13

PROFIT PRIOR TO INCORPORATION-I

Unit Structure

13.0 Objectives
13.1 Introduction
13.2 Meaning
13.3 Calculation of Various Ratios
13.4 Methods of ascertain pre-incorporation Profit / Loss
13.5 Accounting Treatment
13.6 Performa of P & L Account under equitable basis
13.7 Solved Problems

13.0 OBJECTIVES :

After Studying this unit the students will be able to:

- Know the Concept of Profit / Loss Prior to Incorporation
- Calculate the Various Ratios
- Understand the Methods of ascertain pre-incorporation Profit or Loss
- Solve the practical problems.
- Understand the Treatment of Profit or Loss Prior / Post Incorporation

13.1 INTRODUCTION :

In the present scenario, corporate form of organization is preferred. Many existing Non – Corporate concerns get themselves converted into a corporate one, Company is a separate legal entity and enjoy certain tax benefits. Hence existing Propriority / Partnership concern may get converted into a limited company. Therefore they decide to form a Ltd. Co. to take over their business. Formation of a limited co. requires number of formalities and is a time consuming task, such as name approval of proposed company, preparation of Memorandum of Association, Articles of Association etc. In such a situation the promoters who acquire

running business, may continue business on behalf of company prior to its incorporation. Therefore for first year; profit earned upto incorporation is considered as profits prior to incorporation.

13.2 MEANING :

Profits prior to incorporation means profits earned between the date of acquisition of business & the date of incorporation. Such situation arises in the first year of operation of the co; when same books of A/c's of the Vender are continued by promoters. The Profit / Loss Prior to Incorporation is determined nationally by allocating various Income & Expenses, Profit or Losses for the entire period (i.e. pre & post incorporation) between two time periods an appropriate logical basis.

13.3 CALCULATION OF VARIOUS RATIOS :

13.3.1 TIME RATIO :

Time Ratio is used for dividing fixed expenses which arise evenly spread within entire period. Pre Incorporation period consist from business acquired up date of Incorporation. Post Incorporation starts from date of Incorporation till accounting period end. The entire period is normally of a year (12 months). But it can be longer or shorter period also depending upon situation.

Illustration 1 : Calculation & various Time Ratio

	Date of Business Acquired	Date of Incorporation	Accounting End	Time Ratio
a)	1st April 08	31st May 08	31st March 09	= 12 mths
	Pre Incorporation 2 Months		Post Incorporation 10 Months	= 1 : 5
b)	1st Jan 08	31st March 08	31st Dec 08	= 12 mths
	Pre Incorporation 3 Months		Post Incorporation 9 Months	= 1 : 3
c)	1st May 08	30th Sept 08	31st Dec 08	= 8 mths
	Pre Incorporation 5 Months		Post Incorporation 3 Months	= 5 : 3
d)	1st Jan. 08	1st April 08	31st March 09	= 15 mths
	Pre Incorporation 3 Months		Post Incorporation 12 Months	= 1 : 4

13.3.2 SALES RATIO / TURNOVER RATIO

Sales Ratio is used for dividing gross Profit, variable expenses etc. Sales Ratio is calculated by comparing sales of pre & post Incorporation period. However if sales are not even / uniform per month, then Weighted Average Sales ratio should be calculated.

Illustration : 2 (Various Sales Ratio)

a) Net Sales Rs.16,00,000/-
Pre Incorporation Sales Rs.5,00,000/-

Post Incorporation Sales = Net Sales (–) Pre Incorporation Sales
= 16,00,000 (–) 5,00,000
= Rs.11,00,000/-

Sales Ratio = 5:11

b) A Ltd. was incorporated on 1st May 08 to take over A & Co. business w.e.f. Feb. 08, period ended 31st Dec 08 monthly sales were doubled from 1st July.

Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1	1	1	1	1	2	2	2	2	2	2
Pre – Incorporation			Post – Incorporation							
3			14							

Sales Ratio = 3:14

c) B Ltd. was incorporated on 1st May 08 to take over B & Co. business w.e.f. 1st Feb.08, period ending 31st Dec. 08. Monthly Sales were doubled from 1st Sept. 08.

Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1	1	1	1	1	1	1	2	2	2	2
Pre – Incorporation			Post – Incorporation							
3			12							

Sales Ratio = 3:12 = 1:4

d) C Ltd. was incorporated on 1st June 08 to take over business from 1st Jan 08 Accounting year ends 31st December 2008. A sale for each months of July to December was twice the monthly sales of January to June 08.

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1	1	1	1	1	1	2	2	2	2	2	2

Pre – Incorporation	Post – Incorporation
5	13

Sales Ratio : 5:13

e) D Ltd. was incorporated on 1st May 08 to take over business from 1st March 08 for period ending 31st Dec.09. Trend of Sales were as under. Monthly Sales were doubled from 1st July & again from 1st Nov. monthly sales were double that of Oct. Month.

Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec
1	1	1	1	2	2	2	2	4	4
2		18							

Sales Ratio = 2:18 = 1:9

13.3.3 WEIGHTED AVERAGE RATIO

This ratio is calculated when Sales / Incomes expenses are not uniform throughout the period.

Illustration : 3 (Calculated various Weight Average Ratio)

A) There are 5 employees upto Incorporation (3 months) and then 8 employees in post Incorporation period (9 months)

Salary Ratio : No. of employees X no. of months

Pre = 5 X 3 = 15

Post = 8 X 9 = 72

Salary Ratio = 5:24

B) X Ltd. was incorporated on 01/08/07 to take over business from 1st April 07 closes accounts on 31st March 08 due to decrease selling price by 20% from 1st Nov. 07 sales in terms of volume (quantities) were doubled from 1st Nov. 07. Ascertain Sales Ratio.

	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
A	1	1	1	1	1	1	1	2	2	2	2	2
x B	100	100	100	100	100	100	100	80	80	80	80	80
=Sales	100	100	100	100	100	100	100	160	160	160	160	160
Pre 400					Post 1100							

Sales Ratio = 4:11

A B

Note : Quality Sold X Selling Price

(Assuming Selling Price = Rs.100/-)

13.3.4 SPECIFIC RATIO

Some expenses may be incurred during specific part of accounting period. This needs to allocated on basic given data.

a) Interest to vendors paid for period upto date of payment. A company incorporated on 31/07/07. The business taken over on 01/04/07. Interest paid on 31/10/07. This interest is paid upto 31/10/07. These expenses to be allocated as time ratio as follows.

Apr	May	Jun	July	Aug	Sep	Oct
1	1	1	1	1	1	1
4				3		

Ratio = 4:3

b) Expenses incurred for specific period or an specific date.
E.g. Profit or Loss an sale of Asset on a given date.
Bad Debt pertaining to specific period.
Depreciation an asset acquired during year.

13.3.5 SPECIFIC FOR FORM OF ORGANIZATION

The expenses or Income related to particular form or organization is not to be allocated. These are to be pre – Incorporation or post – Incorporation as case may be.

e.g. a) Directors Remuneration paid by company – Post Incorporation
b) Interest on Debenture Issued by company – Post Incorporation
c) Preliminary Expenses – Post Incorporation (Written off by company)
d) Remuneration or Salary to Partner – Pre Incorporation

13.4 METHODS OF ASCERTAINING PRE-INCORPORATION PROFIT / LOSS :

The pre – Incorporation Profit / Loss can be ascertained in three ways as follows :

i) By preparing separate Profit & Loss A/c for the period upto date of incorporation.

ii) By preparing usual Profit & Loss A/c for entire period and then dividing net Profit / Loss on appropriation basis between two periods.

iii) Combined or Equitable basis – as per available information

13.4.1 SEPARATE PROFIT & LOSS A/C

In this method books of A/c's are balanced and trial balance as on date of Incorporation is prepared. The Profit & Loss A/c, Balance Sheet can be prepared. However this method, being inconvenient & is practically unnecessary. As number of adjustment like depreciation, stock valuation, outstanding expenses prepaid expenses are usually carried out for preparing Final Accounts.

13.4.2 PREPARING PROFIT & LOSS A/C FOR ENTIRE PERIOD AND DIVIDING NET PROFIT / LOSS ON SALE BASIS OR TIME BASIS

Under this method, net Profit for both the period is estimate expense as well as Income are not uniform, some expense or Income may relate to either pre or post Incorporation period. Similarly all expenses or Income may not be in same proportion of Time or Sales basis. Therefore this method is not suitable for ascertainment of pre Incorporation Profit / Loss.

Normally Trading Account is to be prepared for full period as combined Account to as certain Gross Profit. The Gross Profit is to be transferred to Profit & Loss A/c on ratio of sales.

However, if information of Sales & Purchase for pre – post period & stock an date of information is available. The Trading Account can also be prepaid for pre & post period separately in columnar format.

13.4.3 COMBINED OR EQUITABLE BASIS

Under this method Trading Account is prepared for the entire period and gross Profit is ascertained. However if division of purchase, sales direct expenses, stock as on date of Incorporation & year end are available, then Trading Account can be prepared in two parts i.e. pre & post Incorporation, Gross Profit for pre & post Incorporation automatically is ascertained.

13.4.4 FOLLOWING PROCEDURE SHOULD BE FOLLOWED

a) Profit & Loss Account Credit side
b) Profit & Loss Account Debit side

a) Profit & Loss Account Credit Side

i) Gross Profit :

Gross Profit is generally divided into sales ratio. In case there is a change in sales price or cost price between two periods then actual Gross Profit is worked by considering change in turn over and / or cost. In case details of sales are not available, then it is assumed that sales are spread

over equally / evenly in the entire period. So Gross Profit is divided in time ratio.

ii) Other Income :

1. Specific Income for a particular period monthly credited to that period e.g. share transfer fees should be credited in post Incorporation.
2. Discount received is on purchase basis, otherwise sales ratio.
3. Income received on time basis should be divided into time basis e.g. Income from investment, Rent received.

b) Profit & Loss Account Debit Side

i) Time Ratio :

Fixed Expenses / Period Expenses which are incurred with reference to time should be allocated on time basis e.g. Salaries, Audit Fees, Postage, Depreciation on Fixed Assets, Rates, taxes.

ii) Sales Ratio :

Variable Expenses / Fluctuating Expenses which are related to turnover should be allocated in sales ratio e.g. Bad Debts w/off Advertisement, Sales Commission, Carriage outward. However if any specific information is given in the problem, then expense should be allocated accordingly e.g. Rent paid for pre Incorporation period.

iii) Specific Expenses / Income :

Corporate expenses incurred are charged to post period Director Fees, M.D. Fees, Debenture Interest etc.

Expenses incurred by vendor are charged to pre Incorporation period.

Expenses for which specific information is available are allocated accordingly.

Illustration : 4 (Division on basis of information given)

4.1 Bad debts w/off in respects of debts taken from vendor should be debited to Pre-Incorporation & remaining bad debt, should be charged to Post-Incorporation.

4.2 Interest paid to vendor on purchase consideration should be allocated according to the ratio calculated with reference to actual period covered. E.g. A Ltd. was incorporated on 1st March 08 to take over business on 1st Jan 08 purchase consideration was discharged on 31st May 08. Interest paid to vendor Rs.20,000/-.

In above example interest is paid for the period 1st Jan 08 to 31st May 08 (5 months.)

