goods sold? Because payroll, if you remember, is part of the continuing normal operating expenses and is thus included as part of the business income coverage, unless endorsed to remove it, to deduct it, which requires an endorsement. That's the reason why you're not going to deal with labor in cost of goods sold on the business income side, which you do on the GAAP side in manufacturing. As you can see, once you get down to the cost of goods sold on page five, you put it in the correct columns on page three of the calculation.

Let's keep going down our subtraction of expenses. We've deducted the cost of goods sold. Now we deduct the cost of services purchased from outsiders.

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line H. from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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Cost of Services Purchased from Outsiders

- Required deduction (if applicable)
- Only applies to outside services billed by the insured as part of their services
- The service has to end when the when production ceases. If there is a contract requiring payment regardless of production, then this cost is NOT deducted.

Note, this says "services purchased." We already talked about merchandise purchased from outsiders and sold to others, under the cost of goods sold calculation. We're deducting here the cost of services purchased. This, like the cost of goods sold, is a required deduction. These are the only two, cost of goods sold and the cost of services purchased from outsiders, are the only two required deductions. The next two are optional, and the last one only applies if you're dealing with a mining operation.

Only these two, cost of goods sold and the cost of services purchased from outsiders are required deductions. Again, it only applies to outside services billed by the insured as part of the insured's services. In order for this deduction to apply, the service must end when production ceases. Basically, if there's a contract that requires the payment to continue, regardless of production, this cost is not deducted. If manufacturing ends because of the loss, these services are no longer purchased so you deduct it.

If, however, there's a contract with the service provider that says, "We don't care whether you have any money coming in it or not. You're paying us $20,000 a month," then you do not deduct it. It's only if they end, if the business is shut down because of a business closing loss.

Let me give you an example of what we're talking about here, as far as cost of services purchased. Let's assume you're insuring a truss manufacturing operation and they hire an outside engineer to approve and stamp the trusses. The engineer's not out on staff. They're providing a service as an independent contractor, if you will. The manufacturer bills the cost, and builds the cost of the engineer into its contract with the final buyer. That's services purchased from outsiders.

If that ends, if the truss manufacturer has a fire, they can't operate, and they shut down, thus they're not hiring the outside contractor anymore to provide the services they were providing to stamp the trusses, improve them, and sign off on them, you deduct what those costs usually would be because you no longer have those expenses continuing.

We know that up front which is why if there's a contract in place that says you still have to pay them, you don't deduct it. Our only two required deductions are the cost of goods sold and cost of services purchased from outsiders.

Our next deduction is power, heat, and refrigeration expenses that do not continue under contract.

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line **H.** from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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Power, Heat and Refrigeration Expenses that do not continue under contract

- An optional deduction
- Requires the attachment of the CP 15 11 endorsement
- Most commonly seen with manufacturing operations

This is an optional deduction that requires the attachment of the CP 15 11 endorsement. If you don't have the CP 15 11 endorsement attached to the policy, you do not make this deduction. Most commonly, and actually, in reality, almost always this applies to manufacturing operations, and as you can see from the form, it only applies to manufacturing operations. You cannot make this deduction under nonmanufacturing. This is a manufacturing deduction – power, heat, and refrigeration expenses that do not continue under contract, and then only if you have the CP 15 11 attached.

The last one we're going to spend any time on discussing and detailing is ordinary payroll expenses, or the amount of payroll expenses excluded.

Income And Expenses	12-Month Period Ending:		Estimated For 12-Month Period Beginning:	
	Manufacturing	Non-Manufacturing	Manufacturing	Non-Manufacturing
Total Revenues (Line H. from previous page)	$	$	$	$
I. Deduct:				
Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1. Business Income Exposure For 12 Months	$	$	$	$
J.2. Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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All "Ordinary Payroll" expenses or the amount of payroll expenses excluded

- An optional deduction
- Only applies if CP 15 10 is attached
- Based on the number of days payroll being covered

What is an "Ordinary Employee?"

What expenses are included?

Again, this is an optional deduction. In the unendorsed business income form, all payroll is included within the definition of business income. Business income is net income loss that would have been earned had no loss occurred, plus continuing normal operating expenses, including payroll. So, in the unendorsed business income form, all payroll is included within the definition of business income.

As I said, the insured has the option to exclude some or all of the payroll, if they apply and attach the CP 15 10 endorsement. When they do that, it's based on the number of days of payroll being covered. The insured can say, "We're going to cover zero days. We're not going to cover any payroll of an ordinary employee at all. None." Or they can say, "We'll give 90 days of coverage. We'll pay for 90 days," or, "We're going to pay for 180 days of coverage." Those are their options. It's the payroll, again, of ordinary employees that is excluded.

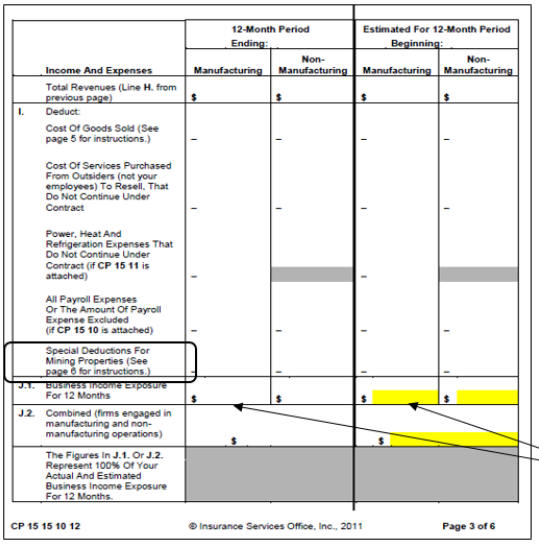
What is an ordinary employee? The policy arrives at the meaning of ordinary employee by, essentially, describing what an ordinary employee isn't. It says ordinary employees are all employees except – so anybody who is on this list is not an ordinary employee – officers, executives, department managers, employees under contract, and any specifically scheduled employee or job classes. Everybody is an ordinary employee, unless you're an officer, executive, department manager, employee under contract, or a specifically scheduled employee or job class. Everybody else is an ordinary employee.

The next question is, what expenses are included as part of an ordinary employee's payroll? It's payroll, employee benefit costs, FICA payments made by the employer, union dues paid by the employer, special compensation, like bonuses and work comp premiums assignable to that employee. That's all what's part of ordinary payroll.

