INSURANCE CLAIM ACCOUNTS

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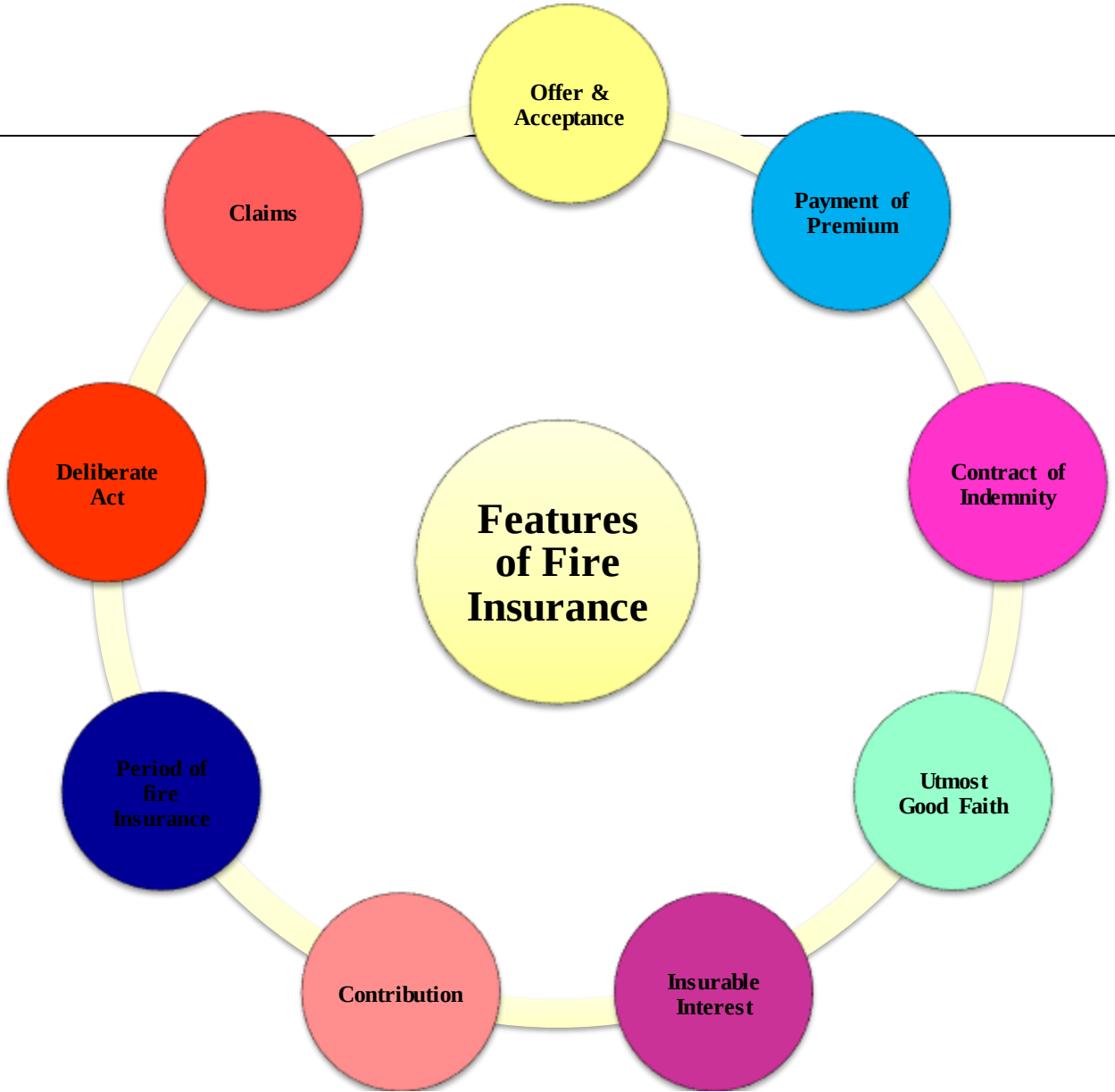
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Introduction

- There are several different reasons by which a business may suffer abnormal losses such as fire, theft, burglary, strike, etc. among them most common which destroys or causes severe damage to the assets like plant, machinery, furniture, etc. is fire.
- So these losses are recovered through insurance so business has to pay there insurance premium at regular intervals. Then only company or business can claim there losses through these insurance policies.
- So, insurance can be studied under two parts:

1. Claim for loss of stock.
2. Claim for loss of profit.

Features of Fire Insurance



Types of Fire Policies

Types of fire policies

- Valued Policy
- Specific Policy
- Average Policy
- Floating Policy
- Excess Policy

Types of fire policies

- Blanket Policy
- Comprehensive Policy
- Consequential Loss Policy
- Re – instatement Policy
- Open Declaration Policy

Types of Fire Claim

- Depending upon the risk covered by an insurance policy, claims against the insurer can be divided as below:

1. Claim for Loss of Stock.
2. Claim for Loss of Fixed Assets.
3. Claim for Loss of Profit or Claim for Consequential Loss.

