

MODULE NO. 2: PROFIT PRIOR TO INCORPORATION

PROBLEMS

1. A Ltd., incorporated on 1st June, **2021** takes over a running business with effect from 1st January, **2021**. Sales for the year ended 31st December, **2021** amounted to ₹ 76,57,000. Sales for the each one of the first five months of the accounting year are one-half, of each one of subsequent months of the accounting year. Calculate sales for pre and post- acquisition period and sales ratio.
2. Soha Ltd., was incorporated on 1st May, **2021** to acquire the business with effect from 1st January, **2021**. From the following information relating to year ending 31st December, **2021**, calculate profit or loss prior to incorporation and after incorporation.
Sales for the year amounted to ₹ 1,80,00,000 out of which sales up to 1st May, **2021** were ₹ 50,00,000 whereas cost of goods sold for the year came to ₹ 1,20,00,000. The expenses debited to Profit & loss Account was as follows:

Particulars	₹
Salaries	3,00,000
Rent & Rates	4,80,000
Directors' fees	75,000
General Expenses	96,000
Discount allowed to customers	72,000
Advertisement	3,60,000
Stationery & Printing	72,000
Commission on sales	4,20,000
Bad debts (₹ 10,000 of Bad debts relate to pre-incorporation period)	30,000
Interest on Debentures	1,25,000
Audit fees	30,000

3. SS Ltd., was formed 1st April, **2021** to take over a running business from 1st January, **2021**. The following is the summarised Profit & Loss Account for the year ended 31st December, **2021**.

Particulars	₹	Particulars	₹
To Administrative Overheads	3,90,000	By Gross Profit b/d	12,50,000
To Selling & Distribution Overheads (60% variable)	42,500		
To Commission on Sales	48,750		
To Goodwill	16,500		
To Preliminary Expenses written off	15,500		
To Interest to Vendors (Loan repaid on 31 st October)	10,000		
To Debenture Interest	18,500		

To	Director's Fees	27,500		
To	Depreciation	25,500		
To	Net Profit c/d	6,55,250		
		12,50,000		12,50,000

The sales during the pre-incorporation period amounted to ₹ 15,00,000. The post-incorporation sales totalled ₹ 47,50,000. You are required to apportion net profit between pre and post incorporation periods showing the basis of apportionment. How the pre-incorporation profits are dealt with in the books of accounts of the company?

4. Mohan Company Ltd., was incorporated on 30th June, **2021** to take over the business from 1st January, **2021**. The financial accounts of the business for the year ended 31st December, **2021** disclosed the following information:

Particulars		₹	₹
Sales:	January to June	1,20,000	
	July to December	1,80,000	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 appropriation account for the year ended 31st December, **2021**.

5. X. Ltd., which was incorporated on May 1, **2021**, acquired a business on January 1, **2021**. The first accounts were closed on September 30, **2021**.

The Gross Profit for the period was ₹ 42,000.

Details of other expenses: general expenses ₹ 7,200; directors' remuneration ₹ 12,000; and preliminary expenses ₹ 2,000.

Rent up to June 30 was ₹ 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 ₹ 5,100 per annum.

The Company earned a uniform Gross Profit. The sales up to September **2021** were ₹ 98,000. The monthly average of sales for the first four months of the year was one-half of the remaining periods.

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

6. The Tiger Ltd., was formed on 1st April to take over the business from 1st January. It was agreed that all profits made subsequent to this latter date should belong to the company, but interest on the purchase consideration (₹ 50,000) at the rate of 6% per annum should be paid to the vendors until the final settlement, which took place on 1st June. The following was the profit and loss account, as prepared on 31st December, for the year ending on that date:

Particulars	₹	Particulars	₹
Expenses of Management	3,050	Gross Trading Profit	20,000
Bad Debts	200		
Directors Fees	1,000		
Interest to Vendors	1,250		
Preliminary expenses written off	500		
Depreciation	1,000		
Balance, being net profit	13,000		
	20,000		20,000

It was found that, of the bad debts written off, ₹ 100 related to debts taken over by the Company.