ISO did something in 2008 that I'm still sort of befuddled by, and I'm planning on asking them about it at some point. In 2008, they introduced the discretionary payroll endorsement, the CP 15 04, which allowed certain employees to be covered. I think it was an unnecessary endorsement, given the options in the CP 15 10. When they put that endorsement out there, they wrote something in the rules that I think is just wrong. Basically, the way I read and understand the business income form, it covers all payroll expenses for the entire period of restoration. If it didn't, why would you need the CP 15 10? If it didn't already cover payroll, why would you need the option to exclude payroll? Doesn't make any sense at all to me. Also, if it didn't include payroll, why wouldn't you pick up the cost of employees, the cost of labor, under the cost of goods sold like generally accepted accounting principles?

I think ISO misconstrued its own business income form, as do a lot of adjusters, because of some of the wording and how loss is determined. Unfortunately, that's a conversation for a completely different day. We don't have time to go into all that right now.

Let's look at our last deduction, special deduction for mining operations. Again, this is only if you're insuring a mining operation, which I'm sure all of you do – obviously, that's supposed to be a bad joke.



	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line H. from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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Special Deductions for Mining Operations

- Royalties (unless specifically included in coverage)
- Actual depletion, commonly known as unit or cost depletion (not percentage depletion)
- Welfare and retirement fund charges based on tonnage
- Hired trucks
- (From page 6 of the worksheet)

Total is placed on appropriate line

If you're dealing with a mining operation, the deductions that are found on page six, that we'll look at very briefly, you deduct royalties, unless specifically included in the coverage, actual depletion, which is commonly known as unit or cost depletion, welfare and retirement fund charges based on tonnage, hired trucks, and that total is placed in the appropriate line.

Once we've done all of these deductions, we get to our big moment, the reveal. We get the drum roll, please. We get our 12-month business income exposures.

	Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
	Total Revenues (Line H. from previous page)	$	$	$	$
I.	Deduct:				
	Cost Of Goods Sold (See page 5 for instructions.)	–	–	–	–
	Cost Of Services Purchased From Outsiders (not your employees) To Resell, That Do Not Continue Under Contract	–	–	–	–
	Power, Heat And Refrigeration Expenses That Do Not Continue Under Contract (if **CP 15 11** is attached)	–		–	
	All Payroll Expenses Or The Amount Of Payroll Expense Excluded (if **CP 15 10** is attached)	–	–	–	–
	Special Deductions For Mining Properties (See page 6 for instructions.)	–	–	–	–
J.1.	Business Income Exposure For 12 Months	$	$	$	$
J.2.	Combined (firms engaged in manufacturing and non-manufacturing operations)	$		$	
	The Figures In **J.1.** Or **J.2.** Represent 100% Of Your Actual And Estimated Business Income Exposure For 12 Months.				

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TOTAL Revenue (Line "H")

(-) Specified Costs (page 3)

Business Income Exposure For 12 Months

We have total revenues from line H which we see at the top of page three, from which we subtract specified costs, everything we just saw in box I, only two of those being required – cost of goods sold and cost of services purchased from outsiders.

We come up with our business income exposure for 12 months, our 12-month business income exposure. That amount is entered in either J1 or J2 that I've highlighted for you. J2 is that situation if you have dual operations, where they have manufacturing and a nonmanufacturing retail outlet or retail operation and both of them operating. That's when you would use the J2 to combine.

Once you have the 12-month business income exposure, found in J1 or J2, depending on the operation, this is the beginning point. We've done all this to get to the beginning, because this is the amount to which you apply the worst-case period of restoration, to develop the coverage limit. As I said before, it is not necessary for you or the insured to know or even guess at what expenses will or will not continue or be reduced following a loss. Only those expenses that we have considered in the form matter at this point. Because now we've developed our 12-month business income exposure.

Once we've developed our 12-month business income exposure, we can apply our worst-case period restoration to come up with our business income limit. There's a couple more costs, there's a couple more expenses that we need to consider before walking away from the business income report and worksheet – two

additional expenses that we want to think about.

Two Additional Expenses

Income And Expenses	12-Month Period Ending: Manufacturing	12-Month Period Ending: Non-Manufacturing	Estimated For 12-Month Period Beginning: Manufacturing	Estimated For 12-Month Period Beginning: Non-Manufacturing
K. Additional Expenses:				
1. Extra Expenses – Form **CP 00 30** Only (expenses incurred to avoid or minimize suspension of business and to continue operations)			$	$
2. Extended Business Income and Extended Period Of Indemnity – Form **CP 00 30** Or **CP 00 32** (loss of Business Income following resumption of operations for up to 60 days or the number of days selected under Extended Period Of Indemnity option)			+	+
3. Combined (all amounts in **K.1.** and **K.2.**)			$	
L. Total Of **J.** And **K.**			"Estimated" Column $	

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.

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- Extra Expenses
- Extended Business Income and Extended Period of Indemnity

Result is total BI Limit for 12 months.

Extra expense is money that the insured purchases to pay for the increase costs of staying in business. We've moved to a new location while the building's being rebuilt. It pays for the cost to move the phone lines, it pays for the cost of advertising. It pays for all those extra costs, all those extra expenses that the insured is going to make in order to remain partially, at least, operational, for some period of time. We have the extra expense that we want to consider and purchase. Then we have extended business income and extended period of indemnity, which is one of our topics for today.

It pays for the additional loss of income suffered after the business reopens. We're going to detail that in just a little bit. Extended business income is a big exposure that very few people think of. Because, as I'm going to mention again, the insured actually has two loss periods anytime there's a business closing loss. We'll come back to that too.

Once you've decided how much extra expense coverage you want to purchase, and once you've decided whether or not you want to purchase more extended business income coverage, and how much more you want to purchase, you put it in K1 and K2. Then you add those together, and you add the total of K to the total of J – J1, J2 – and add that to K3. That tells you what your total business income exposure is for 12 months. Total business income limit for 12 months, plus your additional expenses, extra expense and extended business income.

Now, if you'll notice some key wording in the form under L. Look at the bottom under L. It says, the figure in L represents 100 percent of your estimated business income exposure for 12 months. We've already said that. It's your 12-month business income exposure. That's what you have estimated when you get to J1 or J2, and additional expenses. I love this wording. If the underwriter ever says, "We can't give you more than 12 months

coverage," yeah, you can. Actually, there are underwriters who believe that, so don't think I'm making this stuff up.

It says, "Using this figure" – and here's the key phrase – "as information..." This is information only, this is not anything other than to give you the starting point to develop your business income exposure. That's the reason for the worksheet that we discussed at the beginning of this session. It's information only.

"Determine the appropriate amount of insurance needed based on your evaluation of the number of months needed," which, again, it says in the form, "may exceed 12 months." It goes on to say, basically, to return to operational capability, to be back up and running like you were before. As if no property damage had occurred. The form itself tells you this is informational purposes only. This is where you start.