Pre-Incorporation Interest = $\frac{20,000}{5} \times 3$

(1st March to 31st May 08 = 3 months)

4.3 Gross Profit is usually divided in Sales Ratio. However if there is change S.P. or C.P. or both, ratio should be work out accordingly. Z Ltd. increased its sales price by 20% in post period. However, cost of production remain same if pre – sales Rs.3,00,000/- & cost period sales Rs.15,00,000/- pre-incorporation G.P. was 20% on sales. Find Gross Profit for pre & post incorporation separately.

Pre	S.P.	G.P.	C.P.	G.P. = 3,00,000 x 20%
Let	100	20	80	(Pre) = 60,000
Revised (Post)	120	40	80	(cost remains same)

Post Incorporation G.P. = 15,00,000 X $\frac{40}{120}$ = Rs.5,00,000/-

4.4 Depreciation on Fixed Assets is usually divided in Time Ratio. However if Addition / Sales of fixed assets is given in the problem, then for division of depreciation should be after considering period for which it refers e.g. Y Ltd. was incorporated on 1st May 08 to take over business from 1st Jan 08, Y Ltd. closes its Books of Accounts on 31st Dec. 08.

Depreciation decided to Profit & Loss A/c amounted Rs.30,000/- includes depreciation @ 10% p.a. plant costing Rs.3,00,000/- which was purchased 1st Oct. 08.

	Depreciation	Pre	Post
a)	Dep. on plant purchased on 01/10/08 to 31/12/08 for Post-Incp. 3,00,000 X 10% X $\frac{3}{12}$	-	7,500
b)	Remaining Depreciation in Time Ratio (30,000 – 7,500) = 22,500 in 1:2	7,500	15,000
	Total Depreciation	7,500	22,500

Provision for Income Tax

Income Tax is payable at a specified percentage of Profit. Provision for Income Tax should be calculated at specified percentage net Profit for each period (pre/post) separately. However, if of Income Tax provision is specified for a specific

amount, same should be allocated an ratio of net Profit pre & post period.

Pre-Incorporation Profit	Post-Incorporation Profit
75,000	1,25,000

1. Provision for Income Tax @ 30% of Profit.
   75,000 @ 30% = 22,500, 1,25,000 @ 30% = 37,500
2. Provision for Income Tax Rs.36,000/-
   Ratio of Profit 75:125 or 3:5
   Rs.13,500 Rs.22,500

13.5 ACCOUNTING TREATMENT :

i) Profit prior to Incorporation is a capital Profit & hence it should be transferred to Capital Reserve. Capital Reserve may be used to write off Goodwill, Share Issue Expenses, Discount on issue of Debenture etc.

ii) Loss prior to Incorporation should be debited to Goodwill Account.

iii) Post Incorporation Profit / Loss should be transferred to Profit & Loss Appropriation Account, being revenue profit.

The Final Account

The Final Account companies includes Profit & Loss Account & Balance sheet.

After preparing Profit & Loss Account as explain above, Balance Sheet is to be prepared. Since it includes Assets & Liabilities on a specific date, it should not be allocated. Same is prepared as simple statement.

13.6 PROFORMA OF PROFIT AND LOSS ACCOUNT UNDER EQUITABLE BASIS

Trading Accounts for the year / period

Dr. Cr.

Particulars	Pre	Post	Particulars	Pre	Post
To Stock A/c To Purchase A/c To Direct Expenses A/c To Gross Profit c/d			By Sales A/c By Stock A/c		

Note : If the period wise data of purchases, sales and direct expenses, stock on date of Incorporation is not available, columnar presentation is not possible.

Profit & Loss Account

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries A/c	Time			By Gross Profit c/d	Sales		
To Rent A/c	Time			By Commission on purchase	Purch. or sales		
To Electricity A/c	Time			By Investment Income	Specific		
To Pre-Incorporation Specific Exp. A/c	Pre			By Share Transfer Fee	Post		
To Post-Incorp. Specific Exp. A/c	Post			By Goodwill A/c	(BF)	x	
To Administration Expenses A/c	Time			By Loss A/c	(BF)		x
To Interest on Deb. vendor A/c	Post-Specific						
To Bad debts A/c	Time						
To Advertisement A/c							
To Audit Fees A/c	Time						
To Provision for Income Tax A/c	Net Profit						
To Capital Reserve A/c	(BF)	x					
To Net Profit c/d	(BF)		x				

Note : The above basis would need to be changed as per specific data given.

Balance sheet as on _____

Liabilities	Amt.	Assets	Amt.
Share Capital	XXX	Fixed Assets	
		Goodwill	XXX
Reserves & Surplus		Tangible Assets	XXX
Security Premium	XXX		
Capital Reserve	XXX	Investment	XXX
Profit & Loss A/c	XXX		
		Current Assets	
Loan	XXX	Stock	XXX
		Debtors	XXX
Current Liabilities		Bank	XXX
Creditors	XXX		
		Misc. Exp (not w/off)	
		Preliminary Expenses	XXX

13.7 SOLVED PROBLEMS :

Illustration : 1 (Simple problem)

Jai Ltd. was incorporated on 1st March 08 to take over running business of JR & Co. with effects from 1st Jan. 08. The same books of accounts continued and following Profit & Loss Accounts for the year ended 31st December 2008, was prepared.

Profit & Loss Accounts for the year ended 31st December 2008

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Salaries A/c	48,000	By Gross Profit b/d	3,72,000
To Office Rent A/c	12,000	By Discount earned	5,400
To Printing & Stationery A/c	6,000	By Share Transfer Fees	600
To Directors Fees A/c	7,250		
To Sundry Expenses A/c	3,000		
To Depreciation A/c	9,000		
To Advertisement Expenses A/c	24,000		
To Preliminary Exp. w/off	2,500		
To Sales Commission A/c	42,000		
To Loss on sale of old Furniture A/c	3,000		
To Audit Fees A/c	9,000		
To M.D. Remuneration A/c	6,250		
To Partner Salaries A/c	1,750		
To Interest paid to vendor A/c (upto 30/04/08)	6,000		
To Debenture Interest A/c	14,250		
To Discount on issue of Debentures A/c	4,000		
To Net Profit c/d	1,80,00		
	3,78,000		3,78,000

Other information :

1) Furniture was sold on 31st December 08.

2) Monthly average sale were double from 1st October 2008.

3) 50% of Advertising Expenses were related with sale and balance expenses for outdoor advertising were paid on monthly basis.

4) Purchase consideration was settle on 30/04/08 along with interest due upto that date.

Prepare Profit & Loss Account for the year 31st March appropriating between the pre and post Incorporation period.

Solution :

Jai Ltd.
Profit & Loss Account for the year ended 31st March 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries A/c	TR	8,000	40,000	By Gross Profit		49,600	3,22,400
To Office Rent A/c	TR	2,000	10,000	c/d	SR	720	4,680
To Preliminary Exp.				By Discount		-	600
A/c	TR	1,000	5,000	earned	SR		
To Directors Fees	Post	-	7,250	By Share			
To Sundry Exp. A/c	TR	500	2,500	Transfer Fee	Post		
To Depreciation A/c	TR	3,000	6,000				
To Advertising Exp.							
A/c	W/N	3,600	20,400				
To Preliminary Exp.							
A/c	Post	-	2,500				
To Sales							
Commission A/c	SR	5,600	36,400				
To Loss on Sale of							
Furniture A/c	Post	-	3,000				
To Audit Fees A/c	TR	1,500	7,500				
To M.D.							
Remuneration A/c	Post	-	6,250				
To Partner's							
Salaries A/c	Pre	1,750	-				
To Interest paid to							
vendor A/c	W/N	3,000	3,000				
To Debenture Int.A/c	Post	-	14,250				
To Discount on							
issue Debentures	Post	-	4,000				
To Capital Reserve							
A/c	Pre	20,370	-				
To Net Profit c/d		-	1,59,630				

		50,320	3,27,680			50,320	3,27,680

Working Note :

1) Time Ratio = 1:5

Date of Acquisition	Date of Incorporation	Date of year end
1st Jan 08	1st March 08	31st Dec 08
Pre Incorporation 2 Months	Post Incorporation 10 Months	

Time Ratio = 2:10 = 1:5

b) Sales Ratio = 2:13
Monthly average sales were doubled from 1st Oct. 08

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1	1	1	1	1	1	1	1	1	2	2	2
Pre-Incop	Post Incorporation Period										
2	13										

$\therefore$ Sales Ratio = 2:13

c) Advertisement Expenses = Rs.24,000

	Pre	Post
a) Sales promotion Exp. in Sales Ratio (24,000 X 50% = 12,000 in 2:13)	1,600	10,400
b) Balance 50% in Time Ratio (12,000 in Time Ratio = 1:5)	2,000	10,000
	3600	**20400**

d) Interest paid to vendor Rs.6,000/- for the period from 01.01.08 to 30.04.08 (4 months)

$\therefore$ Pre (2 months) = 6,000 X $\frac{2}{4}$ = 3,000

$\therefore$ Post (2 months) = 6,000 X $\frac{2}{4}$ = 3,000

6,000

Illustration : 2 (Simple problem with basis allocation)

The Trading and Profit & Loss Accounts of M/s. Priti & Co. for the period ended 31st March 2008 is as under –

Trading and Profit & Loss Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	45,000	By Sales 15,25,000	
To Purchases 7,12,000		(-) Return (25,000)	15,00,000
(-) Return (12,000)	7,00,000	By Closing Stock	47,000
To Wages	40,000		
To Carriage	12,000		
To Gross Profit c/d	7,50,000		
	15,47,000		15,47,000
To Salaries A/c	42,000	By Gross Profit b/d	7,50,000
To Travelling Exp. A/c	45,000	By Discount A/c	22,000
To Rent & Taxes A/c	18,000	By Share Transfer	
To Directors Fees A/c	12,000	Fees A/c	3,000
To Discount A/c	18,000		
To General Exp. A/c	6,000		
To Depreciation A/c	48,000		
To Debenture Interest A/c	25,000		
To Interest on Purchase Consideration A/c	27,000		
To Salaries to Partners A/c	20,000		
To Carriage outwards A/c	29,000		
To Net Profit c/d	4,84,000		
	7,74,000		7,74,000

1) In order to acquire the business of the firm, Priti Ltd. was incorporated on 1st Sept. 07. However, the business was taken over with effect from 1st June 07. The purchase consideration was paid on 30th Sept. 07. The net sales upto 1st Sept. 08 was Rs.6,00,000/- and not purchase upto 1st Sept. 08 was Rs.3,00,000/-.

2) Depreciation included Rs.18,000/- on Assets acquired by Prity Ltd.

3) Rent was paid for the period from 1st July 08 to 30th Oct. 08 Rs.6,000/-. Remaining rent was on premises taken over from vendor.

4) Salaries includes salary of managing direct Rs.2,000/- p.m. from Incorporation.

You are required to determine pre & post Incorporation Profit.

