5. PROFIT OR LOSS PRIOR TO INCORPORATION

PROBLEM NO: 1

1. **Time ratio:**

   Pre incorporation period : Post incorporation period

   1/4/2009 to 31/07/2009 : 1/8/2009 to 31/03/2010

   4Months: 8 months

   ∴ Time ratio = 1 : 2

2. **Sales ratio:**

   Let say average sales per month in remaining 8 months be x and therefore sales in first four months is 2x per month

   Pre incorporation sales: Post incorporation sales

   4 months × 2x : 8 months × x

   8x : 8x

   ∴ Sales ratio = 1:1

PROBLEM NO: 2

Statement showing the calculation of Profit for the pre – incorporation and Post – incorporation periods

Particulars	Total Amount (Rs. In Lakhs)	Basis of Allocation	Pre-incorporation (Rs. In Lakhs)	Post-incorporation (Rs. In Lakhs)
Gross Profit (25% of Rs.1,600)	400	Sales	100	300
Less: Salaries	69	Time	23	46
Rent, Rates and insurance	24	Time	8	16
Sundry office expenses	66	Time	22	44
Traveller's commission	16	Sales	4	12
Discount allowed	12	Sales	3	9
Bad debts	4	Sales	1	3
Director's fee	25	Post	-	25
Audit Fees	9	Sales*	2.25	6.75
Depreciation on tangible assets	12	Time	4	8
Debenture interest	11	Post	-	11
Net profit	**152**		**32.75**	**119.25**

WORKING NOTE:

1. **Sales ratio**

Particulars	Amount (Rs. In Lakhs)
Sales for the whole year	1,600
Sales upto 31st July, 2012	400
Therefore, sales for the period from 1st August, 2012 to 31st March, 2013	1,200

   Thus, sales ratio is = 400 : 1200 = 1 : 3

2. **Time ratio**

   1st April, 2012 to 31st July, 2012 : 1st August, 2012 to 31st March, 2013

   = 4 months : 8 months = 1 : 2

   Thus, **time ratio is 1 : 2**

- Audit fees has been assumed to be related with audit and therefore apportioned into Pre and post incorporation periods on the basis of turnover.

Note: If the audit fees is related to the company then charged it to post incorporation period.

PROBLEM NO: 3

Statement showing pre and post incorporation Profit

for the year ended 31st March,2014

Particulars	Total Amount	Basis of Allocation	Pre-incorporation	Post-incorporation
	(Rs.)		(Rs.)	(Rs.)
Gross Profit	5,40,000	2:7	1,20,000	4,20,000
Less: Depreciation	1,23,000	1:2	41,000	82,000
Director's Fees	50,000	Post	-	50,000
Preliminary Expenses	12,000	Post	-	12,000
Office Expenses	78,000	1:2	26,000	52,000
Selling Expenses	72,000	2:7	16,000	56,000
Interest to vendors	5,000	Actual	4,000	1,000
Net Profit (Rs.33,000 being pre-incorporation profit is transferred to capital reserve Account)	**2,00,000**		**33,000**	**1,67,000**

WORKING NOTE:

1. **Sales ratio :**

   The sales per month in the first half year were half of what they were in the later half year. If in the later half year, sales per month is Rs.1 then it should be 50 paise per month in the first half year .So sales for the first four months (i.e. from 1st April,2013 to 31st July, 2013) will be 4 x .50 = Rs.2 and for the last eight months (i.e. from 1st August,2013 to 31st March, 2014) will be (2 x .50 + 6 x 1) = RS.7. Thus sales ratio is 2 : 7.

2. **Time ratio:**

   1st April, 2013 to 31st July, 2013 : 1st August, 2013 to 31st March, 2014

   = 4 months : 8 months = 1 : 2.

   Thus, **time ratio is 1 : 2.**

3. **Gross profit:**

   Gross profit = Net profit + All expenses

   = Rs.2,00,000 + Rs. (1,23,000 + 50,000 + 12,000 + 78,000 + 72,000 + 5,000)

   = Rs. 2,00,000 + Rs. 3,40,000

   = Rs. 5,40,000

PROBLEM NO. 4

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

Particulars	Pre - incorporation (Rs.)	Post - Incorporation (Rs.)
Sales	26,00,000	2,08,00,000
Less: Cost of goods sold	18,20,000	1,45,60,000
Salaries	90,000	10,80,000
Depreciation	36,000	1,44,000
Advertisement	78,000	6,24,000
Discount	1,30,000	10,40,000
M.D.'s remuneration	--	90,000
Misc. Office Expenses	24,000	96,000

Rent	90,000	6,30,000
Interest	3,51,000	6,00,000
Net Profit/(Loss)	**(19,000)**	**19,36,000**

WORKING NOTES:

1. **Calculation of ratio of sales:**

   Let the average sales per month in pre - incorporation period be x Then the average sales in Post - incorporation period are 2x. Thus total sales are (3 x X) + (12 x 2X) or 27X.

