Government college for girls, Ludhiana

Computation of Claim to be lodged of Loss Of Stock

Date of fire 1st April, 2023
Closing date of accounting year = 31st dec. each year
Step 1—Calculate Gross Profit Ratio—If the rate of gross profit of the last year is given in the question, Step 1 is not required. In case, it is not given then it must be calculated by preparing the 'Trading Account' of the preceding year or years.

TRADING ACCOUNT OF ----------
For the year ended 31st Dec. 2022

Particular		Amount	Particular		Amount
To opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales Return	(xxx)	xxx
Less: Purchase returns	(xx)		By stock lost by fire		xxx
Less: Goods Drawing	(xx)	xxx	By Closing Stock		xxx
To Wages		xxx			
To Carriage inward		xxx			
To direct Expenses		xxx			
To Gross Profit (b/f)		xxx			
		Xxx			xxx

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

Step 2—Ascertain the value of stock on the date of fire---The value of stock on the date of fire can be ascertained by preparing a 'Memorandum Trading Account' starting from the Ist day of year and ends upto the date of fire. The following is a specimen of the 'Memorandum Trading A/c' e.g. Closing Date of Accounting Year = 31st Dec. Date of Fire = 1St April, 2019 Therefore, memorandum trading account will be prepared from 1st January, 2019 to 1st April, 2019

MEMORANDUM TRADING ACCOUNT OF__________________
From 1st January, 2023 to 1st April, 2023

Particular		Amount	Particular		Amount
To Opening Stock		xxx	By Sales	xxxx	
To Purchases	xxx		Less: Sales Return	(xxx)	xxx
Less: Purchase Return	(xxx)		By Closing Stock	(b/f)	xxx
Less: Goods Drawings	(xxx)	xxx			
To wages		xxx			
To Carriage inward		xxx			
To Direct Expenses		xxx			
To Gross Profit (%age of Sales)		xxx			
		Xxx			xxx

Step 3 –Calculate Gross Claim

Stock on the date of fire	= xxx
Less: Stock saved	= (xxx)
Gross Claim	xxx

Step 4—Calculate Claim to be lodged

Case 1—If amount of policy is **not given in the question**, then gross claim will be treated as claim to be lodged.

Case 2—If amount of policy is **more than stock on the date of fire**, then gross claim will be treated as claim to be lodged.

Case 3—If amount of policy is **less than stock on the date of fire,** then claim to be lodged will be **calculated by using average clause formula.**

Claim to be lodged == $\dfrac{\text{Amount of policy}}{\text{Stock on date of fire}}$ X Gross Claim

Average Clause—When a fire insurance policy is taken, it may include an 'Average Clause'. This clause is **inserted to discourage under insurance of stock** or any other asset. As per this clause, if the **value of stock on the date of fire is more than the policy value**, insurance company will not be liable to pay full value of loss of stock, **only proportion amount will be payable**.

Net claim = $\dfrac{\text{Amount of Policy}}{\text{Stock on the date of fire}}$ X Gross Claim

Q 1.(April 1998) A fire occurred on 15th September 2015 in the godown of M/s A and B. From the following figures ascertain the claim to be lodged:

Stock on 1st April 2015	1,05,300
Purchases from 1St April 2015 to the date of fire	3,50,400
Manufacturing expenses and wages	2,60,000
Sales from 1St April 2015 to the date of fire	6,76,000
Goods used by the partners themselves (at Cost)	10,500

The rate of Gross Profit is 30% on cost. The stock salvaged was valued at Rs 36,000.

Answer—

MEMORANDUM TRADING ACCOUNT
From 1st April, 2015 to 15th September,2015

To Opening Stock	1,05,300	By Sales	6,76,000
To Purchases 3,50,400 Less: Goods drawing (10,500)	3,39,900	By Closing Stock (b/f)	1,85,200
To Manufacturing Expenses	2,60,000		
To Gross Profit (30/130 of 676000)	1,56,000		
	8,71,700		8,71,700

STATEMENT SHOWING THE AMOUNT OF CLAIM TO BE LODGED

Value of stock on the date of fire **Less:** Value of Stock saved	1,85,200 (36,000)
Gross Claim or Claim to be lodged	1,49,200

LOSS OF PROFIT POLICY

When a fire occurs in a business, not only the assets like building, furniture, machinery, stock etc. are destroyed but it also results in partial or total stoppage of business leading to trading losses. In order **to cover the risk of loss of profits**, a separate policy known as 'Loss of Profit or Consequential Loss Policy' may be taken. This **policy covers the following risks**:

a) Loss of Profit **due to partial or total stoppage** of business activities
b) Loss on account of **payment of Fixed/Standing charges** such as rent, salaries, director's fees etc. These expenses are incurred even if the business is discontinued for some period.
c) Loss due to **increased cost of working incurred** for the purpose of avoiding reduction in sales during the dislocation period like taking on rent some other premises temporarily etc.