(A) CLAIM FOR LOSS OF STOCK

Introduction

- In absence of proper inventory record, the following procedure may be adopted, though it is difficult to decide the estimate. However, a reasonable estimate of loss of stock can be made by the following procedure.

Steps to Claim Loss of Stock

Step 1: Create Trading Account (i.e. Account related to previous year)

Trading Account

Dr. for the year ended ____ Cr.

Particulars	**Amount**	**Particulars**	**Amount**
To opening stock	xxx	By Sales	xxx
To Purchases	xxx	By closing stock	xxx
To Wages	xxx		
To Carriage Inwards	xxx		
To Gross Profit (balancing figure)	xxx		
	xxxx		**xxxx**

Steps to Claim Loss of Stock

Step 2: Create Memorandum Trading Account (i.e. Account related to current year till the date of fire)

Memorandum Trading Account

Dr. for the year ended _____ Cr.

Particulars	**Amount**	**Particulars**	**Amount**
To opening stock	xxx	By Sales	xxx
To Purchases	xxx	By closing stock (Stock on the date of fire) (Balancing figure)	xxx
To Gross Profit (@__ % on sales)	xxx		
	xxxx		**xxxx**

Steps to Claim Loss of Stock

Step 3: Prepare the following working notes:

1. **Calculate Gross Profit Rate:**

$$Gross\ Profit\ Rate = \frac{Gross\ Profit}{Sales} \times 100$$

2. **Prepare Statement of Claim:**

		Amount (₹)
Estimated Stock on the date of fire	=	xxx
Less: Stock saved/ salvaged	=	xxx
Value of Stock destroyed by fire	=	xxxx

Steps to Claim Loss of Stock

3. **Calculate Average Clause: (if policy amount is given)**

Average Clause =

$$\frac{Value\ of\ Policy}{Value\ of\ Stock\ on\ the\ date\ of\ fire} \times Value\ of\ stock\ destroyed$$

Solved Example

- A fire occurred in the business premises of Rajesh Traders on 15th October, 2010. from the following particulars, ascertain the loss of stock and prepare a claim for insurance.

Stock on 1-1-2009 Rs.15,300

Purchases from 1-1-2009 to 31-12-2009 Rs.61,000

Sales from 1-1-2009 to 31-12-2009 Rs.90,000

Stock on 31-12-2009 Rs.13,500

Purchases from 1-1-2010 to 14-10-2010 Rs.73,500

Sales from 1-1-2010 to 14-10-2010 Rs.75,000

The stock were always valued at 90% of cost. The stock saved was worth Rs.9,000. The amount of the policy was Rs.31,500, there was an average clause in the policy.

Solution

Trading Account

Dr. for the year ended 31-12-2009 Cr.

Particulars	Amount	Particulars	Amount
To opening stock (Note No.1(a))	17,000	By Sales	90,000
To Purchases	61,000	By closing stock (Note No. 1(b))	15,000
To Gross Profit (balancing figure)	27,000		
	1,05,000		1,05,000

Memorandum Trading Account

Dr. for the year ended 15-10-2010 Cr.

Particulars	Amount	Particulars	Amount
To opening stock	15,000	By Sales	75,000
To Purchases	73,500	By closing stock	36,000
To Gross Profit ($75{,}000 \times \frac{30}{100}$)	22,500	(stock on the date of fire)	
	1,11,000		1,11,000

Working Notes:

(1) Calculation of Stock:

Stock is always valued at 90% of cost

(A) Opening Stock = Rs.15,300 – (90%)

$= 15{,}300 \times \frac{10}{90} = 1{,}700$ – (10%)

= 15,300 + 1,700 = 17,000

Opening Stock = Rs.17,000

(b) Closing Stock – Rs.13,500 – (90%)

$$13{,}500 \times \frac{10}{90} = 1{,}500$$

13,500 + 1,500 = 15,000

Closing Stock = Rs.15,000.

