

Dalton plc — adjusting the profit and loss account

Dalton plc: trading and profit and loss account for period 1.1.2002 to 31.12.2002			
	£m	£m	£m
SALES REVENUE			1,500
Opening stock		140	
plus Cost of materials		<u>640</u>	
		780	
less Closing stock		150	
minus COST OF SALES (direct costs)			<u>630</u>
equals GROSS PROFIT			870
minus EXPENSES/OVERHEADS			
Salaries	320		
Depreciation	130		
Marketing	100		
Administration	70		
Rent and rates	40		
Other expenses	<u>90</u>		
			750
equals NET PROFIT BEFORE TAX			120
minus CORPORATION TAX			30
equals NET PROFIT AFTER TAX			<u>90</u>
THE APPROPRIATION ACCOUNT			
DIVIDENDS TO SHAREHOLDERS		30	
RETAINED PROFIT		<u>60</u>	
			90



Exercise 1 14 marks

A number of transactions are undertaken. Taking each transaction separately, show how each of the following changes would affect the net profit before tax:

- An increase of rent and rates from £40m to £42m. (2 marks)
- Efficiency savings leading to a 25% reduction in salaries. (2 marks)
- Closing stock being recalculated as £135m instead of £150m. (2 marks)
- An increase of 10% in the value of materials purchased and goods sold. (3 marks)
- The purchase on 1 January of a machine for £46m. The machine has a residual value of £10m and an expected lifetime of 4 years. (3 marks)
- A decision by the board of directors always to pay 20% of the net profit after tax to shareholders as a dividend. (2 marks)

Exercise 2 6 marks

Combining all six changes in Exercise 1, amend the trading and profit and loss account and the appropriation account for Dalton plc (assume that corporation tax is 25% of net profit before tax). By what percentage has the net profit after tax changed?

Exercise 3 15 marks

- (a) Discuss the factors that the board of directors might consider before deciding the level of dividends that will be paid to the shareholders. (8 marks)
- (b) In the light of these factors, explain why the board might decide to change the dividend to be paid to its shareholders. (7 marks)

Exercise 4 7 marks

Returning to the original trading and profit and loss account for Dalton plc, examine the effects of each of the following changes. Taking each change separately, show how it would affect the net profit before tax.

- (a) An increase in selling price of 20%, maintaining the same levels of sales. (2 marks)
- (b) Administrative savings of £30 million. (2 marks)
- (c) The purchase of an additional £100 million of materials, £40 million of which remains in stock at the end of the year. (3 marks)

Exercise 5 8 marks

Combining all the changes in Exercise 4, amend the trading and profit and loss account and the appropriation account for Dalton plc. Assume that one-third of the profit after tax is paid to shareholders as dividends and that corporation tax is cut from 25% to 20% of net profit.