Apportion the profits between prior and subsequent incorporation, assuming that turnover is spread evenly over the year.

7. The Hippo Ltd., was incorporated on 1st March, **2021** and received its certificate of commencement of business on 1st April, **2021**. The company bought the business of the Stream and Co., with **effect** from 1st November, **2020**. From the following figures relating to the year ending 31st October, **2021**, find out the profits available for distribution of dividends and the pre-incorporation profit.
- Sales for the year ₹ 6,00,000, out of which sales up to 1st March were ₹ 2,50,000 and up to 1st April ₹ 3,00,000.
 - Gross profit for the year was ₹ 1,80,000.
 - The expenses debited to the Profit and Loss Account were:

Particulars	₹
Rent	9,000
Salaries	15,000
Directors' fees	4,800
Interest on debentures	5,000
Audit fees	1,500
Discount on sales	3,600
Depreciation	24,000
General expenses	4,800
Advertising	18,000
Stationery and printing	3,600
Commission on sales	6,000

Bad debts (₹ 500 relate to debts created prior to incorporation).	1,500
Interest to vendor on purchase consideration up to May 1, 2021	3,000

8. R & Company Ltd., was formed on 01.04.**2021** to take over the business with effect from 01.01.**2021**.
The Profit and Loss Account of the Company for the year ending 31.12.**2021** given below:

Particulars		₹	Particulars		₹
To	Salaries and allowances	32,000	By	Gross Profit b/d	1,40,000
To	Rent and rates	7,000			
To	Directors' fees	3,600			
To	Commission to agents	11,200			
To	General expenses	9,600			
To	Advertising	2,800			
To	Audit fees	2,000			
To	Debenture interest	3,600			
To	Depreciation	12,800			
To	Interest to vendors (up to 30.06. 2021)	2,000			
To	Net profit	53,400			
		1,40,000			1,40,000

Additional information:

- (i) The average monthly sales for the first three months of **2021** was ₹ 32,000 and for the rest of the year was ₹ 64,000.
(ii) Rent was paid at ₹ 400 per month up to 31.03. **2021** and thereafter it was increased to ₹ 600 per month.

Ascertain profit before and after incorporation.

9. A Public Ltd., Company was formed to take over a running business with effect from 1st April, **2021**. The company was incorporated on 1st August, **2021** and the certificate of commencement of business was received on 1st October, **2021**. The following Profit and Loss Account was prepared for the year ended 31st March, **2022**.

Particulars		₹	Particulars		₹
To	Salaries	24,000	By	Gross Profit b/d	1,60,000
To	Printing & Stationery	2,400			
To	Travelling Expenses	8,400			
To	Advertisement	8,000			
To	Miscellaneous Trade Expenses	18,900			
To	Rent (Office)	13,200			
To	Electricity Charges	2,100			
To	Director's Fees	5,600			

To	Bad Debts	1,600		
To	Commission on Sales	8,000		
To	Audit Fees	3,000		
To	Debenture Interest	1,500		
To	Interest to Vendors	2,100		
To	Selling Expenses	12,600		
To	Depreciation on Fixed Assets	4,800		
To	Net Profit c/d	43,800		
		1,60,000		1,60,000

Additional Information:

- (i) The total sales for the year amounted to ₹ 9,60,000 which arose evenly up to the date of the certificate of commencement, there after sales spurted to record an increase of two-thirds during the rest of the year.
- (ii) Rent of office was paid @ ₹ 1,000 p.m. up to September, **2021** and there-after it was increased by ₹ 200 p.m.
- (iii) Travelling expenses include ₹ 2,400 towards sales promotion.
- (iv) Depreciation includes ₹ 300 for assets acquired in the post-acquisition period.
- (v) Purchase consideration was discharged by the company on 30th September, **2021** by issuing Equity shares.

Prepare a statement showing allocation of profits between pre-incorporation and post-incorporation period and basis of allocation.