   Ratio of sales will be 3X : 24X or 1 : 8
2. **Time ratio is 3months : 12 months or 1 : 4**
3. Expenses apportioned on turnover ratio basis are cost of goods sold, advertisement, discount.
4. Expenses apportioned on time ratio basis are Depreciation, and Misc. office expenses.
5. Ratio for apportionment of Salaries:

   If Pre - incorporation monthly average is X, for 3 months 3X.

   Average for balance 12months 3X, for 12 months 36X.

   Hence **ratio for division, 1 : 12**
6. **Apportionment of Rent:**

	Amount (Rs.)	**Amount (Rs.)**
Total Rent		7,20,000
Additional rent for 9 months(From 1st July 2014 to 31st March,2015)		(2,70,000)
Rent for old premises for 15 months at Rs. 30,000 p.m.		**4,50,000**
	Pre-inc.	**Post.inc.**
Old Premises	90,000	3,60,000
Additional rent	--	2,70,000
	90,000	**6,30,000**

NOTE ON TREATMENT:

Since the profit prior to incorporation are in the negative, they would:

a) Either be considered as a reduction from any capital reserve in relation to the transaction, or

b) Be treated as goodwill.

PROBLEM NO: 5

Pre – incorporation period is for four months, from 1st January, 2014 to 30th April, 2014.

8 month's period (from 1st May, 2014 to 31st December, 2014) is post – incorporation period.

Statement showing calculation of Profit/Loss for pre and post incorporation periods.

Particulars	**Pre - incorporation (Rs)**	**Post - Incorporation (Rs)**
Gross Profit	3,42,000	7,22,000
Interest on Investments	36,000	
Bad debts Recovery	7,000	-
	3,85,000	7,22,000
Less: Rent and Taxes	30,000	60,000
Salaries		
Manager's salary	23,000	62,000
Other salaries	82,000	1,64,000

Printing and stationary	6,000	12,000
Audit fees	-	45,000
Carriage outwards	4,500	9,500
Sales commission	9,900	20,900
Bad Debts(91,000 + 7,000)	31,500	66,500
Interest on debentures	-	25,000
Underwriting Commission	-	26,000
Preliminary expenses	-	28,000
Loss on sale of investment	11,200	-
Net profit	1,86,900*	2,03,100

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

WORKING NOTES:

1. Calculation of ratio of Sales

   Let average monthly sales be X.

   Thus Sales from January to April are 4.5 X and sales from May to December are 9.5X.

   Sales are in the Ratio of 9/2X : 19/2X or 9 : 19.

2. Calculation of time ratio:

   = pre – incorporation period : post incorporation period

   = 1/1/2014 to 1/5/2014 : 1/5/2014 to 31/12/2014

   = 4 months : 8 months

   = 1:2

3. Gross profit, carriage outwards, sales commission and bad debts written off have been allocated in pre and post incorporation periods in the ratio of Sales i.e. 9:19

4. Rent , Salaries, Printing and Stationary ,audit fees are allocated on time basis.

5. Interest on debentures ,Underwriting commission and preliminary expenses are allocated in post incorporation period.

6. Interest on investments, Loss on Sale of investments and bad debt recovery are allocated in pre-incorporation period.

PROBLEM NO: 6

Statement showing the profit & loss between pre-incorporation and Post – incorporation periods

Particulars	Ratio	Pre	Post
Sales WN-1	1:3	2,40,000	7,20,000
COGS WN-2	10:27	(2,10,000)	(5,67,000)
Gross profit		**30,000**	**1,53,000**

EXPENSES:

Particulars	Ratio	Pre	Post
Rent [WN-3]		7,000	33,000
Salaries [WN-4]		4,200	16,800
Traveling Exp [WN-5]		2,600	5,800
Depreciation [WN-6]		1,500	3,300
Carriage outward	1:3	100	300
Printing & stationery	1:2	800	1,600
Advertisement	1:3	2,000	6,000
Misc Expenses	1:2	4,200	8,400
Director's Fee	Post	-	600
MD's Remuneration	Post	-	4,100

Bad Debts	1:3	400	1,200
Commission & Brokerage	1:3	2,000	6,000
Audit Fee	Post	-	3,000
Int on Debentures	post	-	1,500
Int. paid to vendors	WN-7	1,400	700
Selling & Distribution Expenses	1:3	3,000	9,000
Preliminary expenses	Post	-	500
Under writing commission	Post	-	300
		29,200	1,02,100
Net Profit			50,900
Pre incorporation profit transfer to capital Reserve		800	

WORKING NOTE: 1

Computation of Time Ratio

Date of acquisition = 1st April 2011

Date of Incorporation = 1st August 2011

Date of closing = 31st March 2012

Time Ratio = 4:8

= 1:2

WORKING NOTE: 2

Turnover Ratio

Let the Monthly sales be 'x'

Pe- incorporation sales = 4x

Post – incorporation sales = 2x + (6x x 5/3)

= 12x

Turnover Ratio = 1:3

Let COGS fore pre - incorporation = 1

COGS for post -incorporation = 1 – (10%.of 1)

