Module IV

5

PROFIT PRIOR TO INCORPORATION

Unit Structure

5.0 Objectives

5.1 Introduction

5.2 Computation of Profit Before Incorporation

5.3 Solved Problems

5.0 OBJECTIVES

After studying the unit, the students will be able to:

- Understanding the concept of Profit prior to incorporation
- Understanding the accounting treatment of Profit prior to and Post incorporation.
- Understanding the basis of allocation of various items of Income and Expenses in Pre and Post incorporation periods
- Calculating the Profit/Loss for pre and post incorporation periods separately.

5.1 INTRODUCTION

Prior means before and post means after. Profit prior to incorporation refers to the profit before incorporation. For computing the profit before incorporation, the profit and loss account is to be prepared in a columnar form to arrive at profit earned before and after incorporation separately. Alternatively, a statement in columnar form showing the results in the pre/ post incorporation period may be prepared.

4.1.1 Concept-

The profit earned before incorporation cannot be treated as a business profit and hence is not available for distribution as dividend to the shareholders .It is a capital profit and should be transferred to Capital Reserve. The profit earned after incorporation is available for appropriations.

4.1.2 Utilisation of Profit prior to incorporation-

1. For writing off fixed assets acquired
2. For writing off goodwill, if any
3. For paying interest to vendors, if any on the value of purchase consideration
4. For writing off preliminary expenses.

5.2 COMPUTATION OF PROFIT BEFORE INCORPORATION

Step-1 Calculate the Time ratio and Sales ratio-

- Time ratio refers to the number of months in the accounting period before incorporation and after incorporation.
- Sales ratio refers to the sales in the pre incorporation and post incorporation periods.
- For example- The accounting period is from 1-4-2010 to 31-3-2011(12 months) and the date of incorporation is 1-7-2010 .In this case the accounting period can be divided into two distinct periods- 1-4-2010 to 1-7-2010 (3 months before incorporation) and 1-7-2010 to 31-3-2011(9 months after incorporation) Time ratio is 3 months : 9 months or 1:3.
- Sales during the pre incorporation period is Rs. 150000 and the total sales during the entire accounting year is Rs. 900000 This means that the sales in the post incorporation period is 750000(900000-150000). Thus the sales ratio is 150000:750000 or 1:5.

Step-2 Prepare profit and loss account in a columnar format and allocate the expenses profit and incomes on a suitable basis

- If the gross profit is given in the problem, allocate the gross profit in the sales ratio calculated in step 1.
- If the gross profit is not given, then find out the gross profit by preparing trading account as is normally done in final accounts.
- The gross profit can also be worked out by using the formula Gross profit =Sales- Cost of Goods Sold.

Step 3- Allocate all items appearing on the debit side of Profit and loss account and credit side of Profit and Loss a/c on suitable basis. Generally the expenses are allocated in the following manner-

- All fixed expenses, period costs, administration expenses, general expenses in time ratio.
- All selling and distribution expenses, variable expenses in sales ratio

Step 4- There are some items of expenditure and income which are not to be allocated.

- They pertain wholly to the pre incorporation period- for example- Partners salaries, interest on partners' capitals.
- Similarly expenses like preliminary expenses, directors fees , interest on debentures are to be shown in post incorporation only.
- Incomes like share transfer fees will appear on the credit side in the post incorporation column only.
- However, if specific information is given about a particular item of expense, it must be considered while allocating the expense. For example- bad debts are generally allocated on sales ratio but if there is an additional information about bad debts that bad debts relate to sales effected in the pre-incorporation period, then in such case bad debts should not be allocated on sales ratio but it should be shown only in the pre- incorporation column on the debit side of profit and loss account.

Profit and Loss account

For the year ended 31st March 2018

Dr. Cr

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salary	Time	xx	xx	By Gross Profit	Sales	xx	xx
To Rent	Time	xx	xx	By Share transfer fees	Post	-	xx
To Discount	Sales	xx	xx				
To Directors fees	Post	---	xx				
To Partners salary	Pre	xx	---				
To Advertisement	Sales	xx	xx				
To Commission	Sales	xx	xx				
To Capital reserve		xx					
To net profit			xx				
Total		xx	xx	Total		xx	xx

Alternatively the details of profit before and after incorporation may be presented in a statement format as under -

Statement of Profit and loss account for the year ended 31st March 2018

Particulars	Basis	Pre-incorporation	Post incorporation
Incomes Gross Profit	Sales ratio	xxxxx	xxxxx
Less Expenses			
Salaries	Time ratio	xxxxx	xxxxx
Advertisement	Sales Ratio	xxxx	xxxx
Directors fees	Post	-------	xxxx
Debenture Interest	Post	-------	xxxx
Capital Reserve (Balancing figure)		xxxxxxx	
Profit and Loss account (Balancing figure)			xxxxx
Total		xxxxx	xxxxx

Step-5 Balance the Profit and loss account and find out profit/loss.