Solution :

Profit & Loss Account for the period ending on 31st March 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries A/c	WN8	8,400	33,600	By Gross Profit c/d	2:3	3,00,000	4,50,000
To Travelling Exp. A/c	SR	18,000	27,000	By Discount Earned A/c	Purch.	9,000	12,000
To Rent & Taxes A/c	WN5	6,600	11,400	By Share Transfer Fee A/c	Post	-	3,000
To Director's Fess A/c	Post	-	12,000				
To Discount A/c	SR	7,200	10,800				
To General Exp. A/c	TR	1,800	4,200				
To Depreciation A/c	WN4	9,000	39,000				
To Debenture Interest A/c	Post	-	25,000				
To Interest on purchase consideration A/c	WN7	20,250	6,750				
To Salaries to Partners A/c	Pre	20,000	-				
To Carriage outward	SR	11,600	17,400				
To Capital Reserve A/c	-	2,06,150	-				
To Net Profit c/d	-	-	2,77,850				
		3,09,000	4,65,000			3,09,000	4,65,000

Working Note :

1) Time Ratio = 3:7

Date of Acquisition 1st June 07 — Date of Incorp. 1st Sept. 07 — Year end 31st March 08

Pre Incorporation 3 Months | Post Incorporation 7 Months

Time Ratio = 3:7

2) Sales Ratio = 2:3

Pre = Rs.6,00,000/-

Post = Rs.15,00,000 (-) Rs.6,00,000 = Rs.9,00,000

$\therefore$ Sales Ratio = 6:9 i.e. 2:3

3) Purchases
Pre = Rs.3,00,000/-
Post = Rs.7,00,000 (-) Rs.3,00,000 = Rs.4,00,000
∴ Purchase Ratio = 3:4

4) Depreciation Rs.48,000/-

	Pre	Post
On Assets acquired in post period	–	18,000
Remaining Depreciation – Rs.30,000/- in Time Ratio i.e. 3:7	9,000	21,000
	9,000	39,000

5) Rent and Taxes – Rs.18,000/-

	Pre	Post
Rent for July, Aug = 2m Sept, Oct. = 2m } Rs.6,000	3,000	3,000
Balance Rent 18,000 (–) 6,000 = Rs.12,000 in Time Ratio 3:7	3,600	8,400
	6,600	11,400

6) Salaries Rs.42,000/-

	Pre	Post
Salaries of M.D. Rs.2,000 X 7 month (post)	-	14,000
Remaining Salaries Rs.42,000 (-) 14,000 = 28,000 in Time Ratio	8,400	19,600
	8,400	33,600

7) Interest paid on purchase consideration Rs.27,000/- for the period 1st June 07 to 30th Sept. 07 = 4 months

Pre (3 months) = 27,000 X $\frac{3}{4}$ = 20,250

Remaining Post (1 months) = 27,000 X $\frac{1}{4}$ = 6,750

27,000

❖❖❖❖

14

PROFIT PRIOR TO IN-CORPORATION-II

Unit Structure

14.1 Solved problems
14.2 Key Terms
14.3 Exercise

14.1 SOLVED PROBLEMS :

Illustration: 1 (Calculation of Depreciation, Commission on Actual basis)

H Ltd. was incorporated on 1st June 08 to take over a business from 1st Jan 08. The accounts were made upto 31st December 08 as usual and Profit & Loss Accounts showed the following results.

Profit and Loss A/c for the year on ended 31st December 08

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Salaries A/c	24,000	By Gross Profit b/d	2,10,000
To Rent A/c	6,400	By Interest (from	
To Directors Fees A/c	7,000	Bank F.D. made	12,000
To Bad debts	9,000	on 1st July 08)	
To Travellers			
commission A/c	18,900		
To Audit Fees A/c	4,000		
To Office Expenses A/c	10,000		
To Discount A/c	6,000		
To Depreciation A/c	25,000		
To Debenture Interest A/c	9,000		
To Goodwill w/off	4,000		
To Advertisement A/c	7,200		
To Interest on purchase			
consideration (31/7/08)	35,000		

To Printing & Stationery A/c	6,600		
To Net Profit c/d	49,900		
	2,22,000		2,22,000

Additional Information :

1) It is ascertained that safe for February, August, October, November and December were only half the average sales, January were one and half the times of the average of the year end those for July twice the average. Annual net sales amounted Rs.6,00,000/-.
2) Bad debts written off were :
   a) A debt of Rs.4,000/- taken over from vendor
   b) A debt of Rs.5,000/- in respect of Goods sold in August 08.
3) Travellers commission was 2.5 of sales upto 30/06/08 then it is increase to 4% on Sales.
4) Office Rent was Rs.6,000/-p.a. upto 31st August 08, then it was increased by 20%.
5) Depreciation on Furniture amounted to Rs.1,000/- which was discard on 30th May 08, sold at Book value. Depreciation @ 10% on New Furniture costing Rs.60,000/- purchased on 01/10/08.
6) Allocate expenses in an appropriate manner.

Solution :

Profit & Loss A/c for the year ended 31st Dec.08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salaries A/c	TR	10,000	14,000	By Gross Profit c/d	SR	98,000	1,12,000
To Rent A/c	WN4	2,500	3,900	By Interest A/c	-	-	12,000
To Directors Fees A/c	Post	-	7,000				
To Bad debts A/c	Act	4,000	5,000				
To Travellers Commission A/c	WN3	7,000	11,900				
To Audit Fees A/c	TR	1,667	2,333				
To Office Expenses A/c	TR	4,167	5,823				
To Discount A/c	SR	2,800	3,200				
To Depreciation A/c	WN5	10,375	14,625				
To Debenture Interest A/c	Post	-	9,000				
To Goodwill w/off	Post	-	4,000				
To Advertisement A/c	SR	3,360	3,840				
To Interest on purchase consideration A/c	WN	25,000	10,000				

To Printing & Stationery A/c	TR	2,750	3,850				
To Capital Reserve A/c	-	24,381	-				
To Net Profit c/d	-	-	25,519				
		98,000	1,24,000			98,000	1,24,000

Working Note :

1) Time Ratio = 5:7

Date of Acquisition 01/01/08 — Date of Incorporation 01/06/08 — Year end 31/12/08

Pre Incorporation 5 months | Post Incorporation 7 months

Time Ratio = 5:7

2) Sales Ratio = 7:8
Total Sales = Rs.6,00,000

$\therefore$ Average Monthly Sales = $\frac{6,00,000}{12}$ = 50,000

Pre		Post	
January	75,000	June	60,000
February	25,000	July	1,00,000
March	60,000	August	25,000
April	60,000	September	60,000
May	60,000	October	25,000
		November	25,000
		December	25,000
	2,80,000		3,20,000

$\therefore$ Remaining 5 months Sales
= Total Sales (-) Specific Sales Noted
= 6,00,000 (-) 3,00,000 = 3,00,000

$\therefore$ Remaining Monthly Sales = $\frac{300000}{5}$ = 60,000/- p.m.

3) Travellers commission 2.5% of sales upto 30/06/08, then increase to 4% of sales.

Pre = 2,80,000 X 2.5% 7,000

Post = June 60,000 X 2.5%	1,500	
July to Dec 2,60,000 X 4%	10,400	11,900
Total Commission		18,900

4) Office Rent was Rs.6,000/- p.a.
= Rs.500/- p.m. upto 31st August 08.

After 1st August, 08, it was increase by 20%
= 500 + 20% = Rs.600/- p.m.

Pre (upto 31st May 08) 500 X 5		2,500
Post June + July + August = 500 X 3	15,00	
Sept. to Dec = 600 X 4	2,400	3,900
		6,400

5) Depreciation

	Pre	Post
a) On Furniture discarded on 30/05/08	1,000	1,500
b) New purchase on 01/10/08 in post 60,000 X 10% X $\frac{3}{12}$ Balance Depreciation = 25,000 – (1,000+1,500) = 22,500 in Time Ratio i.e. 5:7	9,375	13,125
	10,375	14,625

Total Depreciation = Rs.25,000/-

6) Interest on purchase consideration Rs.35,000/- paid for the period from 1st Jan 08 to 31st July 08 = 7 months

Pre = 1st Jan to 31st May = 5 months = $\frac{35000}{7}$ X 5 = 25,000

Post = June & July = 2 months = $\frac{35000}{7}$ X 2 = 10,000

Total Rs. = 35,000

Illustration : 2

Cho. Chang Ltd. was Incorporation on 1st July 08 to acquire the business of KT & Co. as on 1st April, 08. The purchase price of Goodwill was agreed to the sum equal to 75% of the Profit of the

business for five years commencing from 1st April 08, payment to be made at the end of 5th year on ascertainment of the sum due.

The following is the trial balance of Cho. Chang Ltd as on 31st March 09.

Particulars	Debit	Credit
Equity Share Capital (Rs.10/- each)	-	2,00,000
Sundry Debtors	80,000	-
Stock (on 31.03.09)	1,55,000	-
Director's fees	20,000	-
Bills Receivable	18,000	-
Preliminary Expenses	20,000	-
Sundry Creditors	-	15,000
Net Profit for the year (as per agreement)	-	60,000
	2,75,000	2,75,000

Prepare –

a) Statement of Appropriation of Profit writing of 1/5th of the preliminary expenses.

b) Amount of Goodwill due for the year

Solution :

a) Statement of Appropriation Profit

	Pre-Incorporation		Post-incorporation	
	Rs.	Rs.	Rs.	Rs.
Net Profit for year Time Ratio				
Pre = 60,000 X $\frac{3}{12}$		15,000		45,000
Post = 60,000 X $\frac{9}{12}$				
Less : i) Directors Fees			2,000	
ii) Preliminary Exp		-	4,000	(6,000)
20,000 X $\frac{1}{5}$				
		15,000		39,000

b) Goodwill = 60,000 X 75%
= Rs.45,000/-

Rs.45,000/- due for Goodwill base on Net Profit of year 07 – 08, however amount will be payable along with subsequent years value of Goodwill, at end of 5th year.

Illustration : 3 (Typical Sales Ratio, Rent & Taxes, Salaries, Travelling Expenses allocation)

R. Rice Ltd. was registered on 1st Jan. 08 to acquire the business of **Dalal** Co. as on 1st November 07. The accounts of the company for the period ended 30th September 08 disclosed the following expenses / Income :

Particulars	Rs.	Particulars	Rs.
Office Expenses	5,500	Formation Exp. (1/5 to be written off)	15,000
Rent & Taxes	6,900	Depreciation	4,400
Audit Fees	4,400	Printing & Stationery	1,650
Bad debts (of which Rs.1,000/- debts created before 31.12.07)	1,600	Commission	7,200
Salaries	44,800	Traveling Expenses	16,600
Debenture Interest	5,000	Interest to vendors	6,000
Discount Received	9,000	Discount on Debentures (1/10 to be written off)	10,000
Bad debts realized	1,500	Carriage Outwards	9,000

Additional Information :

a) Net Sales for the entire period amounted to Rs.5,00,000/- of which Rs.50,000/- related to the period from 1st Nov. 07 to 31st Dec. 07.

b) Cost of goods sold for the above period amounted to Rs.3,20,000/-.

c) There three employs upto 31st Jan. 08, four employees from Feb. 08 to 30th June 08 and there are 7 employees after wards.

d) Bad debts realized related to sales effected prior to Incorporation.

e) Purchase consideration was discharged on 31st January 08.

f) Rent was paid Rs.2,400/- p.a. upto 31st Mar 08, after it is increased by 25%.

g) Travelling expenses includes to Rs.10,000/- towards sales promotion, balances expenses were season railway parties to office staff.

