NADAR MAHAJANA SANGAM

SERMATHAI VASAN COLLEGE FOR WOMEN,

AVANIYAPURAM, MADURAI – 12

DEPARTMENT OF COMMERCE

&

BANKING

MATERIALS

CLASS: II B.COM

SUBJECT: FINANCIAL ACCOUNTING - III

Subject Title: FINANCIAL ACCOUNTING – III
Subject Code: CCRJC33

UNIT I

Fire Insurance Claims – Loss of stock policy – Loss of profit policy – Application of average clause.

UNIT II

Royalty Accounts – Accounting treatment in the books of lessor and lessee- Sublease.

UNIT III

Insolvency Accounts – Individual Only – Statement of affairs – Deficiency account (List H) Self balancing system: Self balancing ledger – Transfer from one ledger to another ledger.

UNIT IV

Branch accounts – Types of Branches – Branch not keeping full system of accounting – Branch keeping full system of accounting (Excluding foreign branches) – Simple problems only- Departmental accounts – Allocation of expenses – Inter – Departmental transfers.

UNIT V

Hire purchase accounting – Calculation of interest – Cash price – Accounting treatment in the books of Hire purchaser and Hire vendor – Default and Installment purchase system: Theory only.

BOOKS FOR STUDY

1. Advanced accountancy – R.L.Cupta and Radhaswamy
2. Advanced accounting – S.P.Jain and K.L.Narang
3. Advanced accountancy – M.A.Arulanandam and K.S.Raman
4. Advanced accountancy – S.N.Maheshwari and S.K.Maheshwari
5. Advanced accountancy – T.S.Reddy and A.Murthy

BOOKS FOR REFERENCE

1. Advanced Accounts – M.C.Shukla and T.S.Grewal
2. Advanced Accountancy – P.C.Tulsian

Note: The questions should be asked in the ratio of 60% for problems and 40% for theory.

Unit – I

Fire Insurance:

Fire, in the business premises of any firm, can damage a number of assets like stock, buildings, furniture, fixtures, machinery etc. In addition, the number of working of a firm is affected for a number of days or months, resulting in loss of sales and loss of profits

It is very difficult for a business to replace all the destroyed assets and normalize its working without affecting its working capital position and cash position. During such difficult times, external help is like a boon to the business.

All prudent business firms insure their stock and also other assets against the risk of fire. They take appropriate Insurance Policy from a recognized company by paying required premium. This enables the business to lodge claim against insurance company and receive sufficient funds to replace the lost assets.

Insurance companies investigate any claim made through experienced assessors. They evaluate the causes for fire and the actual loss through the damage. Based on the assessor's report, insurance company settles the claim made against it for loss due to fire.

Types of Fire Insurance Policies

1. Loss Of stock policies and
2. Loss of profits Policy (or) consequential loss policies.

1. Loss of Stock Policies:

***Steps to find out points which are given in problem**

1. Find out fire broke out date.
2. Find out Previous financial year starting date and year ending date.
3. Find out Memorandum Trading Account period -which is related to current year starting date up to the fire broke out date.
4. Find out the value at which stock were given whether it was at cost price or under cost or above cost
5. Find out abnormal items or free samples that were given out.
6. To Separate the given information according to Trading Account (for Previous financial year) and Memorandum Trading Account (from the start of current year to the date of fire break out)

Steps for problem solving-

1. **Prepare Trading Account- to find out Gross Profit.**

Trading A/c as on Previous Accounting year Ending Date

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock (if stock valued at the (i) above cost: Stock amount ×100÷ above cost % (100+% of above cost) Example: if above cost by 10% of stock value Rs. 10000 Calculation: 10000×100÷110 (ii) if Below cost Stock amount ×100÷ Below cost % (100 – % of Below cost) Example: if below cost by 10% of stock value Rs. 10000 Calculation: 10000×100÷90		Xxx	By Sales (-) Sales Return or Return Inwards (or) Goods return by Customer	Xxx Xxx -----	xxx
			By Closing Stock (if stock valued at the (i) above cost: Stock amount ×100÷ above cost % (100+% of above cost) Example: if above cost by 10% of stock value Rs. 10000 Calculation: 10000×100÷110 (ii) if Below cost Stock amount ×100÷ Below cost % (100 – % of Below cost) Example: if below cost by 10% of stock value Rs. 10000 Example: if below cost by 10% of stock value Rs. 10000 Calculation: 10000×100÷90		Xxx