- Profit in the pre- incorporation period- is to be transferred to Capital Reserve account.
- Loss in the pre- incorporation period- debited to Goodwill account.
- Profit in the post- incorporation period- Transferred to Profit and loss appropriation account.

Check your progress

Calculate time ratio and sales ratio from the following information-

The company was incorporated on 1st June 2015 for the purpose of purchasing an established business as from 1st April 2015. The books of account for the year ended 31st March 2016 showed the total sales for the year as Rs 3,21,040 and sales from 1st April to 1st June as Rs 80,260. The gross profit for the year was Rs 41,280

Calculation of TIME RATIO

Accounting period –

Date of incorporation-

Pre incorporation period—

Post incorporation period –

TIME RATIO-

Calculation of SALES RATIO

Total sales during the year –

Sales in the pre incorporation period –

Sales in the post incorporation period –

SALES RATIO

(Answer- TR-1:5, SR -1:3)

5.3 SOLVED PROBLEMS

Illustration 1

Calculate Time ratio and Sales Ratio from the following information-

A limited company was registered on 1st January 2016 to take over a business as on 1st October 2015. The books of accounts are closed on 30th September 2016. The certificate of commencement of business was obtained on 1st February 2016. The turnover (sales) for the year ending 30th Sept 2016 was Rs 3,00,000 of which Rs 50,000 related to the period from 1st Oct 2015 to 1st January 2016. (Answer: TR 1:3 SR 1:5)

The Trading account showed a total gross profit of Rs 1,20,000 . How will the gross profit be allocated?

Illustration 2-

Calculate Time Ratio and Sales Ratio from the following information.

A limited company was incorporated on 1st July 2017 to take over a business as on 1st January 2017 and the company follows calendar year. The books of accounts were closed on 31st December 2017 and the monthly sales effected from 1st Jan to 31st December 2017 were as follows-

January, February, March and April - Rs 50,000 each month May, June Rs 75,000 each month and Sales from July to December was uniform at Rs 1,00,000 each month

Solution:

Time Ratio:

Accounting period – 1 January to 31st December 2017

Date of Incorporation 1st July 2017

Pre incorporation period – 1st January to 30th June 2017 – 6 months

Post Incorporation - 1st July to 31st December 2017 – 6 months

Time Ratio 1:1

Sales Ratio

Sales in pre incorporation period January to June -
50,000+50,000+50,000+50,000+75,000+75,000 = 3,50,000

Sales in the post incorporation period July to December-
1,00,000+1,00,000+1,00,000+1,00,000+1,00,000+1,00,000= 6,00,000

Sales Ratio – 3,50,000 : 6,00,000 or 7:12

Illustration 3

Big Co. Ltd took over the business of Small &Sons, a firm w.e.f. 1-4-2007. The company was registered on 1-11-2007. Profit and loss account for the year ended 31-3-2008 was as under-

Particulars	Amt(Rs.)	Particulars	Amt(Rs.)
To Salaries	2,40,000	By Gross profit b/d	12,60,000
To Rent and rates	1,80,000		
To Printing and stationery	96,000		
To Audit fees	30,000		
To Sundry expenses	24,000		
To Carriage outward	90,000		
To Advertising	63,000		
To Electricity charges	72,000		
To Commission on sales	1,08,000		
To Debenture interest	28,000		
To Depreciation	42,000		
To Interest on purchase consideration	27,000		
To Net profit c/f	2,60,000		
	12,60,000		12,60,000

Additional information:

1. Sales for each of the months July, August, September, January, February and March were twice the sales for each of the months April, May, June, October, November and December.

2. Depreciation shown above includes depreciation on furniture worth Rs. 2,40,000 @ 10% and on delivery van worth Rs.90,000 @ 20%. Both these assets were taken over from Small and sons.
3. Big Co. Ltd. settled Purchase consideration on 1st January,2008
4. Audit fees are payable for the whole year.

Prepare Profit and Loss account for the year ended 31st March, 2008 showing profits for pre- incorporation and post incorporation periods separately.