Show pre and post Incorporation results.

Solution :

R. Rice Ltd.

Profit & Loss A/c for the year ended as on 30th September 08

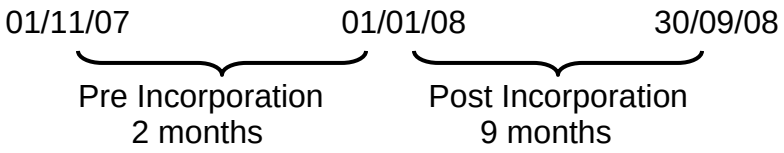
Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Office Salaries A/c	WN4	5,376	39,424	By Gross Profit c/d	SR	18,000	1,62,000
To Office Expenses A/c	TR	1,000	4,500	By Discount A/c	SR	900	8,100
To Rent & Taxes A/c	WN6	1,200	5,700	By Bad debts realized A/c	Pre	1,500	-
To Audit fees A/c	TR	800	3,600				
To Bad debts A/c	Act	1,000	600				
To Debenture Interest A/c	Post	-	5,000				
To Formation Expenses w/off	Post	-	3,000				
To Depreciation A/c	TR	800	3,600				
To Printing & Stationery A/c	TR	300	1,350				
To Commission A/c	SR	720	6,480				
To Travelling Expenses A/c	WN7	2,200	14,400				
To Interest to Vendor A/c	WN5	4,000	2,000				
To Discount on issue of Debenture A/c	Post	-	1,000				
To Carriage outwards A/c	SR	900	8,100				
To Capital Reserve A/c	-	2,104	-				
To Net Profit c/d	-	-	71,346				
		20,400	1,70,100			20,400	1,70,100

Working Note :

1) Time Ratio = 2:9

Date of Acquisition Date of Incorporation Year end



Time Ratio = 2:9

2) Sales Ratio = 1:9
   Pre = 50,000
   Post = 5,00,000 (-) 50,000 = 4,50,000
   50:450 i.e. 1:9

3) Gross Profit = Net Sales Less Cost of Goods sold
   = 5,00,000 (-) 3,20,000 = Rs.1,80,000

4) Salaries

Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
3	3	3	4	4	4	4	4	7	7	7
Pre		Post								
6		44								

Ratio = 3:22

Pre = 44,800 X $\frac{3}{25}$ = 5,376

Post = 44,800 X $\frac{22}{25}$ = 39,424

5) Interest paid to vendor Rs.6,000/- for the period
   From 1st November 07 to 31st January 08 (3 months)
   Pre (November and December) = $\frac{6000}{3} \times 2$ = Rs.4,000
   Post = 6,000 (-) 4,000 = Rs.2,000 (1 month)

6) Rent & Taxes Rs.6,900/-

<u>Rent</u>

Pre = November, December = 200 X 2		400
Post = January, February & March = 200 X 3	600	
April to 30th September = 250 X 6	1,500	2,100
(200 + 25% increase)		
Total Rent		2,500

<u>Taxes</u> (6,900 – 2,500) = 4,400 in Time Ratio i.e. 2:9

Pre = 4,400 X $\frac{2}{11}$ = 800

Post = 4,400 X $\frac{9}{11}$ = 3,600

Rent and Taxes	Pre	Post
Rent	400	2,100
Taxes	800	3,600
Total	1,200	5,700

7) Travelling Expenses

	Pre	Post
Sales promotion exp. In Sales Ratio Rs.10,000/- in 1:9	1,000	9,000
Bal. Season passes in Time Ratio 16,600 (-) 10,000 = 6,600 in 2:9	1,200	5,400
Total	2,200	14,400

Illustration : 4 (Calculation of sales from G.P., Audit Fees typical adjustment)

Hari Ltd. was incorporated on 1st June 08, to take over the running business of JR & Sons with effects from 1st April 08.

The following Profit & Loss A/c was prepaid for the year ended 31st March 2009.

Particulars	Rs.	Particulars	Rs.
To Office Rent A/c	10,000	By Gross Profit b/d	2,00,000
To Printing & Stationery A/c	2,000	By Income from Investment A/c	6,000
To Office Expenses A/c	9,000	By Rent Received A/c	25,000
To Advertisement A/c	8,000		
To Travelling Exp. A/c	7,500		
To Debenture Interest A/c	10,000		
To Auditor Fees A/c	6,000		
To Directors Fees A/c	12,000		
To Bad debts A/c	4,700		
To Interest on Capital A/c	4,000		
To Electricity Charges A/c	3,000		
To Commission A/c	19,000		
To Depreciation A/c	24,000		
To Net Profit c/d	1,11,800		

	2,31,000		2,31,000

Additional Information :

1) Gross Profit upto 30th May 08 amounted to Rs.50,000/- @ Rate of 20% on Sales; however, it was increased to 25% from 1st June 08.
2) Office Rent was paid upto 31st July 08, there after Hari Ltd. purchased Own Building costing Rs.6,00,000/- on 1st August 08, depreciation charge on Building 2.5% p.a., part of Building was let out by company.
3) In lieu of interest on purchase consideration, the vendors would get 40% of the profit earned prior to Incorporation.
4) Investment was purchased on 1st October 08.
5) Board of Directors appointed Auditor on remuneration of 3,000/- p.a. to audit books of accounts from 1st April, 08, however, he resigned on 31st July after auditing upto 30th June 08. He was paid upto 30/06/08. The price Home & Co. accepted to audit from 1st July 08, they were paid accordingly.
6) Commission on sales was paid @ 2% on sales upto 31st May 08, after 1st June 08 it was increased by 1%.

Find out the Profit prior to Incorporation and subsequent to Incorporation.

Solution :

Hari Ltd.

Profit & Loss A/c for the year ended as on 31st March 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Office Rent A/c	WN3	5,000	5,000	By Gross Profit c/d	WN2	50,000	1,50,000
To Printing & Stationery A/c	TR	333	1,667	By Income from invest. A/c	Post	-	6,000
To Office Expenses A/c	TR	1,500	7,500	By Rent recd	Post	-	25,000
To Advertisement A/c	SR	2,353	5,647				
To Travelling Exp. A/c	SR	2,206	5,294				
To Debenture Interest A/c	Post	-	10,000				
To Audit Fees A/c	WN4	500	5,500				
To Director's Fees A/c	Post	-	12,000				
To Bad Debts A/c	SR	1382	3,318				
To Interest on Capital A/c	Pre	4,000	-				
To Electricity Charges A/c	TR	500	2,500				
To Commission A/c	WN5	1,000	18,000				

To Depreciation A/c	WN6	1,000	23,000				
To Profit to Vendor A/c	WN7	12,090	-				
To Capital Reserve A/c		18,136	-				
To Net Profit c/d		-	81,574				
		50,000	1,81,000			50,000	1,81,000

Working Note :

1) Time Ratio = 1:5

Date of Acquisition 01/04/08 — Date of Incorporation 01/06/08 — Year end 31/03/09

Pre Incorporation 2 months | Post Incorporation 10 months

Time Ratio = 1:5

2) Sales Ratio = 5:12

Gross Profit for pre-incorporation @ 20% was Rs.50,000/-

$\therefore$ Pre-sales = $\frac{\text{Gross Profit}}{\text{G.P.}} = \frac{50,000}{20\%}$ = Rs.2,50,000/-

$\therefore$ Post Gross Profit = 2,00,000 (-) Pre G.P. 50,000
= 1,50,000

Gross Profit ratio for post-Incorporation = 25%

$\therefore$ Post Sales = $\frac{\text{Gross Profit}}{\text{G.P.}} = \frac{1,50,000}{25\%}$ = Rs.6,00,000/-

Sale
Pre = 2,50,000/-
Post = 6,00,000/-
Sales Ratio = 5:12

3) Office Rent : Rs.10,000/- paid from 1st April 08 to 31st July 08 (4 months)

Pre = (April, May) $\frac{10,000}{4}$ X 2 = 5,000

Post = (June, July) $\frac{10,000}{4}$ X 2 = 5,000

4) Audit Fees

	Pre	Post
First Auditors Fees $\frac{3,000}{12}$ = 250/- p.m.	250 X 2 = 500	250 X 1 = 250

Audited April, May, June Months Price – Home & Co. Bal. fees in post period (6,000 – 750)	-	5,250
Audit Fees	500	5,500

5) Commission on Sales

	Pre	Post
a) 2% on Sales upto 31/05/08 = 50,000 X 2%	1,000	-
b) 3% on Rs.6,00,000/- post sales	-	18,000
	1,000	18,000

6) Depreciation

	Pre	Post
a) On Building on Rs.6,00,000/- @ 2.5% p.a. from 1st August 08 to 31st March 09 = 8 months **6,00,000 X 2.5% X $\frac{8}{12}$ (post)**	-	**18,000**
b) Balance Depreciation = 24,000 (-) 18,000 Rs.6,000/- in Time Ratio = 1:5	1,000	5,000
Total Rs.	1,000	23,000

7) Profit to vendor = 40% of Pre-Incorporation
= 30,226 X 40%
= Rs.12,090/-

Illustration : 5 (Typical and having different selling price)

Murali Ltd. was incorporated to take over running business of TR & Co. from 1st Jan 08. The following Profit & Loss A/c is prepared for the period ended 31st March 2009.

Profit & Loss A/c for the period ended 31st March 09

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Cost of goods sold A/c		10,00,000	By Sales Cash	3,40,000	
To Administrative Expenses A/c		78,000	Retailers Wholesalers	2,40,000 6,40,000	

To Selling Expenses A/c		10,000	Exports	6,00,000	18,20,000
To Office Rent A/c		3,20,000	By Share Transfer Fees A/c		10,000
To Depreciation A/c		95,000	By Interest on Fixed Deposit A/c		42,000
To Interest paid to Vendor (purchase consideration paid (01/08/08)		35,000			
To Debenture Interest A/c		6,000			
To Preliminary Exp. A/c		4,000			
To Net Profit c/d		3,24,000			
		18,72,000			18,72,000

Additional Information :

1) Goods are sold on the following terms and conditions.

   a) At catalogue price at cash counter which is cost plus 100%.

   b) At catalogue price less 6.25% to retailers.

   c) At catalogue price less 20% to wholesalers.

   d) At catalogue price less 25% for exports.

2) TR & Co. sold goods through following channels only.

   a) At cash counter and retailers. However, Murali Ltd. discontinued the cash counter sale and retail, sale from the date of its Incorporation and decided to expand the Market through wholesalers and exports sales only.

3) Office Rent was Rs.10,000/- p.m. upto 31/08/08 and thereafter it increased by 20%. Balance Rent was for additional space acquired by the directors.

4) Average monthly administrative expenses doubted from date of Incorporation.

5) Depreciation includes Rs.5,000/- on the plant acquired in the post Incorporation period and Rs.15,000/- on plant which was transferred on 31st May 08 sister company.

6) Selling Expenses relates to export sales only.

7) Interest received on Fixed Deposits was from 1st April, 08.

Apportion the Profit between pre-Incorporation and post Incorporation period.

Solution :

Murali Ltd.

