INSURANCE CLAIMS

Insurance
(To cover risk of loss)

- **Life Insurance**
  Maturity of Policy or Death w.e. is earlier
- **General Insurance**
  On the happening of event
  (Generally : 1 Year)
  - Loss of stock
  - Loss of Profit

CONCEPT 1:

Loss of Stock

1/4/21 — 31/7 (Incident of FIRE) — 31/3/22

Step 1:

Memorandum Trading A/c [1/4 to 31/7]

Particulars	Amount	Particulars	Amount
To opening stock (at cost)		By Sales	
To Purchases		Add: Sales Misappropriation	
Less Returns		Less: Sale on Approval basis	
(At cost) Less Samples/Drawings		By Stock with Customers	
Less Capital Expenditure		By Goods sent to Consignee	
To Wages/Direct Expenses		By Closing stock (B.F.)	
To Gross Profit (Sales × GP%)			

1) Purchases means where goods have been received & Sales means where goods have been delivered

2) GP(%)

- If Given
  - Apply Same
  - Eg: Sales 600000
    - 20%
      - GP = 6L × 20%
      - => 120000
    - 20% of Cost
      - GP = 6L × 20/120
      - = 100000
- If Not Given
  - Prepare Last Year/s Trading A/c (as per Information given)
  - Find out GP & then GP(%)
  - $GP(\%) = \frac{GP}{Sales} \times 100$
    - If 2 years data given
      - Apply simple Average
    - If > 2 years
      - Trend ✓
        - Weighted Average
      - Trend ×
        - Simple Average

Step 2: Computation of claim:

In Step 1, we have computed stock on date of fire.

Now there can be

a) Total Loss

b) Partial Loss

a) Total Loss (100% stock destroyed)

	Case 1	Case 2
Loss of Stock	200000	200000
Policy Amount	250000	150000
Claim	200000	150000

b) Partial Loss (Some stock salvaged/ Saved)

	Sufficient Policy	Insufficient Policy: Without Average Clause	Insufficient Policy: With Average Clause
Stock on date of fire	200000	200000	200000
− Salvage	(30000)	(30000)	(30000)
Loss of stock	170000	170000	170000
Policy Amount	250000	150000	150000
Claim	170000	150000	127500

$\left[\frac{170000}{200000} \times 150000\right]$

Note: If salvage delivered to Insurance company, it is consider as stock lost
If there is fire fighting expenses then it will be shown as:

Stock on date of fire	XX
− Salvage	(XX)
+ Fire fighting Expenses	XX (Max. upto Salvage)
Loss of stock	XX

Question

A fire engulfed the premises of a business of M/s X Ltd. in the morning, of 1st October, 2020. The entire stock was destroyed except, stock salvaged of Rs. 50,000. Insurance Policy was for Rs. 3,00,000 with average clause. The following information was obtained from the records saved for the period from 1st April to 30th September, 2020:

Sales	27,75,000
Purchases (including Purchase of Machinery 1,00,000)	20,30,000
Carriage inward	35,000
Sales value of drawings	20,000
Cost of goods distributed as free sample	10,000
Wages (including installation of Machinery 10,000)	50,000
Cost of goods sent to Consignee on 20th September 2020, lying unsold with them	30,000
Stock in hand on 31st March, 2020 (lower than 10% cost)	3,15,000

Additional Information:

(1) Sales upto 30th September, 2020, includes Rs. 75,000 for which goods had not been dispatched.
(2) On 1st June, 2020, goods worth Rs. 1,98,000 sold to Hari on approval basis which was included in sales but no approval has been received in respect of 2/3rd of the goods sold to him till 30th September, 2020.
(3) Purchases upto 30th September, 2020 did not include Rs. 1,00,000 for which purchase invoices had not been received from suppliers, though goods have been received in godown.
(4) Past records show the gross profit rate of 25% on sales.

