PROFIT OR LOSS PRIOR TO INCORPORATION

MEANING

Whenever a running business is taken over by a newly formed company then Profit or loss of a business for the period prior to the date the company came into existence is referred to as Pre-Incorporation Profits or Losses.

Generally there are two methods of computing Profit & Loss prior to Incorporation:

FIRST METHOD

One is to close of old books and open new books with the assets and liabilities as they existed at the date of incorporation. In this way, automatically the result to that date will be adjusted.

SECOND METHOD

Other is to split up the profit of the year of the transfer of the business to the company between 'pre' and 'post' incorporation periods. This is done either on the time basis or on the turnover basis or by a method which combines the two.

Profit or loss prior to incorporation will be calculated by preparing following statement:

Particulars	**Basis**	**Pre Period**	**Post Period**
Gross Profit	Sales Ratio	XXX	XXX
Other Incomes	Pre/Post	XXX	XXX
Total		**XXX**	**XXX**
Less: Expenses	Pre & Post	XXX	XXX
Less: Expenses	Pre	XXX	-
Less: Expenses	Post	-	XXX
Capital Reserve/(Loss)		XXX	-
Net Profit/ (Loss)		-	XXX

Notes:

1) TRADING ACCOUNT WILL BE PREPARED ON TOTAL BASIS.

2) ITEMS TO BE SHARED ON THE BASIS OF SALES RATIO.

a) Gross Profit

b) Carriage/ Cartage Outward
c) Selling & Distribution Expenses
d) Commission to Selling/Travelling Agents
e) Advertisement Expenses
f) Bad Debts
g) Brokerage
h) Sales Promotion Expenses

3) ITEMS TO BE SHARED ON THE BASIS OF TIME RATIO.

a) Salaries
b) Rent, Rates and Taxes
c) Office & Administration Expenses
d) Printing & Stationary
e) Telephone Charges
f) Telegram and Postage
g) Depreciation
h) Interest on Loan

4) ITEMS BELONGS TO PRE PERIOD

a) Partners Salaries
b) Interest on Partners Capital

5) ITEMS BELONGS TO POST PERIOD

a) Formation Expenses
b) Interest on Debentures
c) Director's Fee
d) Director's Remuneration
e) Preliminary Exp Written off
f) Share Issue Expenses
g) Underwriting Commission
h) Discount on Issue of Securities
i) Proposed Dividend
j) Provision for Tax

SPECIAL POINTS REGARDING AUDIT FEES

1) For Companies Audit Under Companies Act -- Post Incorporation Period

2) For Tax Audit Under Section 44AB of Income Tax Act --Sales Ratio

If no information is given in the question, use SALES RATIO

TREATMENT OF PRE AND POST PROFIT

1)Pre Incorporation Profits are Capital Profits and should be transferred to Capital Reserve and shown in The head of Reserves and Surplus in the Balance sheet.

2)Post Incorporation Profits are Revenue Profits and should be transferred to Statement of Profit and loss and shown in The head of Reserves and Surplus in the Balance sheet.

TREATMENT OF PRE AND POST LOSSES

1) Pre Incorporation Losses are Capital Losses and should be transferred to Debit of profit and loss or special account describes as "Loss Prior to Incorporation" & shown as an assets in the Balance sheet.

It can also be debited to Goodwill Account.

2) Post Incorporation Losses are Revenue Loss and should be shown in assets side of the Balance Sheet.

PRACTICAL PROBLEMS

Question 1 X Ltd. was incorporated on 1.8.09 to take over the running business of M/s Kumar Bros. with effect from 1.4.09.The accounts of the company were closed on 31.3.2010. The average monthly sales during the first four months of the year (2009-10) were twice the average monthly sales during each of the remaining eight months. Calculate Time Ratio & Sales ratio. **(PCC May 2010)**

Ans: Time Ratio 1:2, Sales Ratio 1:1.

Question 2 Mr. X formed a Private Limited Company under the same and style of Exe private Limited to take over his existing business as from 1st April, 1990, but the company was not incorporated until 1st July 1990. No entries relating to transfer of the were entered in the books, which were carried on without a break until 31st March, 1991.

The following balances were extracted from the books as on 31st March, 1991.

Particulars	Dr. (₹)	Cr. (₹)
Opening Stock	43,000	
Purchases	1,89,000	
Carriage outward	3,300	
Travelling Commission	7,500	
Office Salaries	21,000	
Administrative Expenses	19,900	
Rent & Rates	12,000	
Director's Fees	18,000	
Fixed Assets	1,00,000	
Current Assets excluding Stock	34,000	
Preliminary Expenses	5,200	
Sales		2,78,000
Mr. X's Capital A/c as on 1-4-1990		2,30,000
Current Liabilities		37,000

You are also given that :
(i) Stock on 31st March, 1991 ₹ 44,000.
(ii) The Gross profit ratio is constant and monthly sales in April 1990, February 1991 and March 1991 are double of the average monthly sales for the remaining months of the year.
(iii) The purchase consideration was agreed to be satisfied by the issue of 3,000 equity shares of ₹ 100 each.
(iv) The preliminary Expenses are to be written off.
(v) You are to assume that carriage outwards and traveller's commission vary in direct proportion to sales.
You are required to prepare Statement for distribution of profit into pre and post period for the year ended on 31st March, 1991. Depreciation shall be provided at 25% p.a. on fixed assets.