To Purchases (-) Purchase Return (or) Return Outwards(or) Goods return to Suppliers (-) Drawings (Goods withdrawn For Personal use (-) Goods given for Sample	Xxx Xxx Xxx Xxx -----	xxx			
To Direct Expenses: ➢ Carriage Inwards ➢ Freight Inwards ➢ Coal, Fuel, Gas, Water ➢ Wages and Salaries ➢ Wages ➢ Royalty ➢ Octroi ➢ Import Duty ➢ Dock Charges ➢ Carriage on Purchases ➢ Expenses on Purchases ➢ Freight On Purchases ➢ Cost of goods manufactured ➢ Manufacturing Expenses ➢ Factory Expenses		Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx			
To Gross Profit (Balancing Figure)		**xxx**	**By Gross Loss (Balancing Figure)**		**xxx**
		xxx			xxx

2. Calculate Gross Profit Ratio using following formula

$$\frac{\textbf{Gross Profit}}{\textbf{Sales}} \times \mathbf{100}$$

3. Prepare Memorandum Trading Account-to find out **stock on date of fire**

Memorandum of Trading A/c as on the Date of Fire

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock (Previous year Closing Stock Current Year Opening Stock)		Xxx	By Sales (-) Sales Return or Return Inwards (or) Goods return by Customer	Xxx Xxx -----	xxx
To Purchases (-) Purchase Return (or) Return Outwards(or) Goods return to Suppliers (-) Drawings (Goods withdrawn For Personal use (-) Goods given for Sample	Xxx Xxx Xxx Xxx -----	xxx	**By Stock on the date of Fire (Bal.Fig.)**		**Xxx**

To Direct Expenses: ➢ Carriage Inwards ➢ Freight Inwards ➢ Coal, Fuel, Gas, Water ➢ Wages and Salaries ➢ Wages ➢ Royalty ➢ Octroi ➢ Import Duty ➢ Dock Charges ➢ Carriage on Purchases ➢ Expenses on Purchases ➢ Freight On Purchases ➢ Cost of goods manufactured ➢ Manufacturing Expenses ➢ Factory Expenses		Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx Xxx			
To Gross Profit: Calculation Sales(Current Year to the date of fire)×%of Gross Profit÷100 If it is Gross Profit on Cost: Sales Current Year to the date of fire))×%of Gross Profit÷100+%of Gross Profit on Cost					
		xxx			xxx

4. Prepare Statement of **Loss of Stock** using following format

Particulars	**Rs**
Stock on date of fire	xxx
(-) Salvaged of Stock	xxx
Loss Of Stock	xxx

***Whenever the Average Clause is not applied, Loss of Stock amount is applicable for the claim.**

5. Average Clause Calculation**-If the Insurance Policy Amount is given and the Average Clause is included then the claim amount calculate using to following Average Clause formula**

$$\textbf{Claim Amount} = \frac{\textbf{Insurance Claim Account}}{\textbf{Stock on date of Fire}} \times \textbf{Loss of Stock}$$

Practical Problem: 1

From the following particulars in respect of Ram Prasad, ascertain the insurance claim with regard to the loss of stock due to afire accident on 11th May 1989:

The company had the practice of valuing stock-at cost less 5%.

The value of fire insurance taken was for Rs, 2, 15,000.

The policy was subject to average clause.

Stock as on 1-1-1988 Rs. 2, 85,000

Stock as on 31-12-1988 Rs. 3, 80,000

Purchases made during the year Rs. 5, 20,000

Sales for the year 1988 Rs. 6, 00,000

Purchases from 1-1-1989 to the date of fire Rs. 2, 19,000

Sales from I-I-1989 to the date of fire Rs. 2, 70,000

Value of stock salvaged Rs. 30,000.

1. Loss of Stock Policies:

***Steps to find out points which are given in problem**

1. Fire broke out date – 11th May 1989
2. Previous financial year starting date 01.01.1988 - and year ending date – 31.12.1988
3. Memorandum Trading Account period - current year starting date 01.01.1989 - up to the fire broke out date – 11th May 1989
4. Stock were given at under cost.

