INSURANCE CLAIMS FOR LOSS OF PROFIT AND LOSS OF STOCK
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

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**

- Calculation of Gross Profit Ratio

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amt (Rs)</th>
<th>Particulars</th>
<th>Amt (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Opening Stock</td>
<td>XXX</td>
<td>By Sales A/c</td>
<td>XXX</td>
</tr>
<tr>
<td>To Purchase A/c</td>
<td>XXX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Direct Expenses A/c</td>
<td>XXX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Gross Profit (Bal. Fig.)</td>
<td>XXX</td>
<td>By Closing Stock</td>
<td>XXX</td>
</tr>
<tr>
<td></td>
<td>XXX</td>
<td></td>
<td>XXX</td>
</tr>
</tbody>
</table>

Gross Profit Ratio = \( \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100 = \_\% \)
## Step 2: Calculation of Stock on the Date of Fire

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amt (Rs)</th>
<th>Particulars</th>
<th>Amt (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Opening Stock</td>
<td>XXX</td>
<td>By Sales A/c</td>
<td>XXX</td>
</tr>
<tr>
<td>To Purchase A/c</td>
<td>XXX</td>
<td>By Stock on the date of Fire (Bal. Fig.)</td>
<td>XXX</td>
</tr>
<tr>
<td>To Direct Expenses A/c</td>
<td>XXX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Gross Profit</td>
<td>XXX</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Dr Memorandum Trading A/c for the year ended __________**

**Cr**
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

- 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
   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 than stock on the date of fire.
## LOSS OF STOCK

<table>
<thead>
<tr>
<th>Step</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Calculation of Gross Profit Ratio</td>
</tr>
<tr>
<td>2</td>
<td>Calculation of Stock on the Date of Fire</td>
</tr>
<tr>
<td>3</td>
<td>Calculation of Loss of stock</td>
</tr>
<tr>
<td>4</td>
<td>Calculation of Amount of Claim</td>
</tr>
</tbody>
</table>
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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock as on 1.10.2011</td>
<td>29,700</td>
</tr>
<tr>
<td>Purchases from 1.10.2011 to 31.12.2011</td>
<td>75,000</td>
</tr>
<tr>
<td>Wages from 1/10.2011 to 31.12.2011</td>
<td>33,000</td>
</tr>
<tr>
<td>Sales from 1.10.2011 to 31.12.2011</td>
<td>1,40,000</td>
</tr>
</tbody>
</table>

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.
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**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Opening Stock</td>
<td>33,000</td>
<td></td>
</tr>
<tr>
<td>(29,700 x 100/90)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Purchases</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Less : Cost of Plant</td>
<td>70,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td>To Wages</td>
<td>33,000</td>
<td></td>
</tr>
<tr>
<td>Less : Wages for Plant</td>
<td>32,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(500)</td>
<td></td>
</tr>
<tr>
<td>To Gross Profit</td>
<td>35,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>35,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>1,70,500</strong></td>
<td><strong>1,70,500</strong></td>
</tr>
<tr>
<td>By Sales</td>
<td>1,40,000</td>
<td></td>
</tr>
<tr>
<td>By Stock on the date of fire</td>
<td>30,500</td>
<td></td>
</tr>
<tr>
<td>(Bal. Fig)</td>
<td><strong>1,70,500</strong></td>
<td><strong>1,70,500</strong></td>
</tr>
</tbody>
</table>
Step 3

• Calculation of Loss of Stock

<table>
<thead>
<tr>
<th>Stock on the Date of Fire</th>
<th>30,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Salvage Value</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Loss of Stock</td>
<td>27,500</td>
</tr>
</tbody>
</table>
Step 4

**Calculation of Amount of Claim**

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

\[
\text{Amount of Claim} = \frac{25,000}{30,500} \times 27,500 = 22,541
\]
LOSS OF STOCK

1. Calculation of Gross Profit Ratio
2. Calculation of Stock on the Date of Fire
3. Calculation of Loss of stock
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.
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
Gross Profit = Net Profit + Insured Standing Charges
Terms to Remember

• 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)
• 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.
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

• 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

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
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
Step 1

• Calculation of Gross Profit Ratio

\[
\text{Net Profit + Insured Standing Charges} \quad \times 100 = \_\% \\
\text{Turnover of the last Financial Year}
\]
LOSS OF PROFIT

Steps

• Indemnity Period Turnover (IPTO)

Sales made during the period of Dislocation
Steps

Loss of Profit

• Adjusted Standard Turnover (STO)

<table>
<thead>
<tr>
<th>Standard Turnover</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>+/- Trend</td>
<td>XXX</td>
</tr>
<tr>
<td>Adjusted STO</td>
<td>XXX</td>
</tr>
</tbody>
</table>
Step 4

- Short Sales

Adjusted STO: XXX
Less IPTO: XXX
Short Sales: XXX (i.e. Step 3 – Step 2)
Step 5

• Loss of Profit

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

LOSS OF PROFIT
Step 6: Additional Expenses

- i. Actual Additional Expense
  - OR
- ii. G. P. Additional Sales
  - OR

iii. \[
\frac{\text{G. P. on Adjusted ATO} + \text{Uninsured Standing Charges}}{\text{Actual Exp.}} \times \text{XXX}
\]

Whichever is less
Step 7

• Statement of Total Loss

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

XXX  
XXX  
XXX  
XXX
Step 8

- Amount of Claim

\[
\text{Amount of Policy} \times \text{Total Loss} = \text{Loss of Profit}
\]

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

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
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 Rs 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 Rs 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.
Step 1

**Calculation of Gross Profit Ratio**

\[
\text{Gross Profit Ratio} = \left( \frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Turnover of the Last Financial Year}} \right) \times 100
\]

\[
= \frac{1,20,000 + 2,40,000}{20,00,000} \times 100 = 18\%
\]

Add : Adj. for Increase in Gross Profit Rate

\[
\text{20\%}
\]

**LOSS OF PROFIT**
• Calculation Indemnity Period Turnover (IPTO)

Sales from 1.10.2010 to 1.3.2011

2,25,000
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

Loss of Profit: 6,00,000
Step 5

• Calculation of Loss of Profit

\[
\text{Loss of Profit} = \text{Short Sales} \times \text{Gross Profit Ratio} \\
= 6,00,000 \times 20\% \\
= 1,20,000
\]
Step 6

**Loss of Profit**

- Calculation of Additional Expenses

1. Actual Expenses
   - 40,000

2. G.P. on Additional Sales
   - 20,000

3. G. P. on Adjusted ATO + Uninsured Standing Charges
   - $\frac{(22,00,000 + 10\%) 20\%}{(22,00,000 + 10\% ) 20\% + 20,000} \times 40,000$
   - 38,413

Least of Above three figures
- 20,000
Step 7

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

• Calculation of Total Loss
Step 8 • Calculation of Amount of Claim

Application of Average Clause

<table>
<thead>
<tr>
<th>Amount of Policy</th>
<th>G.P. on Adjusted ATO</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,63,000</td>
<td>4,84,000</td>
</tr>
</tbody>
</table>

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

Amount of Claim = \( \frac{\text{Amount of Policy}}{\text{G. P. Adjusted ATO}} \times \text{Total Loss} \)

Amount of Claim = \( \frac{1,25,000 \times 3,63,000}{4,84,000} = 93,750 \)
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