Ans: Pre incorporation Capital Reserve ₹ 1,645. Post incorporation Net loss ₹23,545

Question 3 ABC Ltd. was incorporated on 1.5.2010 to take over the business of DEF and Co. from 1.1.2010. The summarised Profit and Loss Account as given by ABC Ltd. for the year ending 31.12.2010 is as under:

Profit and Loss Account

To Rent and Taxes	90,000	By Gross Profit	10,64,000
To Salaries incl. manager's salary of ₹ 85,000	3,31,000	By Interest on Investment	36,000
To Carriage Outwards	14,000		
To Printing and Stationery	18,000		
To Interest on Debentures	25,000		
To Sales Commission	30,800		
To Bad Debts (related to sales)	91,000		
To Underwriting Commission	26,000		
To Preliminary Expenses	28,000		
To Audit Fees	45,000		
To Loss on Sale of Investments	11,200		
To Net Profit	3,90,000		
	11,00,000		**11,00,000**

Prepare a Statement showing allocation of pre-incorporation and post-incorporation profits after considering the following information:

(i) G.P. ratio was constant throughout the year.
(ii) Sales for January and October were 1½ times the average monthly sales while sales for December were twice the average monthly sales.
(iii) Bad Debts are shown after adjusting a recovery of ₹7,000 of Bad Debt for a sale made in July, 2007.
(iv) Manager's salary was increased by ₹2,000 p.m. from 1.5.2010.

(v) All investments were sold in April, 2010.

Ans: Pre incorporation Capital Reserve ₹ 1, 72,436. Post incorporation Profit ₹ 217,564.

Question 4 Inder and Vishnu, working in partnership registered a joint stock company under the name of Fellow Travellers Ltd. on May 31, 2012 to take over their existing business. It was agreed that they would take over the assets of the partnership for a sum of 3, 00,000 as from January 1st, 2012 and that until the amount was discharged they would pay interest on the amount at the rate of 6% per annum. The amount was paid on June 30, 2012. To discharge the purchase consideration, the company issued 20,000 equity shares of ₹ 10 each at a premium of Re. 1 each and allotted 7% Debentures of the face value of 1, 50,000 to the vendors at par.

The Profit & Loss Account of the "Fellow Travellers Ltd." for the year ended 31st December, 2012 was as follows:

Particulars	Amount (₹)	Particulars	Amount (₹)
Purchase, including stock	1,40,000	Sales:	
Freight and carriage	5,000	1st January to 31st May 2012	60,000
Gross Profit c/d	60,000	1st June to 31st Dec., 2012	1,20,000
		Stock in hand	25,000
	2,05,000		2,05,000
Salaries and Wages	10,000	Gross profit b/d	60,000
Debenture Interest	5,250		
Depreciation	1,000		
Interest on Purchase			
Consideration (up to 30-6-2012)	9,000		
Selling Commission	9,000		
Directors' Fees	600		
Preliminary Expenses	900		
Provision for taxes	6,000		
Dividend on equity shares @ 5%	5,000		
Balance c/d	13,250		
	60,000		60,000

Prepare statement apportioning the balance between the 'post' and 'pre-incorporation' periods and also show how these figures would appear in the Balance Sheet of the company.

Ans: Pre Profits: 4,917 and Post profits: 8,333

Question 5 The partners of Maitri Agencies decided to convert the partnership into a private limited company called MA (P) Ltd. with effect from 1st Jan, 2010. The consideration was agreed at ₹ 1, 17, 00,000 based on the firm's Balance Sheet as at 31st Dec, 2009. However, due to some procedural difficulties, the company could be incorporated only on 1st April, 2010.Meanwhile the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% p.a.. The same books of account were continued by the company which closed its account for the first time on 31st March, 2011 and prepared the following summarized profit and loss account.

Particulars	(Rs)	(Rs)
Sales		2,34,00,000
Cost of goods sold:	163,80,000	
Salaries	11,70,000	
Depreciation	1,80,000	
Advertisement	7,02,000	
Discounts	11,70,000	
Managing Director's remuneration	90,000	
Miscellaneous office expenses	1,20,000	
Office-cum-show room rent	7,20,000	
Interest	9,51,000	2,14,83,000
Profit		19,17,000

The company's only borrowing was a loan of ₹ 50,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.
The company was able to double the average monthly sales of the firm, from 1st April, 2010 but the salaries trebled from that date. It had to occupy additional space from 1st July, 2010 for which rent was ₹ 30,000 p.m.
Prepare a statement of profit & loss in a columnar form apportioning cost & revenue between pre incorporation & post-incorporation periods. Also, suggest how the pre-incorporation profits are to be dealt with.

Ans: Pre profit (₹ 19,000), Post Profit 19,36,000

Question 6 ABC Ltd. took over a running business with effect from 1st April, 2009. The company was incorporated on 1st August, 2009.The following Profit & Loss Account has been prepared for the year ended 31.3.2010.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries	48,000	By Gross Profit	3,20,000
To Stationary	4,800		

To Travelling Expenses	16,800		
To Advertisement	16,000		
To Miscellaneous Trade Expenses	37,800		
To Rent (Office Building)	26,400		
To Electricity Charges	4,200		
To Director's fees	11,200		
To Bad debts	3,200		
To Commission to Selling Agents	16,000		
To Audit Fees	6,000		
To Debentures Interest	3,000		
To Interest paid to vendor	4,200		
To Selling expenses	25,200		
To Depreciation on Fixed Assets	9,600		
To Net Profit	87,600		
	3,20,000		3,20,000

Additional Information:

(i) Total Sales for the year, which amounted to ₹ 19,20,000 arose evenly up to the date of 30.9.2009. Thereafter they spurted to record an increase of two-third during the rest of the year.

