

## I. What is profit prior to incorporation:

The profit earned after incorporation, i.e. from 1-10-2017 to 1-12-2017 is normal revenue profit earned by the company. The profit earned before incorporation is capital profit of the company.

### Gross profit

Gross profit is normally divided in the ratio of sales.

### ASERTAINING RATIO OF TIME:

#### RATIO OF TIME

9:3

Acquisition of business 1 <sup>st</sup> January	Pre-incorporation 9 months	Incorporation 1 <sup>st</sup> October	Post-incorporation 1 <sup>st</sup> October	Account incorporation 1 <sup>st</sup> October	Post-	Accounting year ending 31 <sup>st</sup> December
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**Ratio of sales:** Items linked with the volume or value of sales (e.g. variable expenses or selling and distribution overheads like freight outward; commission to salesmen; discount allowed; bad debts etc.)

s. no	Pre-incorporation profit	Pre-incorporation loss
1	It is transferred to capital reserve account (i.e. capitalistic)	It is treated as a part of business acquisition cost (goodwill)
2	It can be used for: <ul style="list-style-type: none"> <li>• Writing off goodwill on acquisition</li> <li>• Writing off share issue expenses</li> <li>• Writing down over-valued assets</li> <li>• Issuing of bonus shares</li> <li>• Paying up partly paid shares</li> </ul>	It can be: <ul style="list-style-type: none"> <li>• Written off against post incorporation</li> <li>• Added to goodwill on acquisition</li> <li>• Written off against capital profit.</li> </ul>

### RAPID REVISION

Step	What is to be done	How is to be done
1	Divide a/c year in two periods	a. period up to incorporation b. period after incorporation
2	Divide gross profit between these two periods	a. on bases of sale
3	Divide income two periods	a. specifically arise in a particular period (e.g. share transfer fees) b. on the bases of time (e.g. interest on bank)
4	Divide expansion between these two periods	a. specifically arrive in a particular period (e.g. preliminary expenses) b. on the bases of time (e.g. fixed expenses)

		c. on the bases of sales (e.g. variable)
5	Calculate net profit between these two periods	a. NP up to incorporation(capital reserved) b. NP after incorporation(profit and loss)

Worksheet 2: COLUMNAR PROFIT AND LOSS ACCOUNT

Expenses	Basis	Pre Inc.	Post Inc.	Income	Basis	Pre Inc.	Post Inc.
To fixed expenses/ Admn. Overheads	Time	Xxx	Xxx	By gross profit	Sales	Xxx	Xxx
To variable expenses/selling O/H	Sales	Xxx	Xxx	By rent recd. Etc.	Time	Xxx	Xxx
To expenses before Inc.	Specific	Xxx	Nil	By income before Inc.	Specific	Xxx	Nil xxx
To expenses after Inc.	Specific	nil	Xxx	By income after Inc.	Specific	Nil	
To capital reserve		Xxx	Nil				
To net profit c/d		Nil	xxx				
		xxx	xxx			Xxx	Xxx

Particular	Total	Basis	Pre-incorporation	Post-incorporation
<b>Income</b>				
Gross profit	Xxx	Sales	Xxx	Xxx
Rent received, etc.	Xxx	Time	Xxx	Xxx
Income before incorporation	Xxx	Specific	Xxx	nil
Income after incorporation	Xxx	Specific	Nil	xxx
<b>Total income</b>	Xxx	Xxx	Xxx	Xxx
<b>Expenses</b>				
Fixed expenses/ Admn. Overheads	Xxx	Time	Xxx	Xxx
Variable expenses/selling O/H	Xxx	Sales	Xxx	Xxx
Expenses before Incorporation	Xxx	Specific	Xxx	nil
Expenses after Incorporation	Xxx	Specific	Nil	xxx
<b>Total expenses</b>	Xxx		Xxx	Xxx
<b>Capital reserve/ (goodwill)</b>	Xxx		Xxx	Nil
<b>Net profit / (loss) c/d</b>	Xxx		Nil	xxx
<b>Total profit/(loss)</b>	xxx		xxx	xxx

No.	Pre-incorporation	Post-incorporation	Ratio of time	Rate of sales
1	Interest to vendor	Fees to directors	Fixed expenses	Gross profit
2	Salary to vendor	Salary to directors	Admin expenses.	Variable expenses
3		Interest on debentures	▪ Rent	Selling overheads
4		Discount on debentures w/o	▪ Insurance	▪ salary to salesman
5		Preliminary expenses w/o	▪ Printing	▪ advertisement
6		Shares issues expenses w/o	▪ Depreciation	▪ freight outward
7		Share transfer fees received	▪ Audit fees	▪ discount allowed
8		Appropriation by company	▪ postage	

**Illustration 1: (from details)**

The promoters of the proposed new company ZEDO Ltd. purchased a running business on 1<sup>st</sup> January, 2017 from Mr. Antonio. The new company was incorporated on 1<sup>st</sup> may 2017. The profit and loss account for the year ended 31<sup>st</sup> December, 2017 was as under:

Particular	₹	Particular	₹
Rent, rates, insurance, electricity	24000	Gross profit	3,00,000
Directors sitting fees	7200	Discount received	12,000
Preliminary expenses	9800		
Interest paid to vendors	11000		
Net profit	20000		
	2,40,000		

Following further information available:

Sales up to 30 April, 2017 was ₹ 6, 00,000 out of total sales of ₹ 30, 00,000 for the year.

Purchases up to 30 April, 2017 was ₹ 6, 00,000 out of total purchase of ₹ 18, 00,000 of the year.

Interest paid to vendors was @ 12% on ₹ 2, 00,000 p.a. till the payment was made. From the above information, prepare statement of profit and loss for the year ended 31<sup>st</sup> December, 2017 showing pre and post- incorporation profits and how it will be treated in accounts.

**Illustration 2: (from horizontal P&L A/C)**

XYZ limited was incorporation on 1<sup>st</sup> July, 2016 to acquire the business from 1<sup>st</sup> April, 2016. It commenced its business on 1<sup>st</sup> august, 2016. Its profit and loss account for the year ending 31<sup>st</sup> march, 2017 is an under.

Particulars	₹	Particulars	₹
To office salaries	60,000	By gross profit b/d	5,20,000
To selling commission	78,000		
To carriage outward	42,250		
To rent and taxes	1,20,000		
To debenture interest	25,400		
To printing and stationery	15,000		
To advertising expenses	65,000		
To net profit	1,14,350		
	5,20,000		5,20,000

Additional information:

Sales for the pre-incorporation period was @ ₹ 5, 00,000 per month. Total sales for the year ended 31<sup>st</sup> march, 2017 was ₹ 65, 00,000.

Prepare statement of profit and loss in the columnar form for the year ended 31<sup>st</sup> march, 2017 allocating various items on suitable basis in the pre-incorporation and post incorporation period.

