UNIT -2

Profit or Loss Prior to Incorporation

Meaning:

A company comes into existence only after its registration or incorporation. A newly formed company may acquire a running or existing business from a data prior to its incorporation. This prior date usually coincides with the date of the Vendor's last balance sheet.

Pre-incorporation profits:

The pre-incorporation profits are, therefore, of a capital nature and should be placed to a special reserve, I,e, capital reserve account.

Pre-incorporation loss:

The pre-incorporation loss is of capital nature and should be treated as goodwill and debited to a separate account called goodwill account.

Pre-incorporation Period:

Pre-incorporation period is the period from the date of purchase or acquisition of business to the date of incorporation and not the date of communication.

Post-incorporation Period:

Post-incorporation period is the period which begins from the date of incorporation and ending with the last date of the accounting period.

Basis of Apportionment

1. Time Ratio:

The fixed expenses such as rent, salaries, insurance, audit fee etc. which are related to the time factor are apportioned on a time base. Thus time ratio is the ratio of pre-incorporation period and post incorporation period.

2. Sales Ratio:

Expenses which are directly related to sales like advertisement, Commission on sales, traveling expenses discount allowed, bad debts etc. are allocated on the basis of the sales of each period when the sales are spread over evenly during the year. Thus sales ratio is the ratio of pre-incorporation sales and post-incorporation sales.

3. Weighted Ratio:

Certain expenses does not remain the same throughout the year because of expansion of business due to the purchase of a business or conversion of partnership into a limited company. Under this circumstances. Weighted ration is to be calculated.

4. Revised Time Ratio:

When the vendor is not entitled to take pre-incorporation profit himself, he is usually paid interest on the purchase consideration from the date of acquisition of busness to the date on which the purchase consideration is discharged.

The interest payable to the vendor is apportioned in the Revised Time Ratio. Revised Time Ratio is a slight variant of time ratio where the pre-incorporation and post-incorporation period is calculated on the basis of time from the date of acquisisiotn of business to the date of discharge of purchase consideration.

5. Actual Basis:

Certain expenses which are incurred by the company (I,e post-incorporation period) or incurred only in the pre-incorporation period. Those expenses should be charged to profit and loss account for the respective periods only on actual basis.

Basis of Apportionment of Expenses and Incomes

Nature of the item	Basis of Apportionment
1. Gross Profit or Gross Loss	Sales or Turnover ratio or Time Ratio
2. All fixed or standing charges and fixed incomes	On the Time Basis, Time Ratio
3. All variable expenses and incomes directly varying with turnover.	On the Sales or Turnover basis
4. Expenses belonging to pre-incorporation	Actual Basis I,e completely to pre-incorporation period
5. Expenses belonging wholly to post-incorporation period only.	Actual Basis I,e completely to post incorporation period
6. Interest to Vendors on purchase consideration (if the settlement of claim is made before closure of books of accounts).	Revised Time Ratio
7. Discount received form creditors, commission on purchases and other expenses and income relating to purchase	Net purchases Ratio (I,e, Ratio of Net purchases in pre and post incorporation periods)

Procedure to determine the pre and post incorporation profit or loss

1. Calculate the Time Ratio, Sales Ratio and other Ratios
2. Prepare the trading account for the entire accounting period.
3. Prepare the profit and loss account and divide (with separate columns) the profit and loss account into pre-incorporation and post-incorporation period.
4. Apportion all the items appearing on the debit side (expenses) and credit side (gross profit and other receipts) of the profit and loss account on the basis of their characteristics.

Problems:

1. ABC Company Ltd. was incorporated on 30th June 2011 to take over the business of Supreeth as from 1st January 2011. The financial accounts of the business for the year ended 31st December 2011 disclosed the following information.

	Rs	Rs
Sales:		
January to June	1,20,000	
July to December	1,80,000	3,00,000
		3,00,000
Less: Purchases		
January to June	75,000	
July to December	1,20,000	1,95,000
Gross Profit		1,05,000
Less:		
Salaries	15,000	
Selling expenses	3,000	
Depreciation	1,500	
Director's remuneration	750	
Debenture Interest	90	
Administration expenses (Rent, Rates, etc)	4,500	24,840
Profit for the year		80,160

You are requested to prepare a statement apportioning the balance of profit between the periods prior to and after incorporation and show the profit and loss account for the year ended 31st December 2011.

