CHAPTER 10

PROFIT OR LOSS PRE AND POST INCORPORATION

INTRODUCATION

1. Profit and loss of a such business for the period prior to the date the company incorporated is referred to as Pre-incorporation Profit and Losses.
2. Such Profit and Losses, though belonging to the company or payable by it, are of capital nature.
3. It is necessary to disclose them separately from trading profits or losses.

Treatment of Pre-Incorporation Profit/Loss?

S.No.	Pre-incorporation Profits	Pre-incorporation Losses
1	It is transferred to Capital Reserve Account (i.e. capitalized).	It is treated as a part of business acquisition cost (i.e. Goodwill) Or Shown as Negative Balance in Reserves under BS.
2	It can be used for : • writing off Goodwill on acquisition • writing off Preliminary Expenses • writing down over-valued assets • issuing of bonus shares • paying up partly paid shares	It can be used for : • setting off against Post Incorporation Profits • addition to Goodwill on acquisition • writing off capital profits

- **In short, Pre-incorporation Profits/Losses are not included in Free Reserves therefore it can-not be distributed as Dividend to shareholders.**
- Sometimes, Vendor (i.e. Seller) demands Interest on Late discharge of Purchase consideration, then such interest shall be calculated from the date of transfer of business to the date of actual payment of PC. **This interest will be expense for the company (Pre period till the date of incorporation and Post period after date of incorporation).**

How to calculate Profit/Loss Pre and Post Incorporation?

- All the Incomes and Expenses of the business apportioned on a reasonable basis in to Pre incorporation period and Post incorporation period.
- Such reasonable basis may be Time Ratio, Sales Ratio, or any other method suitable to the nature of Income and Expense.

Following basis of **apportionment** can generally be used for the various incomes and expenses:

Items of Incomes and Expenses	Basis of Apportionment between pre and Post incorporation perio
Gross Profit or Gross Loss	**First preference-** Sales Ratio- On the basis of turnover in there spective periods Or **Second preference** On the basis of cost of goods sold in the respective periods in the absence of any information regarding turnover Or **Third preference** Time Ratio- On the basis of time in the respective periods in the absence of any information regarding turnover and cost of goods sold
Variable expenses linked with Turnover [e.g. Carriage/Cartage outward, Selling and distribution expenses, Commission to selling agents/travelling agents, advertisement expenses, Bad debts, Brokerage, Sales Promotion]	Sales Ratio
Fixed Common charges [e.g., Salaries, Office and Administration Expenses, Rent, Rates and Taxes, Printing and Stationery, Telephone, Telegram and Postage, Depreciation, Miscellaneous Expenses]	Time Ratio
Expenses exclusively relating to pre-Incorporation period [e.g.Interest on Vendor's Capital]	Charge to pre-incorporation period (but if the purchase consideration is not paid on taking over of business, interest for the subsequent period is charged to post incorporation period)
Expenses exclusively relating to post-incorporation period [e.g. Formation expenses, interest on debentures, director's fees, Directors' remuneration, Preliminary Expenses, Share issue Expenses, Underwriting commission, Discount on issue of securities.	Charge to Post-incorporation period

Audit Fees (i) For Company's Audit under the Companies Act. (ii) For Tax Audit under section 44AB of the Income tax Act, 1961	Charge to Post-incorporation period On the basis of turnover in the respective periods
Interest on purchase consideration to vendor: For the period from the date of acquisition of business to date of incorporation. From the date of incorporation	 Charge to Pre-incorporation period Charge to Post-incorporation period

DO NOT FORGET THIS:-

Time Ratio	Sales Ratio	Pre Incorporation Exp	Post Incorporation Exp
Salary exp	Sales	Interest on Vendors capital	Company Audit fees
Rent exp	COGS		Directors' Remuneration
Rents/Taxes	GP		Preliminary Exp
Office Exp	Commission on Sales		Interest on Debentures
Depreciation	Bad-debts		Underwriting exp
Interest on Loans	Selling exp		
Stationary Exp	Sales promotion		
Electricity Exp	Tax Audit Fees		
General Exp	Discount Allowed		
	Advertisement Exp		

***Time Ratio means Pre period months and Post period months**

Class Example:

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 (1.4.20X1to1.8.20X1) = 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 weightage for each post-incorporation month is x, then

Weighted sales ratio = 4 *2x : 8 *1x = 8x : 8x or 1 : 1

IMPORTANT QUESTIONS

QUESTION - 1.