Once you developed all these, you start here. You apply the period of restoration to it and you come up with your correct business income limit and extra expense and extended business income limit. Just so you can say that you saw and that we talked about it, here's that special deduction for mining operations.

Supplementary Information		
Calculation Of Special Deductions – Mining Properties		
	12-Month Period Ending:	**Estimated For 12-Month Period Beginning:**
Royalties, Unless Specifically Included In Coverage	$	$
Actual Depletion, Commonly Known As Unit Or Cost Depletion (not percentage depletion)	+	+
Welfare And Retirement Fund Charges Based On Tonnage	+	+
Hired Trucks	+	+
Enter This Figure In Item **I.** On Page 3.	$	$

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Now we've gone through developing our 12-month business income exposure. If you have questions, you can visit www.independentagent.com/VU to research the topic further. Big "I" members can also use the Virtual University's Ask An Expert service, and you can always reach out to us at VirtualUniversity@iiaba.net.

“INSURABLE” VERSUS “COMPENSABLE” BUSINESS INCOME

Let's discuss a fact of business income that few agents, quite honestly and underwriters, ever really consider, and that’s the difference between insurable business income and compensable business income. These are actually two different things.

Insurable business income is a function of the revenues and expenses contemplated in the CP 15 15, the business income report and worksheet, what we just went over. It's the revenues and expenses to come up with our J1 or J2 exposure, business income, 12-month business income exposure and apply that to the worst-case period of restoration. Simply put, the insurable business income is the amount of business income developed in by use of the business income report and worksheet, the CP 15 15, again, found in the J1 and J2, modified by the worst-case period of restoration, which, again, might be more than 12 months.

If you have a situation when you calculate the worst-case period of restoration because of the facts of a loss, settling the loss, getting the plans drawn, everything you have to do before you can actually get the building built and then everything you have to do to actually be operational again. That's your worst-case period of restoration. You take your 12-month business income exposure and you apply the worst-case period of restoration to that to come up with what limit you actually need to cover the insured's business income exposure.

I hate to say it again, but I want to beat this home to you. Only specific sales-related expenses and production-related expenses are contemplated when creating a business income report and worksheet which develops the insurable business income. As I've already said 27 times, it does not matter any other expenses that continue, decrease, or disappear following a loss. We don't think about them. It does not matter when we're developing the business income exposure. That's when we're developing the insurable business income. We're not considering any other expenses. However – as I've said, in insurance there's always a however – we have the other side of this. We have the insurable business income but then we have compensable business income.

Compensable business income is the actual amount of business income paid to cover the amount of business income lost during the period of restoration. Business income as defined in the form. Compensable business income is the actual amount of business income paid to cover the amount of business income lost during the period of restoration. Basically, it's the amount necessary to indemnify the insured. It's based on net profit or loss before taxes plus continuing normal operating expenses, continuing normal and ongoing operating expenses incurred during the period of restoration, not

until after a loss do we consider and think about the expenses that will or will not continue.

Compensable business income, that phrase, that concept, represents the actual loss sustained. Wait a minute, I want to throw this out there very quickly. Everybody gets all worked up. They like the BOP because the BOP provides coverage for the actual loss sustained for business income but so does the business income form. It covers the actual loss sustained if you're writing coverage on a coinsurance basis. So the BOP isn't all that great, isn't all that wonderful. It isn't all of that because the regular business income form, if you write it correctly, provides coverage for the actual loss sustained by the insured and it's based on and applies the definition of business income.

Again, when written on a coinsurance basis, the business income policy indemnifies the insured. Indemnification requires that the policy pay the lost profit or any increase in expenses if it's operating at a loss plus continuing normal operating expenses. Excluded from the payment, we're not considering it when we're calculating insurable business income, but when we're calculating compensable business income, we exclude coverage or we exclude payment for operating expenses that are reduced or do not continue during the business shutdown, during the period of restoration.

Just for the sake of the conversation, what kind of expenses might cease or be reduced when the business is shut down? Things like advertising might be reduced if you shut down completely, but if you shut down partially, that might be an extra expense situation when you have to pay for more advertising to say, "We're at this new location right now." There might be an increased expense, but advertising might be reduced or go away completely. Charitable contributions. I hate to be that cold, but if you're not operating you may not be able to continue your charitable contributions. Might not be covered in business income anyway because it's not a normal operating expense necessarily. We won't get in that debate right now.

Janitorial services, there's nothing to clean. The building is damaged or destroyed. There's nothing to clean, so janitorial services go away. Maintenance and upkeep costs go away. Cutting the grass, all that good stuff might go away or be reduced because you don't have to cut it every week. Now you only cut it when the construction crews aren't there. Power and utility services might go away. Office supplies. You don't have an office, you don't have to buy office supplies. Postage, travel, legal fees, maybe, and other expenses might be reduced or be discontinued completely following a loss. Those are not covered when we talk about compensable business income.

Remember, none of these are contemplated when we are completing the business income report and worksheet and developing the insurable business income limit. Let's look at some key questions in regard to insurable versus compensable business income.

How much difference is there between the insurable business income amount and the compensable business income amount? I have no idea. There is no way to know. It depends on the operation and it depends on which expenses will disappear and which ones will be reduced and which ones will continue. There is no way to know for sure. If anything, it's nothing but a guess, and even that's going to be wrong. There's no way to know the difference between these two amounts, between compensable and insurable business income.

When might the difference be noticeable between the fact that you have insurable business income versus compensable business income? In reality, probably never. However, there are situations that might highlight the difference, like a partial period loss, if you will, might highlight the difference.

Let me give you a very simplified example. We'll keep the math very simple for me. Let's say the insured has a 12-month business income exposure of $100,000. They estimate that their worst-case period of restoration is 12 months, so they purchase the entire $100,000 worth of coverage. A covered loss occurs that results in a six-month shutdown, one half of the year. The insured said, "I bought $100,000 worth of coverage for one year of coverage, 12 months of coverage. I was closed down for six months." By simple math, I should get $50,000, but because of the expenses that ceased during the period of restoration, they are fully indemnified with only $40,000.

The insured might think they were cheated because, "Hey, I paid for $100,000 worth of coverage for 12 months. I was closed for six, but you only sent me a check for $40,000." That's because they were indemnified. They realized the same profit they would have realized and all of their expenses that were ongoing operating expenses were paid by just the $40,000. That's when it might be noticeable, but it's a reality that it does exist, the difference between insurable and compensable business income.

