INTRODUCTION

Business enterprise today is exposed to various risk. Every organization tries to reduce the risk by insuring such risks if they can be insured

Insurance claim can be studied under two parts as under

A – Loss of stock

B – Loss of Profit

LOSS OF STOCK

To Calculate the Stock in the godown on the date of fire.

LOSS OF STOCK

steps

Step 1
- Calculation of Gross Profit Ratio

Step 2
- Calculation of Stock on the Date of Fire

Step 3
- Calculation of Loss of stock

Step 4
- Calculation of Amount of Claim

LOSS OF STOCK

Step 1

- Calculation of Gross Profit Ratio

Dr Trading A/c for the year ended _________ Cr

Particulars	Amt (Rs)	Particulars	Amt (Rs.)
To Opening Stock	XXX	By Sales A/c	XXX
To Purchase A/c	XXX		
To Direct Expenses A/c	XXX		
To Gross Profit (Bal. Fig.)	XXX	By Closing Stock	XXX
	XXX		XXX

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100 = \_\_\ \%$$

LOSS OF STOCK

Step 2

- Calculation of Stock on the Date of Fire

Dr Memorandum Trading A/c for the year ended ________ Cr

Particulars	Amt (Rs)	Particulars	Amt (Rs.)
To Opening Stock	XXX	By Sales A/c	XXX
To Purchase A/c	XXX		
To Direct Expenses A/c	XXX		
To Gross Profit	XXX	By Stock on the date of Fire (Bal. Fig.)	XXX
	XXX		XXX

LOSS OF STOCK

Step 3

- Calculation of Loss of Stock

Stock on the Date of Fire	XXX
Less : Salvage Value	XXX
Loss of Stock	XXX

LOSS OF STOCK

Step 4

- Calculation of Amount of Claim

Total Loss : If the goods are totally destroyed

Fully insured

- Amount of Claim will be equal to Loss of Stock

Under insurance

- Amount of Claim will be equal to Amount of Policy

LOSS OF STOCK

Step 4

- Calculation of Amount of Claim

Partial Loss

1 : Without Average Clause

Amount of Claim = Lower of Actual loss or sum assured

2 : With Average Clause

$$\text{Amount of Claim} = \frac{\text{Amount of Policy}}{\text{Stock on the Date of Fire}} \times \text{Loss of Stock}$$

Note: Average Clause is applicable only when insured value is less then stock on the date of fire

LOSS OF STOCK

steps

Step 1
- Calculation of Gross Profit Ratio

Step 2
- Calculation of Stock on the Date of Fire

Step 3
- Calculation of Loss of stock

Step 4
- Calculation of Amount of Claim

LOSS OF STOCK

- Practice Problem – practice manual Q - 2

Mr. A Prepares accounts on 30th Sept each year, but on 31st Dec, 2011 fire destroyed the greater part of his stock. Following information was available

	Rs
Stock as on 1.10.2011	29,700
Purchases from 1.10.2011 to 31.12.2011	75,000
Wages from 1/10.2011 to 31.12.2011	33,000
Sales from 1.10.2011 to 31.12.2011	1,40,000

The rate of G.P is 33.33% on Cost. Stock to the value of Rs. 3,000 was salvaged and Insurance policy was for Rs. 25,000 subject to Average Clause.

Additional Information

1. Stock at the beginning was calculated at 10% less than the cost.
2. A Plant was installed by the firm's own workers. Wages Paid Rs. 3000 was included in wages.
3. Purchases included purchase of Plant for Rs. 5,000

You are required to calculate the claim for the loss of stock

LOSS OF STOCK

Step 1

- Calculation of Gross Profit Ratio

The Question has provided that the gross profit rate is 33.33% on cost i.e $1/3^{rd}$ on cost, which means $1/4^{th}$ on sales, which means that gross profit is 25% on sales

LOSS OF STOCK

Step 2

- Calculation of Stock on the Date of Fire

Dr Memorandum Trading A/c for the year ended ________ Cr

Particulars	Rs.	Rs.	Particulars	Rs.
To Opening Stock (29,700 x 100/90)		33,000	By Sales	1,40,000
To Purchases	75,000			
Less : Cost of Plant	(5,000)	70,000		
To Wages	33,000			
Less : Wages for Plant	(500)	32,500	By Stock on the date of fire (Bal. Fig)	30,500
To Gross Profit (1,40,000 x 25%)		35,000		
		1,70,500		1,70,500

LOSS OF STOCK

Step 3

- Calculation of Loss of Stock

Stock on the Date of Fire	30,500
Less : Salvage Value	(3,000)
Loss of Stock	2 7,500

LOSS OF STOCK

Step 4

- Calculation of Amount of Claim

$$\text{Amount of Claim} = \frac{\text{Amount of Policy}}{\text{Stock on the Date of Fire}} \times \text{Loss of Stock}$$

$$= \frac{25{,}000}{30{,}500} \times 27{,}500 = 22{,}541$$

Amount of Claim | 22,541

LOSS OF STOCK

steps

Step 1
- Calculation of Gross Profit Ratio

Step 2
- Calculation of Stock on the Date of Fire

Step 3
- Calculation of Loss of stock

Step 4
- Calculation of Amount of Claim

LOSS OF PROFIT

When the Fire occurs, apart from the direct loss on account of stock or other assets destroyed, there is also a consequential loss.

