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DEPARTMENT OF COMMERCE

JANTA KOSHI COLLEGE BIRAUL, DARBHANGA

For – LNMU B. Com part -2 ,PAPER -IV CORPORATE ACCOUNTING (Hons.)

Lecture -5 unit-2&3 profit or Loss prior to incorporation &Accounting for Amalgamation and Reconstruction

Acquisition of Business

Q.1 What do you understand by "Purchase Consideration"? How is it ascertained? What journal entries are passed in the books of Purchasing Company for the purchase of business and payment of purchase consideration?

Ans.: Purchase Consideration:

Whenever any running business is purchased by any newly established company it is known as "Purchase of Business". The concern selling its business is known as „Vendor‟. The amount paid by purchaser to

vendor in consideration of purchase of business is known as purchase consideration.

Ascertainment of Purchase Consideration : It can be decided by following two methods :-

(1) Net Payment Method:** **According to this method purchase consideration is equal to amount paid by purchaser in consideration of purchase of business which also includes shares or debentures issued by purchasing company.

(2) Net Assets Method:** **If no purchase consideration has been decided between purchaser and seller or only a part of it has been decided, then purchase consideration can be decided by net assets method. Computation of Net Assets: Total of assets of vendor taken over at revalued price (If revalued price is not given then book value) less total of Liabilities of vendor taken over at revalued price (If revalued price is not given then book value.)

Calculation of Value of Good will or Capital Reserve :

- ✓ ***Goodwill = Purchase Consideration – Net Assets***
- ✓ ***Capital Reserve = Net Assets – Purchase Consideration***

Note : Either there will be goodwill or capital reserve, both can not arise in The same question.

Journal Entries in the Books of Purchaser when Assets and Liabilities Are Purchased :

1.Sundry Assets A/c Dr. (Show each assets separately)

To Sundry Liabilities A/c (Show each liability separately)

To Vendor "s A/c (By purchase consideration)

(Sundry assets and liabilities taken over)

Note : If total of Debit side is less, balance amount will be shown in the Debit side as Goodwill. If total of Credit side is less balance amount will be Shown as capital reserve in credit side.

Final Amount is paid to Vendor :

2. Vendor "s A/c Dr. (By purchase Consideration)

To Equity Share Capital A/c

To Preference Share Capital A/c

To Debentures A/c

To Bank A/c

(Purchase Consideration discharged)

If there is any delay in payment to vendors, interest will be paid to Vendors and following entry will be passed :-

3. Interest to Vendor A/c Dr.

To Bank A/c

(Being interest paid for delay in payment of)

Q.2 What would be accounting treatment if purchasing company collects And pays the amount of debtors and creditors respectively of vendor?

Ans.: Following entry will be passed when amount is recovered from debtors or Vendors :

(i) Cash A/c Dr. (Net amount realized)

To Vendor "s Adjustment A/c

Note : No entry will be passed for discount or bad debts of Vendor.

(ii) Following entry will be passed when any amount is paid to Creditors of Vendors :

Vendors Adjustment A/c Dr. (Total amount paid)

To cash A/c

(iii) If any commission is accrue for providing such service :

Vendors Adjustment A/c Dr.

To Commission A/c

(iv) For making final payment to Vendors :-

Vendors Adjustment A/c Dr.

To cash A/c

Q.3 What is "Profit Prior to and Post Incorporation"? Explain the method of Ascertaining them.

Ans.: According to the companies Act, 1956 a company comes into existence Only from the date on which certificate of incorporation is obtained by it.

If any company has purchased a running business and certificate of Incorporation is obtained later on, then profit earned till the date of such Certificate will be known as profit prior to „incorporation" rest of the profit Will be known as profit of post incorporation.

Profit prior to incorporation is a capital profit and transferred to capital Reserve. If it is a loss it can be transferred to goodwill account.

Steps to Ascertain Profit Prior To and Post Incorporation :

(i) At first, Trading Account will be prepared to ascertain gross profit For the period. Trading account is prepared for whole of the year, The word „for the period ending" will be used

instead of „for the year ending. So, Trading Account may be prepared for a period less Than of more than 12 months.

(ii) Time ratio will be determined between profit prior to incorporation And post incorporation. All expenses shown in P&L account related To time such as rent, salary, insurance premium, depreciation etc. Will be apportioned on the basis of time ratio.

(iii) Sales ratio will be determined on the basis of sales prior to Incorporation and post incorporation. Gross profit for the period Will be apportioned on this basis. All expenses related to sales such As advertisement expenses, commission, expenses on agents, bad Debts, packing expenses etc. will be apportioned on this basis.

(iv) Some expenses are of different nature which can neither be Apportioned on time basis nor it can be apportioned on sale basis. Such expenses can be apportioned as follows:

a) Some expenses are related to post incorporation period only e.g. vendor is an individual or firm then salary to owner, interest on capital, drawing etc. are purely expenses of prior period and no part of it will be apportioned to post incorporation period.

b) ***Some expenses are related to post incorporation period only e.g., purchases is company and vendor is not a company then interest on debentures, directors fee, share transfer fee (income) and amortization of preliminary expenses relates to Post incorporation. No part of it can be charged against Profit prior to incorporation.***

Note: In case vendor and purchaser both are company Ltd. Then it cannot be said that expenses relates to post Incorporation period only. So, in that case such expenses Related to company form should be apportioned on time Basis.

c) ***For some type of expenses, specific information is provided Either directly or indirectly. In such a situation expenses Should be apportioned accordingly.***

After following steps aforesaid steps profit & loss account is Prepared in columnar form. Two columns are prepared for the Pre-incorporation items and post incorporation items. All the Pre-incorporation items and past incorporation items will be Shown in these two columns separately. The difference of debit And credit side will be the net profit or loss prior to Incorporation and post incorporation. Pre-incorporation profit is Revenue profit and post incorporation profit is capital profit