Rama Udyog Limited was incorporated on August 1, 20X1. It had acquired a running business of Rama & Co. with effect from April 1, 20X1. During the year 20X1-X2, 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, Rs. 2,00,000 was worked out after charging the following expenses:

- ***Depreciation- 1,23,000,***
- ***Directors'fees- 50,000,***
- ***Preliminaryexpenses-12,000,***
- ***Office expenses -78,000,***
- ***Selling expenses -72,000***
- ***Interest to vendors up to August 31, 20 X1 - 5,000.***

Please ascertain pre-incorporation and post-incorporation profit for the year ended 31st March, 20X2.

SOLUTION:

Statement showing Pre and Post Incorporation Profit for the year ended 31ST March, 20X2

Particulars	Total Amount	Basis of Allocation	Pre-incorporation	Post-Incorporation
Gross Profit (W.N.3)	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
	2,00,000		**33,000**	**1,67,000**

Net Profit (33,000 being pre- incorporation profit is transferred to Capital Reserve Accounts)

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 x then it should be 0.5 x per month in the first half year. So sales for the first four months (i.e. from 1st April, 20X1 to 31st July, 20X1) will be 4 *.50 = ` 2 and for the last eight months (i.e.from1st August, 20X1 to 31st March, 20X2) will be (2×.50 + 6 × 1) = ` 7. **Thus sales ratio is 2:7.**

2. **Time ratio**

   1st April, 20X1 to 31st July, 20X1: 1st August, 20X1 to 31st March, 20X2
   = 4 months: 8 months = 1:2 Thus, **time ratio is 1:2.**

3. **Gross Profit**

Gross profit = Net profit + All expenses
=2,00,000 + (1,23,000+50,000+12,000+78,000+72,000+5,000)
=2,00,000 + 3,40,000 = 5,40,000.

QUESTION – 2. (ICAI MODULE)

The partners of Maitri Agencies decided to convert the partnership into a private limited company called MA (P) Ltd. with effect from 1st January, 20X2. The consideration was agreed at ` 1,17,00,000 based on the firm's Balance Sheet as at 31st December, 20X1. However, due to some procedural difficulties, the company could be incorporated only on 1st April, 20X2. Meanwhile the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% per annum. The same books of account were continued by the company which closed its account for the first time on 31st March, 20X3 and prepared the following summarised profit and loss account.

Sales		*23,40,0000*
Less: Cost of goods sold	*1,63,80,000*	
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*	
Total Expenses		*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, 20X2 but the salaries tripled from that date. It had to occupy additional space from 1st July, 20X2 for which rent was ` 30,000 per month.

Prepare statement of apportioning cost and revenue between pre-incorporation and post-incorporation periods and calculation of profits/losses for such periods.

SOLUTION:

MA (P) Ltd.
Statement showing calculation of Profit/Losses
for Pre and Post Incorporation periods

	Basis of allocation	**Pre-inc. Amount`**	**Post-inc. Amount `**
Sales	Sales ratio	26,00,000	2,08,00,000
Less: Cost of goods sold	Sales ratio	18,20,000	1,45,60,000
Salaries	W.N.4	90,000	10,80,000
Depreciation	Time ratio	36,000	1,44,000
Advertisement	Sales ratio	78,000	6,24,000
Discounts	Sales ratio	1,30,000	10,40,000

M.D.'s remuneration	Post-inc	—	90,000
Misc. Office Expenses	Time ratio	24,000	96,000
Rent	W.N.5	90,000	6,30,000
Interest	Time ratio	3,51,000	6,00,000
Net Profit/(Loss)		**(19,000)**	**19,36,000**

Working Notes:

(1) Calculation of Sales ratio:

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

$(3 \times x) + (12 \times 2x)$ or $27x$. Ratio of sales will be $3x$: $24x$ or 1:8.

Time ratio is 3 months: 12 months or1:4

(2) Expenses apportioned on turnover ratio basis are cost of goods sold, advertisement, discounts.

(3) Expenses apportioned on time ratio basis are Depreciation, and misc. office expenses.

(4) Ratio for apportionment of Salaries:

If pre-incorporation monthly average is x, for 3 months 3x. Average for balance 12 months 3x, for 12 months 36x.

Hence ratio for division, 1:12.