Consequential loss is the Loss of Profit suffered, which the business would have earned otherwise, because, for sometime, the business is disorganized or has to be discontinued.

Also the standing expenses of the business like rent, salaries etc continue.

LOSS OF PROFIT

The Loss of Profit Policy normally covers the following items

- A. Loss of Net Profit
- B. Standing Charges
- C. Any increased cost of working e.g renting of temporary premises

LOSS OF PROFIT

Terms to Remember

1

- Gross Profit

Gross Profit = Net Profit + Insured Standing Charges

LOSS OF PROFIT

Terms to Remember

2

- Standing Charges :

Interest on debentures, Mortgage Loans and Bank Overdraft, Rent, Rates and Taxes, Salaries of Permanent Staff and Wages to Skilled Employees, Boarding and Lodging of resident Directors and / or Manager, Directors Fees, Unspecified Standing Charges (Not exceeding 5% of the amount recoverable in respect of Specified Standing Charges)

LOSS OF PROFIT

Terms to Remember

3

- Indemnity period Turnover (IPTO)

It is the sales during the period when the business is disorganized.

For eg. There was a fire on 1/4/2012 and the business was disrupted for 3 months then IPTO shall be sales from 1/4/2012 to 1/7/2012

LOSS OF PROFIT

Terms to Remember

4

- Standard Turnover (STO)

The turnover during that period in the twelve months immediately before the date of fire which corresponds with the indemnity period

For eg : Considering the same example given above, STO shall be the sales from 1/4/2011 to 1/7/2011

LOSS OF PROFIT

Terms to Remember

5

- Annual Turnover (ATO)

The turnover for twelve months ending the date of the fire

For eg : Considering the same example given above, ATO shall be the sales from 1/4/2011 to 31/3/2012

LOSS OF PROFIT

Exercise

Date of Fire – 1/5/2012

Period of Dislocation – 5 months

IPTO – 1/5/2012 TO 1/10/2012

STO – 1/5/2011 TO 1/10/2011

ATO – 1/5/2011 TO 30/4/2012

LOSS OF PROFIT

The Amount to be claimed is the sum of

A. Loss of Profit : It is the loss suffered due to reduction in sales. It is calculated by applying the gross profit ratio to the short sales i.e difference between the possible sales (Adjusted STO) and the Actual sales (IPTO) during the period of dislocation.

B. Increase in cost of working : The additional expenditure is subject to certain provisions which will be discussed in detail while discussing steps.

The sum of A and B above will be reduced by any saving in standing charges. And finally we shall determine if the average clause is applicable or not to calculate the amount of claim

LOSS OF PROFIT

Steps

1. Gross Profit Ratio
2. IPTO
3. Adjusted STO
4. Short Sales
5. Loss of Profit
6. Additional Expense
7. Statement of Total Loss
8. Amount of Claim

LOSS OF PROFIT

Steps

Step 1

- Calculation of Gross Profit Ratio

$$\frac{\text{Net Profit + Insured Standing Charges}}{\text{Turnover of the last Financial Year}} \times 100 = \_\_\ \%$$

LOSS OF PROFIT

Steps

Step 2

- Indemnity Period Turnover (IPTO)

Sales made during the period of Dislocation

LOSS OF PROFIT

Steps

Step 3

- Adjusted Standard Turnover (STO)

Standard Turnover	XXX
+ / - Trend	<u>XXX</u>
Adjusted STO	<u>XXX</u>

LOSS OF PROFIT

Steps

Step 4

- Short Sales

Adjusted STO	XXX	
Less IPTO	<u>XXX</u>	
Short Sales	<u>XXX</u>	i.e Step 3 – Step 2

LOSS OF PROFIT

Steps

Step 5

- Loss of Profit

Short Sales X G.P.Ratio i.e Step 4 x Step 1

LOSS OF PROFIT

Steps

Step 6

- Additional Expenses

It is

i. Actual Additional Expense XXX

- OR

ii. G. P. Additional Sales XXX

- OR

iii. $\dfrac{\text{G. P. on Adjusted ATO}}{\text{G. P. on Adj ATO + Uninsured Standing Charges}}$ X Actual Exp. XXX