The next question, what can be done to adjust for the difference? Nothing. You can't do a doggone thing about it. In fact, nothing should be done. If you try to correct for the difference or the expected difference, you can create for the insured, or the insured can create for themselves, a coinsurance problem because the limits for the calculation of coinsurance in the business income form follow and use the same factors, the same methodology as does developing the insurable business income limit. The insured would basically just hurt themselves if they try to adjust for it, if they try to do something because there's a difference between insurable and compensable business income.

When the carrier goes to figure the coinsurance, the amount necessary to meet the coinsurance requirements get calculated the exact same way as the amount to come up with insurable business income, or essentially the exact same way. You don't want to adjust for it.

Our last question, are there any benefits to the difference? Yeah, actually there are. There are a couple, actually. There's additional coverage limits that get built in if the period of restoration is longer than expected. Remember the time doctrine; the business income policy pays as long as business income is being lost, coverage limits are available, and the insured has not or could not have reached operational capability, the ability to operate at pre-loss levels, or what we call the end of period of restoration.

If they have the insurable business income, the padding created by the difference between the insurable business income and compensable business income, if they underestimated the period of restoration, there is a little bit of fudge room in there, a little bit of a fudge factor in there that allows them to have a little bit longer coverage because of that difference, because of the gap between those two amounts.

A second benefit of the gap is that it also allows and provides some coverage for the 60-day extended business income, the 60-day extended period of restoration that's granted in the policy. Whether or not there's going to be enough to cover that 60 days is a function of the business income loss itself, the facts of that loss, and the difference between insurable and compensable business income.

Since we're talking about extended business income, let's focus on that a little bit. It's very unlikely that any insured's income will return to pre-loss levels immediately or soon after reopening, soon after reaching operational capability. How can the insured prepare for this loss of income experienced after reopening?

EXTENDED BUSINESS INCOME

We're going to detail in the next few minutes four main questions that have to be considered regarding the continued loss of income that the insured experiences after it returns to operational capability, after it has reached the end of the period of restoration. Remember, the return to operational capability, the end of the period of restoration, when they're back up and running, that does not equate to pre-loss income levels. Just because the store is open, just because the manufacturing operation can manufacture again does not mean it is making the same income that it would be making had nothing occurred – had there not been a fire, had there not been a windstorm damage, had there not been anything that happened to them. Just because they're now back up and running and able to operate in the same level they were able to operate at prior to loss, does not mean they are bringing in the same amount of money.

That's what we're talking about. We're talking about the difference between what they would have been bringing in – we'll define this again in a minute – hadn't the loss

occurred and what they are actually bringing in because of the realities of the post-loss, post reopening income levels.

There are four questions we're going to be looking at and answering. We're going to be talking about when do business income payments end. We're going to talk about what happens to the insured's customers or clients during a business shutdown. Then we'll talk about how long will it take for the insured to return to pre-loss operational income levels and, in all actuality, if they ever do. We'll end with how does the insured secure payment for this additional loss of income.

A lot of agents don't think about this. The insured needs income protection once it has returned to operational capability as much as it did during the period of shutdown. Think about this, once they become operational, they're going to be subject or victimized by a couple of different things. One, they're probably not going to have the same level of traffic, the same level of sales, the same level of production or orders or whatever that they did prior to the loss. Plus, all those expenses that disappeared during the period of restoration come back. They're now back up and running. They got all the expenses back that they lost during the period of restoration but they don't have as much income coming in. The difference between how much they have coming in and how much they would have had coming in is what we're insuring, but that could be a huge difference depending on the facts of the situation.

Let's talk first about when do business income payments end. Business income payments end once the insured has returned to operational capability. Operational capability is the ability to operate at pre-loss production and sales levels. The ability, not actually there, I have the ability to operate at pre-loss production and pre-loss sales levels. They've reached the end of the period of restoration and the business income policy specifically states that the period of restoration ends the earlier of, whichever one occurs first, the date when the property or the described premises SHOULD BE repaired, rebuilt, or replaced with reasonable speed and similar quality, not IS.

This is going to become important in just a couple of minutes – should be repaired or replaced, not is – or the day when the insured, the business, resumed at a new permanent location. We talked about that already.

The business income payment ends, the period of restoration ends the earliest of one of those two. Once the period of restoration ends, business income payments cease, except for a very limited amount that we're going to talk about in just a couple of minutes as it relates to extended business income.

Before we discuss the limited protection for the income that occurs after reopening, let's discuss what happens during the shutdown. Depending on the operation, there's a lot of different effects that the loss can have on the clients and the customers of your insured.

Retail operations, retail customers might find other stores or probably will find other stores because if I'm buying something from you and you're no longer there, I'm going to go find another store. Once I get to the other store, I might find out they have better prices or I like their people better or I went to school with the owner. I don't know, but I'm going to go find another store because you're not there. Retail customers go somewhere else and develop new buying habits or new buying places.

Service operations to some extent are victimized by the same thing. Their customers create new habits. Restaurant customers may develop new dining habits and start going to a different Mexican restaurant or a different Italian restaurant or a different hamburger place or whatever. They develop a new dining habit while you're shut down, while the insured is shut down. They might forget about the insured. "Hey, I really like these burritos better than the other burritos." Or like, "I'm a big Queso cheese dip kind of guy. I really like the cheese dip here better than the other place. I hope they reopen soon but I'm still going to come here. I like their cheese dip more than the other place." We've got this situation where they develop new buying habits.

Manufacturing, which is unique all the way around when it comes to business income, is one of those areas where you're going to see a real major effect on the customers or clients of the manufacturing insured because those within the manufacturing process enter new and likely long-term contracts and they find alternative buyers and suppliers. The buyer of the insured's widgets finds another widget supplier. The insured's supplier who is selling them the parts they needed to make the widgets finds another buyer. When you find another supplier or another buyer, production capacity changes.

If I have somebody who's supplying me and I am buying 30 percent of their capacity, and I shut down, I have a business closing loss. Now, I'm buying 30 percent of this company's capacity. When I'm back up and running, they lost 30 percent of their income because of me – we'll talk about dependent property coverage in just a second. They lost 30 percent of their production capacity or production output because of me, so they went and found a new buyer. Now that they've got that 30 percent or close to that 30 percent taken up already by another buyer, they may not have the capacity to manufacture it for me anymore.

