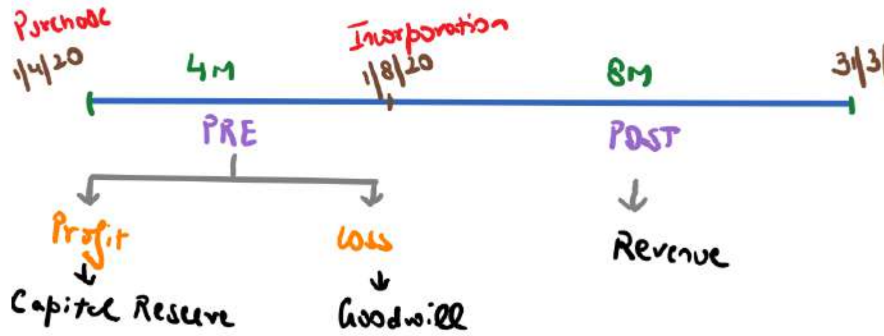
Profit or Loss Pre & Post Incorporation

Meaning	• Usually, in the case of a newly formed company; an existing business is taken over as going concern at date, prior to date of incorporation of Company. • Thus; the profit (loss) earned (incurred) from the date of purchase to the date of incorporation of company, is called the "Profit (Loss) Prior to Incorporation."
Example	'X Ltd. is incorporated on 1st August 2020 to take over the running business of M/s. Y as From 1st April, 2020. Thus, the profit earned by X Ltd. from 1st April 2020 till 1st August 2020 is called " Profits Prior to Incorporation".



Ratios :

1) Time Ratio

4 : 8 = 1 : 2

2) Sales Ratio

Pre sales : Post sales

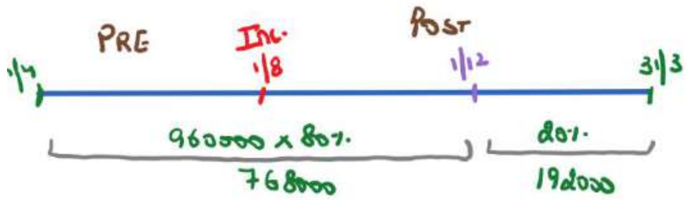
Calculation of Sales Ratio

Date of taking over Business	1.4.2020
Date of Incorporation	1.8.2020
Total Sales during 2020-21	9,60,000

Required: Calculate the Sales Ratio in each of the following alternative cases:-

Case (a)

80% sales upto 1.12.2020 and the balance for the remaining period



Sales from 1/4 - 1/12 (8 months) = 768000

Sales from 1/4 - 1/8 [PRE - 4 Months] : $768000 \times \frac{4}{8} = 384000$

Sales from 1/8 - 31/3 [Post - 8 Months] : $(768000 - 384000) + 192000$

$= 576000$

Sales Ratio = 384000 : 576000

$= \boxed{2 : 3}$

Case (b)

Sales were as under:

For April – twice the average sale in each month

For May – equal to average sale in each month

From August to November – one fourth of the average sale in each month

For January & February – 3 times the average sale in each month

Inc.

1/4 — PRE — 1/8 — POST — 31/3

960000

Avg. sales in each month = $\frac{960000}{12}$ = 80000

April = 80000 × 2 = 160000

May = = 80000

August = 80000 × 1/4 = 20000

September = 20000

October = 20000

November = 20000

January = 80000 × 3 = 240000

February = 240000

For 8 months 800000

Remaining 4 months = 160000

(June, July, Dec, March)

Sales / month = 160000/4 = 40000

PRE : POST

1/4 – 31/7   1/8 – 31/3

160000 + 80000 + 40000 + 40000

=) 320000 : 960000 – 320000

=) 320000 : 640000

=) $\boxed{1 : 2}$

Case (c)

The monthly average of turnover during the first 6 months of 2020-21 was half the corresponding figure for remaining period.

Inc.

1/4 — PRE — 1/8 — POST — 31/3

Let monthly average T/O for first 6 months (1/4 – 30/9) = x

So monthly average T/O for Remaining 6 months (1/10 – 31/3) = 2x

PRE   POST

1/4 – 31/7   1/8 – 31/3

4 × x : (2 × x) + (6 × 2x)

4x : 14x

$\boxed{2 : 7}$

Case (d)

The monthly sales in April, Feb. and March are double the monthly sales for the remaining months of the year.

Let monthly sales = x

So sales for April, Feb & March = $2x$

PRE		POST
1/4 - 31/7		1/8 - 31/3
$(1 \times 2x) + (3 \times x)$	:	$(2 \times 2x) + (6 \times x)$
$5x$	:	$10x$

$$\boxed{1:2}$$

Case (e)

The turnover was evenly upto 01.10.2020, where after the same spurted to record an increase of two-thirds during rest of year.