Profit and Loss Account for the period ended 31st March 09

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Administrative Expenses A/c	WN6	12,000	66,000	By Gross Profit c/d	WN4	3,80,000	4,40,000
To Selling Expenses A/c	Post	-	10,000	By Share transfer Fees A/c	Post	-	10,000
To Office Rent A/c	WN5	40,000	2,80,000				
To Depreciation A/c	WN7	32,000	63,000	By Interest on Fixed Deposit A/c	WN9	3,500	38,500
To Interest to vendor A/c	WN8	20,000	15,000				
To Debenture Int.A/c	Post	-	6,000				
To Preliminary Expenses A/c	Post	-	4,000				
To Capital Reserve A/c	-	2,79,500	-				
To Net Profit c/d	-	-	44,500				
		50,000	1,81,000			50,000	1,81,000

Working Notes :

1) Time Ratio = 4:11

Date of Acquisition 01/01/08 — Date of Incorporation 01/05/08 — Year end 31/03/09

Pre Incorporation 4 months | Post Incorporation 11 months

Time Ratio = 4:11

2) Let the cost price be Rs.100/-

∴ Cost counter price = 100 + 100 = Rs.200/- per unit

a) Catalogue Price = Rs.200/-

b) Retail Price = 200 – 6.25% = Rs.187.50

c) Wholesale Price = 200 – 20% = Rs.160/-

d) Export Price = 200 – 25% = Rs.150/-

3) Gross Profit Ratio = $\frac{\text{Gross Profit}}{\text{Sales}}$

S.P. (–) Cost = Gross Profit

	Gross Profit	G.P. Ratio=$\left(\frac{\text{S.P.}}{\text{Sales}}\right)$
Cash counter price	200 – 100 = 100	$\frac{100}{200}$
Retail Sales	187.50 – 100 = 87.50	$\frac{87.50}{187.50}$
Wholesale	160 – 100 = 60	$\frac{60}{160}$
Export Sale	150 – 100 = 50	$\frac{50}{150}$

4) Gross Profits

	Pre	**Post**
a) On case counter sales 3,40,000 X $\frac{100}{200}$	1,70,000	-
b) Retail Sales 2,40,000 X $\frac{87.50}{100}$	2,10,000	-
c) Wholesales 6,40,000 X $\frac{60}{160}$	-	2,40,000
d) Export Sales 6,00,000 X $\frac{50}{150}$	-	2,00,000
Total Gross Profit	3,80,000	4,40,000

Gross Profit = Sales (–) Cost of Goods Sold
= 18,20,000 (–) 10,00,000
= 8,20,000

5) Office Rent Rs.3,20,000/-

	Pre	**Post**
a) From 01/05/08 to 30/04/08 = 10,000 X 4 =	40,000	-
b) From 01/05/08 to 31/08/08 = 10,000 X 4 =	-	40,000
c) From 01/09/08 to 31/03/09 = 12,000 X 7 =	-	84,000

d) For Addition Space taken by directors = Post Incorporation [3,20,000 – (40,000 + 40,000 + 84,000)] = Rs.1,56,000/-	-	1,56,000
Total Rent	40,000	2,80,000

6)

Monthly Administrative Expenses were doubled from date of incorporation	**Pre**	**Post**
No. of Months	4	11
It was doubled from date of Incorporation	X 1	X 2
	4	22

Administrative Expenses Ratio = 4:22

Pre-incorporation = 78,000 X $\frac{4}{26}$ = Rs.12,000

Post-incorporation = 78,000 X $\frac{22}{26}$ = Rs.66,000

Rs.78,000

7) Depreciation : Rs.95,000/-

	Pre	**Post**
a) On Assets acquired in post period	-	5,000
b) On Assets transferred used 01/01/08 to 31/05/08 (5 months) pre $\frac{15000}{5}\times 4$ post $\frac{15000}{5}\times 1$	12,000	3,000
c) Balance Depreciation (95,000 – 20,000) = 75,000 in Time Ratio 4:11	20,000	55,000
	32,000	63,000

8) Interest paid to vendor Rs.35,000/- (from 01/01/08 to 01/08/08) = 7 months

Pre-Incorporation = $\frac{35,000}{7}\times 4$ Rs.20,000

Post-Incorporation = $\frac{35,000}{7}\times 3$ Rs.15,000

Rs.35,000

9) Interest received on fixed deposit from 1st April 08 to 31st March 09 (12 months)

Pre-Incorporation April 08 only one month 3,500

$\left(\frac{42,000}{12}\times 1\right)$

Post-Incorporation 1st May 08 to 31st March 09 (11 months)	38,500
Total Rs.	42,000

Illustration : 6 (Calculation of Sales commission on a provision for taxations)

The N.C. Ltd. was registered on 1st April 2008 to take over business of C.N. & Sons from 1st January 2008. From the following information calculate the Profit earned by the company in pre and post incorporation period.

1) Sales during year ended 31st Dec 08 amounted to Rs.7,20,000/- sales for the month of January, February, November and December 08 were half the monthly sales in each of remaining month.
2) Cost of goods sold Rs.2,20,000/-.
3) Rent and Taxes Rs.30,000/-.
4) Bad debts Rs.5,000/-.
5) Salaries (There are four employees in the Pre-Incorporation period and six employees in Post-Incorporation period) Rs.22,000/-.
6) Interest on purchase consideration (purchase consideration was paid on 1st June 08) Rs.30,000/-.
7) Partner's Remuneration Rs.11,000/-.
8) M.D. Remuneration Rs.40,000/-.
9) Commission sales paid 2% of sales upto Incorporation, then after in post-Incorporation 5% on sales.
10) Provision for Taxation @ 30% for entire period.
11) Donation given by the company Rs.11,000/-.
12) Preliminary Expenses amounted to Rs.15,000/-, agreed to be written off over five years.

Solution :

Profit & Loss Account for the year ended 31st December 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Rent & Taxes A/c	TR	7,500	22,500	By Gross Profit			
To Bad debts A/c	SR	1,000	4,000	c/d	SR	1,20,000	4,80,000
To Salaries A/c	WN4	4,000	18,000				
To Interest to							

vendors A/c	WN5	18,000	12,000				
To Partners							
Remuneration A/c	Pre	11,000	-				
To M.D.							
Remuneration A/c	Post	-	40,000				
To Sales	WN6	2,880	28,800				
Commission A/c							
To Donation A/c	Post	-	11,000				
To Preliminary							
Expenses w/off	Post	-	2,250				
To Provision for							
Taxation A/c	WN8	22,686	1,02,435				
To Capital Reserve							
A/c	-	52934	-				
To Net Profit c/d	-	-	2,39,015				
		1,20,000	4,80,000			1,20,000	4,80,000

Working Note :

1) Time Ratio = 1:3

Date of Purchase 01/01/08 — Pre Incorporation 3 months — Date of Incorporation 01/04/08 — Post Incorporation 9 months — Year end 31/12/08

Time Ratio = 1:3

2) Sales each of month January, February, November and December 2008 were half, for remaining each of monthly sales.

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0.5	0.5	1	1	1	1	1	1	1	1	0.5	0.5
Pre			Post								
2			8								

$\therefore$ Sales Ratio = 1:4

3) Gross Profit = Sales (-) Cost of goods sold
= 7,20,000 (-) 2,20,000
= 6,00,000

4) Salaries Rs.22,000/-. There are four employees in Pre-Incorporation period and six employees Post-Incorporation.

	Pre	Post
No. of months X No. of employyes	3 X 4	9 X 6
	12	54

$\therefore$ Ratio = 2:9

Pre-Incorporation = 22,000 X $\frac{2}{11}$ = Rs.4,000

Post-Incorporation = 22,000 X $\frac{9}{11}$ = Rs.18,000

Total Salaries Rs.22,000

5) Interest on purchase consideration, Rs.30,000/- paid for the period from 1st January 08 to 1st June 08, for 5 months.

Pre = Jan. + Feb. + Mar. = 3 months = $\frac{30,000}{5}$ X 3 = Rs.18,000

Post = Apr. + May = 2 months = $\frac{30,000}{5}$ X 2 = Rs.12,000

6) Commission on sales 2% in Pre-Incorporation and 5% on Post-Incorporation sales

Pre-Incorporation sales commission

= 7,20,000 X $\frac{1}{5}$ = Rs.1,44,000 X 2% = 2,880

Post-Incorporation sales commission

= 7,20,000 X $\frac{4}{5}$ = Rs.5,76,000 X 5% = 28,800

7) Preliminary Expenses to be w/off over 5 years

= $\frac{15,000}{5}$ X $\frac{9}{12}$ (post months) = Rs.2,250/-, balance preliminary expenses should shown in Balance sheet.

8) Provision for Taxation @ 30%

	Pre		Post
Gross Profit Less : Total Expenses	1,20,000 (44,380)		4,80,000 (1,38,550)
N.P.B.T. Less : Tax @ 30%	75,620 (22,686)		3,41,450 (1,02,435)
Capital Reserve	52,934	N.P.	2,39,015

Illustration : 7

STC Ltd. was incorporated on 1st December 2007 to take over the business of C & Co. with effect from 1st April 2007. The accounts were maintained as usual upto 31st March 2008 and following balances were extracted from the books of accounts as on that date.

Particulars	Rs.
Stock on 1st April 2007	2,00,000
Carriage outwards	44,000
Purchases	20,50,000
Sales	25,60,000
Sales Return	60,000
Purchase Return	50,000
Preliminary Expenses	40,000
Office Expenses	48,000
Sundry Debtors	1,40,000
Sundry Creditors	1,80,000
Land & Building	16,00,000
Furniture	1,50,000
Bills Receivable	65,000
Bills Payable	2,25,000
Directors Fees	82,000
Salaries	1,20,000
Interest on purchase consideration	75,000
Capital Accounts of C & Co.	17,00,000
Bank Balance (Dr.)	41,000

Prepare the final accounts of STC Ltd. as on 31st March 08, after considering following information / adjustments.

1) Stock as on 31st March 08 valued Rs.7,50,000/-
2) Depreciation Land & Building by 2% and Furniture by 10% p.a.
3) Net sales turnover for the Pre-Incorporation was Rs.15,00,000/-.
4) Purchase consideration was agreed Rs.21,00,000/- to be satisfied by the issue on 31st January 08 of Rs.1,00,000/- Equity shares of Rs.10/- each fully paid at Rs.11.40/- per share and by in 12% Debentures at 4% discount.
5) Write off 1/5 of Preliminary Expenses.
6) The company deals in only one type of product. The unit cost of sales reduced by 10% in post Incorporation period as compared to post Incorporation period in the year.

7) Salaries includes Salaries of company Secretary Rs.24,000/- p.a. appointed on 1st December 07.

8) Provide Income Tax @ 40% for entire period and proposed Dividend @ 10%.