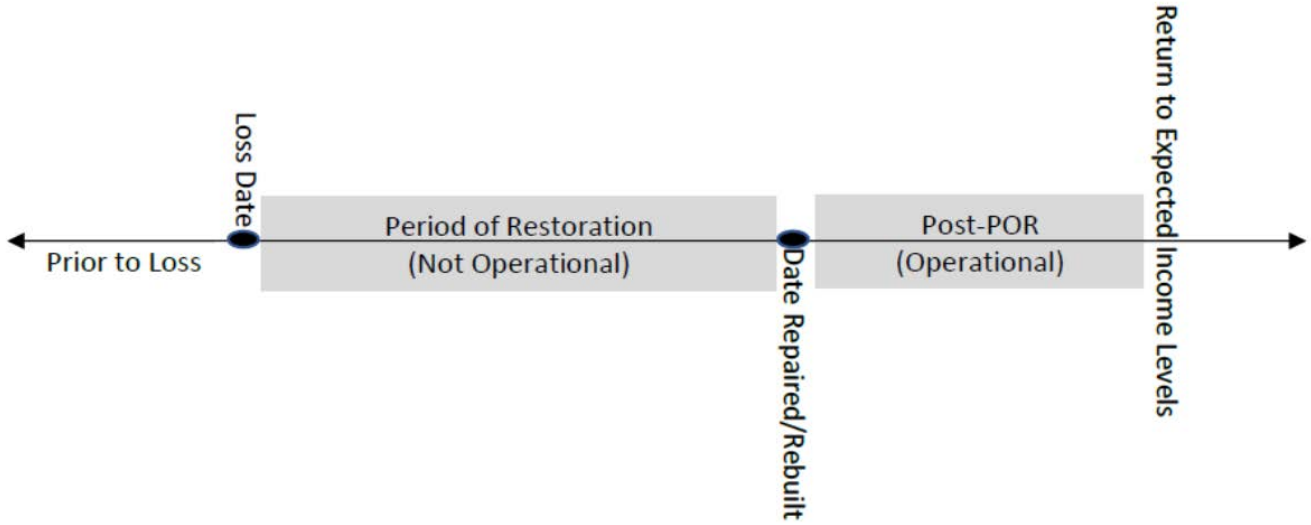
I have to find a whole new supplier, and that might take time until I get my supplier. Or if I am selling to somebody, they've started buying from somebody else, and they've got a long-term contract that says they agreed to buy from this other company for a minimum

of 18 months before they can cancel the contract. My buyer is now not buying from me, so I've got to go find a new buyer.

We have all these situations where the manufacturer may not be able to get what they need because their supplier entered new contracts or they might not be able to sell to who they used to sell to because they entered into new contracts and can't just escape the contracts because I'm back up and running. It becomes a situation that I am now victimized as a manufacturer by who's buying my product. I've got to go out and find new buyers. I've got to go out and find new suppliers or whatever the situation might be.

The result of all this is that even though the insured has returned to full operational capability, they're able to operate at the same level they were prior to loss, the insured might not return to pre-loss operational income levels for a long time after they return to operations.

What's the result? What are we talking about here? What we're looking at is that the insured actually has two loss periods. Take a look at this graphic.



You have their business prior to the loss. Then they have a business closing loss, and we have the period of restoration. They're not operational. The date when they repaired or rebuilt they're back up and running. They've reached operational capability as soon as they should have. They've met the should requirement. They're back up and running. However, our second loss period is that post-period of restoration. When they're operational but their customers have gone elsewhere or they have other problems such as they're not making the same amount of money that they were making before.

They have the loss period that's easily seen while the business is closed down. Then they have that second loss period that occurs after they're back up and running. Now, how

long that loss period's going to be depends on a lot of different things. Let's talk about that.

How long will it take to return to pre-loss income levels? I'm going to give you a deep, deep answer. It depends. I know…that's not an answer, but that is the reality. There are a lot of things on which the answers depend.

One, it depends on the operations. We talked about this already. Retail operations might actually have a relatively short return time. They might be able to return to pre-loss income levels within one or two months or three months. It might be pretty short. Restaurants and other service operations might require several months. For a restaurant, it might be anywhere from three months to six months. Now, these are not rules, so don't go and say, "Boggs said that a restaurant needs to have three to six months' worth of extended business income." There are too many other factors that go into this. I'm just talking about the reality of the fact that it depends on what the operations are. A restaurant, the old clientele might say, "Oh, they're back up and open." It might take them that long to find out, or they get bad service from the new place that they were enjoying, so they come back to the old place. It might take three to six months or so for a restaurant.

Hotels might take 8 to 12 months because if they had banquets, if they had all this other stuff that they had scheduled and the loss occurred right before Christmas, or right before the Super Bowl or whatever the situation might be, it might take them quite a while to return to pre-loss income levels.

Manufacturing operations and any operation on a production schedule or operating under contracts may require a year longer. In essence, it really is a guess based on how long it might take people to re-establish old habits or be able to re-establish old habits in the case of a manufacturing operation. I loved buying from this insurer that had the loss, but I'm in a contract with this guy over here and I can't get out of it for another 12 months. I'm going to come back to you but not for another so many months until this contract ends. That’s the reality. It depends on the operation. It also depends on market conditions.

Wildfires in California or hurricanes on the East Coast, the entire area might have been subject to a catastrophe. It really doesn't matter if I'm open and can operate if there's no one around or no one who can get to me or whatever the situation may be. It might be a collectively catastrophic problem. It depends on the market conditions. Or economic conditions in general might be poor in my area following a major catastrophic loss. The problem with that, that dependence if you will, is that loss due to market conditions is not covered by the policy or any standard endorsement. Now, I'm sorry the insured can't recover this type of loss. The reason for the inability to recover for a market condition

loss is because the market conditions aren't necessarily a function of the direct loss to that building. They're collectively catastrophic. They're area-wide. That's something that the policy is not able and is not willing to cover. These are basically indirect losses, if you will.

One last thought on the “it depends” method is it might also depend on the length of shutdown. The longer the shutdown, the longer it might take to return to pre-loss income levels. You have to consider that when you're thinking about the worst-case period of restoration, the worst-case shutdown when you're thinking about extended business income limits.

A city I used to live in, we had a restaurant that was damaged in a fire. It was shut down for two years for various reasons. By the time it was up and running again after that long, people had truly forgotten that it existed because it had been closed for so long. Yes, they were operational, they were up and running, but the time that it took them to get back to pre-loss income levels was a lot longer than it would've been if they'd only been shut down for six months because people literally forgot they existed. Advertising and everything else was required, all the costs that go with that, but because of the length of shutdown and people developed new habits, it took them a lot longer to get back where they were before the loss occurred.

How does the insured secure payments for this additional income loss, this second loss period? Remember, unendorsed business income policies provide a limited amount of coverage under the Additional Coverage 5.c. Coverage for extended business income is limited to the earliest of or the shortest of the insured returns to pre-loss operational income levels or 60 consecutive days. Again, we're calling this extended business income, so whichever one of those comes first. What happens if 60 days is not long enough?