(ii) Rent of office building was paid @ ₹ 2,000 p.m. up to September, 2009 & thereafter it was increased by ₹ 400 p.m.

(iii) Travelling Expenses include ₹ 4,800 towards sales promotion.

(iv) Depreciation include ₹ 600 for assets acquired in the post incorporation period.

(v) Purchase consideration was discharged by the company on 30th Sept., 2009 by issuing equity shares of ₹ 10 each.

Prepare Statement showing distribution of Profit & Loss in columnar form showing distinctly the allocation of expenses between pre & post incorporation periods.

Ans: Capital Reserve ₹ 12,800; Net Profit ₹ 74,800.

Question 7 Rama Udyog Limited was incorporated on August 1, 2008. It had acquired a running business of Rama & Co. with effect from April 1, 2008. During the year 2008-09, the total sales were ₹36,00,000. The sales per month in the first half year were half of what they were in the later half year. The net profit of the company, ₹2,00,000 was worked out after charging the following expenses:

(i) Depreciation ₹1,08,000, (ii) Audit fees ₹15,000, (iii) Directors' fees ₹50,000, (iv) Preliminary expenses ₹12,000, (v) Office expenses ₹78,000, (vi) Selling expenses ₹72,000 & (vii) Interest to vendors up to August 31, 2008 ₹5,000.

Please ascertain pre-incorporation and post-incorporation profit for the year ended 31st March, 2009. **(Nov 2009)**

Ans: Net Profit: Pre 34,667 & Post 1,65,333

Question 8 A firm M/s. Alag , which was carrying on business from 1st July, 2013 get itself incorporated as a company on 1st Nov ,2013 . The first accounts are drawn upto 31st March, 2014.The gross profit for the period is ₹ 56,000 .The general expenses are ₹ 14,220; Director's fee ₹ 12000 p.a ; Incorporation expenses ₹ 1,500. Rent upto 31st December was ₹ 1,200 p.a. after which it is increased to ₹3,000 p.a. Salary of the manager, who upon incorporation of the company was made a Director is ₹6,000 p.a. His remuneration thereafter is included in the above figure of fee to the directors.

Give statement showing pre and post incorporation profit. The net sales are ₹ 8,20,000, the monthly average of which for the first four months is one-half of that of the remaining period. The company earned a uniform profit. Interest and tax may be ignored.

Ans: Capital Reserve ₹ 7,280 ; Net Profit ₹ 24,650.

Question 9 The Promoters of Glorious Ltd. Took over on behalf of the company a running business with effect from 1st April, 2012.The company got incorporated on 1st August,2012. The annual accounts were made up to 31st March, 2013 which revealed that the sales for the whole year totalled ₹ 1,600 lakhs out of which sales till 31st July, 2012 were for ₹ 400 lakhs. Gross profit ratio was 25%.

The expenses from 1st April,2012 till 31st March, 2013 were as follows:

Particulars	₹ in (lakhs)
Salaries	69
Rent, Rates and Insurance	24
Sundry office Expenses	66
Travellers' Commission	16
Discount Allowed	12
Bad Debts	4
Directors' Fee	25
Audit Fee	9
Depreciation on Tangible Assets	12
Debenture Interest	11

Prepare a statement showing the calculation of Profits for the pre-incorporation and post incorporation periods.

Ans: Capital Reserve ₹ 32.75; Net Profit ₹ 119.25.

Question 10 Sneha Ltd. was incorporated on 1st July, 2013 to acquire a running business of Atul Sons with effect from 1st April, 2013. During the year 2013-14, the total sales were

₹ 24,00,000 of which ₹ 4,80,000 were for the first six months. The Gross profit of the company ₹ 3,90,800. The expenses debited to the Profit & Loss Account included:

(i) Director's fees ₹ 30,000
(ii) Bad debts ₹ 7,200
(iii) Advertising ₹ 24,000 (under a contract amounting to ₹ 2,000 per month)
(iv) Salaries and General Expenses ₹ 1,28,000
(v) Preliminary Expenses written off ₹ 10,000
(vi) Donation to a political party given by the company ₹ 10,000.
Prepare a statement showing pre-incorporation & post-incorporation profit for the year ended 31st March, 2014.

Ans: Capital Reserve ₹ 360 ; Net Profit ₹ 1,81,240.

Question 11 The partners Kamal & Vimal decided to convert their existing partnership business into a Private Limited Company called M/s. KV Trading Private Ltd. with effect from 1-7-2014. The same books of accounts were continued by the company which closed its account for first term on 31-3-2015.

The summarized Profit and Loss Account for the year ended 31-3-2015 is below:

Particulars	₹ in (lakhs)	₹ in (lakhs)
Turnover		240.00
Interest on investments		6.00
		246.00
Less: Cost of goods sold	102.00	
Advertisement	3.00	
Sales Commission	6.00	
Salary	18.00	
Managing directors remuneration	6.00	
Interest on Debentures	2.00	
Rent	5.50	
Bad Debts	1.00	
Underwriting Commission	2.00	
Audit fees	2.00	
Loss on sale of investment	1.00	
Depreciation	4.00	152.50
		93.50

The following additional information was provided
(i) The average monthly sales doubled from 1-7-2014. GP ratio was constant.
(ii) All investments were sold on 31-5-2014.
(iii) Average monthly salary doubled from 1-10-2014.

