Subject CB1

Corrections to 2022 study material

0 Introduction

This document contains details of any errors and ambiguities that have been brought to our attention in the Subject CB1 study materials for the 2022 exams. We will incorporate these changes into the study material each year. We are always happy to receive feedback from students, particularly details concerning any errors, contradictions or unclear statements in the courses. If you have any such comments on this course please email them to CB1@bpp.com.

You may also find it useful to refer to the Subject CB1 threads on the ActEd Discussion Forum. (You can reach the Forums by clicking on the 'Discussion Forums' button at the top of the ActEd homepage, or by going to **www.acted.co.uk/forums/**.)

This document was last updated on **19 November 2021**.

1 Course Notes

Chapter 2

Page 15 ***(added on 19 November 2021)***

The final paragraph of the chapter summary has been cut off at the bottom of the page. A replacement page is attached.

Chapter 13

Page 25 ***(added on 19 November 2021)***

The final ratio in the chapter summary has been cut off at the bottom of the page. A replacement page is attached.

Chapter 2 Summary

Types of business entity

There are four main types of business entity: the sole trader, the partnership, the limited company, and the limited liability partnership.

A *sole trader* is a business which is owned by one person and which is not a limited company. Sole traders have unlimited liability for their business debts.

A *partnership* is a business which is owned by more than one person and is not a limited company. All the partners are jointly and severally liable for any business debts.

A *limited company* is a business which has a legal identity separate from the owners of the business. A company is owned by its shareholders. Their liability is limited to the fully paid value of their shares.

A *public limited company* sells share to the general public and has an issued share capital of at least £50,000. Public companies can apply for a listing on the Stock Exchange.

A *private limited company* is a company that is not a public limited company. Private companies' shares cannot be listed on the Stock Exchange.

A *limited liability partnership* (LLP) is owned by its members but has a separate legal identity. The members benefit from limited liability. The members are free to agree amongst themselves the relationship between them.

A *social enterprise* is a business with a clear social or environmental aim. Social enterprises are defined by this, rather than the legal form of the business.

Pros and cons of limited companies

Limited liability makes it easier for a company to raise capital. This is particularly important for business ventures where there is a risk of incurring substantial debts, or businesses which need to raise large amounts of finance from many people.

The main disadvantage of limited companies is that creditors may not get their money back if the company is wound up. Also, ownership is often divorced from control.

The practice questions start on the next page so that you can keep the chapter summaries together for revision purposes.

Banks

Banks earn profits by earning more interest on their assets than they are required to pay to finance their liabilities. The difference is called the Net Interest Spread (NIS) or Net Interest Margin (NIM). In addition, a bank will need to regularly assess 'impairments' to the values of some assets, which will lead to further losses, and banks will earn profits from other activities referred to as 'non-interest income'.

Banks are heavily regulated to protect depositors in the event that the bank makes losses. This regulation can involve:

- requiring a bank to hold capital that ranks lower than depositors (for example, equity capital or Core Equity Tier 1 (CET1) capital)
- requiring a bank to hold a proportion of its assets in highly marketable instruments
- ensuring that the riskiness of a bank's asset portfolio, as measured by its risk-weighted assets, is not excessive with respect to its equity capital buffer.

Three key accounting ratios that reflect a bank's balance sheet strength include:

1. CET1 capital ratio which equals $\dfrac{\text{CET1 capital}}{\text{risk-weighted assets}}$
2. Liquidity coverage ratio which equals $\dfrac{\text{High Quality Liquid Assets}}{\text{30 calendar day stresses outflows}}$
3. Loan to deposit ratio which equals $\dfrac{\text{personal and corporate loans}}{\text{personal and corporate deposits}}$.

Three key accounting ratios that help analyse a bank's profitability include:

4. Net Interest Margin (NIM)
5. Cost to income ratio
6. Return on capital employed.

The practice questions start on the next page so that you can keep the chapter summaries together for revision purposes.