If 60 days is not long enough, the insured needs to decide how long is coverage needed. We call this the extended period of indemnity. How much longer do we need than the 60 days to cover the secondary loss period? How long is coverage needed? Then we need to calculate how much additional coverage is needed, again also called the extended business income. We need to include that amount on the CP 15 15 in K2 that we talked about a little bit ago. We calculate how long coverage is needed. We take that length of time and we come up with a limit that we need to purchase and we include that on the business income report and worksheet.

There's not an endorsement required for this. A box has to be checked on the application, the ACORD 810, the business income supplementary application or if you're using a proprietary form whatever the proprietary application is. You specify the number of days coverage is desired and then you develop the amount.

Let's talk about where the money comes from for the first 60 days, the automatic coverage period. One thing I want you to pay attention to and understand about this "automatic coverage." Although the coverage for the first 60 days is found under additional coverages in the coverage form, the amount is not in addition to the business income coverage limit purchased. It is not in addition to the business income limit purchased, so it is not really additional limits. The amount for the extended business income for that 60 days is taken from the business income coverage purchased as long as there are limits available. What is paid during that "automatic coverage period"?

What's paid is the difference between what is made and what would have been made had there been no loss or damage. The difference between what is made by the insured and what would have been made had there been no loss or damage, and proof is required.

One more caveat that I want to mention as it relates to extended business income coverage. It does not begin to pay, it does not kick in, until operations ACTUALLY resume, not SHOULD HAVE resumed. There could be a gap between when the business income policy, the business income coverage, stops paying and the extended business income coverage begins to pay because the business income payments end when operations should have resumed.

If they should have been completed in 14 months but they're not completed for 16 months, that 2 months between when they should have and when they actually began, there is no coverage for that 2 months because the extended business income payments are not going to pick up until operations actually resume.

Now back to our question here. The amount paid is based on the definition of business income. It uses the same definition as it does for the period of restoration coverage, the business income coverage. We're paying the difference between what is made and what would have been made had there been no loss. It doesn't start calculating until operations actually resume, which leads us to the question, "Does the insured need to increase the business income limit to cover this initial 60 days?" As we said, it is not really additional coverage, is not really additional limits. It comes out of the business income limit purchase.

Part of the answer to that is found in the difference or gap between insurable business income and compensable business income that we just talked about. It depends on the loss situation, so there is no one answer.

What happens when 60 days is not enough? Depending on the operations, 60 days probably isn't going to be enough. In a general sense, 60-days automatic coverage for that second loss period probably isn't going to be enough. The insured does have the

option to increase the amount of time coverage is provided. The options available are 90 days, 120 days, 150, 180, 270, 365, 450, 540, 630, and 730 days so you can get extended business income coverage for up to two years.

- Options available:
  - 90 Days
  - 180 Days
  - 450 Days
  - 120 Days
  - 270 Days
  - 540 Days
  - 730 Days
  - 150 Days
  - 365 Days
  - 630 Days

- Calculate the estimated amount of coverage needed:

(12 mos. BI exposure / 365) x (Total Number of Days – 60) = Amount

($1,387,000 / 365) x (180-60) = **$456,000** (place on K.2.)

Once the insured has chosen how much coverage they want, the additional amount of time they need, then they can develop or estimate the amount of extended business income coverage, the limit that they need.

We've given you an example right here. In our situation, we're going to take the 12-month business income exposure that we developed off the business income report and worksheet. We're going to divide that by 365. Now, why in the world would we do that? [laughs] Because there's 365 days in most every year.

We're going to multiply that times the total number of days minus 60 because we're subtracting the 60 days of "automatic coverage" that we get to equal the amount of coverage we want to purchase. In our example, which we had a business income exposure of $1,387,000 for 12 months, we divide that by 365.

We multiply that times 180 minus 60, which is 120, which gives us $456,000 of extended business income coverage for our extended period of indemnity. We put that on line K2.

Now, there are a couple schools of thought, there are a couple of different ways to choose the needed limit. It depends on your perspective, if you will. The first school of thought is what I laid out here, where you subtract the number of automatic days, the 60 days, and do 180 minus 60. You need 180 days-worth or six months-worth of coverage. You subtract the 60 that's automatic in the form and you purchase the $456,000 limit. You put 180 days down because, remember, there's no coinsurance involved in this

situation. There's just a limit that they're paying. You put down 180 days and the $456,000 worth of coverage.

There's the other school of thought that says ignore the 60 days and buy the amount of coverage that you need or buy the amount that the full 180 days institutes or creates. In our case, if we did the $1,387,000, divide that by 365 and we multiply that times 180, the extended business income limit would be $684,000.

My recommendation is to do both calculations. Do the total number of days you've chosen minus the 60 times the 12-month exposure amount divided by 365. Do it that way and do it where you don't consider the first 60 days. Then take the average of those two.

Again, there's not a penalty and I would much rather be over-insured than underinsured. The reason why, in my personal opinion, I don't think you need to take the total number of days, the 180 and ignore the 60 days, is because the insurer should have some income coming in. We're not going from zero here. They do have some income coming in, hopefully. At least the anticipation is they have something coming in, so this is not a full business income loss, if you will. This is a partial loss, second loss period. I recommend doing both calculations, the total number of days you want minus 60 times the calculation to come up with that amount and forget the 60 and come up with that amount, and take the average of those two.

It might be too high. It might be overkill, but, again, I'd rather be over-insured, than underinsured following a loss. You're not going to suffer any penalty anyway. That's my recommendation.

What are some limitations that apply to extended business income? Extended business income cannot be used with the maximum period of indemnity or the monthly limit of indemnity.

The inability to use extended business income with either one of those options, monthly limit or maximum period of indemnity, is just one more reason not to use them. The key reason is because they're not actual loss sustained coverage, necessarily. They're a non-indemnity option. You get a maximum, so I don't recommend using them anyway.

We haven't discussed those at all, but I recommend against them. Use the coinsurance. It also cannot be used if coverage is written on a no coinsurance basis, which is not the same as a non-coinsurance option, and the option is not available for extra expense protection.

EXTENDED BUSINESS INCOME

And now let's move to our last topic – dependent property coverage or what some people call contingent business income coverage.

Isn't that a pretty car? I just put that up there because we're going to talk about Corvettes, just very quickly. Dependent property coverage or contingent business income. I'm going to start with a brief quiz.

Assume, for a moment, that you work in the Risk Management Department at General Motors. You find out that the three most popular colors for the Corvette, representing 52 percent of your total 2017 model year Corvette sales, are manufactured in only one place in the world. Question, do you think GM has a potential problem? Yes.

It's called dependent property or contingent business income coverage, because if they can't get the paint they can't paint the cars and they can't sell the cars, so they lose money. That's one example of a dependent property exposure.