Solution :

S.T.C Ltd.
Trading Account for the year ended 31/03/08

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock A/c		2,00,000	By Sales	25,60,000	
To Purchases	20,50,000		(-) Returns	(60,000)	25,00,000
(-) Returns	(50,000)	20,00,000	By Closing Stock A/c		7,50,000
To Gross Profit c/d		10,50,000			
		32,50,000			32,50,000

Profit & Loss Accounts for the year ended 31st March 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Office Expenses A/c	TR	32,000	16,000	By Gross Profit b/d	WN8	5,00,000	5,50,000
To Director's Fees A/c	Post	-	82,000				
To Co. Secretaries Salaries A/c	Post	-	8,000				
To Staff Salaries A/c	WN6	68,000	34,000				
To Carriage outwards A/c	SR	29,333	14,667				
To Preliminary Expenses A/c	Post	-	8,000				
To Interest paid to vendor A/c	WN9	60,000	15,000				
To Depreciation							
Land & building	TR	21,333	10,667				
Furniture	TR	10,000	5,000				
To Debenture Interest A/c	Post	-	20,000				
To Provision for Taxation A/c	WN10	1,11,734	1,34,666				
To Capital Reserve A/c		1,67,600	-				
To Net Profit c/d		-	2,02,000				

		5,60,000	5,50,000			5,60,000	5,50,000

Profit & Loss Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Proposed Dividend A/c	1,00,000	By Net Profit b/d	2,02,000
To Surplus carried to Balance sheet	1,02,000		
	2,02,000		2,02,000

STC Ltd.
Balance sheet as on 31st March 2008

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital			Fixed Assets		
			Goodwill		4,00,000
Authorized		?	Land & Building	16,00,000	
			(-) Depreciation	(32,000)	15,68,000
Issued, Paid up			Furniture	1,50,000	
1,00,000 Equity			(-) Depreciation @	(15,000)	1,35,000
Shares of Rs.10/-			10%		
each fully paid		10,00,000			
(All above shares			Investment		NIL
issued to vendor					
for consideration			Current Assets &		
other than cash)			Loans Advances		
			a) Current Assets		
Reserves &			Stock	7,50,000	
Surplus			Debtors	1,40,000	
Securities Premium	1,40,000		Bank Balance	41,000	9,31,000
Capital Reserve	1,67,600		b) Loans &		
P&L A/c Surplus	1,02,000	4,09,600	Advances		
			Bills Receivable		65,000
Secured Loans					
12% Debentures		10,00,000	Miscellaneous		
			Expenditure		
Unsecured Loans		NIL	(to the extent not		
			w/off on adjusted)		
Current Liabilities			Preliminary Exp.	40,000	
& Provision			Less : : w/off (1/5)	(8,000)	32,000
a) Current Liab.			Discount on issue		
Sundry Creditors	1,80,000		of Debentures		40,000
Bills Payable	2,25,000				
Accrued Deb. Int	20,000	4,25,000			
(not due)					

b) Provisions Provision for Taxation Proposed Divd.	2,46,400 1,00,000	3,46,400			
		31,81,000			31,71,000

Working Notes :

1) Time Ratio = 2:1

Date of Acquisition	Date of Incorporation	Year end
01/04/07	01/12/07	31/03/08
Pre Incorporation 8 months	Post Incorporation 4 months	

$\therefore$ Time Ratio = 2:1

2) Sales Ratio = 3:2

Gross Sales	25,00,000
(-) Sales Return	(60,000)
Net Sales	25,00,000

Pre Sales = Rs.15,00,000/-
Post Sales = Rs.10,00,000/- (Bal.)
$\therefore$ Sales = 3:2

3) Purchase consideration 21,00,000
Less : Equity shares 1,00,000 Equity shares of Rs.10/- each @ Rs.11.40/- per share (11,40,000)
12% Debentures @ Rs.96/- each 9,60,000

$\therefore \frac{9,60,000}{96}$ = 10,000, 12% Debentures of Rs.100/- each at 4% discount.

4) Accrued Debenture Interest (issued not due)
= 10,00,000 X $\frac{12}{100}$ X $\frac{2}{12}$ = Rs.20,000/-

5) Purchase consideration 21,00,000
Less : Capital A/c of C & Co. 17,00,000
Goodwill 4,00,000

6) Salaries 1,20,000
Less : Company Secretary's Salaries (Post) 8,000

$\frac{24000}{12}$ X 4 Months

Salaries in Time Ratio	1,02,000

Pre 1,02,000 X $\frac{2}{3}$ = 68,000

Post 1,02,000 X $\frac{1}{3}$ = 34,000

7) Cost of Sales

Opening Stock	2,00,000
Purchases (20,50,000 – 50,000)	20,50,000
	22,00,000
Less : Closing Stock	(7,50,000)
Cost of Sales	14,50,000

	Pre	Post
Let pre – cost per unit X Sales Ratio	100 X 2	90 X 1
Cost of Production Ratio	200	90

Cost of Sales Ratio = 20:9

Pre-Cost of sales = 14,50,000 X $\frac{20}{9}$ = Rs.10,00,000

Post-Cost of Sales = 14,50,000 (-) 10,00,000
= 4,50,000

8) Gross Profit

	Pre	Post
Sales	15,00,000	10,00,000
(-) Cost of sales	(10,00,000)	(4,50,000)
Gross Profit	5,00,000	5,50,000

9) Interest on purchase consideration Rs.75,000/- paid for the period 1st April 07 to 31st Jan. 08

Pre-Incorporation Interest = $\frac{75,000}{10}$ X 6 = Rs.60,000

Post-Incorporation Interest = 75,000 – 60,000
= 15,000

10) Provision for Taxation @ 40%

	Pre	Post
Credit Total	5,00,000	5,50,000
Less : Debit Total	(2,20,666)	(2,13,334)
N.P.B.T.	2,79,334	3,36,666

Less : Income Tax @ 4%	(1,11,734)	(1,34,666)
Profit After Tax	1,67,600	2,02,000

Illustration: 8 (Typical – Payment to vendor in installments same books of Accounts continued)

Trial balance of A Ltd. as on 31.12.08

Particulars	Debit (Rs.)	Credit (Rs.)
Opening Stock	50,000	-
Purchase / Sales	6,00,000	7,50,000
Wages	25,000	
Carriage	30,000	
Salaries	24,000	
Rent	18,000	
Capital TR & Co.		5,00,000
10% Bank Loan (1st Oct 08)		1,00,000
Printing & Stationery	6,000	
Debtors / Creditors	50,000	40,000
Bad debts	10,000	
Audit Fees	10,000	
Sundry Expenses	4,000	
Plant & Machinery	2,00,000	
Land & Building	3,00,000	
Bank Balance	5,000	
Furniture & Fixture	58,000	
	13,90,000	13,90,000

Additional Information :

1) A Ltd. was incorporated on 1st July 2008 to take over business of TR & Co. as from 01.04.08. No entries relating to transfer of the business were entered in the books which were carried on without a break until 31st December 2008.

2) Purchase consideration agreed Rs.6,00,000/- and discharge as under :

a) 10,000 9% Preference shares of Rs.10/- each @ Rs.12/-.

b) Rs.3,00,000/- 12% Debenture issued at 5% discount.

c) Bal in Equity share of Rs.5/- each, at par shares were allotted on 1st July 2008 where as Debentures were allotted on 1st Oct. 2008. Provide interest on Purchase Consideration @ 12% p.a.

3) Monthly sales were doubled from 1st Oct. 2008.

4) Salary includes salary of company's secretary appointed on 1st July 2008 Rs.6,000/- & balance salary includes salary of manager Rs.1,000/- per month who resign on 1st August 08.

5) Bad debts includes Rs.8,000/- written off on 1st July 08.

6) Preliminary Exp. Amounted to Rs.12,000/- paid by directors, yet not accounted is to be written off over period of 5 years.

7) Gross Profit was 20% of sales throughout period.

8) Depreciate Land & Building by 6% p.a. & Plant & Machinery 15% p.a.

Solution :

Trading Account for the period ended on 31.12.2008

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	50,000	By Sales	7,50,000
To Purchases	6,00,000	By Closing Stock (Bal. fig)	1,05,000
To Wages	25,000		
To Carriage	30,000		
To Gross Profit (20% on Sales)	1,50,000		
	8,55,000		8,55,000

Profit & Loss Accounts for the year ended 31st December 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Salary A/c	WN	7,667	16,000	By Gross Profit			
To Rent A/c	TR	6,000	12,000	b/d	SR	37,500	1,12,500
To Bank Interest A/c		-	2,500	by Goodwill A/c	-	20,833	-
To Printing & Stationery A/c	TR	2,000	4,000				
To Bad Debts (Actual)		8,000	2,000				
To Audit Fees A/c	TR	3,333	6,667				

To Sundry Expenses A/c	TR	1,333	2,667				
To Interest payable vendor A/c	WN	18,000	8,550				
To Debenture Int.A/c		-	9,000				
To Preliminary Exp. w/off A/c	WN	-	1,200				
To Depreciation on Land & Building A/c	TR	4,500	9,000				
To Depreciation on Plant & Machinery A/c	TR	7,500	15,000				
To Net Profit c/d		-	23,583				
		58,333	1,12,500			58,333	1,12,500

A Ltd.
Balance sheet as on 31.12.2008

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital			Fixed Assets		
			Goodwill		1,20,833
Authorized		?	(1,00,000+20,833)		
			Land & Building	3,00,000	
Issued, Paid up			(-) Depreciation	(13,500)	2,86,500
10,000 10%			(9 months)		
Preference shares			Plant & Machinery	2,00,000	
of Rs.10/- each			(-) Depreciation	(22,500)	1,77,500
fully paid up		1,00,000	(9 months)		
39,000 Equity			Furniture & Fixture		58,000
shares of Rs.5/-					
each fully paid of			Investment		NIL
all above shares					
allotted vendor for			Current Assets &		
consideration in			Loans & Advances		
cash		1,95,000	Sundry Debtors	50,000	
			Stock in trade	1,05,000	
Reserve & Surplus			Bank balance	5,000	1,60,000
Security Premium	20,000				
P&L A/c	23,583	43,583	Miscellaneous Exp		
			(to the extend not		
Secured Loan			w/off)		
12% Debentures	3,00,000		Discount on issue		
(+) Interest due	9,000	3,09,000	of Debentures		15,000
			Preliminary Exp.	12,000	
Unsecured Loan			(-) w/off	(1,200)	10,800
10% Bank Loan	1,00,000				
(+) Interest due	2,500	1,02,500			
Current Liabilities					

& Provisions					
Sundry Creditors	40,000				
Interest payable to vendor	26,550				
Preliminary Expenses payable	12,000	78,550			
		8,28,633			8,28,633

Working Notes :

1)

TR & Co. Capital A/c

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To 9% Preference Share Capital A/c	1,00,000	By Bal b/d (as per trial balance)	5,00,000
To Debentures A/c	2,85,000	By Goodwill (Bal fig.)	1,00,000
To Equity Share Capital A/c	1,95,000		
To Securities Premium A/c	20,000		
	6,00,000		6,00,000

2) Time Ratio

Date of take over 01/04/08 — Date of Incorporation 01/07/08 — Year end 31/12/08

Pre Incorporation 3 months | Post Incorporation 6 months

$\therefore$ Time Ratio = 1:2

3) Sales Ratio

Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec
1	1	1	1	1	1	2	2	2
Pre			Post					
3			9					

$\therefore$ Sales Ratio = 1:3

4) Salary Rs.24,000/-

	Pre	Post
Salary to Secretary	-	6,000
Salary to Manager (1,000 per month upto 31st July 08)	3,000	1,000