2. Jayanth Ltd was incorporated on 1-7-2011 to take over the business of Lohith Enterprises as a going concern with effect from 1-4-2011. Their Profit and Loss Account for the year ended 31-3-2012 is as follows

Particular	Rs	Particular	Rs
To Opening Stock To Purchases To Administration Expenses To Director's Fee To Selling Expenses To Audit Fees To Preliminary Expenses To Net Profit	60,000 87,500 9,000 1,500 18,000 500 1,500 7,000	By Sales (upto 30-6-94 Rs. 50,000) By Closing Stock	1,50,000 35,000
	1,85,000		1,85,000

Prepare a statement showing the profit earned prior to and after incorporation

3. Yogesh Ltd was incorporated on May 1, 2011 to take over the business of Vinay Ltd, as a going concern from 1-1-2011. The Profit and Loss Account for the year ending on 31-12-2011 is as follows:

Profit and Loss Account of Victory Ltd

For the year ended 31st December 2011

Particular	Rs	Particular	Rs
To Rent and Taxes To Insurance To Electricity charges To Salaries To Director's Fees To Auditor's fees To Commission To Advertisement	12,000 3,000 2,400 36,000 3,000 1,600 6,000 4,000	By Gross Profit	1,55,000

To Discount	3,500		
To Office Expenses	7,500		
To Carriage	3,000		
To Bank Charges	1,500		
To Preliminary Expenses	6,500		
To Bad Debts	2,000		
To Interest on Loan	3,000		
To Net Profit	60,000		
	1,55,000		1,55,000

The total turnover for the year ending 31-12-2011 was Rs. 10,00,000 divided into Rs. 3,00,000 for the period upto 1-5-2011 and Rs. 7,00,000 for the remaining period. Ascertain the profits earned prior to and a post incorporation period.

4. The Prashanth CO Ltd was formed on 1-4-2011 to take over the business formerly carried on by Mrs. Manu Co Ltd as form 1st January 2011. It was agreed that all profits made subsequent to this latter date should belong to the company. But interest on the purchase consideration Rs. 50,000 at the rate of 6% P.a. Should be paid to the vendors until the final settlement which took place on 1-6-2011. The following was the profit and Loss Account as prepared on 31-12-2011.

Particular	Rs	Particular	Rs
To Management Expenses	1500	By Gross Profit	10,000
To Bad debts	100		
Tp Director's Fees	500		
To Int to vendors	625		
To Preliminary expenses written off	250		
To Depreciation	500		
To Netprofit	6525		
	10000		10000

It was fount that, of the bad debts written off Rs. 100 related to debts taken over by the company. Calculate from the above, pre and post-incorporation profit

5. Shankar Pvt Ltd. Co took over the business of Shankar on 1-4-2011 and it was incorporated on 1-4-2011 and it was incorporated on 1-7- 2011. The profit and Loss Account of Shankar Pvt Ltd. On 31-3-2012 was as follow

Particular	Rs	Particular	Rs
To Commission (Sales)	2,625	By Gross Profit	98,000
To Advertising	5,250	By Bad Debts Recovered	500
To M.D's Remuneration	9,000		
To Depreciation	2,800		
To Salaries	18,000		
To Insurance	600		
To Preliminary Expenses written off	700		
To Rent and Taxes	3,000		
To Discount	350		
To Bad Debts	1,250		
To Net Profit	54,925		
	98,500		98,500

Further Details

a. The average monthly sales after incorporation was twice the average monthly sales before
b. Rent, which was paid for the first three months at Rs. 200 per month, increases by Rs. 50 per month for the balance of the period
c. Bad Debts of Rs. 350 related only to the period after 1-9-2011 and the balance related to the sales made up to 1-9-2011
d. The Bad Debts realized belonged to the Bad Debts which were written off in 2010.