For Opening Stock

$$\frac{\text{Stock Value}}{95} \times 100$$

$$\frac{2,85,000}{95} \times 100 = 3,00,000$$

for Closing Stock

$$\frac{\text{Stock Value}}{95} \times 100$$

$$\frac{3,80,000}{95} \times 100 = 4,00,000$$

5.

Trading Account (for Previous financial year) Items		**Memorandum Trading Account (from the start of current year to the date of fire break out) Items**	
Stock as on 1-1-1988	3, 00,000	Purchases from 1-1-1989 to the date of fire	2, 19,000
Stock as on 31-12-1988	4, 00,000	Sales from I-I-1989 to the date of fire	2, 70,000
Purchases made during the year	5, 20,000		
Sales for the year 1988	6, 00,000		

6. Trading A/c as on 31.12.1988

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	3, 00,000	By Sales	6, 00,000
To Purchases	5, 20,000	By Closing Stock	4, 00,000
To Gross Profit (Bal.Fig)	**1,80,000**		
	10,00,000		10,00,000

7. Calculation of Gross Profit Ratio

$$\frac{\textbf{Gross Profit}}{\textbf{Sales}} \times 100$$

$$= \frac{1,80,000}{6,00,000} \times 100 = 30\%$$

8. Memorandum of Trading A/c as on 11.05.1989

Particulars	Rs.	Particulars	Rs.
To Opening Stock	4, 00,000	By Sales	2, 70,000
To Purchases	2, 19,000	**By Value of the stock at the date of fire (Bal.Fig.)**	**4,30,000**
To Gross Profit $2,70,000 \times \frac{30}{100}$	81,000		
	7,00,000		7,00,000

9. Statement of **Loss of Stock:**

Particulars	**Rs**
Stock on date of fire	4,30,000
(-) Salvaged of Stock	30,000
Loss Of Stock	**4,00,000**

10. Average Clause Application (Because the Value of Stock at the date of fire is higher than Policy Amount):

$$\textbf{Claim Amount} = \frac{\textbf{Policy Amount}}{\textbf{Stock on date of Fire}} \times \textbf{Loss of Stock}$$

$$= \frac{\mathbf{2,15{,}000}}{\mathbf{4,30{,}000}} \times \mathbf{4,00{,}000}$$

$$= \mathbf{2,00{,}000}$$

Therefore, Claim Amount = Rs. 2, 00,000

Practical Problem: 2

Problem:

A fire occurred on the premises of a merchant on 1-7-1990 and a considerable part of stock was destroyed.

Value of stock saved from fire was Rs. 21,600.

On 01-04.1990 the stock was valued at Rs. 83,500.

Purchases from 1-4-1990 to the date of fire were Rs. 1,12,000 and Sales were Rs. 1,54, 000.-

On investigation of books of accounts it was understood that average gross profit during the past 3 years was 25% on sales.

Stock was insured for Rs. 75,000.

Solution:

Loss of Stock Policies:

***Steps to find out points which are given in problem**

1. Fire broke out date – 01.07.1990
2. Previous financial year starting date - and year ending date – No need to find out.
3. Memorandum Trading Account period - current year starting date 01.04.1990 - up to the fire broke out date – 01.07.1990

4. Stock was given at cost.

5.

Trading Account (for Previous financial year) Items	**Memorandum Trading Account (from the start of current year to the date of fire break out) Items**	**Rs.**
No need to calculate Trading A/C. Because the **Gross Profit Ratio was given.**	Stock as on 01-04-1990 Purchases from 01-04-1990 to the date of fire Sales from 01-04-1990to the date of fire	83,500 1,12,000 1,54,000

6. No need to calculate Trading A/C.

7. No need to calculate Gross Profit Ratio. (It was given in the problem).

8. **Memorandum of Trading A/c as on 11.05.1989**

Particulars	Rs.	Particulars	Rs.
To Opening Stock	83,500	By Sales	1,54,000
To Purchases	1,12,000	**By Value of the stock at the date of fire (Bal.Fig.)**	**80,000**
To Gross Profit $1,54,000 \times \frac{25}{100}$	38,500		
	2,34,000		2,34,000

9. Statement of **Loss of Stock:**

Particulars	**Rs**
Stock on date of fire	**80,000**
(-) Salvaged of Stock	21,600
Loss Of Stock	**58,400**