Other Salary (Bal. Rs.14,000/- in TR)	4,667	9,333
	7,667	16,333

5) Purchase Consideration

	Rs.	Rs.
9% Preference share Capital	1,00,000	
(+) Premium @ Rs.2/- per share	20,000	1,20,000
12% Debentures	3,00,000	
(-) 5% Discount on issue	(15,000)	2,85,000
Bal. in Equity shares of Rs.5/- each		1,95,000
$\frac{1,95,000}{5}$ = 39,000 Equity shares of Rs.5 each		
Purchase Consideration		6,00,000

Capital A/c ……..Dr. 6,00,000
Discount on issue of Debentures A/c ….Dr. 15,000
To 9% Preference Share Capital A/c 1,00,000
To Securities Premium A/c 20,000
To Equity Share Capital A/c 1,95,000
To 12% Debentures A/c 3,00,000

Preliminary Expenses w/off
Over 5 years from 1st July 08 onwards
= 12,000 X $\frac{1}{5}$ X $\frac{6}{12}$
= Rs.1,200/-

Interest on Purchase Consideration

	Pre	Post
a) On Shares allotted on 1st July 08 from 01.04.08 to 01.07.08 (Pre) 3,15,000 X 12% X $\frac{3}{12}$	9,450	-
b) For balance Purchase Consideration, by allotting Debentures on 01.10.08	8,550	8,550

Pre = From 01.04.08 to 30.06.08 = 3 months Post = From 1st July to 30th Sept. 08 = 3 months 2,85,000 X 12% X $\frac{6}{12}$		
Total Interest	18,000	8,550

Outstanding Interest payable to vendor Rs.26,550/-

Illustration : 9 (Division of Trading Account and P&L A/c)

The Dil Ltd. was Incorporation on 1st July 08 to acquire the business of M/s. Top & Son, with effect from 1st Jan. 08. The accounts were maintained as usual upto 31st December, 2008, on which date the following balances were extracted from the books.

Particulars	Debit (Rs.)
Purchase (upto 31st May 08, Rs.45,000/-)	1,35,000
Sales (upto 31st May 08, Rs.1,20,000/-)	4,80,000
Stock as on 1st January 08	50,000
Carriage Inwards (2% on Purchase)	2,700
Rent	15,000
Formation Expenses	6,000
General Expenses	18,000
Plant & Machinery	60,000
Sundry Debtors	40,000
Sundry Creditors	25,000
Carriage Outwards (2.5% on Sales)	10,000
Bills Receivable	22,000
Bills Payable	5,000
Interest on Purchase Consideration (upto 01/08/08)	21,000
Cash at Bank	9,000
Capital A/c of Top & Sons	90,000
Directors Fees	6,000
Land and Building	2,20,000
General Reserve (31.12.07)	14,700

Additional Addition :

1) Closing stock as on 31st May 08 and 31st December 08 was valued at Rs.60,000/- and Rs.1,10,000/- respectively.

2) Depreciation on Land & Building 5% p.a. and plant and machinery @ 20% p.a.

3) Rent upto 31st October 08 was Rs.1,000/- p.m., it was increased to 1,200 p.m. from 1st November 08, Rent includes advance paid to landlords.

4) Mangeri Salary at Rs.2,000/- p.m. is payable. The manager became a director on formation of the company. His remuneration as director is included in director's fees.

5) The Purchase Consideration was agreed at Rs.2,14,700/-, was satisfied on 01/08/08, by issued of 1,000 Equity shares of Rs.10/- each @ Rs.15/- per share and balance in 12% Debenture of Rs.100/- each at par.

6) Provide Income tax @ 40%.

7) Director's proposed Equity dividend @ 20%.

Prepare Final Accounts of the DIL Ltd. showing in Profit in the pre and post Incorporation periods after written off 1/6 of formation expenses.

Solution :

Trading Account for the ended 31st December 2008

Dr. Cr.

Particulars	Pre	Post	Particulars	Pre	Post
To Opening Stock A/c	50,000	60,000	By Sales	1,20,000	3,60,000
To Purchases A/c	45,000	90,000	By Closing Stock A/c	60,000	1,10,000
To Carriage Inward A/c (2% on Purchase)	900	1,800			
To Gross Profit c/d (Bal figure)	84,100	3,18,200			
	1,80,000	4,70,000		1,80,000	4,70,000

Profit & Loss Accounts for the year ended 31st December 08

Dr. Cr.

Particulars	Basis	Pre	Post	Particulars	Basis	Pre	Post
To Rent A/c	WN3	5,000	7,400	By Gross Profit b/d		84,100	3,18,200
To General Exp. A/c	TR	7,500	10,500				
To Carriage Outwards A/c	WN	3,000	9,000				
To Formation Exp. A/c		-	1,000				
To Interest paid to vendor A/c	WN6	15,000	6,000				
To Director's Fees A/c	Post	-	6,000				
To Depreciation A/c On Land & Build.	TR	4,583	6,417				

On Plant & Mach.	TR	5,000	7,000				
To Manager's Salary A/c	Pre	10,000	-				
To Debenture Int.A/c	Post	-	3,235				
To Provision for Taxation A/c	WN8	13,607	1,04,659				
To Capital Reserve A/c		20,410	-				
To Net Profit c/d		-	1,56,989				
		84,100	3,18,200			84,100	3,18,200

Profit & Loss Appropriation A/c

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Proposed Dividend A/c	20,000	By Net Profit b/d	1,56,984
To Surplus Carried to Balance sheet	1,36,989		
	1,56,989		1,56,989

DIL Ltd. Balance sheet as on 31.12.2008

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
I. Share Capital			Fixed Assets		
			Goodwill		1,10,000
Authorized		?	Land & Building	2,20,000	
			(-) Dep^{n}	(11,000)	2,09,000
Issued, Paid up			Plant & Machinery	60,000	
1,000 Equity shares of Rs.10/- each fully paid up			(-) Dep^{n}	(12,000)	48,000
			II. Investment		-
(All the above Equity shares issued to vendor for consideration received in cash)		1,00,000	III. Current Assets & Loans & Advances		
			a) Current Assets		
			Stock	1,10,000	
II. Reserve & Surplus			Sundry Debtors	40,000	
			Bank balance	9,000	1,59,000
Security Premium	50,000				
Capital Reserve (P.P.I.)	20,410		b) Loans & Advances		
P&L A/c Surplus	1,36,989	2,07,399	Bills Receivable	22,000	
			Rent Deposits	2,600	24,600
III. Secured Loan					
12% Debentures	64,700		IV. Miscellaneous Exp.		
(+) Accrued Int.	3,235	67,935	(to the extend not w/off)		
IV. Unsecured Loan			Formation Exp.	6,000	
			(-) w/off	(1,000)	5,000
V. Current Liabilities & Provisions					
a) Current Liab.					
S. Creditors	25,000				
Bills Payable	5,000				

O/s Carriage Outwards	2,000				
O/s Manager's Salaries	10,000	42,000			
b) Provisions					
Proposed Divd.	20,000				
Provision for Taxation	1,18,266	1,38,266			
		5,55,600			5,55,600

Working Notes :

1) Time Ratio

Date of take over 01/01/08 — Date of Incorporation 01/06/08 — Year end 31/12/08

Pre Incorporation 5 months | Post Incorporation 7 months

∴ Time Ratio = 5:7

2) Sales Ratio

Pre = Rs.1,20,000
Post Rs.4,80,000
Rs.1,20,000
Rs.3,60,000

∴ Sales Ratio = 1:3

3) Rent Rs.15,000/-

	Pre	Post
a) From 01.01.08 to 31.05.08 (1,000X5)	5,000	-
b) The month June, July, Aug, Sept., Oct	-	5,000
c) For November, December 1200X2	-	2,400
Total Rent	5,000	7,400

Rent Deposit = 15,000 – (5,000 + 7,400) = 2,600

4) Carriage Outwards 2.5% of Sales

Pre = 1,20,000 X 2.5% =	3,000
Post = 3,60,000 X 2.5% =	9,000
Total	12,000
Less : Paid	(10,000)
Outstanding	2,000

5) Interest paid to vendor Rs.21,000/- for period 1st January 08 to 1st August 08 = 7 months out of which 5 months are pre & balance post.

Pre = $\frac{21,000}{7}$ X 5 = Rs.15,000

Post = 21,000 (-) 15,000 = Rs.6,000

6) Debenture Interest = 64,700 X 12% X $\frac{5}{12}$ = Rs.3,235/-

7) Goodwill

	Rs.
Top a son Capital Balance	90,000
Add : General Reserve Balance	14,700
Final Capital Balance	1,04,700
Add : Goodwill (Balancing figure)	1,10,000
Purchase Consideration	2,14,700

8) Provision for Tax

	Pre	Post
Profit & Loss Credit balance	84,100	3,18,200
Less : P&L A/c Dr. Exp.	(50,083)	(56,552)
N.P.B.T.	34,017	2,61,648
Less : Income Tax 40%	13,607	(1,04,659)
Profit after Tax	20,410	1,56,989

9) Closing stock as on 31st May 08 is opening stock for the post period.

14.2 KEY POINTS / KEY TERMS :

1) Incorporation : Date of Registration i.e. date on which company comes in existence.

2) Pre-Incorporation : Period from date of acquisition to date of Incorporation.

3) Post-Incorporation : Period from Incorporation to year end.

4) Sales Ratio : Ratio between sales of pre and post Incorporation it is used for dividing Gross Profit and Variable Expenses, Selling and Distribution Expenses.

5) **Time Ratio :** Ratio indication period of pre-Incorporation & post-Incorporation time. It is used to divide Fixed Expenses, Administrative Expenses.

6) **Interest paid to Vendor :** Interest is paid from date of acquisition to payment of purchase consideration, it should be divided considering actual period.

7) **Purchase Consideration :** It is the amount agreed to be paid to vendor for taking over business.

8) **Pre-Incorporation Profit :** Transfer to Capital Reserve

9) **Pre-Acquisition Loss :** Transfer to Goodwill

10) **Goodwill :** Excess of Purchase consideration over net assets taken over (Capital of vendor)

14.3 EXCERCISES :

14.3.1 THEORY QUESTIONS :

1) What is pre-Incorporation Profit?
2) What are different methods of ascertaining Pre-Incorporation Profit?
3) What are different bases of Allocation of Income / Expenses?
4) How would you treat Pre-Incorporation losses in Accounts?

14.3.2 OBJECTIVE TYPE QUESTIONS

- **Fill in the blanks :**

1) Interest on Debentures is _____ expenditure.
2) Gross Profit are divided in the ratio of _____ .
3) Interest paid to vendor is _____ expenditure.
4) Share transferred fees received is _____ Income.
5) Goodwill written off is charged to _____ .
6) Audit fees are divided in the ratio of _____ .
7) Fixed expenses are divided in the ratio of _____ .
8) Depreciation on asset purchased after incorporation is charged to _____ .
9) Managing directors renunciation charged to _____ .
10) Interest on vendor's capital is charged _____ period.

11) The provision for Income tax is allocated in the ratio of _____ .

12) The pre-incorporation period loss considered as _____ .

13) Vendor's salary is charged to _____ period.

14) The fixed expenditure allocated in the ratio of _____ .

15) Post-incorporation profit is transferred to _____ .