Let monthly T/O upto 1/10/20 (First 6 months) = x

So monthly T/O after 1/10/20 (Balance 6 months) = $x + \frac{2}{3}x = \frac{5}{3}x$

PRE		POST
1/4 - 31/7		1/8 - 31/3
$(4 \times x)$	:	$(2 \times x) + (6 \times \frac{5}{3}x)$
$4x$	:	$2x + 10x$
$4x$	:	$12x$

$$\boxed{1:3}$$

Determination of Pre Incorporation & Post Incorporation Profits

S.No.	Item	Example	Basis of Apportionment
1.	Gross Profit or Gross Loss	-	• Sales Ratio (Assumed GP rate is constant) or • Cost of Goods Sold ratio (If sales ratio is not given) • Time Ratio (if COGS Ratio not given)
2.	Expenses Related with the turnover	• Carriage Outward • Cartage Outward • Selling & Distribution Expenses • Commission to Selling Agent • Advertisement Expenses • Discount Allowed • Traveller's Commission • Sales Promotion • Bad Debts (if actual Bad Debts for two periods are not given) • Tax Audit Fees	Sales ratio
3.	Expenses Related with Time	• Salaries • Administration Expenses • Office Expenses • Rates & Taxes • Rent • Printing & Stationery • Depreciation • Telephone Expenses • Telegram & Postage • Electricity Charges • General Expenses • Insurance	Time Ratio
4.	Expenses Relating Exclusively to Pre-Incorporation Period	• Vendor's Salary • Interest on Vendor's Capital	• Charge to Pre Incorporation Period
5.	Expenses Relating Exclusively to Post-Incorporation Period	• Director's Fees • Debenture Interest • Director's Remuneration • Preliminary Expenses • Goodwill written off • Share Issue Expenses • Underwriting Commission • Discount on Issue of Shares / Debentures • Formation Expenses • Audit Fees relating to company	Charge to Post – Incorporation Period
6.	Interest on Purchase Consideration to Vendor	From Date of Purchase - Date of Incorporation From Date of Incorporation -Date of Payment	Charge to Pre – Incorporation Period Charge to Post- Incorporation Period

Question

X Limited took over the running business of a partnership firm M/s Naresh Brothers with effect from 1st April, 2019. The company was incorporated on 1st September, 2019. The following profit and loss account has been prepared for the year ended 31st March, 2020.

Particulars	Amount	Particulars	Amount
To Salaries	1,33,000	By Gross Profit b/d	7,50,000
To Rent	15,000		
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 Interest to vendor	12,000		
To Depreciation	80,000		
To Advertising expenses	24,000		
To Preliminary expenses	5,000		
To Interest on debentures	6,000		
To Managing Director's remuneration	6,000		
To Net Profit c/d	2,14,000		
	7,50,000		**7,50,000**

Additional Information:

1. Trend of sales during April, 2019 to March, 2020 was as under:

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

2. X Limited took over a machine worth Rs. 7,20,000 from Naresh Brothers &purchased a new machine on 1st February, 2020 for Rs. 4,80,000. The company decides to provide depreciation @ 10% p.a.
3. Office Rent was paid @ Rs. 12,000 p.a. upto 30th September 2019 and thereafter it was paid @ Rs. 18,000 p.a.
4. Out of travelling expenses, Rs. 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.
7. Advertising Rs. 24,000 (under a contract amounting to Rs. 2,000 per month)
8. Purchase consideration was settled on 30th September, 2019 along with interest of 12,000.

You are required to prepare a statement apportioning the expenses between pre and post incorporation periods.

Solution

Statement showing calculation of profits for pre and post incorporation periods for the year ended 31.3.2020

Particulars	Basis	Pre-incorporation period	Post- incorporation period
Gross profit	SR (1:2)	2,50,000	5,00,000
Less: Salaries	W.N.3	35,000	98,000
Carriage outward	SR (1:2)	25,000	50,000
Audit fee	Post	-	12,000
Travelling expenses	W.N. 4	24,500	41,500

Commission on sales	SR (1:2)	16,000	32,000
Printing & stationary	TR (5:7)	10,000	14,000
Rent	W.N. 5	5,000	10,000
Electricity charges	TR (5:7)	12,500	17,500
Interest to Vendor	5:1	10,000	2,000
Depreciation	W.N. 6	30,000	50,000
Advertisement	TR (5:7)	10,000	14,000
Preliminary expenses	Post	-	5,000
Interest on Debentures	Post	-	6,000
MD remuneration	Post	______-	6,000
Pre-inc .profit – tfd. to Capital reserve		72,000	-
Net profit (Bal. Fig.)		-	1,42,000

Working Notes:

1. **Time Ratio**

Pre incorporation period = 1st April, 2019 to 31st August, 2019 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 x 4)	6,00,000
	10,00,000

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

3. **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

4. **Travelling expenses**

	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**

5. **Rent**

Rent for Pre incorporation period (12,000/12*5)	5,000
Rent for Post incorporation period (12,000/12*1) + (18,000/12*6) = 1,000+9,000	10,000