10. Average Clause Application (Because the Value of Stock at the date of fire is higher than Policy Amount)

$$\textbf{Claim Amount} = \frac{\textbf{Policy Amount}}{\textbf{Stock on date of Fire}} \times \textbf{Loss of Stock}$$

$$= \frac{75{,}000}{80{,}000} \times 58{,}400$$

$$= 54{,}750$$

Therefore, Claim Amount = Rs. 54,750

UNIT – I
LOSS OF PROFIT POLICY

FORMAT

Step: 1 claim for reduction in turn over:

(a) Short Sales:

	Rs.
Standard Turnover	xxx
(Standard turnover refers the turnover Effected in the last accounting period Corresponding to the indemnity period)	
Indemnity period:	
(Any period not exceeding twelve months From the date of damage during which The results of the business shall be Affected due to fire is known as Indemnity period.)	
Add: Increase for trend	xxx
(Or)	
Less: Decrease for trend	xxx
Less: Affected period turnover	xxx
(This is the actual sales made during The Indemnity period in which work Is affected by fire.)	

Short sales =	xxx

(b) Claim for Reduction in Turnover

= Short sales× Gross profit rate.

$$\text{Gross profit rate} = \frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Accounting Year Turnover}} \times 100$$

(This is the turnover of the Last accounting year.)

Step: 2 Claim for increased cost of working

(a) Actual increased cost of working xxx

(b) If all standing charges are not insured:

(Standing Charges: These are the Fixed expenses which are incurred Irrespective of the reduction in turnover. Example: Salaries, rent, rates, taxes, Insurance, interest on bank overdraft, Debentures etc.)

(Insured Standing Charges:

Those charges specified

In the policy, which insured

Desires to recover in the case of

An accident is called

Insured standing charges.)

(Uninsured Standing Charges:

These arc incurred fixed expenses

Which are not Mentioned in the

Insurance policy.)

Net Profit +

Insured standing charges

------------------------------------- $\times$ ***Actual Increased cost of Working*** **xxx**

Net profit + all standing

Charges

c) Saved turnover

(This is the sales achieved due to

Spending additional amounts during

The affected period.)

(Or)

Short sales avoided through

increased cost of working xxx

Amount to be claimed for increased cost of working

(lowest of a, b and c)

Step: 3 Total claim for loss of Profits:

Claim for reduction in turnover (As per step 1)	**xxx**
Add: Claim for increased cost of working (As per step 2)	**xxx**

	Xxx
Less: Savings in standing charges (Some of the fixed expenses need not be Incurred by the firm due to fire accident.)	**Xxx**

Total claim for loss of profit	**xxx**

Step: 4 Application of average clause:

If the policy amount is less than gross profit on annual turnover, then average clause applies.

$$\text{Claim} = \frac{\text{Sum Insured}}{\text{G.P. on Annual Turnover}} \times \text{Total claim}$$

(Annual Turnover during The twelve months exactly Before fire.)

UNIT – I
LOSS OF PROFIT POLICY

FORMAT

Step: 1 claim for reduction in turn over:

(a) Short Sales:

	Rs.
Standard Turnover	**xxx**
Add: Increase for trend	**xxx**
(Or)	
Less: Decrease for trend	**xxx**
Less: Affected period turnover	**xxx**

Short sales =	**xxx**

(b) Claim for Reduction in Turnover

$$= \text{Short sales} \times \frac{\text{Gross profit rate}}{100}$$

Gross profit rate:

$$\frac{\text{Net Profit + Insured Standing Charges}}{\text{Accounting Year Turnover}} \times 100$$

Step: 2 Claim for increased cost of working

(a) Actual increased cost of working xxx

(b) If all standing charges are not insured:

$$\frac{\text{Net Profit + Insured standing charges}}{\text{Net profit + all standing Charges}} \times \textit{Actual Increased cost of Working} \quad \text{xxx}$$

c) Gross Profit on Saved turnover

(Or)

Gross Profit Short sales avoided through increased cost of working xxx

Amount to be claimed for increased cost of working (lowest of a, b and c)

Step: 3 Total claim for loss of Profits:

Claim for reduction in turnover (As per step 1)	**xxx**
Add: Claim for increased cost of working (As per step 2)	**xxx**

	Xxx
Less: Savings in standing charges	**xxx**

Total claim for loss of profit	**xxx**

Step: 4 Application of average clause:

If the policy amount is less than gross profit on annual turnover, then average clause applies.