- **Multiple Choice Questions :**

1) Profit post incorporation are available for _____ .
   a) Acquisition of fixed asset b) Debenture interest
   c) Payment of dividend d) For drawing by owner

2) Share issue expenses written off should be charged to _____ .
   a) Trading Account b) Liabilities
   c) Post incorporation Profit d) None of these

3) Goodwill written off is charged to _____ .
   a) Current Liabilities b) Floating Assets
   c) Capital Account (share) d) None of these

4) Discount allowed to Customers by a limited company is charged to _____ .
   a) Pre-incorporation period b) Post-incorporation period
   c) Post acquisition period d) None of these

5) Profit upto date of incorporation is _____ .
   a) Capital Reserve b) Capital Profit
   c) Security Premium d) Revenue Reserve

6) Expenses exclusively relating to vendor should be charged to _____ period.
   a) Pre-incorporation b) Post acquisition period
   c) Post-incorporation d) Both

7) The excess of purchased consideration over net assets taken over is debited to _____ .
   a) Fixed Assets b) Goodwill
   c) Capital Reserve d) None of above

8) The date of taken over 1st January 2008, incorporation 1st June 08 year end – 31st December 2008. Time ratio is _____ .
   a) 5:1 b) 2:5

c) 1:6 d) None of these

9) Sales for the year Rs.15 Lakhs pre acquisition sales Rs.3 Lakhs, pre-incorporation Rs.2 Lakhs, Balance post-incorporation. The sales Ratio is _____ .
a) 4:1 b) 3:5
c) 1:6 d) None of these

10) Purchased Consideration Rs.60,000/- net assets taken over Rs.45,000/-. The value of goodwill is _____ .
a) Rs.25,000/- b) Rs.45,000/-
c) Rs.15,000/- d) Rs.60,000/-

- **Match the Column :**

1)

Group "A"	Group "B"
i) Pre acquisition Loss	a) Post incorporation
ii) Company related expenses	b) Goodwill
iii) Asset	c) Belongs to vendor
iv) Salaries	d) In Time Ratio
	e) In Sales Ratio

2)

Group "A"	Group "B"
i) M. D. Salaries	a) Note to Balance sheet
ii) Contingent Liabilities	b) No Allocations
iii) Share Capital	c) Post incorporation
iv) Purchase Consideration	d) Net Assets taken over

3)

Group "A"	Group "B"
i) Audit Fees	a) Time Ratio
ii) Depreciation on Assets Purchased	b) Sales Ratio
	c) Post-incorporation
iii) Gross Profit	d) Goodwill
iv) Pre-incorporation Loss	e) Sales Less Cost of Sales

4)

Group "A"	Group "B"
i) Pre-incorporation Profit	a) Belongs to vendor
ii) Net Profit upto pre-incorporation period	b) Date of incorporation
	c) Sales Ratio
iii) Dividing point for ascertaining pre / post incorporation period	d) Capital Reserve
	e) Time Ratio
iv) Rent	
v) Gross Loss	

- **State whether True / False**

1) The Profit made on acquisition is debited to General Reserve.
2) Profit after incorporation is post acquisition.
3) Discount on issue of Debenture is charged to pre acquisition period.
4) Advertisement expense is allocated on the basis of Sales.
5) Depreciation on fixed asset taken over by vendor is charged to post incorporation period.
6) Debenture Interest is debited to post incorporation.
7) Pre acquisition Profit belongs to vendor.
8) Interest paid on purchased consideration is allocated in Sales Ratio of pre incorporation & post incorporation period.
9) Business Commencement Certificate date should be considered for allocation of expenses.
10) Provision for Sales Tax is allocated in the ratio between pre acquisition & pre incorporation period.
11) The partner's salary before acquisition should be allocated to both the period in Sales ratio.
12) Bad debts realized should be debited to pre incorporation period.
13) The corporate expenses should be debited to post acquisition period.
14) The advertisement under the contract Rs.1,000/- month should be divided between pre & post incorporation period in Sales ratio.
15) The Gross Profit should be divided pre & post incorporation period in Sales ratio.

14.3.3 PRACTICAL QUESTIONS:

Example : 1

Sonu Ltd. was incorporated on 01-07-2008 to take over the business of A.K. Enterprises as a going concern with effect from 01-04-2007. Their Profit and Loss Account for the year ended 31-03-2007 is as follows :

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	75,000	By Sales (upto 30-06-01 Rs.60,000/-)	3,00,000
To Purchases	1,00,000		
To Administration Expenses	12,000	By Closing Stock	46,500

To Director's Fees	4,000		
To Selling Expenses	20,000		
To Audit Fees	6,000		
To Preliminary Expenses	3,000		
To Net Profit	1,26,500		
	3,46,500		3,46,500

Prepare a statement showing the Profit earned prior to and after incorporation.

Example : 2

TCSO Ltd. was incorporated on May 1, 2007 to take over the business of Ltd. as a going concern from 01-01-2007. The Profit and Loss Account for the year ending on 31-12-2007 is as follows :

Profit and Loss Account of TSCO Ltd.

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Rent and Taxes	50,000	By Gross Profit	4,20,000
To Insurance	6,000		
To Electricity charges	3,000		
To Salaries	60,000		
To Director's Fees	2,500		
To Auditor's Fees	6,000		
To Commission	24,000		
To Advertisement	12,600		
To Discount	3,000		
To Office Expenses	7,500		
To Carriage Outwards	9,000		
To Bank Charges	1,200		
To Preliminary Expenses	7,500		
To Bad debts	6,000		
To Interest on Loan	9,000		
To Net Profit	2,12,700		
	4,20,000		4,20,000

The total turnover for the year ending 31-12-07 was Rs.15,00,000/- divided into Rs.5,00,000/- for the period up to 01-05-07. Ascertain the profits earned prior to and post Incorporation period.

Example : 3

OT Ltd. was incorporated on 1st July, 2008 to take over the running business of Mr. R with effect from 1st April, 2008.
The following Profit & Loss Account for the year ended 31st March 09 was drawn up.

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Advertisement	10,600	By Gross Profit	2,00,000
To Managing Director's Remuneration	21,000	By Rent	5,000
		By Bad debts Realized	6,000
To Depreciation	4,000	By Income Tax Refund (2006)	4,300
To Salaries	18,000		
To Insurance	4,000		
To Preliminary Expenses	1,000		
To Rent and Taxes	6,000		
To Discount	700		
To Debenture Interest	40,000		
To Net Profit	1,10,000		
	2,11,000		2,11,000

The following details are available :

a) Average monthly turnover from July 2008 onwards was double than that of previous months.

b) Rent for the first four months was paid @ Rs.400/- per month and thereafter it is increased by Rs.50/- per month.

c) Bad debts realization of bad debts was in respect of bad debts written off during 2004.

d) Advertisement expenses were directly proportionate to the sales.

You are required to find out the Profit prior to Incorporation.

Example : 4

Mr. OP formed a private Ltd. Company under the name and style of Dut K. Ltd. to take over his existing business as from 1st April, 2007, but the company was not incorporated until 1st July, 2007. No entries relating to transfer of the business were entered in the books, which were carried on without a break until 31st March, 2008.

The following balances were extracted from the books as on 31-03-2008.

Particulars	Debit (Rs.)	Credit (Rs.)
Opening Stock	40,000	
Purchases	1,80,000	
Carriage Outwards	3,000	
Traveling Commission	30,000	
Office Salaries	20,000	
Administration Expenses	18,000	
Rent and Rates	24,000	
Director's Fees	8,000	
Fixed Assets	2,00,000	
Current Assets, excluding stock	54,000	
Preliminary Expenses	6,000	
Sales		3,20,000
Mr.X's Capital Account on 01-04-07		2,50,00
Current Liabilities		23,000

You are also given that –

a) Stock on 31st March, 2008 Rs.75,000/-

b) The Gross Profit ratio is constant and monthly sales in April 2007, February 2008 and March 2008 are double the average monthly sales for the remaining months of the year.

c) The Purchase Consideration was agreed to be satisfied by the issue of 5,000 Equity shares of Rs.100/- each.

d) The half preliminary expenses are to be written off.

You are required to prepare Profit & Loss Account for the year ended on 31st March, 2008 apportioning the Profit or Loss of the periods before and after incorporation. Depreciation shall be provided at 25% per annum on Fixed Assets.

Example: 5

B Ltd. company was incorporated on 1st March, 2008 to take over an existing business from 1st January, 2008. The Purchase Consideration was agreed at Rs.3,00,000/- to be satisfied by an issue of Rs.50,000/- 6% Mortgage Debentures; interest at 6% per annum to be payable on the Purchase Consideration from 1st January, 2008 to the date of settlement. The Debentures were issued on 1st June 2008 on which date the company also allotted 25,000 Equity shares of Rs.10/- each fully paid to vendor. The Profit & Loss Account of the business for the year to 31st December, 2008 appears as below :

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Purchase (after adjusting stocks)	16,50,000	By Sales (Jan.– April)	10,00,000
		By Sales (May & Dec.)	
To Gross Profit	5,50,000		12,00,000
	22,00,000		22,00,000
To Administrative Expenses	1,00,000	By Gross Profit	5,50,000
To selling Expenses	80,000		
To Carriage Outward	22,000		
To Depreciation	20,000		
To Debenture Interest (Gross)	18,750		
To Interest on Purchase Consideration	9,000		
To Director's Fees	10,000		
To Preliminary Expenses	4,000		
To Goodwill (Amount written off)	10,000		
To Dividend on Equity Shares	25,000		
To Net Profit	2,51,250		
	5,50,000		5,50,000

Prepare a statement apportioning the balance of profits between the periods prior to and since Incorporation.

Example : 6

S.R. Private Ltd. was incorporated on 1st May 2007 to acquire the business of Zero Lal as from January 1, 2007 on the basis of the Balance sheet dated December 31, 2007. The accounts for the year ended December 31, 2007 disclosed the following :

a) There was a gross Profit of Rs.5,50,000/-.

b) The sales for the year amount to Rs.10,80,000/- of which Rs.4,80,000/- was for the first six months.

c) The expenses debited to Profit and Loss Account included Director's fees Rs.25,000/-; Bad debts Rs.6,600/-; Advertising Rs.12,000/- (under a contract amounting to Rs.1,000/- per month); Salaries and General Expenses Rs.54,000/-, Preliminary Expenses written off Rs.3,000/-; Donation to the political party given by the company Rs.5,000/-.

Prepare a statement showing the amount of profit made before incorporation and state how it should be dealt with in the accounts of the company.

Example : 7

The TY Ltd., was registered on 1st May, 2008 to take over the business of TK form 1st January, 2008. The company was granted certificate to commence business on 1st June, 2008. From the following information calculate the Profit earned by the company in the 'pre' and 'post' incorporated periods.

a) The sales for the year ended 31st December, 2008 amounted to Rs.4,80,000/-. The trend of the sales was as under :

   January and February – twice the average monthly sales

   June and July – one and a half times the average sales in each month

   September, October and November – half the average sales in each month.

b) Cost of goods sold Rs.3,60,000/-.

c) Salaries Rs.36,000/-. (There were 5 employees in the pre-incorporation period and 6 employees in the post incorporation period.)

d) Bad debts Rs.12,000/-.