(5) Apportionment of Rent:

Particulars		**Amount**
Total Rent		7,20,000
Additional rent for 9 months (From 1st July 20X2 to 31st March, 20X3)		(2,70,000)
Rent for old premises for 15 months at ` 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**

QUESTION - 3. (ICAI MODULE)

ABC Ltd. took over a running business with effect from1st April, 20X1. The company was incorporated on 1st August, 20X1. The following summarized Profit and Loss Account has been prepared for the year ended 31.3.20X2:

Salaries	*48,000*	*Gross Profit*	*3,20,000*
Stationery	*4,800*		
Travelling expenses	*16,800*		
Advertisement	*16,000*		
Miscellaneous trade expenses	*37,800*		
Rent (office buildings)	*26,400*		
Electricity charges	*4,200*		
Director's fee	*11,200*		
Bad debts	*3,200*		

Commission to selling agents	*16,000*		
Tax Audit fee	*6,000*		
Debenture interest	*3,000*		
Interest paid to vendor	*4,200*		
Selling expenses	*25,200*		
Depreciation on fixed assets	*9,600*		
Net profit	*87,600*		
	3,20,000		*3,20,000*

Additional information:

- ***Total sales for the year, which amounted to ` 19,20,000 arose evenly up to the date of 30.9.20X1. Thereafter they recorded an increase of two-third during the rest of the year.***
- ***Rent of office building was paid @ ` 2,000 per month up to September, 20X1 and thereafter it was increased by ` 400 per month.***
- ***Travelling expenses include ` 4,800 towards sales promotion.***
- ***Depreciation include` 600 for assets acquired in the post incorporation period.***
- ***Purchase consideration was discharged by the company on 30th September, 20X1 by issuing equity shares of ` 10each.***

Prepare Statement showing calculation of profits and allocation of expenses between pre and post in corporation periods.

SOLUTION:

Statement showing calculation of profits for Pre and Post Incorporation periods for the year ended 31.3.20X2

Particulars	**Pre-Incorporation period**	**Post-Incorporation period**
Gross profit (1:3)	80,000	2,40,000
Less*:* Salaries (1:2)	16,000	32,000
Stationery (1:2)	1,600	3,200
Advertisement (1:3)	4,000	12,000
Travelling expenses (W.N.4)	4,000	8,000
Sales promotion expenses (W.N.4)	1,200	3,600
Misc. trade expenses (1:2)	12,600	25,200
Rent (office building) (W.N.3)	8,000	18,400
Electricity charges (1:2)	1,400	2,800
Director's fee (post-incorporation)	-	11,200
Bad debts (1:3)	800	2,400
Selling agents commission (1:3)	4,000	12,000
Audit fee (1:3)	1,500	4,500
Debenture interest (post-incorporation)	-	3,000
Interest paid to vendor (2:1) (W.N.5)	2,800	1,400
Selling expenses (1:3)	6,300	18,900
Depreciation on fixed assets (W.N.6)	3,000	6,600
Capital reserve (Bal.Fig.)	12,800	-
Net profit (Bal.Fig.)	**-**	**74,800**

Working Notes:

1. Time Ratio

Pre incorporation period = 1st April, 20X1 to 31st July, 20X1 i.e. 4 months

2. Sales ratio

Let the monthly sales for first 6 months (i.e. from 1.4.20X1 to 30.09. 20X1) be x
Then, sales for 6 months = **6x**
Monthly sales for next 6 months (i.e. from 1.10.X1 to 31.3.20X2) = x + 2/3x=5/3x
Then, sales for next 6 months= 5/3x*6=**10x**
Total sales for the year = 6x + 10x = 16x
Monthly sales in the pre incorporation period = 19,20,000/16 = 1,20,000
Total sales for pre-incorporation period = 1,20,000 x 4 = 4,80,000
Total sales for post incorporation period = 19,20,000 – 4,80,000 =14,40,000
Sales Ratio = 4,80,000 : 14,40,000 = **1 : 3**

3. Rent

Rent for pre-incorporation period (2,000 x 4)		**8,000 (pre)**
Rent for post incorporation period		
August, 20X1 & September, 20X1 (2,000 x 2)	4,000	
October, 20X1 to March,20X2 (2,400 x 6)	14,400	**18,400 (post)**

4. Travelling expenses and sales promotion expenses

Particulars	Pre	Post
Traveling expenses ` 12,000 (i.e. ` 16,800-		
` 4,800) distributed in Time ratio (1:2)	4,000	8,000
Sales promotion expenses ` 4,800 distributed	1,200	3,600
in Sales ratio (1:3)		

5. Interest paid to vendor till 30th September,20X1

Particulars	*Pre*	*Post*
Interest for pre-incorporation period (4200*4/6)	**2,800**	
Interest for post incorporation period i.e. for August, 20X1 &September, 20X1 =(4200*2/6)		**1,400**