You are required to prepare the statement of claim for loss of stock for submission to the Insurance Company

Solution

Memorandum Trading A/c
(1.4.20 to 30.9.20)

Particulars	(Rs.)	Particulars	(Rs.)
To Opening stock (3,15,000*100/90)	3,50,000	By Sales	25,68,000
To Purchases (W.N. 1)	20,05,000	By Goods with customers (for approval) (W.N.2)	99,000
To Wages (50,000 – 10,000)	40,000	By Goods with consignee	30,000
To Carriage inward	35,000	By Closing stock (bal. fig.)	3,75,000
To Gross profit (Rs. 25,68,000 x 25%)	6,42,000		
	30,72,000		**30,72,000**

Computation of claim for loss of stock

	Rs.
Stock on the date of fire (i.e. on 1.10.2020)	3,75,000
Less: Stock salvaged	(50,000)
Stock destroyed by fire (Loss of stock)	3,25,000

Insurance claim

Average clause is applicable as insurance policy amount (Rs. 3,00,000) is less than the value of closing stock ie. Rs. 3,75,000

$$\text{Claim} = \frac{\text{Loss of Stock x Policy Amount}}{\text{Stock on date of fire}}$$

$$= \frac{3,25,000 \times 3,00,000}{3,75,000}$$

$$= 2,60,000$$

Working Notes:

1. **Computation of Purchases**

	Rs.
Purchases (Given)	20,30,000
Less: Purchase of Machinery	(1,00,000)
Less: Cost of Drawings (20,000-25%)	(15,000)
Less: Cost of Goods distributed as samples	(10,000)
Add: Goods physically received in godown	1,00,000
	20,05,000

2. **Calculation of goods with customers**

   Since no approval for sale has been received for the goods of Rs. 1,32,000 (i.e. 2/3 of 1,98,000) hence, these should be valued at cost i.e. Rs. 1,32,000 – 25% of Rs. 1,32,000 =Rs. 99,000.

3. **Calculation of actual sales**

   Total sales – Goods not dispatched - Sale of goods on approval (2/3rd) =
   Sales (Rs. 27,75,000 – 75,000 – Rs.1,32,000) = Rs. 25,68,000

CONCEPT 1A: Abnormal Stock/Item

Trading Account [Last Year]

Particulars	Amount	Particulars	Amount
To Opening Stock		By Sales	
To Purchases		By Closing Stock Actual Value shown in books Add: Amount written off	
To Gross Profit (Bal. Figure)			

Memorandum Trading A/c

Particulars	Normal	Abnormal	Total	Particulars	Normal	Abnormal	Total
To Opening Stock				By Sales			
To Purchases				By Loss on sale			
To Direct Expenses				By Loss on revaluation			
To Gross Profit (% of Normal sales)				By Closing Stock (Bal. figure)			

<u>Treatment of Abnormal Items of Stock</u>

1) If any abnormal items of stock is given in question, then amount which has been written off from this stock shall be 1st of all added in closing stock while preparing last year Trading A/c.
2) Total value of this closing stock shall be written in total column in Memo Trading A/c, the original cost of abnormal items shall be written in abnormal column & the balance stock shall be written in normal column.
3) For loss of stock on date of fire, closing stock includes both normal & abnormal stocks.
4) Unless otherwise stated, estimated value of stock on date of fire consists of book value of normal items & book value of abnormal items. Sometimes specific valuation of abnormal items is given for purpose of claim, then instead of book value such valuation should be taken.