(University of Mumbai- October 2009)

Solution:--

WN - Time ratio-

Pre- incorporation period- 1-4-2007 to 1-11-2007(7 months)

Post- incorporation period- 1-11-2007 to 31-3-2008(5 months)

Time ratio - 7:5

Sales ratio-

Let monthly sales be-1

Pre-incorporation period- 1+1+1+2+2+2+1=10

Post- incorporation period-1+1+2+2+2=8

Sales Ratio- 10:8 or 5:4

Interest on purchase consideration-

(payable for 9 months from April to December)

Pre-incorporation- 1-4-2007 to 1-11-2007 (7 months)

Post- incorporation- 1-11-2007 to 31-12-2007(2 months)

Specific ratio- 7:2

Depreciation on assets- Furniture- 240000x10%= 24,000

Delivery van- 90,000x 20%= 18,000

Total Depreciation (24,000+ 18,000) = 42,000 in Time Ratio 7:5

Profit and Loss account for the year ended 31st March, 2008

Dr.						Cr	
Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries	Time	1,40,000	1,00,000	By Gross profit	Sales	7,00,000	5,60,000
To Rent and taxes	Time	1,05,000	75,000				
To Printing &Stationery	Time	56,000	40,000				
To Audit fees	Time	17,500	12,500				
To Sundry expenses	Time	14,000	10,000				
To Carriage outward	Sales	50,000	40,000				
To Advertising	Sales	35,000	28,000				
To Electricity charges	Time	42,000	30,000				
To Commission on sales	Sales	60,000	48,000				
To Debenture interest	Post	----------	28,000				
To Depreciation	Time	24,500	17,500				
To Interest on purchase consideration	7:2	21,000	6,000				
To Capital Reserve (bal fig)		1,35,000	----------				
To Net Profit (bal fig)		----------	1,25,000				
Total		7,00,000	5,60,000	Total		7,00,000	5,60,000

Note: Alternatively the depreciation on Delivery van may be allocated in sales ratio also. The working note on depreciation will be as follows –

Depreciation on Furniture in Time ratio (Rs 24,000 in Time ratio) and Depreciation on delivery van in sales ratio (Rs 18,000 in sales ratio).

In such case the answer will change and profit before incorporation would be Rs 1,35,500 which will be transferred to capital reserve and the profit after incorporation would be Rs 1,24,500

Illustration 4

M/s Abani Offshore Ltd took over a running business with effect from 1st April, 2018. The company was incorporated on 1st September, 2018. The summarized Profit and Loss Account for the year ended 31st March,2019 is as under:

Particulars	Rs.	Particulars	Rs.
To Printing and Stationery	2,40,000	By Gross Profit	1,70,00,000
To Salaries	39,00,000	By Interest on Fixed Deposit	12,00,000
To Directors fees	5,00,000		
To Selling expenses	24,30,000		
To Debenture Interest	5,80,000		
To Auditors Fees	1,00,000		
To Rent and taxes	9,60,000		
To Office Expenses			
To Bad Debts	6,00,000		
To Preliminary Expenses	12,00,000		
To Net Profit	10,00,000		
	66,90,000		1,82,00,000
	1,82,00,000		==========
	==========		

Additional Information:

1. It is ascertained that monthly sales from October 2018 to March 2019 was twice the average of the monthly turnover from April 2018 to September 2018.
2. Out of bad debts Rs. 2,00,000 relate to debts created prior to incorporation. Remaining bad debts are out of sales affected throughout the year.
3. Rent is doubled from 1st December, 2018.
4. Salaries include salary of three employees at equal monthly remuneration. However one of them was appointed as manager from 1st January, 2019. His salary was doubled from that date.
5. Vendors were entitled to 40% of the profit earned in Pre-incorporation period.
6. Interest on Fixed Deposit was received for the entire year.

Prepare the Statement of Profit and Loss in columnar form, showing distinctly the allocation of profits between pre incorporation and post incorporation periods, indicating the basis of allocation.

Solution:

Working Notes –

Time Ratio 5:7

Sales Ratio 5: 13

Basis for Allocating Rent 5:11

Salaries 15:24 or 5:8

Bad Debts Rs. 12,00,000

Rs 2,00,000 in pre incorporation (given)

Balance bad debts Rs 10,00,000 to be divided in Sales Ratio:

Pre incorporation: 2, 77,778

Post Incorporation: 7, 22,222

Total Pre Incorporation Bad Debts Amount:

2,00,000 + 2,77,778 = 477778

Post Incorporation Bad Debts=722222

Statement of Profit And Loss

For The Year Ended 31ST March 2019

	Pre-Incorporation	Post-Incorporation
INCOMES		
Gross profit (SR)	47,22,222	122,77,778
Interest on FD (TR)	+ 5,00,000	+ 7,00,000
Total Income (A)	52,22,222	129,77,778
EXPENSES		
Printing and Stationery (TR)	1,00,000	1,40,000
Salaries (5:8)	15,00,000	24,00,000
Directors Fees (Post)	----------	5,00,000
Selling Expenses (SR)	6,75,000	17,55,000
Debenture Interest (Post)	----------	5,80,000
Auditors fees (TR)	41,667	58,333
Rent and Taxes (5:11)	3,00,000	6,60,000
Office Expenses (TR)	2,50,000	3,50,000

Bad Debts (WN)	4,77,778	7,22,222
Preliminary expenses (Post)	----------	10,00,000
Total expenses (B)	33,44,445	81,65,555
Capital Reserve (A-B) (bal.fig)	18,77,777	
Net Profit (A-B) (bal.fig)		48,12,223

Illustration 5:

Avenue Ltd was incorporated on 1st August, 2017 to acquire the business of Shah and Bros from 1st April, 2017. The company received the certificate of commencement of business on 1st October, 2017.

The agreement also provided that vendors are entitled to 60% of Profits (or Loss, if any) for the period upto 1st August, 2017.

The following Profit & Loss Account for the year ended 31st March, 2018 is presented as under:

Particulars	Rs.	Particulars	Rs.
To Office Salaries	36,00,000	By Gross Profit	1,20,00,000
To Bad Debts	5,00,000	By Profit on sale of Investment	20,00,000
To Depreciation	18,00,000		
To Office rent	9,00,000		
To Commission on Sales	15,00,000		
To Debenture Interest	8,00,000		
To Directors Fees	8,00,000		
To Interest on Purchase Consideration	6,00,000		
To Net Profit	35,00,000		
	1,40,00,000		1,40,00,000

You obtained the following additional information :

(a) Monthly Sales for October, 2017 to March, 2018 is 150% of monthly sales for April, 2017 to September, 2017.

(b) Office rent was increased from Rs. 50,000 per month to Rs. 1,00,000 per month effective from 1st October, 2017.

(c) Investment was sold on 1st November, 2017.

(d) Bad debts were in respect of sales affected two years ago.

(e) Consideration to Vendors was paid on 1st October, 2017.

Prepare the Statement of Profit and Loss in columnar form, showing distinctly the allocation of profits between pre incorporation and post incorporation periods, indicating the basis of allocation.

Working notes-

Time Ratio 1:2

Sales Ratio 4:11

Interest on Purchase Consideration 4: 2 or 2:1

Interest is paid for 6 months from April to September.

(April, May, June, July) 4 months pre incorporation period

While (August and September) 2 months post incorporation period.

Office rent	Pre	Post
50,000x4 months	2,00,000	
50,000x2 months		1,00,000
1,00,000x6 months		6,00,000
Total office rent	2,00,000	7,00,000

Statement of Profit and Loss

For the year ended 31st March 2018

	Pre-Incorporation	Post-Incorporation
Incomes		
Gross Profit (SR)	32,00,000	88,00,000
Profit on Investment (Post)	----------	+20,00,000
Total Income (A)	32,00,000	1,08,00,000
Expenses		
Office Salaries(TR)	12,00,000	24,00,000
Bad Debts(Pre)	5,00,000	----------
Depreciation (TR)	6,00,000	12,00,000
Office Rent(WN)	2,00,000	7,00,000
Commission on Sales (SR)	4,00,000	11,00,000
Debenture Interest(Post)	----------	8,00,000

Directors Fees(Post)	----------	8,00,000
Interest on Purchase consideration (2:1)	4,00,000	2,00,000
Total Expenses (B)	33,00,000	72,00,000
Loss(A-B) Less Vendors share 60% Loss transferred to Goodwill	1,00,000 (60,000) 40,000	
Net Profit (A-B)		36,00,000

Illustration 6

Kalpana Limited was registered on 1st February 2013 to acquire the business of M/s. XYZ as on 1st October 2012. The accounts of the company for the period ended 30th September 2013 disclosed the following facts:

1) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013
2) The trading account showed a gross profit of Rs. 96,000
3) The following items appeared in the Profit and Loss Account:

a. Directors Fees – Rs. 1,500
b. Auditors fees – Rs. 750
c. Rent, rates and Taxes – Rs. 4,800
d. Bad debts (of which Rs. 700 related to book debts created before 1st February 2013) – Rs. 2000
e. Salaries – Rs. 12,000
f. Interest on Debentures – Rs. 6,000
g. Depreciation – Rs. 3,600
h. Preliminary expenses – Rs. 2,400
i. General Expenses – Rs. 1,800
j. Commission on sales – Rs. 3,600
k. Printing and Stationery – Rs. 2,400
l. Advertising – Rs. 4,200
m. Traveller's salaries – Rs. 8,400
n. Interest to Vendor at 10% p.a. on Rs. 1,00,000 from 1st October 2012 to 31st May 2013 – Rs. 6,667

Prepare a statement showing profits earned by the company prior to incorporation and after incorporation clearly indicating the basis of allocation of expenses. Assume Audit fees is for the entire year.