6. Depreciation

Particulars	Amount	Pre- Inc.	Post Inc.
Total depreciation	9600		
Less: Depreciation exclusively for post incorporation period	600		
Less: Depreciation exclusively for post incorporation period	9000		
Depreciation for pre-incorporation period (9000*4/12)		3,000	
Depreciation for post incorporation period (9000*8/12)			6,000
* **Time ratio = 1 : 2**		**3,000**	**6,600**

QUESTION – 4. (ICAI MODULE)

ABC Ltd. was incorporated on 1.5.20X1 to take over the business of DEF and Co. from 1.1.20X1. The summarised Profit and Loss Account as given by ABC Ltd. for the year ending 31.12.20X1 is asunder:

Summarized Profit and Loss Account

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

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

- ***G.P. ratio was constant throughout the year.***
- ***Sales for January and October were 1½ times the average monthly sales while sales for December were twice the average monthly sales.***
- ***Bad Debts are shown after adjusting a recovery of ` 7,000 of Bad Debt for a sale made in July, 20X0.***
- ***Manager's salary was increased by ` 2,000 p.m. from1.5.20X1.***
- ***All investments were sold in April, 20X1.***
- ***The entire audit fees relates to the company.***

SOLUTION:

Pre-incorporation period is for four months, from 1st January, 20X1 to 30th April, 20X1. 8 months' period (from 1st May, 20X1 to 31st December, 20X1) is post- incorporation period.

Statement showing calculation of Profit/Losses for Pre and Post Incorporation periods

Particulars	*Pre-Inc.*	*Post Inc.*
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		
Managers salary (85,000- refer note below)	23,000	62,000
Other salaries (3,31,000 – 85,000)	82,000	1,64,000

Printing and stationery	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 investments	11,200	-
Net Profit	**1,86,900**	**2,03,100**

(i) Calculation of Sales ratio

Let average monthly sales be x.

Thus Sales from January to April are 4½ x (i.e., 1.5x + x + x + x) and sales from May to December are 9½x(x+x+x+x+x+1.5x+x+2x).

Sales are in the ratio of $9/2x$: $19/2x$ or 9: 19.

Calculation of Time Ratio

Pre-incorporation period = 1.1.20X1 to 30.4.20X1 = 4 months

Post-incorporation period = 1.5.20X1 to 31.12.20X1 = 8 months

Time ratio = 1:2

(ii) Gross profit, carriage outwards, sales commission and bad debts written off (after adjustment for bad debt recovery) have been allocated in pre and post incorporation periods in the ratio of Sales i.e**. 9 :19.**

(iii) Rent, salaries (subject to increase in manager's salary), printing and stationery are allocated on **time basis.**

(iv) Interest on debentures, underwriting commission and preliminary expenses are allocated in post incorporation period.

(v) Interest on investments, loss on sale of investments and bad debt recovery are allocated in pre-incorporation period.

Note:

Let Pre-incorporation period manager's monthly salary be x

Total pre-incorporation period manager's monthly salary = 4x

Post-incorporation period manager's monthly salary =x + 2,000

Total pre-incorporation period manager's monthly salary = 8(x+2,000)

Total manager's salary (pre and post) = 85,000

Thus, 4x + 8(x+2,000) = 85,000

x = 5,750

Total pre-incorporation period manager's monthly salary = 4 x 5,750 = 23,000

Total pre-incorporation period manager's monthly salary = 8(5,750 + 2,000) = 62,000.

QUESTION - 5. (ICAI MODULE)

Inder and Vishnu, working in partnership registered a joint stock company under the name of Fellow Travellers Ltd. on May 31, 20X1 to take over their existing business. It was agreed that they would take over the assets of the partnership from January 1st, 20X1 for a sum of ` 3,00,000 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, 20X1. To discharge the purchase consideration, the company issued 20,000 equity shares of ` 10 each at a premium of ` 1 each and allotted 7% Debentures of the

face value of 1,50,000 to the vendors at par.
The summarised Profit and Loss Account of the "Fellow Travellers Ltd." for the year ended 31st December, 20X1 was as follows:

Particulars	***Amount***	***Particulars***	***Amount***
Purchase, including Inventory	*1,40,000*	*Sales:*	
Freight and carriage	*5,000*	*1st January to 31st May 20X1*	*60,000*
Gross Profit c/d	*60,000*	*1st June to 31st Dec., 20X1*	*1,20,000*
		Inventory 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- 20X1)	*9,000*		
Selling commission	*9,000*		
Directors' Fee	*600*		
Preliminary expenses	*900*		
Provision for taxes (entirely related with company)	*6,000*		
Dividend paid on equity shares @ 5%	*5,000*		
Balance c/d	*13,250*		
	60,000		***60,000***

Prepare statement apportioning the expenses and calculate profits/losses for the 'post' and 'pre-incorporation' periods and also show how these figures would appear in the Balance Sheet of the company.