- 10.** A Co. Ltd., was incorporated on 01.07.**2021** taking over the business from 01.04.**2021**. The following was the Profit and Loss Account for the year ended 31.03.**2022**:

Particulars	₹	Particulars	₹
Salaries and wages	72,000	Gross Profit b/d	1,40,000
Rent and rates	3,600	Net loss	6,000
Office expenses	24,000		
Commission on sale	16,000		
Free samples	4,000		
Audit fees	2,000		
Depreciation	8,000		
Interest on debentures	6,000		
Directors' fees	2,000		
Formation expenses written off	2,000		
Printing and stationery	4,000		
Sundry expenses	800		
Bad debts	1,600		

	1,46,000	1,46,000
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Additional Information:

- (a) Sales up to 01.07.2021 amounted to ₹ 1,60,000 and thereafter ₹ 2,40,000.
- (b) Rent was paid at ₹ 300 per month.
- (c) Bad debts up to 30.06.2021 was ₹ 400.

Prepare a statement showing profit or loss prior to incorporation.

- 11.** The Elephant Ltd., was registered on 1st January, **2021**, to take over the business of Black and Company as on 1st October, **2020** and obtained its certificate for commencement of Business on 1st February, **2021**. The accounts of the company for the period ended 30th September, **2021** disclosed the following facts:
- (i) The turnover for the whole period ended 30th September, **2021** amounted to ₹ 2,40,000, which ₹ 40,000 related to the period from 1st October, **2020** to 1st February, **2021**.
 - (ii) The Trading Account showed a gross profit of ₹ 96,000.
 - (iii) The following items appeared in the Profit and Loss Account:

Particulars	₹	Particulars	₹
Directors' Fees	1,500	Printing and Stationery	2,400
Auditors' Fees	750	Advertising	4,200
Rents, Rates, etc.	4,800	Travellers' expenses and Salaries	8,400
Staff Salaries	12,000	Bad Debts (of which ₹ 700 Related to Book Debts created before 1 st February, 2021)	2,000
Debenture Interest	6,000		
Depreciation on Plant and Machinery	3,600	Interest to vendors at 6% on ₹ 1,00,000 from 1 st October, 2020 to 31st May, 2021 .	4,000
Preliminary Expenses	2,400		
General Expenses	1,800		
Commission sales	3,600		

You are requested to find out profits available for distribution and profits prior to commencement.

- 12.** The following trial balance was extracted from the books of Heera Ltd. on 1st April, **2021** but was incorporated on 1st July, **2021**. No entries relating to the transfer of the business were entered in the books which were carried on until 31st March, **2022**.

Trial Balance as on 31st March, **2022**:

Particulars	₹	Particulars	₹
Stock (01.04.2021)	42,940	Sales	2,79,300
Purchases	1,96,780	Capital Account (01.04.2021)	2,00,000
Carriage outward	1,650	Current Liabilities	31,660
Travelers' Commission	6,150		
Office Salaries	16,640		
Rent and Taxes	1,640		
Office expenses	2,400		

Director's Salary	15,000		
Fixed Assets	1,25,000		
Current Assets (other than stock)	1,01,200		
Preliminary Expenses	1,560		
	5,10,960		5,10,960

Further Information:

(i)	Stock on 31 st March, 2022 amounted to ₹ 35,420.
(ii)	Purchase consideration ₹ 2,50,000 to be paid by the issue of 25,000 Equity Shares of ₹ 10 each.
(iii)	Gross profit percentage is fixed; turnover is double in April, November and December.
(iv)	Preliminary expenses are to be written off.
(v)	Carriage outward and travelers' commission vary in direct proportion to sales.

Prepare the Income Statement & Balance Sheet for the year ended 31st March, **2022** showing the appropriation between the pre and post-incorporation periods and a Balance Sheet as on 31st March, **2022**.

- 13.** Swetha Ltd. was incorporated on 01-04-**2021** to take over the running business of Soumya Ltd., from 01-01-**2021**. Prepare the Income Statement & Balance Sheet, dividing the profit/loss between pre- and post-incorporation periods, considering the following details:

(i)	Stock at close ₹ 14,000.
(ii)	Bad debts ₹ 200 (₹ 50 belongs to pre-incorporation period).
(iii)	Sales up to April ₹ 7,500.
(iv)	Provision for doubtful debts ₹ 250.
(v)	Depreciated Buildings by 5% and plant by 20%.