Question

A fire occurred in the premises of M/s. Z & Co. on 30-06-2020. From the salvaged accounting records, the following particulars were ascertained

Stock at cost as on 01-04-2019	1,20,000
Stock valued as on 31-03-2020	1,30,000
Purchases less return during 2019-20	5,25,000
Sales less return during 2019-20	6,00,000
Purchases from 01-04-2020 to 30-06-2020	1,32,000
Sales from 1.4.2020 to 30.6.2020	1,66,000

In valuing the stock for the Balance Sheet at 31st March, 2020, Rs. 5,000 had been written off on certain stock which was a poor selling line having the cost of Rs. 8,000. A portion of these goods were sold in May, 2020 at a loss of Rs. 1,000 on original cost of Rs. 7,000. The remainder of the stock was now estimated to be worth its original cost. Subject to that exception, gross profit had remained at a uniform rate throughout the year.
The value of the salvaged stock was Rs. 10,000. M/s. Z & Co. had insured their stock for Rs. 1,00,000 subject to average clause. Compute the amount of claim to be lodged to the insurance company.

Solution

Trading A/c
(1.4.19 to 31.03.20)

Particulars	Amount	Particulars	Amount
To Opening Stock	1,20,000	By Sales	6,00,000
To Purchases	5,25,000	By Closing Stock (1,30,000 + 5,000)	1,35,000
To G.P (Bal. figure)	90,000		
	7,35,000		**7,35,000**

GP Ratio for 19-20 = $\frac{90,000}{6,00,000} \times 100 = 15\%$

Memorandum Trading A/c
(1.4.20 to 30.6.20)

Particulars	Normal	Abnormal	Total	Particulars	Normal	Abnormal	Total
To Opening Stock	1,27,000	8,000	1,35,000	By Sales	1,60,000	6,000	1,66,000
To Purchases	1,32,000		1,32,000	By Loss		1,000	1,000
To Gross Profit (15% of 1,60,000)	24,000		24,000	By Closing Stock (Bal. figure)	1,23,000	1,000	1,24,000
	2,83,000	**8,000**	**2,91,000**		**2,83,000**	**8,000**	**2,91,000**

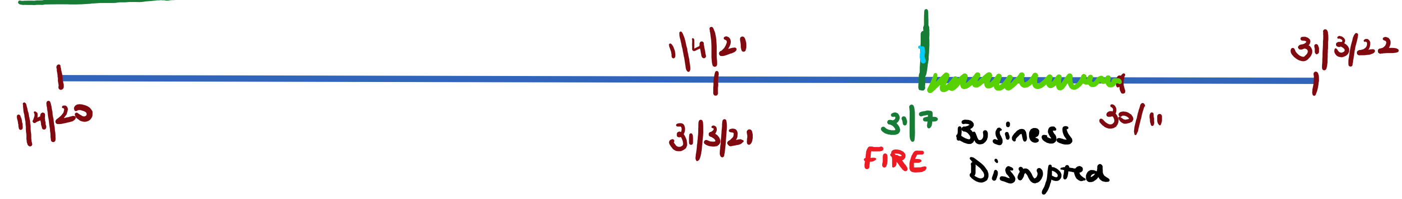
Computation of Insurance Claim

Stock on the date of fire	1,24,000
Less: Stock salvaged	(10,000)
Loss of stock	**1,14,000**

Claim subject to average clause:

Insurance Claim = $\frac{1,14,000}{1,24,000} \times 1,00,000 = 91,935$

CONCEPT 2: LOSS OF PROFIT POLICY



Step 1: Calculate GP Ratio of Last/Previous Year:
It is calculated as per Insurance Rules & has nothing to do with GP ratios in accounts.

$$GP\ (\%) = \frac{NP + \text{Insured standing charges}}{\text{Sales}} \times 100$$

Effective GP(%)= GP (%) ± Increase/(Decrease) in trend
Note: Insured standing charges means fixed charges which has been insured.