6. **Depreciation**

	Pre-incorporation	**Post-incorporation**

Total depreciation	80,000		
Less: Depreciation exclusively for post			8,000
(4,80,000 x 10% x 2/12)	(8,000)		
	72,000		
Depreciation for pre-incorporation period			
(Rs. 72,000 x 5/12)		30,000	
Depreciation for post incorporation period			42,000
(Rs. 72,000 x 7/12)			
		30,000	**50,000**

Question

A partnership firm M/s. Suresh Brothers was carrying on business from 1st May, 2019. The partners of the firm decided to convert the partnership firm into a private company called MNT (P) Ltd. with effect from 1st September, 2019. The annual accounts were drawn upto 31st March, 2020. The summarised Profit and Loss Account from 1st May, 2019 to 31st March, 2020 is as follows:

Particulars		**Amount**
Gross Profit	18,60,000	
Interest on Investment	40,000	19,00,000
Less:		
Printing & Stationery	77,000	
Manager's Salary	82,000	
Tax Audit Fees	18,000	
Travelling Expenses	7,800	
Rent	1,33,000	
Bad Debts	27,000	
Underwriting Commission	20,000	
Depreciation	71,500	
Director Fees	6,300	
Advertising campaign expenses	36,000	
Sundry office expenses	99,000	
Interest on borrowings	1,25,000	(7,02,600)
Net Profit		**11,97,400**

Additional Information Provided:

(1) MNT (P) Ltd. initiated an advertising campaign on 1st September, 2019, which resulted increase in monthly average sales by 100% (doubled from 1st September)

(2) Gross Profit rate increased from 20% to 30% from 1st October 2019

(3) All investments were sold in August 2019 at a profit of Rs. 60,000. Profit on Sale of Investment inadvertently included to Sales and ultimately to Gross Profit.

(4) The company's only borrowing was a loan of Rs. 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, 2019.

(5) The company occupied additional space from 1st September, 2019 for which rent of Rs. 8,000 per month was incurred.

(6) Bad debts recovered amounting to Rs. 36,000 for a sale made in June 2019, has been deducted from bad debts mentioned above.

(7) Travelling Expenses includes Sales promotion 4,500

(8) The salary of Manager was increased by Rs. 3,000 p.m. from 1st July, 2019.

Prepare a statement showing pre-incorporation and post-incorporation profit for the year ended 31st March 2020

Solution

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

	Ratio	Pre incorporation	Post incorporation
Gross Profit	1:5 (W.N.3)	3,00,000	15,00,000
Interest on Investments	Pre	40,000	
Bad debts recovered	Pre	36,000	
Profit on sale of investment	Pre	60,000	
		4,36,000	**15,00,000**
Printing & Stationary	TR (4:7)	28,000	49,000
Manager's Salary	W.N.4	26,000	56,000
Tax Audit fees	SR (2:7)	4,000	14,000
Travelling Expenses	W.N.5	2,200	5,600
Rent	W.N.6	28,000	1,05,000
Bad debts (27,000+36,000)	SR (2:7)	14,000	49,000
Underwriting commission	Post	-	20,000
Depreciation	TR (4:7)	26,000	45,500
Director Fees	Post	-	6,300
Advertisement	Post	-	36,000
Sundry office expenses	TR (4:7)	36,000	63,000
Interest on Borrowing	W.N.7	46,250	78,750
		2,10,450	**5,28,150**
Net Profit		**2,25,550**	**9,71,850**

Working Notes:

1. Calculation of time Ratio

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

2. Calculation of Sales Ratio

Let the average sales per month be x
Total sales from 01.05.2019 to 31.08.2019 will be 4x
Average sales per month from 01.09.2019 to 31.03.2020 will be 2x
Total sales from 01.09.2019 to 31.03.2020 will be 2x X 7 =14x
Ratio of Sales will be 4x: 14x =2:7

3. Calculation of Gross Profit Ratio

Sales for Pre Incorporation Period = 4x
Gross Profit for Pre Incorporation Period = 4x * 20% = 0.8x

Sales for Post Incorporation Period = 2x* 7 = 14x
Gross Profit for Post Incorporation Period = (2x * 20%) + (12x * 30%) = 0.4x + 3.60x = 4x
Gross Profit Ratio = 0.8x : 4x = 1:5

Correct Gross Profit = 18,00,000- 60,000 = 18,00,000 divided in 1:5

4. 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+,8000=27,000
Salary from Sep to March	8,000*7= 56,000

5. Travelling expenses and sales promotion expenses

	Pre	Post
Travelling expenses 3,300 (i.e. 7,800- 4,500) distributed in 4:7 ratio	1,200	2,100
Sales promotion expenses 4,500 distributed in 2:7 ratio	1,000	3,500
	2,200	**5,600**

6. Apportionment of Rent

Total Rent	1,33,000
Less: additional rent from 1.9.2019 to 31.3.2020	(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
	28,000	1,05,000

7. Interest on borrowing

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

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