The company's trial balance as on 31-12-**2021** was:

Particulars	Debit (₹)	Credit (₹)
Share Capital		22,500
Cash at bank	4,860	
Building	8,000	
Furniture	750	
Salaries	1,200	
Purchases & Sales	48,500	45,000
Plant	1,000	
Sundry debtors & Sundry creditors	4,500	3,000
Rent received		600
Rent Paid	450	
Director's fees	720	
Sundry charges	120	
Interest to vendors paid up to 01-07- 2021	1,000	

	71,100	71,100
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14. The Leopard Ltd., was incorporated on 1st July, **2021** with an authorized capital of ₹ 5,00,000 in Equity Shares of ₹ 10 each to take over as a going concern as from 1st April, **2021**. The agreement for taking over provided that all profits made from 1st April, **2021**, should belong to the company. The purchase consideration of ₹ 2,00,000 together with interest at $8\frac{3}{4}\%$ p.a. was satisfied on 1st October, **2021**, by the allotment to the vendors, 17,500 Equity Shares fully paid and the balance in cash.

The Trial Balance of the Company on 31st March, **2022**, was as follows:

Particulars	Debit (₹)	Credit (₹)
Share Capital		2,25,000
Freehold land-at cost	25,000	
Building -at cost	65,000	
Furniture -at cost	7,500	
Salaries	12,000	
Purchases including stock taken over	4,85,000	
Sales including sales prior to incorporation ₹ 75,000		4,50,000
Sundry debtors	45,000	
Sundry creditors		30,000
Rent received		6,000
Rates & Taxes	3,000	
Repairs	1,500	
Director's fees	1,200	
Miscellaneous Expenses	7,200	
Interest to vendors	8,750	
Cash in hand	1,800	
Cash at bank	48,050	
	7,11,000	7,11,000

You are required to prepare the Income Statement & Balance Sheet for the year ended 31st March, **2022** after taking into account the following adjustments:

(i)	Stock on 31-3- 2022 , ₹ 1,40,000.
(ii)	Bad Debts ₹ 500 (including ₹ 200 out of book debts taken over from the vendors) to be written off.
(iii)	Provision for Doubtful debts to be made at ₹ 2,500.
(iv)	Depreciate Buildings by 5% and Furniture by 10%.

15. Rowlock Ltd., was incorporated on 1st October, **2021** to acquire a business with effect from 1st June, **2021**. The purchase consideration was agreed at ₹ 35,000 to be satisfied by the issue on 1st December, **2021** to the vendor by 20,000 Ordinary Shares of ₹ 1 each, fully paid and 15,000 7% Debentures. The entries relating to the transfer were not made in the books which were carried on without a break until 31st May, **2022**.

On 31st May, **2022**, the trial balance extracted from the books showed the following:

Particulars	₹
Sales	52,185
Purchases	38,829
Wrapping	840
Postage	441
Warehouse Rent & Rates	921
Packing Expenses	1,890
Office Expenses	627
Stock on 31 st May, 2021	5,261
Director's Salary	1,000
Debenture Interest (Gross)	525
Fixed Assets	25,000
Current Assets (Other than stock)	9,745
Current Liabilities	4,162
Formation Expenses	218
Capital Account- on 31 st May, 2021	28,950

You also ascertain the following:

(i)	Stock on 31 st May, 2022 amounted to ₹ 4,946.
(ii)	The average monthly sales for June, July and August were one-half of those for the remaining months of the year. The gross profit margin was constant throughout the year.
(iii)	Wrapping, postage and packing expenses varied in direct proportion to sales, whilst - office expenses were constant each month.
(iv)	Formation expenses are to be written off.

You are required to prepare the Income Statement & Balance Sheet for the year ended 31st May, **2022** apportioned between the periods before and after incorporation.