Step 2: Calculate Short Sales

Turnover in corresponding period of Previous Year/ Standard Turnover [After adjusting trend, if any]	xxx
Less: Actual Turnover in dislocated/effected period	(xxx)
Short Sales	xxx

Note:
Trend will be given or calculated as below:

Sales in Current Year (Non Affected Period)	xxx
Sales in Previous Year (Non Affected Period)	xxx
Increase/Decrease in Turnover	xxx

$$\text{Trend} = \frac{\text{Increase/Decrease in Turnover}}{\text{Turnover in Previous Year}} \times 100$$

Step 3: Loss of Profit = Short Sales X GP (%) (i.e. Step 2 X Step 1)

Step 4:
a) Adjusted Annual turnover= Turnover during 12 months immediately the preceding date of fire [After adjusting trend, if any]
b) Insurable Amount = Adjusted Annual Turnover X GP (%)

Step 5: Additional Expenses (***Lower*** of the following to be considered)

1. Actual Additional expenses
2. Actual Additional Expenses X $\frac{\text{Insurable Amount}}{\text{Insurable Amount} + \text{Uninsured standing charges}}$
3. Turnover achieved due to additional expenses X GP Ratio
   (If not given then take Turnover in dislocated period)

Step 6: Calculate Total Loss

Loss of Profit (Step 3)	xx
Add: Additional Expenses (Step 5)	xx
Less: Saving in insured standing charges	(xx)
Total Loss	**xx**

Step 7: Applicability of Average Clause: It is applied if Insurable Amount > Insured Amount

$$\text{Claim to be Lodged} = \text{Total Loss (Step 6)} \times \frac{\text{Insured Amount}}{\text{Insurable Amount}}$$

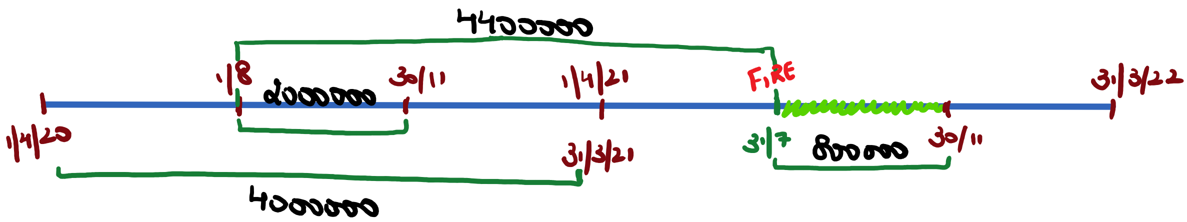
Question

The premises of a company were partly destroyed by the fire which took place on 31st July, 2021 and as a result of which the business was disorganized from 31st July to 30th November, 2021. Accounts are closed on 31st March, every year. The company is insured under a loss of profit policy for Rs.7,50,000. The period of indemnity specified in the policy is 6 months. From the following information you are required to compute the amount of claim under the Loss of Profits policy:

Particulars	**Rs.**
Turnover for the year 2020-21	40,00,000
Net profit for the year 2020-21	2,40,000
Insured standing charges	4,80,000
Uninsured standing charges	80,000
Turnover during the period of dislocation, i.e., from 1.8.2021 to 30.11.2021	8,00,000
Standard turnover for the corresponding period in the preceding year, i.e., from 1.8.2020 to 30.11.2020	20,00,000
Annual turnover for the year immediately preceding the fire i.e., from 1.8.2020 to 31.7.2021	44,00,000
Increased cost of working	1,50,000
Savings in insured standing charges	10,000
Reduction in turnover avoided through increase in working cost	3,00,000

Owing to reasons acceptable to the insurer, the "special circumstances clause" stipulates for:

1. Increase of turnover (Standard and annual) by 10% and
2. Increase of rate of gross profit by 2%.



Solution

1) GP (%) = $\frac{\text{Net Profit + Insured standing charges}}{\text{Sales}}$ X 100

$= \frac{2,40,000+4,80,000}{40,00,000}$ X 100 = 18%

Effective GP Ratio

GP (%)	18%
+ Increase in Trend	2%
Effective GP(%)	20%

2) Short Sales =

Turnover in corresponding period of Previous Year i.e. from 01.08.20 to 30.11.20	20,00,000
Add: Trend in Turnover i.e. 10%	2,00,000
Expected Turnover	22,00,000
Less: Actual Turnover in dislocated period i.e. from 01.08.21 to 30.11.21	(8,00,000)
Short Sales	14,00,000