Find out the profits before and after incorporation./

6. X Ltd which was incorporated on May 1st 2012 acquired a business on January 1st 2012. The first accounts were closed on September 30th 2012.

The Gross profit for the period was Rs. 42,000

Details of other expenses: General Expenses Rs. 7,200, Directors remuneration Rs. 12,000 and preliminary expenses Rs. 2000.

Rent up to June 30 was Rs. 6,000 per annum after which it was increased by 40%

Salary of the manager, who on formation of the Company had become a whole time director and whose remuneration has been given above, was agreed at Rs. 5,100 per annum.

The company earned a uniform Gross Profit. The sale up to September 2012 were Rs/ 98,000. The monthly average of sales for the first four months of the year was one-half of the remaining period.

Show the profit and Loss Account and indicate how you would deal with the pre-incorporation results.

7. Purshootham Ltd was incorporated on January 1st 2012, with an authorized capital of Rs. 50,000 and took over the running business of Deepak . as from October 1st 2011. The following is the summarized Profit and Loss Account for the year ended September 30th 2012.

	Rs	Rs
Sales:		
Oct 1st 2011 to Dec 21st 2011	60,000	
Jan 1st 2012 to Sept 30th 2012	1,90,000	2,50,000
		2,50,000
Cost of sales for the year	1,54,000	
Administrative expenses	17,680	
Selling expenses	8,750	
Goodwill written off	2,000	
Interest to vendors (loan repaid on Feb 1st 2012)	3,730	
Distribution expenses(60% variable)	12,500	

Preliminary expenses	3,300	
Debenture interest	3,200	
Depreciation	4,440	
Director's fees	1,000	2,10,600
Net Profit		39,400

The Company deals in only one product. The cost of sales per unit was reduced by 10% in the post –incorporation period. As compared to pre-incorporation period.

Prepare a statement showing the Net Profit of the Pre-Incorporation as well as the Post-incorporation period. Also showing the basis of apportionment.

8. Puneeth Ltd, incorporated on April 1st, 2011, with a capital of Rs. 50,000 in equity shares of Rs. 10 each took over the running business of Punetha as from January 1st 2011. The purchase price Rs. 20,000 was settled on July 1st 2011, together with interest at 10% per annum by fully paid shares for Rs. 17,500 and the balance in Cheque.

The Company's Trial Balance as on December 31st 2011, was as below:

Partiuclar	Debit	Credit
Cash and Bank balances (Cash Rs. 180)	4,860	
Share capital		22,500
Land and buildings	8,000	
Fixtures	750	
Cycles	1,000	
Salaries	1,200	
Purchases	48,500	
Sales		45,000
Debtors and Creditors	4,500	3,000
Rent from tenants		600
Rent, rates and taxes	300	
Building upkeep	150	
Directors fees	720	
Sundry Charges	120	

Interest to vendor	1000	
	71,100	71,100

Prepare the final accounts for the year ending December 31 2011, considering the following additional details:

- Stock at end Rs. 14,000
- Bad debts Rs. 200 (including Rs. 50 on debtors taken over form vendor) to be written off
- Sales above include sales up to April 1, 2011, Rs. 7,500
- Provide for doubtful debts Rs. 250
- Depreciate buildings 5% and cycles 20%

Section A

1. What do you mean by Profit Prior to Incorporation ?
2. Where do you transfer the Profit and Loss form the Pre-incorporation Period
3. What is Time Ratio?
4. What is Sales Ratio?
5. What is Revised Time Ratio?
6. What ratios are normally used to apportion pre and post-incorporation profit?
7. Mention any for expenses apportioned on Time Ratio
8. Mention any four expenses apportioned on Sales Ratio
9. When do you use Weighted Ratio?
10. How do you apportion Gross profit?
11. Give any two expenses charged only to pre-incorporation period
12. Give any four expenses charged only to post-incorporation period?
13. What do you meant by Pre and Post – incorporation period
14. How do you apportion the interest to vendors on purchase consideration, if the settlement is mad before closure of books of accounts?