SOLUTON:

Fellow Travelers Ltd.

Statement showing calculation of Profit /Losses for pre and post Incorporation periods

Particulars		**Ratio**	**Pre –Inc.**	**Post- Inc.**
Gross profit allocated on the basis of sale		1:2	20,000	40,000
Less:				
Administrative Expenses allocated				
On time basis:				
(*i*) Salaries and wages	10,000			
(*ii*) Depreciation	1,000			
	11,000	5:7	4,583	6,417
Selling Commission on the basis of sales		1:2	3,000	6,000
Interest on Purchase Consideration (Time basis)		5:1	7,500	1,500
Expenses applicable wholly to the Post-incorporation period				
Debenture Interest (1,50,000 x 7% x 6/12)	5,250			
Director's Fee	600			
	5,850	Post		5,850

Preliminary expenses				
Provision for taxes				
Balance c/d to Balance Sheet			**4,917**	**13,333**

Fellow Travelers Ltd.

Extract from the Balance Sheet as on 31st Dec., 20X1

	Particulars	Notes	`
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	2,00,000
b	Reserves and Surplus	2	33,250
2	**Non-current liabilities**		
a	Long-term borrowings	3	1,50,000
3	**Current liabilities**	4	
a	Short term provisions		6,000
	Total		**3,89,250**

Notes to accounts

			`
1.	**Share Capital**		
	20,000 equity shares of `10 each fully paid		2,00,000
2.	**Reserves and Surplus**		
	Profit Prior to Incorporation		4,917
	Securities Premium Account		20,000
	Profit and loss Account	13,333	
	Less: Dividend on equity share	(5,000)	8,333
	Total		33,250
3.	**Long term borrowings**		
	Secured		
	7% Debentures		1,50,000
4.	**Other Current liabilities**		
	Provision for Taxes		6,000

Time Ratio

Pre incorporation period = 1 January 20X1 to 31 May 20X1 = 5 months Post incorporation period = 1 June 20X1 to 31 December 20X1 = 7 months Time ratio = 5:7

Sales Ratio

Sales in pre incorporation period (1 January 20X1 to 31 May 20X1) = ` 60,000

Sales in post incorporation period (1 June 20X1 to 31 December 20X1) = `1,20,000 Sales ratio = 1:2

QUESTION – 6. (PM)

A firm M/s. Alag, which was carrying on business from 1st July, 2013 gets it self-incorporated as a company on 1st November, 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` 12,000 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 yearnedauni form profit. Interest and tax may be ignored.

SOLUTION:

Statement showing pre and post-incorporation profits

Particulars	**Basis**	**Pre**	**Post**	**Total**
Gross Profit	Sales ratio	16,000	40,000	56,000
Less: General expenses	Time ratio	6,320	7,900	14,220
Directors' fee	Actual	-	5,000	5,000
Formation expenses	Actual	-	1,500	1,500
Rent (600 + 750)	W.N. 2	400	950	1,350
Manager's salary	Actual	2,000	-	2,000
Net Profit transferred to:				
Capital Reserve		**7,280**	-	-
P & L A/c	-	-	**24,650**	**31,930**

Working Notes:

1. Calculation of sales ratio

Let the average monthly sales of first four months = 100 and next five months = 200
Total sales of first four months = 100 x 4 = 400 and Total sales of
next five months = 200 x 5 = 1,000 The ratio of sales = 400:
1,000 = 2: 5

2. Rent

Till 31st December, 2013, rent was ` 1,200 p.a. i.e. ` 100 p.m. So,
Pre-incorporation rent = ` 100 x 4 months = ` 400
Post-incorporation rent = (` 100 x 2 months) + (` 250 x 3 months) = `950

3. Time ratio

Pre-incorporation period =1st July, 2013 to 31st Oct. 2013 = 4 months Post –incorporation = 1 st November 2013 to 31st March 2014 = 5 months
= 4 months: 5 months Thus, **time ratio is 4:5**

Student Notes:-