(2) Calculation of Gross Profit Rate:

(Take the values of previous year i.e. Trading Account)

$$\text{Gross Profit Rate} = \frac{Gross\ Profit}{Sales} \times 100$$

$$= \frac{27{,}000}{90{,}000} \times 100$$

$$= 30\%$$

Gross Profit Rate = 30%

(3) Statement of Claim:

Estimated stock on the date of fire	=	36,000
Less: Stock saved	=	9,000
Value of stock destroyed by fire	=	Rs.27,000

(4) Calculation of Average Clause:

(As there is policy value given so we have to calculate average clause)

Average Clause =

$$\frac{\textbf{\textit{Value of Policy}}}{\textbf{\textit{Value of stock on the date of fire}}} \times \textbf{\textit{Value of stock destroyed by fire}}$$

$$= \frac{31,500}{36,000} \times 27,000$$

$$= 23,625$$

Average Clause = Rs.23,625

(B) CLAIM FOR LOSS OF PROFIT

Introduction

- The fire not only destroys stock or assets but also causes disturbances to the business and hence, the business concern – suffers reduction in usual profits. But to compensate such loss of profit, Insurance Co. issues a cover but before claiming the loss of profit there is a condition that you should have policy for loss of stock and you have claimed for loss of stock. Procedure or steps are to be followed.

Steps to Claim Loss of Profit

1. **Calculate Short Sales:**

The short sales are calculated as under

Particulars Rs.	
Estimated sales durinf the period of indemnity	xxx
Add: Increase in price (if any)	xxx
Less: Actual sales during the period of indemnity	xxx
Short Sales	xxxx

Indemnity period = Period during which sales are expected to be affected due to fire, this period is mentioned in policy.

The usual period is one year.

Steps to Claim Loss of Profit

2. Calculate Gross Profit Rate:

$$\text{Gross Profit Rate} = \frac{Net\ profit + Insured\ standing\ charges}{Annual\ Sales} \times 100$$

Standing charges = These are the expenses required to be incurred irrespective of the fact whether the business activities are suspended or not. They includes wages & salary, rent, rates, taxes, insurance, directors fees, auditors fees, interest on loan, etc.

3. Calculate Loss of Profit:

Loss of Profit = Short Sales × Gross Profit Rate

Steps to Claim Loss of Profit

4. Calculate increase in cost of working (Working Expenses):

$$= \frac{Net\ profit + Insured\ standing\ charges}{Net\ profit + All\ standing\ charges} \times increased\ working\ expenses$$

5. Average Clause:

If the amount of the policy is less than the Gross Profit in the standard sales, the amount of claim is reduced in the ratio of amount of policy to Gross Profit in standard sales.

6. Insurance Claim:

$$\text{Insurance claim} = \frac{Amount\ of\ policy \times Amount\ of\ claim}{Gross\ Profit\ in\ standard\ sales}$$

Solved Example

- From the following information, find the claims under a loss of profit policy: (all figures are in rupees)

Sales in 2012	1,00,000	Policy value	50,000
Sales in 2013	1,20,000	Date of dislocation by fire	1-1-2016
Sales in 2014	1,44,000	Period of dislocation	3months
Sales in 2015	1,72,800	Indemnity period	9 months
Standing charges		Sales	
(all insured) in 2015	7,280	1-1-15 to 31-12-15	43,200
Net profit in 2015	10,000	Sales	
		1-1-16 to 31-12-16	11,840

There was no reduction in standing charges during the dislocation period, nor were there any additional costs.

Solution

(1) **Calculation of Gross Profit Rate:**

$$\text{Gross Profit Rate} = \frac{Net\ profit + Insured\ standing\ charges}{Annual\ Sales} \times 100$$

$$= \frac{10{,}000 + 7{,}280}{1{,}72{,}800} \times 100$$

$$= 10\%$$

Gross Profit Rate = 10%

(2) Calculation of Short Sales

Particulars	Amount
Sales (from 1-1-2015 to 31-12-2015)	43,200
Add: 20% increase on 43,200	8,640
Standard Sales	51,840
Less: Actual Sales	11,840
Short Sales	40,000

Short Sales = Rs.40,000

(3) Calculation of Loss of Profit:

Loss of Profit = Short sales × Gross Profit Rate

$$= 40{,}000 \times \frac{10}{100}$$

$$= 4{,}000$$

Loss of Profit = Rs.4,000

Note: - Sales figures of 2012 to 2015 clearly indicates 20% in year. So standard sales are to be adjusted according.

The claim payable in full since the policy is adequate.

THANK YOU