Solution-

WN 1

Time ratio – 1:2

Sales Ratio 1: 5

Total Turnover for the accounting periods = Rs 2,40,000

Sales in the pre incorporation period (OCT- FEB) = Rs. 40,000

Therefore Sales in post incorporation period = Rs. 2, 00,000

Therefore SR 1: 5

WN2

Interest to Vendor

10% on 1,00,000 for 8 months – Rs 6666.66

Rounded off to Rs 6667

Out of which from 1st October 2012 to 1st February 2013 –

4 months will be pre incorporation.

From 1st Feb 2013 to 31st May 2013-

4 months will be post incorporation.

Thus the amount will be allocated in the ratio 4: 4 or equally among the pre and post incorporation periods.

Statement showing Profit and loss

For the year ended 30th September 2013.

Particulars	Basis	Pre-Incorporation		Post-Incorporation	
		Debit	Credit	Debit	Credit
Gross Profit –SR	Turnover		16,000		80,000
Expenses					
Directors fees	Post			1,500	
Auditors fees –TR	1:2	250		500	
Rent , Rates	1:2	1600		3200	
Bad Debts	Given	700		1300	
Salaries	1:2	4000		8000	
Debenture Interest	Post			6000	
Depreciation	1:2	1200		2400	
Preliminary expenses	Post			2400	
General expenses	1:2	600		1200	

Commission on sales	1:5	600		3000	
Printing and Stationery	1:2	800		1600	
Advertising	1:5	700		3500	
Travellers Salary	1:5	1400		7000	
Interest to vendor	4:4	3333		3334	
Total of expenses		15183		44934	
Capital Reserve (Bal. fig)		817			
Net Profit (Bal Fig)				35066	
Total		16,000	16,000	80000	80,000

Illustration 7

Sunderam Brothers was taken over by Sunderam Ltd on 1st May 2017. However the company was incorporated on 1st February 2018. The following was the Profit and Loss a/c for the period from 1st May 2017 to 31st March 2018.

To Salaries	72,000	By Gross Profit	7,00,000
To Rent(Net)	39,000	By Discount	7,000
To Delivery van expenses	14,000		
To General Expenses	22,000		
To Advertisement expenses	3,50,000		
To Bad debts written off	14,000		
To Debenture Interest	70,000		
To Directors meeting fees	10,000		
To Preliminary expenses	4,000		
To Net profit c/d	1,12,000		
Total	7,07,000	Total	7,07,000

You are informed that –

a) Salaries in pre- incorporation and post- incorporation period were Rs 6,000 p.m and Rs 9,000 p.m respectively.

b) Gross profit percentage is fixed. Average monthly turnover is nine times in May, October and November 2017 as compared to average monthly turnover of remaining months .

c) Audit fees Rs 4,400 is to be provided for the above period.

d) Rent on the debit side is after subtracting rent received at Rs 4,000 p.m from 1st December 2017.

You are requested to prepare Statement of Profit and Loss in columnar form apportioning various incomes and expenses on suitable basis in the pre and post incorporation period from 1st May 2017 to 31st March 2018.

(Mumbai University April 2010)

Solution:

Working notes1:

Pre incorporation period 1st May 2017 to 1 Feb 2018 = 9 months post incorporation 1st Feb. 2018 to 31st Mar. 2018 = 2 months
Time ratio (TR) 9:2 and
Sales ratio (SR) 33:2
WN-2 Salaries
Pre incorporation Rs 6,000x 9 months = 54,000
Post incorporation Rs 9,000x 2 months = 18,000
WN- 3 Rent received
Pre incorporation 4000 x 2 months = 8,000
Post incorporation 4,000 x 2 months= 8,000
WN-4 Rent paid
Pre incorporation 5,000x 9 months =45,000 post incorporation 5,000x 2 months =10,000
WN-4 Audit fees to be allocated in the Time ratio 9:2

In the books of Sunderam Ltd –
Profit and Loss a/c
For the period 1st May 2017 to 31st March 2018
Dr. Cr.