Business income coverage covers the loss of business income when a covered cause of loss damages an insured location resulting in a suspension of operation. In the unendorsed form, damage to dependent properties is not covered by the form. Dependent property losses are key exposures that you have to consider when you're dealing with business income, when you're dealing with your insured and talking about who helps them make money, if you will. We're depending on somebody else to make money. It's not just me out here. There's somebody else that does something that brings people to me, that sends me things, that buys stuff from me, whatever. They have a dependency on somebody or something else.

Let's talk about what constitutes dependent property. Dependent property is an external, which means one outside of the insured's operations, outside the insured's family, if you will. An external property or operation necessary for or vital to the continued viability of

the insured. Basically, the insured needs this place to make money. The GM needs this paint, these three colors of paint manufactured by this one manufacturing operation in this one building in this one town in the world in order to paint the Corvettes to sell them. They have a dependency on the continued operation, the continued viability of that building, of that operation.

When we're dealing with dependent properties, dependent properties are not limited to mutually beneficial relationships. In fact, there might be situations where the insured is the only party benefiting from the existence of the property.

Let's talk very briefly about where you might find some dependent properties. I'm going to give you my terminology for it and I'm going to give you ISO's terminology. I think my terminology is much easier to remember than ISO's, but that's just my personal opinion.

The four types of dependent properties that we're dealing with on a regular basis are:

1. Suppliers
2. Buyers
3. Providers
4. Drivers.

Suppliers, buyers, providers, and drivers, that's my terminology because it's easy to remember.

ISO calls suppliers contributing locations. That's stupid, you think, just call them suppliers. No. Suppliers are contributing locations. ISO calls buyers recipient locations, providers manufacturing locations, and drivers leader locations.

Easy to remember if you just call them suppliers, buyers, providers, and drivers. Suppliers are contributing locations. Buyers are recipient locations. Providers are manufacturing locations, and drivers are leader locations.

Suppliers or contributing locations according to ISO, they created the form. Suppliers supply the insured with parts, raw materials, or services. They might be the sole source or the major source of the material. If the source cannot supply the necessary material, what happens to the insured? If the insured needs the sprocket manufactured by Spacely Space Sprockets – those of you who remember "The Jetsons" know what I'm talking about – to make the widget and Spacely suffers a loss, a business closing loss and they cannot supply the sprockets, the insured ceases to operate until they can find a new supplier of those goods. They need Spacely's sprockets in order to operate, to

manufacture what they manufacture. They need this supplier. They need this contributing location.

One thing to remember, we're talking about contributing locations and suppliers. Water, power, and communication service providers are not within the definition of a supplier. Those have to be covered under time element, the CP 15 45.

The supplier is supplying, is contributing something to your insurer. If that supplier, if that contributing location cannot supply it, cannot contribute that part, that service, whatever it is because of a business closing loss which we'll see in just a minute, that would be covered if it happened to the insured, the insured cannot operate until that supplier can be replaced.

Buyers or recipient locations per ISO are the other side of that. These are the ones that buy or accept the products or goods manufactured or made by the insured. A big deal is how much of the manufactured product is bought by a particular buyer, and contracts can play a major part in that. There's a dairy farm example of this that a loss occurred way back in 2008. In 2008, Saputo Cheese Plant in Vermont burned down. Which is bad enough, the fact that you have a cheese plant that burns down, and 88 local dairy farmers derived all or a large majority of their income by supplying milk to that plant.

The plant was no longer operational. They were no longer buying milk from those dairy farmers. What happened to those dairy farmers' income? Nothing happened to their location, nothing happened to their buildings, but their buyer, their recipient was no longer operational, thus they lost all or a majority of their income. That is a buyer or recipient location dependent property exposure.

Who is your insured buying from? Who is your insured supplying to, and how much of it? If a buyer only constitutes five percent of my income, I'm not too worried about that, but if they constitute 25, 35, 50, 75 percent of my income, and they're no longer operational, that's a big hit on me. I depend on them. If I get 75 or 50 percent of my supplies from one supplier, we got a major problem if something happens to that supplier. We're looking at supply chain problems on both sides, the supplier and the buyer. Some people might call it a supply chain type coverage, but it's dependent property coverage.

Our third are providers. Providers are called manufacturing locations by ISO. It's a manufacturing operation that is not a location owned by the insured. It's a separate manufacturer outside the family, remember? This is dependent property, they're outside the family. They act as the manufacturer for the insured, but they're not owned by or a subsidiary of the insured.

I used to have an insured who was an inventor. He was some kind of engineer. He invented a type of system that supported buildings that were on sand in case an earthquake hit. Sand, evidently, when it's hit by an earthquake, liquefies and just disappears. He invented a system that would keep the building standing. He was a one-man operation. He didn't have the capacity to manufacture this system. So he contracted out the manufacturing work to a provider, to a manufacturing location. If all his manufacturing is being done by this one manufacturing location and it burns down, he is no longer having his system built until he finds a new manufacturer. That's a dependent property for him. That's the provider. The provider is no longer there, thus, he's not making any sales of the system he created, that he designed. He's got a dependency on the continued viability of that provider.

Our last one is drivers or leader locations per ISO. What drives people to you? This is the fun one. Many of your insureds have this exposure and you don't even realize it. I don't mean to be snotty in the way I say that, but a lot of agents don't realize the effects of leader locations, of drivers. In this situation, in the driver or leader location situation, this is exclusively beneficial to the insured. The driver does not benefit from the existence of the insured necessarily. Like anchor stores – Belk, Macy's, Heck's, Sears – all the big stores at the corners of the mall, those are the drivers. That's what people come to the mall for. Then you have all these little shops in the middle of the mall where people walk by and walk into this little mom and pop shop, where that mom and pop shop is dependent upon the leader locations that bring everybody to the mall.

Sporting events, sporting venues are leader locations. Imagine a few years ago when the damage occurred in New Orleans to the Super Dome. What if they had something getting ready to go on there and they couldn't go on because of the damage? That's a leader location to all the hotels and all the restaurants in the area. That's a driver.

Major attractions, convention centers, casinos, those are all drivers. Those are all leader locations. There's some other examples that you might not think of. Bass Pro Shops is one of the most visited places in North Carolina. It's in top 10 of tourism in North Carolina. It's just a big place for boats and everything else. That's a driver location to everybody in that mall, where the Bass Pro Shop is located.