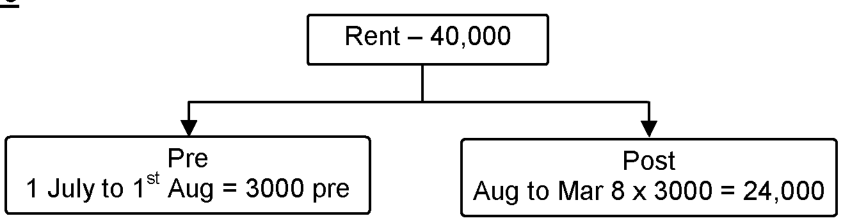
= 0.9

COGS ratio in sales mix = 1 x 1 : 3 x 0.9

= 1:2.7

= 10:27

WORKING NOTE: 3



Total rent = Rs.40,000

Less: Rent for additional space

From July 1st to March 31st

(Rs.3000 x 9) = (Rs.27,000)

Remaining = 13,000

Let the monthly rent be 'x'

[Pre – incorporation = 4x

Post – incorporation = 3x + 5 (x+20% of x)

= 3x + 5x + x

= 9x

Pre : post = 4x : 9x

= 4 : 9

Pre → 4000 Post → 9000

∴ Total pre – incorporation = 3000 + 4000

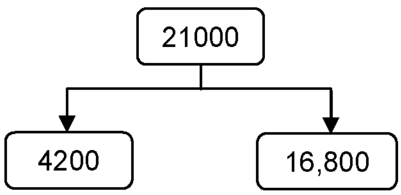
= 7000

Post – incorporation = 24000 + 9000

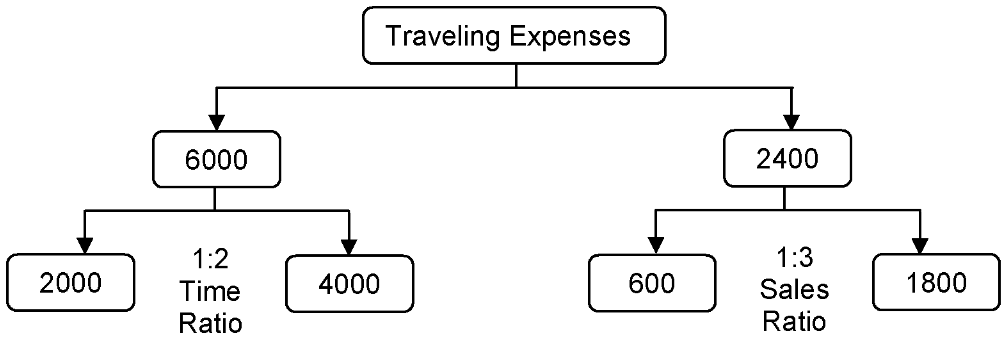
= 33,000

WORKING NOTE: 4 Computation of salaries Ratio

Pre	:	post	
3x + 3x	:	8x x 3	
6x	:	24x	= 1 : 4



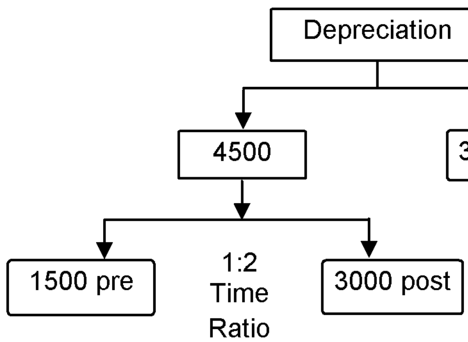
WORKING NOTE: 5



Pre = 2600

Post = 5800

WORKING NOTE: 6



Pre = 1500

Post = 3,300

WORKING NOTE: 7

Interest paid to vendors

4:2

Pre
2100 x 4/6 = 1400

Post (Aug 1st to 30th Sep)
2100 x 2/6 =700

PROBLEM NO: 7

Statement showing the calculation of Profits for the pre-incorporation and postincorporation periods

For the year ended 31st March, 2014

Particulars	*Total Amount*	*Basis of Allocation*	*Pre-incorporation*	*Post-incorporation*
Gross Profit	3,90,800	Sales	39,080	3,51,720
Less: Directors' fee	30,000	Post		30,000
Bad debts	7,200	Sales	720	6,480
Advertising	24,000	Time	6,000	18,000
Salaries & general expenses	1,28,000	Time	32,000	96,000
Preliminary expenses	10,000	Post		10,000
Donation to Political Party	10,000	Post		10,000
Net Profit	1,81,600			1,81,240
Pre-incorporation profit transfer to Capital Reserve			360	

WORKING NOTES:

1. **Sales ratio**

Particulars	**Amount (Rs.)**
Sales for period up to 30.06.2013 (4,80,000 * 3/6)	2,40,000
Sales for period from 01.07.2013 to 31.03.2014 (24,00,000 – 2,40,000)	21,60,000

Thus, Sales Ratio = 1 : 9

2. Time ratio

1st April, 2013 to 30 June, 2013: 1st July, 2013 to 31st March, 2014

= 3 months: 9 months = 1: 3

Thus, Time Ratio is 1: 3

THE END