3) Loss of Profit = Short Sales X GP (%)
= 14,00,000 X 20% = 2,80,000

4)

a) Adjusted Annual turnover=

Turnover during 12 months immediately the preceding date of fire i.e. from 01.08.20 to 31.07.21	44,00,000
Add: Trend in Turnover i.e. 10%	4,40,000
Adjusted Annual turnover	48,40,000

b) Insurable Amount = Adjusted Annual Turnover X GP (%)
= 48,40,000 X 20% = 9,68,000

5) Additional Expenses

a) 1,50,000

b) $1{,}50{,}000 \times \frac{9{,}68{,}000}{9{,}68{,}000+80{,}000} = 1{,}38{,}550$

c) 3,00,000 X 20% = 60,000

(Turnover achieved due to additional expenditure)

Lower out of above is Rs. 60,000

6) Total Loss

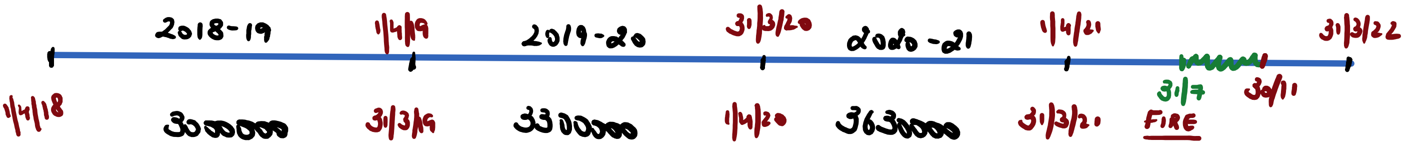
Loss of Profit (Step 3)	2,80,000
Add: Additional Expenses (Step 5)	60,000
Less: Saving in insured standing charges	(10,000)
Total Loss	**3,30,000**

7) Average clause applicable since Insurable Amount > Policy Amount

Claim to be Lodged= $3{,}30{,}000 \times \frac{7{,}50{,}000}{9{,}68{,}000} = 2{,}55{,}682$

TREND IN TURNOVER

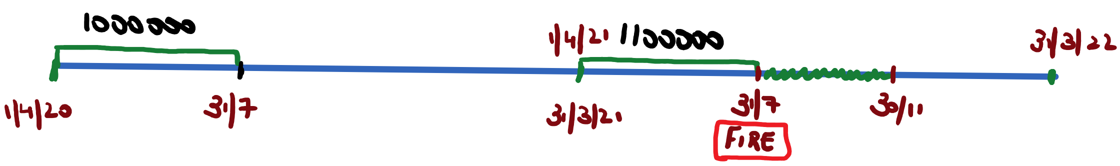
Case 1:



18-19 & 19-20 = $\frac{33L - 30L}{30L} \times 100 = \frac{3L}{30L} \times 100 =$ 10% Inc.

19-20 & 20-21 = $\frac{36.30L - 33L}{33L} \times 100 = \frac{3.30L}{33L} \times 100 =$ 10% Inc.

Case 2



% Inc./(Dec.) Trend => $\frac{11L - 10L}{10L} \times 100 = \frac{1L}{10L} \times 100 =$ 10% Inc.

CONCEPT 2A: Computation of Policy Amount

Step 1: Compute GP (%) of Last Year

$$GP (\%) = \frac{\text{Net Profit} + \text{Standing charges}}{\text{Sales}} \times 100$$

Step 2: Compute Policy Amount

Expected GP	=	Expected Sales (after Trend) × GP (%)	=	xx
± Increase/(Decrease) in Standing charges			=	xx/(xx)
Policy Amount				xx