(iv) The company occupied additional space from 1-7-2014 for which rent of ₹ 20,000 per month was incurred.
(v) Bad debts recovered amounting to ₹ 50,000 for a sale made in 2012, has been deducted from bad debts mentioned above.
(vi) Audit fees pertain to the company.
Prepare a statement apportioning the expenses between pre and post incorporation periods and calculate the Profit/Loss for such periods. Also suggest how the preincorporation profits are to be dealt with.

Ans: Capital Reserve ₹ 18.79 ; Net Profit ₹ 74.71.

Question 12 SALE Limited was incorporated on 01 .08 .2014 to take-over the business of a partnership firm w.e.f. 01.04.2014.
The following is the extract of Profit and Loss Account for the year ended 31.03.2015 :

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries	1,20,000	By Gross Profit	6,00,000
To Rent Rates & Taxes	80,000		
To Commission on Sales	21,000		
To Depreciation	25,000		
To Interest on Debentures	32,000		
To Director Fees	12,000		
To Advertisement	36,000		
To Net Profit for the Year	2,74,000		
	6,00,000		**6,00,000**

1. SALE Limited initiated an advertising campaign which resulted increase in monthly average sales by 25% post incorporation.
2. The Gross profit ratio post incorporation increased to 30% from 25%.
You are required to apportion the profit for the year between preincorporation and post-incorporation, also explain how pre incorporation profit is treated in the accounts.

(Nov 2015)

Ans: Capital Reserve 69,000 and Post profits 2,05,000

Question13 What are the purposes for which Pre-incorporation Profit & Pre incorporation Losses can be used for? **(4 Marks) (CA IPCC Nov 2016)**

Ans:
Purposes for which pre-incorporation profits and pre-incorporation losses can be used are as follows:

Pre-incorporation Profits can be used for:	Pre-incorporation Losses can be used for:
• writing off Goodwill on acquisition • writing off Preliminary Expenses	• Setting off against Post-Incorporation Profit

• writing down over-valued assets • issuing of bonus shares • paying up partly paid shares.	• addition to Goodwill on acquisition • writing off Capital Profit

Question 14 Green Ltd. was established on 1st August, 2013 and received its certificate of commencement of business on 1st November, 2013. The company bought the business of Purple & Co. with effect from 1st April, 2013. From the following information for the year ended on 31st March, 2014, find out the profit available for dividends :

(i) Sales for the year ₹12,00,000 out of which sales upto 1st August, 2013 was ₹5,00,000

(ii) Gross profit for the year was ₹3,60,000

(iii) Expenses shown in the statement of profit and loss were as under :

	₹
Salaries	24,000
Rent	12,000
Audit fee	12,000
Directors' fee	9,600
Interest on debentures	10,000
Commission	19,200
Depreciation	51,000
General expenses	16,800
Bad debts (₹1,000 prior to incorporation)	3,000

(CS Executive June 2015)

Ans: Capital Reserve 1,01,400 Net Profit 1,01,000

Question.15 What do you mean by profit or loss prior to incorporation ? How is the profit or loss prior to incorporation treated in the books of a company ?

(CS Executive Dec 2014)

Question.16 X ltd. was incorporated on 1st July 2015 to acquire a running business of Barsha & co. with effect from 1st April 2015. During the year 2015-16, the total sales were ₹36,00,000 of which ₹7,20,000 were for the first six months. The gross profit of the company was ₹5,86,000. The expenses debited to the profit and loss account included:

a) Directors fee ₹50,000.
b) Bad debts ₹7,200.
c) Advertising ₹36,000 (under a contract amounting to ₹3,000 per month)
d) Salaries and general expenses ₹2,40,000.
e) Preliminary expenses written off ₹10,000.

Prepare a statement showing pre-incorporation and post-incorporation profit for the year ended 31st March 2016. **(CS Executive June 2017)**

Question.17 Roshni and Reshma working in Partnership, registered a joint stock company under the name of Happy ltd. on may 31st 2016 to take over their existing business. The summarised profit and loss a/c as given by Happy ltd. for the year ending 31st March, 2017 is as under:

Happy ltd.

Particulars	₹	Particulars	₹
To salary	1,44,000	By gross profit	4,50,000
To interest on debentures	36,000		
To sales commission	18,000		
To bad debts	49,000		
To depreciation	19,250		
To rent	38,400		
To audit fees	12,000		
To net profit	1,33,350		
Total	4,50,000	Total	4,50,000

Prepare a statement showing allocation of expenses and calculation of pre-corporation & post in-corporation profits after considering the following information:

(i) GP ratio was constant throughout the year.
(ii) Depreciation includes ₹1,250 for assets acquired in post in-corporation period.
(iii) Bad debts recovered amounting to ₹14,000 for a sale made in 2013-14 has been deducted from bad debts mentioned above.
(iv) Total sales were 18,00,000 of which 6,00,000 were for April to September.
(v) Happy ltd. had to occupy additional space from 1st Oct 2016 for which rent was ₹2,400 per month. **(May 2017)**

Answer 17: Pre-incorporation period is for two months, from 1st April, 2016 to 31st May, 2016. 10 months' period (from 1st June, 2016 to 31st March, 2017) is post-incorporation period.