One I guarantee that a lot of people don't ever think about is Walmart. Whenever a Walmart goes up, an entire little city gets built around Walmart. That Walmart becomes a leader location. That's what's bringing everybody to the spot. I have one near my house. After the Walmart was built, all these shops and little restaurants, and little knick knack shops, everything went up around the Walmart. If something happened to that Walmart, people would stop coming to that area. That is a leader location. That's a driver.

Essentially, when you're looking at drivers, you're looking at what is bringing people. What is driving customers to your location? They're coming to go to Walmart, but they're eating lunch at your insured's restaurant. They're coming to go to Bass Pro Shop, but they're going to the knick knack shop on their way, whatever. What's bringing people to the area?

Dependent property coverage is added to the policy by endorsement. There are five dependent property endorsements that we want to mention very quickly. There are three business income dependent property endorsements and two extra expense business income dependent property endorsement.

- Business Income from Dependent Properties – Limited International Coverage (CP 15 01)
- Extra Expense from Dependent Properties – Limited International Coverage (CP 15 02)
- Business Income from Dependent Properties – Broad Form (CP 15 08)
- Business Income from Dependent Properties – Limited Form (CP 15 09)
- Extra Expense from Dependent Properties (CP 15 34)

Let's briefly look at each one of these.

Two international coverage forms – Business income from dependent properties limited international coverage. Limited is the key term in there, the CP 15 01. You can attach it to both the CP 00 30, business income with extra expense and the 32, the business income without extra expense. It only covers the business income exposure, the dependent property exposures created by suppliers or providers, not buyers, suppliers or providers only. If they're sending something to you or they're manufacturing something for you on an international basis, that can be covered by this form. Not buyers, suppliers or providers only.

The insured has to select a specific amount of coverage for this, and it's designed to extend coverage to locations outside the normal coverage territory, coverage territory as defined in the commercial property policy, which defines it as US territories, possessions, Puerto Rico, and Canada. If it's a supplier or a provider outside the traditional coverage territory, you use limited international coverage, but again, only suppliers or providers, not buyers. Only suppliers or providers, and you cannot use it with a business income agreed amount, agreed value option.

Then extra expense from dependent properties, limited international coverage. Basically, it mirrors the CP 15 01 except that it provides only extra expense coverage, and rates on these are generally company specific.

Business income from dependent properties broad form, the CP 15 08, which applies to all four dependent property types – suppliers, buyers, providers, and drivers. All four dependent property types you can put on the broad form, the CP 15 08.

The entire business income amount developed for the insured, the J1 or J2 amount, is available to cover a dependent property loss. The entire amount that you purchase for the insured is available for the dependent property as well, and it includes extra expense coverage if you attach to the CP 00 30.

The endorsement, the CP 15 08, cannot be used if you're providing coverage on an agreed value basis, on an agreed amount basis, or using the premium adjustment endorsement, the CP 15 20 that we talked about at the beginning of class. That's the business income from dependent properties broad form.

The business income from dependent properties limited form, the CP 15 09, again applies to all four types of dependent properties, but the insured specifies the amount of coverage they want, and it includes business income and extra expense, if they are attaching it to CP 00 30.

Our extra expense endorsement, the CP 15 34, extra expense from dependent properties. It mirrors the CP 15 09 limited form, applies to extra expense coverage only, and the insured chooses to limit.

Here are five policy provisions that apply to every dependent property endorsement.

No coverage if the loss leading to the dependent property shutdown is limited to the damage or destruction of electronic data. Business income and extra expense are defined the same in these forms as they are in the business income form.

The period of restoration here is the same definition beginning at 72 hours or whatever it's endorsed down to after the loss and ending when the property should be repaired, rebuilt, or replaced with reasonable speed. To be covered, the loss causing the dependent property shutdown must be one that would be covered if it occurred to the insured's property.

So if it's flood, there's no coverage. If it's fire and the insured's property is covered by fire, there's coverage. It has to be something that would be covered if it happened to the insured.

Last page, policy provisions, applicable to the broad form, the CP 15 08 and the limited form, the CP 15 09. Remember, this is domestic coverage only. The dependent property business income loss will be reduced if and when the insured can find another buyer or supplier. They'll pay for your loss of your supplier or your buyer until you can find a new buyer or a supplier to replace the one that you lost.

With that, I bid you farewell. I appreciate the time you've taken to read this document and hope it has been of some benefit to you. If you have any questions about what we've covered, please visit www.independentagent.com/VU to research the topic further. Big "I" members can also use the Virtual University's Ask An Expert service, and you can always reach out to us with questions, comments, or concerns at VirtualUniversity@iiaba.net.

ABOUT THE AUTHOR

Christopher J. Boggs, CPCU, ARM, ALCM, LPCS, AAI, APA, CWCA, CRIS, AINS, is the executive director of the Independent Insurance Agents & Brokers of America (the Big "I") Virtual University. He joined the Big "I" team in November 2016. His current duties involve researching, writing, and teaching property and casualty insurance coverages and concepts to Big "I" members and others in the insurance industry.

During his 29-year insurance career, Boggs has authored nearly 1,000 insurance and risk management-related articles on a wide range of topics as diverse as Credit Default Swaps, the MCS-90, and enterprise risk management. Additionally, Boggs has written 15 insurance and risk management books:

- *The Insurance Professional's Practical Guide to Workers' Compensation: From History through Audit*, now in its second edition;
- *Business Income Insurance Demystified: The Simplified Guide to Time Element Coverages*, now in its third edition;
- *Property and Casualty Insurance Concepts Simplified: The Ultimate 'How to' Insurance Guide for Agents, Brokers, Underwriters and Adjusters*;
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- *The Truth about Enterprise Risk Management;*
- *The Experience Mod Worksheet;*
- *What has ISO Done to us Now?* and
- *Cancellations, Non-Renewals & Conditional Renewals: THE Insurance Professional's Guide to Statutory Insurance Carrier Notification Requirements for All 50 States!*

In addition to his responsibilities at the Big "I", Boggs is a regular speaker at industry events including the National Association of Mutual Insurance Companies (NAMIC), the National Society of Insurance Premium Auditors (NSIPA), the American Association of Managing General Agents (AAMGA), the Institute of Work Comp Professionals (IWCP), and the Chartered Property Casualty Underwriter (CPCU) Society. He has also earned numerous professional accolades including the 2017 Institute and Faculty of Actuaries (IFoA) Brian Hey Prize and the 2019 Casualty Actuarial Society (CAS) Charles A. Hachemeister Prize as part of a of collaboration with a diverse group of industry professionals.

His professional background includes work as a risk management consultant, loss control representative, insurance producer, claims manager, journalist and columnist, and quality assurance specialist.

Boggs earned a Bachelor of Science degree in journalism at Liberty University in Lynchburg, Virginia, and holds nine professional designations.

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