Particulars	Pre	Post	Particulars	Pre	Post
To Salaries – WN1	54,000	18,000	By Gross Profit -SR	6,60,000	40,000
To Rent –WN 3	45,000	10,000	By Rent received	8,000	8,000
To Delivery van expenses –SR	13,200	800	By Discount – SR	6,600	400
To General	18,000	4,000	By Net Loss		90,000

Expenses –TR			(Bal. Fig)		
To Advertisement expenses - SR	3,30,000	20,000			
To Bad debts written off – SR	13,200	800			
To Debenture Interest- Post		70,000			
To Directors meeting fees- Post		10,000			
To Preliminary expenses –Post		4,000			
To Audit - TR	3,600	800			
To Capital Reserve (Bal Fig)	1,97,600				
	6,74,600	1,38,400		6,74,600	1,38,400

Illustration 8

Abhishekh Ltd was incorporated on 1st August 2017 to take over a running partnership business with effect from 1st April 2017. Following are the details of Income and Expenses for the year ended 31st March 2018

Particulars	Amt Rs	Amt Rs
Gross Profit		19,20,000
Less Expenses		
Directors Fees	98,000	
Rent	1,71,000	
Bad debts	24,000	
Salaries	3,66,000	
Interest on Debentures	45,000	
Depreciation	1,32,000	
Preliminary expenses written off	87,000	
General Expenses	98,400	
Commission on Sales	72,000	
Printing and Stationery	1,86,000	
Advertisement Expenses	2,41,000	

Audit Fees	1,17,200	
Carriage Outward	1,45,600	
Electricity charges	88,800	
Insurance Premium	48,000	
Net Profit	NIL	
	19,20,000	19,20,000

Additional information-

a) Rent is paid on the basis of floor space occupied .Floor space occupied was doubled in the post incorporation period

b) Sales for each month of December 2017 to March 2018 were double the monthly sales of April 2017 to November 2017.

c) Audit fees is for entire year

d) Bad debts Rs 4,000 is in respect of sales effected two years ago.

e) Mr Anil was a working partner in the firm entitled to a remuneration of Rs 24,000 per month From 1st August 2017, he was made the Managing Director of the company and was entitled to salary Rs 30,000 per month. The remaining salary is to two clerks employed during the period from 1st July 2017 to 31November 2017.

Prepare a statement showing profits in the pre and post incorporation period separately.

Solution:

WN 1-

Time ratio- TR 4: 8 or 1: 2

Sales Ratio- SR 4:12 or 1: 3

WN-2

Bad debts total 24,000 to be allocated as under

	Pre	Post
Given	4,000	
Balance Rs. 20,000 in SR	5,000	15,000
TOTAL	9,000	15,000

WN-3

Rent to be allocated on the basis of floor space which was doubled in post incorporation ratio is 1:4

WN-4

Salary to Anil as partner

24,000 x 4 months= 96,000 in pre incorporation

Salary to Anil as Managing director –

30,000 x 8 months = 2,40,000 in post incorporation

Balance salary

3,66,000 – (96000+240000) = 30,000 to be paid to clerks from 1st July 2017 to 30th November in 1: 4 ratio

Statement Showing Pre and Post Incorporation Profit/ Loss

For The Year Ended 31st March 2018

Particulars	Basis	Pre	Post
Gross Profit	SR(1:3)	4,80,000	14,40,000
Less Expenses			
Directors fees	POST		98,000
Rent	WN 2 (1:4)	34,200	1,36,800
Bad debts	WN 1	9,000	15,000
Salary--- Anil	WN 3	96,000	2,40,000
Clerks	WN 3 (1:4)	6,000	24,000
Interest on Debentures	POST		45,000
Depreciation	TR (1:2)	44,000	88,000
Preliminary expenses written off	POST		87,000
General expenses	TR(1:2)	32,800	65,600
Commission on sales	SR	18,000	54,000
Printing and stationery	TR	62,000	1,24,000
Advertising expenses	SR	60,250	1,80,750
Auditors fees	TR	39,066	78,134
Carriage outward	SR	36,400	1,09,200
Electricity charges	TR	29,600	59,200
Insurance premium	TR	16,000	32,000
Total expenses		4,83,316	14,36,684
Loss transferred to Goodwill (Bal. Fig)		3,316	
Net Profit (Bal. Fig)			3,316

5.4 EXERCISE

Practical Problems

1. A limited company was incorporated on 1st July 2018 to take over business as a going concern as from 1stApril 2018. The profit and loss a/c was drawn as on 31st December 2018. Calculate Time ratio.