STEPS TO BE FOLLOWED FOR THE CALCULATION OF LOSS OF PROFIS

Step 1: Calculate Short Sales

Short sales is calculating by comparing the sales made during the period affected by the fire (maximum upto the indemnity period) with the sales of the corresponding period in the previous year.

Sales in the corresponding period in the last year	= xxx
Add: Expected Increase	= xxx
Standard Sales	xxx
Less: Actual Sales in the dislocation period	= (xx)
Short Sales	xx

Step 2 Calculate Rate of Gross Profit of the financial year preceding the year of fire.

$$\text{Rate of Gross Profit} = \frac{\text{Net Profit of the last accountg. year + Insured standing charges}}{\text{Net Sales of the last accounting year}} \times 100$$

Step 3 Calculate additional or increased cost of working

Increased cost of working means additional expenses incurred for the purpose of minimizing the loss on account of short sales. The claim for additional expenses is restricted to the lowest of the following amounts:

a) Actual expenses incurred

b) Gross profit on sales generated by the additional expenses

c) $\frac{\text{Net Profit + Insured standing charges}}{\text{Net Profit + All standing charges}}$ X Additional Expenses

OR

$\frac{\text{Gross Profit on annual turnover (adjusted)}}{\text{Gross + Uninsured Standing Charges}}$ X Additional Expenses

Note—If increased sales is not given in the question then actual sales in dislocation period will be considered.

Step 4: Calculate Gross Claim

Loss of Profit (Short Sales X G.P. Rate)	= xxx
Add: Additional Cost of working	= xxx
	xxx
Less: Saving in standing charges	(xx)
Gross Claim	xx

Step 5: Calculate claim to be lodged

Case A—If amount of policy is **not given** in the question, then gross claim will be treated as claim to be lodged.

Case B—If amount of policy is **more than gross profit** on adjusted annual turnover, then gross claim is to be treated as claim to be lodged.

Case C—If amount of policy is **less than gross profit on adjusted annual turnover**, then claim to be lodged will be calculated by using the average clause formula:

Claim to be lodged = $\frac{\text{Amount of Policy}}{\text{Gross profit on the adjusted annual turnover}}$ X Gross Claim

Adjusted Annual Turnover—Sales of proceeding 12 months immediately from the date of fire + Expected increase.

SUMMARY OF LOSS OF PROFIT CLAIM

1. Short Sales
2. Calculate Gross Profit Ratio
3. Calculate additional cost of working
4. Gross claim
5. Calculate claim to be lodged by using average clause formula

Q 1 (2007 APR,2004 APR,2003 APR) A **fire occurred in** a factory on **30.6.2010**. Compute consequential loss claim from the following:
Financial year ends on **31st Dec**.
Turnover Rs 2,00,000 Standard Turnover Rs 65,000
Indemnity Period 6 Months
Period of dislocation 1st July to 31st Oct.
Actual Turnover Rs 25,000 out of which **Rs 6000 from a place rented at Rs 600 p.m.**
Net Profit Rs 18,000
Standing charges Rs 42,000 out of which Rs **10,000 have been insured.**
Sum Insured Rs 50,000 Saving in standing charges—Rs 4725 p.a.
Annual Turnover **preceding the date of fire** Rs 2,40,000
Business trend leads to 10% increase in turnover.

Answer—

Step 1 Compute Short Sales

Standard Sales	= Rs 65,000
Add: Expected Increase (10%)	= Rs 6,500
Adjusted Standard Sales	= 71,500
Less: Actual Sales	= 25,000
Short Sales	= 46,500

Step 2 Calculate Gross Profit Ratio

$$\text{G.P Ratio} = \frac{\text{Net profit of last accounting year + Insured Standing Charge}}{\text{Net Sales of last accounting year}} \times 100$$

$$= \frac{18{,}000 + 10{,}000}{2{,}00{,}000} \times 100 = 14\%$$

Step 3 Calculate Additional Cost of Working

Least of the following three:-

a) **Actual additional** cost of working = Rs 600X4= 2400
b) **G.P. on increased** Sales (6000 X 14%) = 840
c) $\frac{\text{Net profit + Insured Standing Charges}}{\text{Net profit + All standing charges}} \times \text{Actual Additional Cost of working}$

$\frac{18000+10000}{18000 + 42000} \times 2400 = 1120$

Therefore, additional cost of working for claim purposes is Rs 840

Step 4 Calculate Gross Claim

Loss Of Profit (Short Sales X G P Rate)	= 6510
Add: Additional Cost of Working	= 840
	7350

Less: Saving in Insured Standing Charges (4725 X 4/12) = (1575)
Gross Claim = **5775**

Step 5—Claim to be lodged
Adjusted Annual Turnover = 2,40,000 + 10% = 2,64,000
G.P. on Adjusted Annual Turnover = 2,64,000 X 14% = 36,960
Amount of Policy = Rs 50,000
In this case, **amount of policy is more than G.P.** on adjusted sales,. Therefore, gross claim will be treated as claim to be lodged.
So that, Claim to be lodged = 5,775

It always seems impossible until it's done.