Statement showing calculation of profit/losses for pre and post incorporation periods

	Pre-inc ₹	Post-Inc ₹
Gross Profit	50,000	4,00,000
Bad debts Recovery	14,000	
	64,000	4,00,000
Less: Salaries	24,000	1,20,000
Audit fees	-	12,000
Depreciation	3,000	16,250
Sales commission	2,000	16,000
Bad Debts (49,000 + 14,000)	7,000	56,000
Interest on Debentures	-	36,000
Rent	4,000	34,400
Net Profit	24,000	1,09,350

* Pre-incorporation profit is a capital profit and will be transferred to Capital Reserve.

Working Notes:

(i) Calculation of ratio of Sales
Sales from April to September = 6,00,000 (1,00,000 p.m. on average basis)
Oct. to March = ₹12,00,000 (2,00,000 p.m. on average basis)
Thus, sales for pre-incorporation period = ₹2,00,000
post-incorporation period = ₹16,00,000
Sales are in the ratio of 1:8
(ii) Gross profit, sales commission and bad debts written off have been allocated in pre and post incorporation periods in the ratio of Sales.
(iii) Rent, salary are allocated on time basis.
(iv) Interest on debentures is allocated in post incorporation period.
(v) Audit fees charged to post incorporation period/ assuming relating to company audit. It can also be distributed in the ratio of sales.
(vi) Depreciation of ₹18,000 divided in the ratio of 1:5 (time basis) and ₹1,250 charged to post incorporation period.
(vii) Bad debt recovery of ₹14,000/- is allocated in pre-incorporation period, being sale made in 2013-14.
(viii) Rent
(₹38,400 – Additional rent for 6 months) ₹
[38,400- 14,400 (2,400 x 6)] = 24,000
1/4/16 -31/5//16 (2,000 x 2) = 4,000
1/6/16 -31/3/17 – [(2,000 x 10) +14,400] = 34,400
38,400

Question.18 The Promoters of Shiva Ltd. took over on behalf of the company a running business with effect from 1st April, 2017. The company got incorporated on 1st August, 2017. The annual accounts were made up to 31st March, 2018 which revealed that the sales for the whole year totalled ₹2400 lakhs out of which sales till 31st July, 2017 were for ₹600 lakhs. Gross profit ratio was 20%.
The expenses from 1st April, 2017, till 31st March, 2018 were as follows:

Particulars	₹ in Lakhs
Salaries	75
Rent, Rates and Insurance	30
Sundry Office Expenses	72
Travellers' Commission	20
Discount allowed	16
Bad Debts	8
Directors' Fee	30
Tax Audit Fee	16
Depreciation on Tangible Assets	15
Debenture Interest	14

Prepare a statement showing the calculation of profits for the pre-incorporation and Post incorporation period. **10 Marks** **(INTER MAY 2018)**

Answer 18: Statement showing the calculation of Profits for the pre-incorporation and post-incorporation periods

Particulars	Total Amount (₹ in lakhs)	Basis of Allocation	Pre-incorporation (₹ in lakhs)	Post-incorporation (₹ in lakhs)
Gross Profit (20% of ₹2,400)	480	Sales	120	360
Less: Salaries	75	Time	25	50
Rent, rates and Insurance	30	Time	10	20
Sundry office expenses	72	Time	24	48
Travellers' commission	20	Sales	5	15
Discount allowed	16	Sales	4	12
Bad debts	8	Sales	2	6
Directors' fee	30	Post	-	30
Tax Audit Fees*	16	Sales	4	12
Depreciation on tangible	15	Time	5	10
assets	14	Post	-	14
Debenture interest	184		41	143
Net profit				

* Tax Audit Fees allocated in the ratio of sales.

Thus, pre-incorporation profits is₹41 lakhs and post- incorporation profit is ₹143 lakhs.

Working Notes:

1. Sales ratio

	(₹ in lakhs)
Sales for the whole year	2400
Sales up to 31st July, 2017	600
Therefore, sales for the period from 1st August, 2017 to 31st March, 2018	1800

Thus, sale ratio = 600:1800 = 1:3

2. Time ratio

1st April, 2017 to 31st July, 2017 : 1st August, 2017 to 31st March, 2018

= 4 months: 8 months = 1:2, Thus, time ratio is 1:2.

Question.19 A partnership firm M/s. Nice Sons was carrying on business from 1st May, 2017. The partners of the firm decided to convert the partnership firm into a private company called Zenith (P) Ltd. with effect from 1st September, 2017. The annual accounts were drawn upto 31st March, 2018. The summarised Profit and Loss Account from 1st May, 2017 to 31st March, 2018 is as follows:

Particulars	Amount (₹)
Turnover	55,20,000
Interest on Investment	60,000
Profit on sale of Investment	42,000

		56,22,000
Less:		
Cost of Goods Sold	34,50,000	
Printing & Stationery	77,000	
Manager's Salary	82,000	
Audit Fees	41,000	
Rent	1,33,000	
Bad Debts	33,000	
Underwriting Commission	56,000	
Depreciation	71,500	
Interest on Debentures	8,900	
Advertising campaign expenses	69,800	
Sundry office expenses	1,06,700	
Interest on borrowings	1,25,000	42,53,900
NET PROFIT		13,68,100

Additional Information Provided:

(1) The company's only borrowings was a loan of ₹15,00,000 at 9% p.a., to pay the purchase consideration due to the firm and for working capital requirements. The loan was taken on 1st September, 2017.