(Answer: Time Ratio-3: 6 or 1:2)

2. A limited company was incorporated on 1st April 2018 to take over business with effect from 1st January 2018.The company prepared its Profit and Loss account for the year ended 31st March 2019.The company was able to double the average monthly sales from 1st April 2018. Calculate Time Ratio and Sales Ratio.

(Answer: Time Ratio 3: 12 or 1: 4 Sales Ratio 3: 24 or 1: 8)

3. A limited company took over the business of a partnership firm with effect from 1st January 2018. The company was registered on 1st August, 2018. Details of Income and expenses for the year ended 31st December 2018 is as under –

Particulars	Amt (Rs)	Amt (Rs)
Gross Profit		37,80,000
Less Expenses		
Salaries	7,20,000	
Rates and Insurance	5,40,000	
Printing and Stationery	2,88,000	
Audit Fees	90,000	
Directors Fees	72,000	
Carriage Outward	2,70,000	
Advertising	1,89,000	
Electricity charges	2,16,000	
Commission on sales	3,24,000	
Debenture Interest	84,000	
Depreciation	1,26,000	
Interest on Purchase consideration	81,000	30,00,000
NET PROFIT		7,80,000

Additional Information-

1) Sales for each of the months April, May, June, October, November and December were twice the sales for each of the months January, February, March, July, August and September.

2) The purchase consideration was settled on 1st November 2018.

3) Audit fees are payable for the entire year .Calculate the profits for Pre and post incorporation periods separately.

(Answer – Time Ratio 7: 5 Sales Ratio 5:4)

(Hints- Rs 81,000 Interest on Purchase consideration to be allocated in 7:

3 Ratio. Amount in pre incorporation Rs 56,700 and in post incorporation Rs 24,300 Final answer Profit prior to incorporation transferred to Capital Reserve Rs 453300 and Profit post incorporation Rs 326700)

4. RJ Ltd was incorporated on 1st August 2017 to acquire business as on 1st April 2017. The first accounts were closed on 31st March 20118. The following items appeared in the Profit and Loss Account .

Profit and Loss A/c for the year ended 31st March 2018

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Particulars	Amt (Rs)	Particulars	Amt(Rs)
To Directors Fees	49,000	By Gross Profit	9,60,000
To Rent	85,500		
To Bad Debts	12,000		
To Salaries	1,83,000		
To Interest on Debentures	24,000		
To Depreciation	66,000		
To Preliminary expenses	42,000		
To General Expenses	49,200		
To Commission on Sales	36,000		
To Printing and Stationery	93,000		
To Advertising	1,20,000		
To Audit Fees	58,600		
To Carriage Outward	72,800		
To Electricity charges	44,400		
To Insurance Premium	24,000		
Total	9,60,000	Total	9,60,000

Additional Information-

1) Rent is paid on the basis of floor space occupied. The floor space was doubled in the post incorporation period.
2) Sales for each month of December 2017 to March 2018 were double the monthly sales of April to November 2017.
3) Bad Debts Rs 2,000 were in respect of sales effected two years ago.

4) Mr Amit was working partner in the firm entitled to a remuneration @ Rs 12,000 p.m from 1st August 2017. He was Managing Director of a company entitled to salary @Rs 15,000 p.m . The remaining salary is to two clerks employed during the period 1st July to 30th November 2017.You are required to prepare Statement of Profit and Loss for the year ended 31st March 2018 and show the Pre and post incorporation profit or Loss .

(Answer: Time Ratio 1:2 Sales Ratio 1: 3 Pre incorporation loss Rs 1658 Post Incorporation Profit Rs 1658)
(Hints-

- Bad debts Rs 12,000 Rs 2000 old bad debts to be shown in pre incorporation and balance (12000-2000=10,000) to be allocated in the sales ratio 1: 3 Allocation of Bad debts in -Pre incorporation period (2000+ 2500) 4500 and Post incorporation 7500.
- Rent to be allocated in 4: 16 ratio
- Salaries a) Amit pre incorporation 12000x4 months =48,000 post incorporation From August2017 to March 2018 8 months @ 15,000 per month 15000x8= 1,20,000 Total Salary as per P&L a/c Rs 1,83,000 Total salary to Amit (48000+ 120000) 1,68,000 Therefore balance amount to clerks for 5 months July to November is 183000-168000=15000

b) For clerks pre incorporation 1 month Rs 3000 and post incorporation for 4 months August to November 2017 3000x4 =12,000)

