Insurance Claims

1. Introduction

- Business may face several abnormal events which results into losses. To cover these losses entity may get insured themselves.

- Losses could be as follows:-
  - Loss of stock by fire
  - Loss of stock by theft.
  - Loss due to earthquake
  - loss of asset, etc.

- Following losses are part of syllabus -

  I. Loss of Stock by fire
  II. Loss of Profit [Consequential Loss]

I. Loss of Stock

2.

- To calculate Loss of Stock by fire we need to calculate Stock as on the date of fire. Following steps will be applied -

Step 1:- Calculation of Rate of Gross Profit

- Rate of Gross Profit may be calculated by Preparing Trading Account of Last year.

Trading Account
For the year ended ....

Particulars	Amount ₹	Particulars	Amount ₹
To Opening Stock	✓	By Sales	✓
To Purchase	✓	By Closing Stock	✓
To Wages	✓		
To Other Direct Exp.	✓		
To Gross Profit (bal. fig.)	✓		
	✓		✓

Note:- This step shall be ignored if rate of gross profit is given in question.

Step 2:- Preparation of Memorandum Trading Account

- Prepare Memorandum Trading Account from Beginning of current year to the date of fire to calculate the stock on the date of fire.

Memorandum Trading Account
For the year ended ....

Particulars	Amount ₹	Particulars	Amount ₹
To Opening Stock	✓	By Sales	✓
To Purchase	✓	By Closing Stock (bal. fig.)	✓
To Wages	✓		
To Other Direct Exp.	✓		
To Gross Profit [Sales x Rate of GP]	✓		
	✓		✓

Step 3:- Calculation of Amount of Loss

Stock on the date of fire	✓
Less:- Salvage	(✓)
	✓
Add:- Fire-fighting Expenses [if admitted]	✓
	✓

Note:-

i) Salvage means stock saved from fire.

ii) Salvage shall not be deducted if the same is taken over by insurance Company.

Step 4:- Amount of Claim

Loss

- Total Loss
  - Lower of
    - Actual Loss
    - OR
    - Policy Amount
- Partial Loss
  - Under Insured
    - No
    - Yes
      - whether Policy is subject to Average Clause
        - No
        - Yes
          - $\frac{\text{Policy Amount}}{\text{Gross Loss}} \times \text{Actual Loss}$

Note:- Gross loss means Stock on the date of fire [Normal + Abnormal]

3. Special Adjustment

i) Stock in Trading or Memorandum Trading Account should be shown at cost only i.e., any under or over valuation of stock, if any shall be adjusted.

ii) Purchase and Sale should be shown net of returns.

iii) Any Capital Expenditure should not form part of Trading or Memorandum Trading Account eg; Purchase of asset or installation cost thereon.

iv) Goods distributed as free sample i.e., advertisement and Goods withdrawn by Proprietor should be deducted from Purchase at cost Price.

Note:- Goods drawn shall also be deducted from Sales at Sale Price, if the same is included in sales.

v) Goods received without invoice should be included in Purchase, if not included.

vi) Goods not dispatched though invoice has been made will be deducted from Sales, if included in Sales.

vii) Goods with Consignee, if any, Should be shown at Credit Side at cost Price.

viii) Goods Sold on Approval

- Approved
  - ↓ Included in Sales
    - Yes → Ignore
    - No → Include in sales
- Not yet Approved
  - ↓ Included in Sales
    - Yes →
      - Deduct from sales at sale value
      - Show goods with customer at cost price on credit side
    - No → Ignore.

ix) If there is any change in price structure then following should be applied -

Change in

- Cost only / selling price only → Consider effect of the same in Memorandum Trading Period's Gross Profit Rate by adjusting Sale or Cost Price only.
- Both → Consider effect of the same in Memorandum Trading Period's Gross Profit Rate by adjusting Sale and cost Price both.

e.g.) Existing G.P Rate = 20%

Case-i) → Selling price increase by 10%

Case-ii) → Selling price decrease by 5%

case-iii) → cost increase by 10%
case-iv) → cost decrease by 5%.
case-v) → cost increase by 5% but selling price by 10%.

Calculate new G.P. Rate for each cases for opening stock as well as for new goods sold.

Sol. Existing Sales = 100 (let)
G.P. Rate = 20%
Profit = 20
cost = 100 − 20 = 80

Cases	Selling Price	Cost		Profit		G.P. Rate	
		Existing	New	Existing	New	OP. Stock	New Goods
i)	110	80	80	30	30	3/11	3/11
ii)	95	80	80	15	15	3/19	3/19
iii)	100	80	88	20	12	20%	12%
iv)	100	80	76	20	24	20%	24%
v)	110	80	84	30	26	3/11	26/110

4) Poor Selling Line [PSL]

- Whenever any stock cannot fetch its original selling price is considered as Abnormal item or PSL item.

- If question includes PSL item, then followings should be applied −

  i) Whole Trading and Memorandum Trading Account shall be free from PSL -

PSL included in

Only closing stock of Trading Account

- Deduct amount of PSL included in stock
[cost - written off amount]
- Deduct cost of PSL from Purchase Account of Trading
- Deduct sale price of PSL item sold from from respective sale i.e. Trading as well as Memorandum Trading A/c.

Opening stock as well as Closing stock of Trading Account

- Deduct amount of PSL included in opening and closing stock.
[cost - written off amount]
- Deduct sale price of PSL item sold from from respective sale i.e. Trading as well as Memorandum Trading A/c.
- No adjustment required in Purchase Account.

ii) Treatment of unsold PSL item

PSL Item

Sold

Ignore

Unsold

Consider the same as Stock on the date of fire
= Cost of unsold PSL × Agreed %