Whichever is less

LOSS OF PROFIT

Steps

Step 7

- Statement of Total Loss

Loss of Profit	XXX
Add Additional Expenses	XXX
Less Saving in Standing Charges	XXX
Total Loss	XXX

LOSS OF PROFIT

Steps

Step 8

- Amount of Claim

$$\frac{\text{Amount of Policy}}{\text{G. P . Adjusted ATO}} \times \text{Total Loss}$$

Note: Average Clause is applicable when G. P on Adjusted ATO exceeds Amount of Policy

LOSS OF PROFIT

Steps

1. Gross Profit Ratio
2. IPTO
3. Adjusted STO
4. Short Sales
5. Loss of Profit
6. Additional Expense
7. Statement of Total Loss
8. Amount of Claim

LOSS OF PROFIT

- Practice Problem – practice manual Q - 7

X Ltd has insured itself under a loss of profit policy for Rs 3,63,000. The indemnity period under the policy is six months. There was a fire on 1.10.2010 and normal business was affected upto 1.3.2011

The following information is complied for the year ended 31.3.2010

Sales – 20,00,000 Insured Standing Charges - 2,40,000 Uninsured Standing Charges 20,000

Net Profit 1,20,000

Following further information is furnished

a) Turnover during the period of 12 months ending on the date of fire 22,00,000

b) Turnover during the period of interruption was 2,25,000

c) Actual turnover from 1.10.2009 to 1.3.2010 was 7,50,000

d) X Ltd spent 40,000 as additional cost of working during the indemnity period

e) There was a saving of Rs. 15,000 in insured standing charges

f) Reduction in turnover avoided was 1,00,000

A Special Clause in the policy stipulates that

1) Increase in turnover standard and actual by 10%

2) Increase in the rate of Gross Profit by 2% from previous year's level

X Ltd asks you to compute the claim for the loss of profit.

LOSS OF PROFIT

Step 1

- Calculation of Gross Profit Ratio

$$= \frac{\text{Net Profit + Insured Standing Charges}}{\text{Turnover of the Last Financial Year}} \text{ X } 100$$

$$= \frac{1{,}20{,}000 + 2{,}40{,}000}{20{,}00{,}000} \text{ X } 100 \qquad = 18\%$$

Add : Adj. for Increase in Gross Profit Rate	2%
	20%

LOSS OF PROFIT

Step 2

- Calculation Indemnity Period Turnover (IPTO)

Sales from 1.10.2010 to 1.3.2011

2,25,000

LOSS OF PROFIT

Step 3

- Calculation of Adjusted Standard Turnover (STO)

STO (1.10.2009 to 1.3.2010)	7,50,000
Increase in Turnover (10%)	75,000
	8,25,000

LOSS OF PROFIT

Step 4

- Calculation of Short Sales

Adjusted Standard Turnover	8,25,000
Less : Indemnity Period Turnover	2,25,000
	6,00,000

LOSS OF PROFIT

Step 5

- Calculation of Loss of Profit

= Short Sales x Gross Profit Ratio

= 6,00,000 x 20%

= 1,20,000

LOSS OF PROFIT

Step 6

- Calculation of Additional Expenses

1. Actual Expenses 40,000

2. G.P. on Additional Sales
(1,00,000 x 20%) 20,000

3. $\dfrac{\text{G. P. on Adjusted ATO}}{\text{G. P. on Adj ATO + Uninsured Standing Charges}}$ X Actual Expenses

$\dfrac{(22,00,000 + 10\%)\ 20\%}{(22,00,000 + 10\%)\ 20\% + 20,000}$ X 40,000 38,413

Least of Above three figures 20,000

LOSS OF PROFIT

Step 7

- Calculation of Total Loss

Loss of Profit	1,20,000
Add : Additional Expense	20,000
Less : Saving in Standing Charges	15,000
Total Loss	1,25,000

LOSS OF PROFIT

Step 8

- Calculation of Amount of Claim

Application of Average Clause

Amount of Policy	3,63,000
G.P. on Adjusted ATO	4,84,000

Since the Amount of policy is less than the G.P. Adjusted ATO, the claim is subject to Average Clause

$$\text{Amount of Claim} = \frac{\text{Amount of Policy}}{\text{G. P . Adjusted ATO}} \text{ X Total Loss}$$

Amount of Claim = 1,25,000 x 3,63,000 / 4,84,000 = 93,750

Amount of Claim 93,750

LOSS OF PROFIT

Steps

1. Gross Profit Ratio
2. IPTO
3. Adjusted STO
4. Short Sales
5. Loss of Profit
6. Additional Expense
7. Statement of Total Loss
8. Amount of Claim