Objective Questions

5. Match the Columns-

GROUP A	GROUP B
1) Sales related expenses 2) Time related expenses 3) Share transfer fees 4) Debenture Interest 5) Partners Salaries 6) Pre- incorporation profit 7) Post incorporation profit	a) Transferred to Profit and loss Appropriation account b) Transferred to Capital Reserve c) Shown in debit side pre incorporation column only d) Shown in debit side post incorporation column only e) Shown in credit side pre incorporation column only f) Shown in credit side post incorporation column only g) Allocated in time ratio h) Allocated in Sales ratio

(Answers 1-h 2-g 3-f 4-d 5-c 6-b 7-a)

GROUP A	GROUP B
1) Gross Profit	a) is revenue profit
2) Audit Fees	b) Transferred to Goodwill account
3) Profit prior to incorporation	c) Date of incorporation
4) Profit post incorporation	d) is not available for dividend
5) Loss prior to incorporation	e) Allocated in Sales Ratio
6) Dividing point for pre and post incorporation	f) Allocated in Time ratio
7) Preliminary expenses	g) Shown in pre incorporation only
	h) Transferred to General Reserve
	i) Shown in post incorporation

(Answers - 1— e 2— f 3— d 4— a 5— b 6— c 7— i)

6. State whether the following statements are True or False

1) The fixed expenses are normally to be allocated in Time ratio- True

2) The variable expenses are normally to be allocated in sales ratio- True

3) Gross profit is to be allocated in Sales ratio- True

4) Directors fees are to be allocated equally in the Pre and Post incorporation periods –False

5) The Profit before incorporation is to be transferred to General Reserve – False

6) The Profit after corporation is a revenue Profit- True

7) While computing pre and post incorporation profits, Audit fees are allocated on Time basis – True

8) Profit prior to incorporation is available for payment of dividend – False

9) Loss prior to incorporation is debited to Goodwill account- True

10) Preliminary expenses should be debited to pre-incorporation period- False

7. Multiple Choice Questions

1) While calculating profit prior to incorporation, the fixed expenses are to be allocated _____
a) in Sales ratio b) in Time ratio
c) equally d) none of the above

2) While calculating profit prior to incorporation, the variable expenses are to be allocated _____
   a) in Sales ratio b) in Time ratio
   c) equally d) none of the above

3) While calculating profit prior to incorporation, the Directors fees are to be _____
   a) allocated in sales ratio b) shown as pre incorporation expense
   c) shown as post incorporation expenses d) ignored

4) While calculating profit prior to incorporation, the partners salaries are to be _____
   a) allocated in sales ratio b) shown as pre incorporation expense
   c) shown as post incorporation expenses d) ignored

5) The profit prior to incorporation is transferred to _____
   a) Capital Reserve b) General Reserve
   c) Securities Premium d) Goodwill

6) The share transfer fees are _____
   a) to be shown on the credit side of P&L A/c in the pre-incorporation column
   b) to be allocated equally
   c) to be shown on the debit side of P&L A/c in the pre-incorporation column
   d) to be shown on the credit side of P&L A/c in the post - incorporation column

   (Answer: 1- b, 2- a, 3- c, 4- b, 5- a, 6- d.)

8. Short Numerical Objective Questions –

1) Kalpana Limited was registered on 1st February 2013 to acquire the business of M/s. XYZ as on 1st October 2012. The accounts of the company for the period ended 30th September 2013 disclosed the following facts:

a) The turnover for the whole period 1st October 2012 to 30th September 2013 was Rs. 2,40,000 of which 40,000 related to the period from 1st October 2012 to 1st February 2013

b) The Trading account showed a Gross profit of Rs. 96,000

Calculate Time Ratio and Sales Ratio. State how the Gross profit will be allocated between the pre and post incorporation periods.

(Answer- Time ratio 4:8 or 1:2 Sales Ratio 1: 5 Gross profit Rs 96,000 to be allocated in Sales Ratio Pre incorporation amount Rs 16,000 post incorporation Rs 80,000)

2) Friendship Ltd was incorporated on 1st April 2017 to take over business of the partnership firm with effect from 1st January 2017. The company prepared its Profit and Loss a/c for the year ended 31st March 2018 . The company was able to double the average monthly sales from 1st April 2017. Calculate Time ratio and Sales ratio

(Answer Time Ratio 3:12 or 1:4 Sales Ratio 3:24 or 1:8)

3) Indo-Japan Ltd was incorporated on 1st May 2018 to take over a business as a going concern from 1st January of the same year. The total turnover for the year ended 31st December was Rs 2,00,000 namely Rs 60,000 for the first period upto 1st May and Rs 1,40,000for the remaining period. Calculate Time Ratio and Sales Ratio

(Answer Time ratio 4: 8 or 1:2 and Sales ratio 6:14 or 3: 7)

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