(2) The company occupied additional space from 1st September, 2017 for which rent of ₹8,000 per month was incurred.

(3) Audit fees pertains to the company.

(4) Bad debts recovered amounting to ₹36,000 for a sale made in June 2017, has been deducted from bad debts mentioned above.

(5) All investments were sold in August 2017.

(6) Zenith (P) Ltd. initiated an advertising campaign on 1st September, 2017, which resulted increase in monthly average sales by 40%.

(7) The salary of Manager was increased by ₹3,000 p.m. from 1st July, 2017.

Prepare a statement showing pre-incorporation and post-incorporation profit for the year ended 31st March, 2018. **8 Marks** **(IPCC MAY 2018)**

Answer 19:

Statement showing calculation of profit/loss for pre and post incorporation periods

	Ratio	Total	Pre Incorporation	Post Incorporation
Sales	1:2.45	55,20,000	16,00,000	39,20,000
Interest on Investments	Pre	60,000	60,000	-
Bad debts recovered	Pre	36,000	36,000	-
Profit on sale of investment	Pre	42,000	42,000	-
(i)		56,58,000	17,38,000	39,20,000
Cost of goods sold	1:2.45	34,50,000	10,00,000	24,50,000
Advertisement	Post	69,800	-	69,800

Sundry office expenses	4:7	1,06,700	38,800	67,900
Printing & Stationary	4:7	77,000	28,000	49,000
Manager Salary	(W.N.3)	82,000	26,000	56,000
Interest on Debentures	Post	8,900	-	8,900
Rent	(W.N.4)	1,33,000	28,000	1,05,000
Bad debts	1:2.45	69,000	20,000	49,000
Underwriting commission	Post	56,000	-	56,000
Audit fees	Post	41,000	-	41,000
Depreciation	4:7	71,500	26,000	45,500
Interest on Borrowing	(W.N.5)	1,25,000	46,250	78,750
(ii)		42,89,000	12,13,050	30,76,850
Net Profit [(i) – (ii)]		13,68,100	5,24,950	8,43,150

Working Notes:

1. Calculation of Sales Ratio

Let the average sales per month be x

Total sales from 01.05.2017 to 31.08.2017 will be 4x

Average sales per month from 01.09.2017 to 31.03.2018 will be 1.4x

Total sales from 01.09.2017 to 31.03.2018 will be 1.4x X 7 =9.8x

Ratio of Sales will be 4x: 9.8x =1:2.45

2. Calculation of time Ratio

4 Months: 7 Months i.e. 4:7

3. Manager Salary ₹

Total salary	82,000
Less: Increased salary	27,000
	55,000
Monthly Salary =55,000/11	5,000
Salary from May to Aug	5,000+5,000+8,000+8,000=26,000
Salary from Sep to March	8,000×7=56,000

4. Apportionment of Rent ₹

Total Rent	1,33,000	
Less: additional rent from 1.9.2017 to 31.3.2018		56,000
Rent of old premises for 11 months	77,000	
	Pre	**Post**
Apportionment in time ratio (4:7)	28,000	49,000
Add: Rent for new space		56,000
Total	28,000	1,05,000

5. Interest on borrowing

Company's Borrowing Interest = ₹15,00,000 x 9% x 7/12= ₹78,750

Interest for Pre-incorporation period = ₹1,25,000 – 78,750 = ₹46,250

<u>Question 20</u> Sun Limited took over the running business of a partnership firm M/s A & N Brothers with effect from 1st April, 2017. The company was incorporated on 1st September,2017. The following Profit and Loss account has been prepared for the year ended 31st March, 2018.

Particulars	₹	Particulars	₹
To Salaries	1,33,000	By Gross Profit b/d	7,50,000
To rent	96,000		
To carriage outward	75,000		
To audit fees	12,000		
To travelling expenses	66,000		
To commission on sales	48,000		
To printing and stationery	24,000		
To electricity charges	30,000		
To depreciation	80,000		
To advertising expenses	24,000		
To preliminary expenses	9,000		
To Managing Directors' remuneration	8,000		
	1,45,000		
To Net Profit c/d	7,50,000		7,50,000

Additional Information:

1. Trend of sales during April, 2017 to March, 2018 was as under:

April, May	₹85,000 per month
June, July	₹1,05,000 per month
August, September	₹1,20,000 per month
October, November	₹1,40,000 per month
December onwards	₹1,50,000 per month

2. Sun Limited took over a machine worth ₹7,20,000 from A&N Brothers and purchased a new machine on 1st February, 2018 for ₹4,80,000. The company decides to provide depreciation @10% p.a.
3. The company occupied additional space from 1st October, 2017 @ rent of ₹6,000 per month.
4. Out of travelling expenses, ₹30,000 were incurred by office staff while remaining expenses were incurred by salesmen.
5. Audit fees pertains to the company.
6. Salaries were doubled from the date of incorporation.

You are required to prepare a statement apportioning the expenses between pre and post incorporation periods and calculate the profit/ (loss) for such periods.