- 16.** Ashok Ltd., was incorporated on 1st April to take over as from 1st January in the same year an existing business of Desai Brothers. Under the agreement all the profits made from 1st January are to belong to the company. The following balances appeared in the company's ledger as at 31st December, **2021**.

Particulars	₹	Particulars	₹
Share Capital	4,50,000	Preliminary expenses written off	8,000
Bank overdraft	1,65,000	Salaries	48,000
Sundry creditors	65,000	Rent received	13,000
Fixed deposits	35,000	Rates and taxes	7,000
Freehold land	50,000	Repairs to building	3,000
Building at cost	1,30,000	Miscellaneous expenses	22,000
Furniture	15,000	Directors' fees	2,400

Transport vehicles	35,000	Interest to vendors	
Stock on 1 st January, 2021	4,20,000	(up to 30th June, 2021)	17,500
Books debts	95,000	Purchases	7,70,000
Cash in hand	12,000	Sales	9,10,000
		Goodwill	3,100

Stock on 31st December, **2021** amounted to ₹ 4,80,000. Bad debts amounting to ₹ 1,000 of which ₹ 500 related to book debts taken over by the company and a provision of ₹ 5,000 to be for doubtful debts. Depreciation has to be written off at 5% on building, 10% on furniture and 20% on vehicles. Preparing Income Statement showing post and prior to incorporation of the company assuming that the sales are evenly spread over throughout the year and Balance as at the end of year **2021**.

17. KK Limited to take over the existing business as from April 1, **2021**, but the company was not incorporated until July 1, **2021**. No entries relating to transfer of the business were entered in the books, which were carried on without a break until March 31, **2022**. The following Trial Balance was extracted from the books as on March 31, **2022**:

Particulars	Debit (₹)	Credit (₹)
Stock, April 1, 2021	4,300	
Sales		27,800
Purchases	18,900	
Carriage outwards	330	
Travellers' commission	750	
Office salaries and expenses	2,100	
Rent and rates	1,200	
Capital Account April 1, 2021		23,000
Directors' fees	1,800	
Fixed assets	13,400	
Current liabilities		3,700
Current assets (other than stock)	11,200	
Preliminary expenses	520	
	54,500	54,500

You are given the following information:

- (i) Stock, March 31, **2022**, ₹ 4,400.
- (ii) The purchase consideration was agreed at ₹ 30,000 to be satisfied by the issue of 3,000 Equity Shares of ₹ 10 each.
- (iii) The Gross Profit margin is constant and the monthly sales in April **2021**, February, **2022** and March **2022**, are double the monthly sales for the remaining months of the year.
- (iv) The preliminary expenses are to be written off.

(v) You are to assume that carriage outwards and travelers' commission vary in direct proportion to sales.

Prepare the Income Statement & Balance Sheet for the year ended March 31, **2022**, apportioning the periods before and after incorporation. Ignore depreciation.

18. Adarsh Udyog Ltd., incorporated on 01.05.**2021**, received the certificate to commence business on 31.05.**2021**. It had acquired a running business with effect from 01.01.**2021**. The purchase consideration as ₹ 50,00,000 of which ₹ 10,00,000 was to be paid in cash/ bank and ₹ 40,00,000 in the form of fully paid shares.

The company also issued shares for ₹ 40,00,000 for cash/bank. Machinery costing ₹ 25,00,000 was then installed. Assets acquired from the vendors were: Machinery - ₹ 30,00,000; Buildings - ₹ 6,00,000; and Patents - ₹ 4,00,000.

During the year **2021** the total sales were ₹ 1,80,00,000, the sales per month in the first half-year being one-half of what they were in the latter half-year. At the end of the year cash at bank ₹ 5,00,000

The gross profit of the company, before charging the following expenses, was ₹ 21,24,000.

Particulars	₹
Depreciation	5,40,000
Audit fees	26,000
Directors' fees	60,000
Preliminary expenses	10,000
Office expenses	2,40,000
Selling expenses	1,98,000
Interest to vendors	50,000

Ascertain the pre-incorporation and post-incorporation profit and prepare the balance sheet of the company as on 31.12.**2021**. The closing stock was valued at ₹ 10,00,000.