Annual Turnover	**xxx**
Add: Increase Trend	**xxx**
Or	
Less: Decrease Trend	**xxx**

Annual Turnover	**xxx**

$$\text{Gross Profit on Annual Turnover} = \text{Annual Turnover} \times \frac{\text{Gross Profit Rate}}{100}$$

$$\text{Claim} = \frac{\text{Policy Amount}}{\text{Gross Profit on Annual Turnover}} \times \text{Total claim}$$

UNIT – I
LOSS OF PROFIT POLICY
2nd Practical Problem & Solution

Problem:

From the following particulars, prepare a claim for loss of profit under consequential loss policy.

Date of Fire	30th June 1991
Period of Indemnity	6 Months
Sum Insured	40,000
Sales Up to 30th June 1991	2, 00,000

Net profit for the accounting period ending 31-03-1991 Rs.12, 500, standing charges for the same period Rs.28,500 and sales Rs.1,98,000.

Sales for the indemnity period from 01-07-91 to 31-12-1991 Rs.56, 000; Sales for the period from 01.07.1990 to 3 1-12-1990 Rs.1, 10,000. The sales 1991-92 is expected to be 10% more than the previous year.

Solution:

Step: 1 claim for reduction in turn over:

(a) Short Sales:

	Rs.
Standard Turnover	1, 10,000
Add: Increase for trend (10%)	
$1,10{,}000 \times \dfrac{10}{100}$	11,000

	1, 21,000
Less: Affected period turnover	56,000

Short sales	65,000

(b) Claim for Reduction in Turnover

$$= \text{Short sales} \times \text{Gross profit rate}$$

Gross profit rate:

$$\frac{\text{Net Profit + Insured Standing Charges}}{\text{Accounting Year Turnover}} \times 100$$

$$= \frac{12{,}500 + 28{,}500}{1{,}98{,}000} \times 100$$

$$= 20.70\%$$

Claim for Reduction in Turnover

$$= \text{Short sales} \times \text{Gross profit rate}$$

$$= 65{,}000 \times \frac{20.70}{100}$$

$$= 13455$$

Therefore, Claim Amount is Rs. 13,455

UNIT – I
LOSS OF PROFIT POLICY
3rd Practical Problem & Solution

Problem:

A company was insured for consequential loss. A fire occurred on 31st March 1988 and as a result there was diminished turnover, as compared with The corresponding months of the preceding year, of 20,000. The company Was insured for a period which adequately covered the dislocation and No special factors existed.

The account for last accounting period of a year to 31st January 1988, showed a Net profit of 4,000 after debiting standing charges (all Insured) 6,000 And turnover being 1, 00,000 The Company had taken a loss of profits policy Of 4,800 and the turnover for the year immediately preceding the fire was 64,000. Calculate the claim on Average basis.

Solution:

Step: 1 claim for reduction in turn over:

(a) Short Sales:

Given in Problem = 20,000

(b) Claim for Reduction in Turnover

= Short sales × Gross profit rate

Gross profit rate:

$$= \frac{\text{Net Profit + Insured Standing Charges}}{\text{Accounting Year Turnover}} \times 100$$

$$= \frac{4{,}000 + 6{,}000}{1{,}00{,}000} \times 100 = 10\%$$

Claim for Reduction in Turnover

= Short sales × Gross profit rate

$$= 20{,}000 \times \frac{10}{100} = 2{,}000$$

Step: 2 Application of average clause:

Check whether average clause applies or not by calculating Annual Turnover on Gross Profit Ratio

Gross Profit on Adjusted Annual Turnover $= 64{,}000 \times \dfrac{10}{100} = 6{,}400$

Policy amount is less than gross profit on annual turnover, so average Clause applies

$$\text{Claim} = \frac{\text{Policy Amount}}{\text{G.P. on Annual Turnover}} \times \text{Total claim}$$

$$= \frac{4{,}800}{6{,}400} \times 2{,}000$$

$$= 1{,}500$$

Therefore, Claim Amount is Rs. 1,500

THANK YOU

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