(12 Marks) CA INTER Nov 2018

Answer 20

Statement showing calculation of profits for pre and post incorporation periods for the year ended 31.3.2018

Particulars	Pre-incorporation Period ₹	Post-incorporation Period ₹

Gross profit (1:2)	2,50,000	5,00,000
Less: Salaries (5:14)	35,000	98,000
Carriage outward (1:2)	25,000	50,000
Audit fee	-	12,000
Travelling expenses (W.N.3)	24,500	41,500
Commission on sales (1:2)	16,000	32,000
Printing & stationary (5:7)	10,000	14,000
Rent (office building) (W.N.4)	25,000	71,000
Electricity charges (5:7)	12,500	17,500
Depreciation	30,000	50,000
Advertisement (1:2)	8,000	16,000
Preliminary expenses	-	9,000
MD remuneration	-	8,000
Pre-incorporation profit –t/f to Capital reserve (B/F)	64,000	-
Net profit (Bal. Fig.)	-	81,000

Working Notes:

1. Time Ratio

Pre incorporation period = 1st April, 2017 to 31st August, 2017 i.e. 5 months

Post incorporation period is 7 months

Time ratio is 5: 7.

2. Sales ratio

April	85,000
May	85,000
June	1,05,000
July	1,05,000
August	1,20,000
	5,00,000
September	1,20,000
Oct & Nov.	2,80,000
Dec. to March (1,50,000×4)	6,00,000
	10,00,000

5,00,000:10,00,000 = 1:2

3. Travelling expenses

	Rs.	Rs.
	Pre-incorporation	**Post-incorporation**
30,000 office staff (5:7)	12,500	17,500
36,000 sales (1:2)	12,000	24,000
	24,500	41,500

4. Rent

	Rs.
Rent for additional space ₹ (6,000 x 6)	36,000

Remaining rent ₹ (96,000-36,000) Pre-incorporation period (5/12 of 60,000) Post- incorporation period ₹35,000 + ₹36,000	60,000 25,000 71,000

5. Salaries

Suppose x for a month in pre- incorporation period then salaries for pre-incorporation period = 5x salaries for post- incorporation period = 2x X 7= 14x

Ratio = 5:14

6. Depreciation

		Rs. Pre-period	Rs. Post-period
Total depreciation	80,000		
Less: Depreciation exclusively for post incorporation period(₹ 4,80,000 x 10 x 2/12)	8,000		8,000
	72,000		
Depreciation for pre-incorporation period (72,000X5/12)		30,000	
Depreciation for post incorporation period (72,000 x 7/12)			42,000
		30,000	50,000

Question 21 Tarun Ltd. was incorporated on 1st July, 2018to acquire a running business of Vinay Sons with effect from 1st April, 2018. During the year 2018-19, the total sales were ₹12,00,000 of which ₹2,40,000 were for the first six months. The Gross Profit for the year is ₹4,15,000. The expenses debited to the Profit and Loss Account included:

(i) Directors' Fees ₹25,000.

(ii) Bad Debts ₹6,500.

(iii) Advertising ₹18,000

(under a contract amounting to ₹1,500 per month).

(iv) Company Audit fees ₹15,000.

(v) Tax Audit Fees ₹10,000.

(1) Prepare a statement showing pre-incorporation and post-incorporation profit for the year ended 31st March, 2019.

(2) Explain how profits are to be treated. **(5 Marks) CA INTER June 2019**

Ans: Pre 35,350 and Post 3,05,150

Question 22 M/s New Venture was carrying on business from 1st June, 2017 gets itself incorporated as a company on 1st October, 2017. The first accounts are drawn upto 31st March, 2018. The gross profit for the period is ₹1,20,000.

Following information is given:

(a) General Expenses are ₹24,000.

(b) Directors' Fees is ₹24,000 p.a.

(c) Incorporation Expenses ₹4,000.

(d) Rent upto 31st December, 2017 was ₹6,000 p.a., after which it is increased to ₹8,000 p.a.

(e) Salary of the Manager, who upon incorporation of the company was made a director, is ₹12,000 p.a. His remuneration as director in included in the above figure of fees to the directors.
(f) Advertisement Expenses ₹5,000 pretains to the Incorporated company.
(g) Bad debts ₹4,000.
Give statement showing per and post incorporation profit. The net sales are ₹20,00,000., the monthly average of which for the first four months is one-half of that of the remaining period. The company earned a uniform profit. Interest and tax may be ignored.

(10 Marks) CA IPCC June 2019

Ans: Pre 13,400 and Post 48,100

Question 23 The partners of C&G decided to convert their existing partnership business into a private limited called CG trading Pvt. ltd. with effect from 1.7.2018.
The same books of accounts were continued by the company which closed its accounts for the first term on 31.3.2019.
The summarized Profit & Loss account for the year ended 31.3.2019 is below:

Particulars	**₹ in lakhs**	**₹ in lakhs**
Turnover	245.00	
Interest on Investments	6.00	251.00
Less: Cost of goods sold	124.32	
Advertisement	3.50	
Sales Commission	7.00	
Salaries	18.00	
Managing Director's Remuneration	6.00	
Interest on Debenture	2.00	
Rent	5.50	
Bad debt	1.15	
Underwriting Commission	1.00	
Audit fees	3.00	
Loss on sale of Investments	1.00	
Depreciation	4.00	176.47
		74.53

The following additional information was provided:
(i) The average monthly sales doubled from 1.7.2018, GP ratio was constant.
(ii) All investments were sold on 31.5.2018.
(iii) Average monthly salaries doubled from 1.10.2018.
(iv) The company occupied additional space from 1.7.2018 for which rent of ₹20,000 per month was incurred.
(v) Bad debts recovered amounting to ₹60,000 for a sale made in 2016-17 has been deducted from bad debts mentioned above.
(vi) Audit fees pertains to the company.
Prepare a statement apportioning the expenses between pre and post incorporation periods and calculate the profit/loss for such periods. **(10 Marks) CA INTER NOV 2019**

Ans: Pre : 16.16 and Post 58.37

Question 24 Moon Ltd. Was incorporated on 1st August, 2019 to take over the running business of a partnership firm w.e.f 1stapril, 2019. The summarized Profit & loss Account for the year ended 31st March, 2020 is as under:

		Amount
Gross Profit		6,30,000
Less: Salaries	1,56,000	
Rent, Rates and Taxes	72,000	
Commission on sales	40,600	
Depreciation	60,000	
Interest on Debentures	36,000	
Director's fees	24,000	
Advertisement	48,000	4,36,600
Net Profit for the year		1,93,400

Moon ltd. Initiated an advertising campaign which resulted in increase on monthly sales by 25% post incorporation.

You are required to prepare a statement showing the profit for the year between pre-incorporation. Also, explain how profits are to be treated in the accounts?

(5 Marks) CA INTER NOV 2020

Study Material New Questions Added for May 2021 & Onwards

Que1 Y Ltd was incorporated on 1/7/20X1 to take over the business of Z Ltd from 1/4/20X1. The year ended on 31/3/20X2.Calculate the pre incorporation period.

Solution: Business was taken over from 1/4/20X1 and incorporated on: 1/7/20X1
Pre Incorporation period = 1/4/20X1 to 1/7/20X1 (3 months)

Que2 Q Ltd was incorporated on 1/8/20X1 to take over the business of W Ltd from 1/5/20X1. The year ended on 31/3/20X2. Which Period should be taken as the Pre Incorporation Period and Post-Incorporation Period?

Solution: Date of Incorporation: 1/8/20X1 Date of take over: 1/5/20X1
Pre Incorporation Period = 1/5/20X1 to 1/8/20X1 (3 months)
Post Incorporation Period = 1/8/20X1 to 31/3/20X2 (8 months)

Que3 (Determination of pre and post incorporation periods)
The partners of Omega Ltd. decided to convert their partnership into a private limited company called Omega (P) Ltd. with effect from 1st April, 20X1. However, due to some procedural difficulties, the company could be incorporated only on 1st July, 20X1. The accounts of the business continued for the accounting year ended 31st March, 20X2. Determine the pre and post incorporation periods and corresponding time ratio.

Solution: Pre-incorporation period (1.4.20X1 to 1.7.20X1) = 3 months
Post incorporation period (1.7.20X1 to 31.3.20X2) =9 months Time Ratio = 3:9 = 1:3

Que 4 M Ltd which was incorporated on 1st June 20X1, took over the business of N, a proprietary concern from 1st April 20X1. The accounts of the business continued for the accounting year ended 31st March, 20X2. Determine the time basis on which the amount of salaries will be split as pre and post incorporation periods.
Solution: Pre Incorporation period (1 April 20X1 to 1 June 20X1) = 2 months
Post Incorporation Period (1 June 20X1 to 31 March, 20X2) = 10 months Time Ratio = 1:5

Que 5 (Calculation of time ratio and sales ratio)
Lion Ltd. was incorporated on 1.8.20X1 to take over the running business of M/s Happy with assets from 1.4.20X1. The accounts of the company were closed on 31.3.20X2. The average monthly sales during the first four months of the year (20X1-X2) was twice the average monthly sales during each of the remaining eight months. Calculate time ratio and sales ratio for pre and post incorporation periods.
Solution: Time ratio: Pre-incorporation period (1.4.20X1 to 1.8.20X1) = 4 months
Post incorporation period (1.8.20X1 to 31.3.20X2) = 8 months Time ratio = 4:8 or 1 : 2

Sales ratio: Average monthly sale before incorporation was twice the average sale per month of the post incorporation period. If x is the sales per month in post incorporation period, then sales per month of pre incorporation period will be 2x. Weighted sales ratio = 4 2x: 8 1x =8x: 8x or 1: 1

Que 6 Calculate the time ratio in following cases:
Date of Acquisition Date of Incorporation Dates of closing (i) 1.4.20X1 1.7.20X1 31.3.20X2 (ii) 1.10.20X1 1.3.20X2 31.3.20X2

Solution (i) 1:3; (ii) 5:1.

Que 7 Lotus Ltd. was incorporated on 1st July, 20X1 to acquire a running business of Feel goods with effect from 1st April, 20X1. During the year 20X1-20X2, the total sales were ₹ 48,00,000 of which ₹ 9,60,000 were for the first six months. The Gross profit of the company ₹ 7,81,600. The expenses charged to the Profit & Loss Statement included:
(i) Director's fees ₹ 60,000
(ii) Bad debts ₹ 14,400
(iii) Advertising ₹ 48,000 (under a contract amounting to ₹ 4,000 per month)
(iv) Salaries and General Expenses ₹ 2,56,000
(v) Preliminary Expenses written off ₹ 20,000
(vi) Donation to a political party given by the company ₹ 20,000.
Prepare a statement showing pre-incorporation and post-incorporation profit for the year ended 31st March, 20X2.
Ans: ₹ 720 and ₹ 3,62,480

NOTES...