

Chartered Banker

Leading financial professionalism

Professional Banker Diploma

Introduction to Business Banking

Key Updates – February 2012

These notes must be read in conjunction with Edition 1 (October 2010) of the main textbook

**The material contained with this update document will be examined
with effect from 1st May 2012**

Chapter 1

Page 8

3rd paragraph, opening sentence is replaced with:

At the time of writing the economy has been in a state of recession and is still struggling with low, or no growth.

4th paragraph: after "...radio," is amended to read:

quality newspapers and journals (including *Chartered Banker*), and the internet.

Page 10

The Financial Services Authority (FSA) is replaced with a new heading: **Regulation**

The final sentence of the paragraph is replaced as follows:

In 2010 the government outlined plans to reform the UK regulatory framework. Prudential regulation of financial institutions will come under the supervision of the Prudential Regulation Authority (PRA), a subsidiary of the Bank of England. The Financial Policy Committee (FPC) within the Bank of England will be responsible for macro-prudential regulation, and the Financial Conduct Authority (FCA) will be responsible for conduct issues across the entire spectrum of financial services. These changes are expected to be in place by the end of 2012 once the legislation has been passed. You should keep in touch with developments through the quality press and the *Chartered Banker*. The Bank of England website will also be a useful source of information. [www.bankofengland.co.uk]

Code of Practice

3rd paragraph: First sentence remains (Banks are very large organisations...)

Remainder of the whole section down to the Quick Question is replaced with following paragraph:

To inform customers of what level of service and conduct of fair dealing they were entitled to expect, the banks, until November 2009 subscribed to a voluntary Banking Code. The financial crisis of 2008 has meant that the banks have now moved away from this voluntary code and comply with Financial Services Authority (FSA) regulation that is no longer voluntary. The FSA have issued a Banking Code of Conduct Sourcebook (BCOBS) and also their "Principles for Business". (www.fsahandbook.info/FSA/htm/handbook/).

Page 11

Partnerships, line 2, "(in Scotland)" is added after "which is"

Chapter 2

Page 18

Introduction

New bullet point added after “foreign currency exchange transactions”: **interest rate risk**

Current accounts: line 3, “company” is changed to “business”

In last line of text before Quick Question, the word “firm’s” is replaced by “business’s”

Page 19

Money transmission: 2nd paragraph, line 2: “every aspect” is changed to “**all aspects**”

3rd paragraph, 2nd last line: “automated” is changed to “**electronic**”

Page 21

Overdraft: 1st paragraph, line 2: “company’s” is changed to “**business’s**”

Page 25

Insurance: line 2: “**individually**” is deleted

Page 28

Key Words: forward contract is replaced with **exchange rate risk**

Chapter 3

Page 31

Objectives, 1st bullet: “... and projects under the Private Finance Initiative (PFI)/Public-Private Partnership (PPP)” is deleted.

Page 33

Partnerships, line 1: “under Scots law” is deleted.

Page 34

Joint and several liability New 3rd paragraph is added:

In England and Wales it is the partners who are the legal entities. There each partner in a partnership is liable jointly for the debts of the firm. However, the bank’s mandate (account opening document) will include a joint and several liability clause rendering each partner liable for the debts of the partnership.

Page 35

2 new paragraphs are added before Question Time 3:

Limited liability partnerships

An additional business structure is the limited liability partnership (LLP), a legal entity which is separate from its members in that each member of the partnership acts as an agent of the partnership. LLPs are governed by the *Limited Liability Partnerships Act 2000* and the *Limited Liability Partnerships Regulations 2001*. An LLP must be registered at Companies House in the same way as a company.

LLPs have become a common form of business structure, for example solicitors, auditors and surveyors often constitute themselves as limited liability partnerships. An LLP is an alternative corporate business vehicle that gives the benefits of limited liability but allows its members the flexibility of organising their internal structure as a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of members will be limited. The disclosure requirements are similar to those for a company. LLPs are required to provide financial information equivalent to that of companies.

Page 37

Public Limited Companies

Final paragraph: "set out by the UK Listing Authority and the London Stock Exchange" is added after "regulations"

Memorandum and Articles of Association

First line: "artificial entity" is now "**distinct** entity"

Page 38

Articles of Association

2nd paragraph, 3rd sentence: "New model Articles of Association **have been published to replace Table A.**"

Pages 39-40

The **whole section on Private Finance Initiative (PFI)/Public-Private Partnership (PPP)** has been removed.

Page 41

Review

The last point is deleted.

Chapter 4

Page 48

Second paragraph, third line down, is amended to: "... and then obtain **internal credit** approval for the loan"

Page 59

1st bullet: "(legal mortgages in England and Wales)" is added.

Page 62

Overdrafts

Final paragraph, 2nd sentence is replaced with:

Although overdrafts are normally repayable on demand there will still be a number of terms and conditions, agreed at the outset, with which the customer must comply during the term of the overdraft facility.

Chapter 5

Page 89

Yearly Analysis...: "Debentures" is changed to "Debentures/Secured Loans"

"Preference Shares" have been deleted.

Page 90

Trading Results analysis form has been replaced with the following:

Customer name.....

Profit and Loss Account for period to _____

	<u>£000s</u>	<u>£000s</u>	<u>£000s</u>
Sales			
Net purchases (or Cost of Sales)			
Gross Profit			
Distribution Costs & Administration Expenses			
Operating Profit			
Interest payable			

Profit before tax			
Tax			
Profit after tax			
Dividends			
Retained profit			

Note : Cost of Sales = Opening Stock plus Purchases, less Closing Stock

Ratios

Stock turnover ratio: Stock/ Cost of Sales x 365

Page 91

Auditing of the accounts

3rd paragraph, last sentence is replaced with:

Always ensure that you read the auditor's certificate and that you thoroughly investigate and understand the reasons behind anything other than a clean auditor's certificate.

Page 93

Case Study (W Smith plc) accounts are now as follows:

Balance Sheet

	20X1	20X2	20X3
	<u>£000s</u>	<u>£000s</u>	<u>£000s</u>
Fixed assets			
Goodwill	85	65	45
Land & buildings	625	625	625
Plant & machinery	530	615	700
Total Fixed Assets	1,240	1,305	1,370
Current assets			
Stock	330	360	380
Debtors	375	405	420
Cash	-	-	-
Total Current Assets	705	765	800
Total Assets	1,945	2,070	2,170

Current Liabilities			
Bank loans and overdrafts	50	50	50
Creditors	60	100	140
Current tax payable	150	185	210
Proposed dividend (Provisions)	60	70	85
Total Current Liabilities	320	405	485
Creditors: Amounts falling due after more than one year (or Non-Current Liabilities)			
Borrowings:			
7% Debentures	200	200	200
10% Unsecured Loan Stock	400	400	400
Bank Term Loan	350	350	350
Total Non-Current Liabilities	950	950	950
Total Liabilities	1,270	1,355	1,435
Net Assets	675	715	735
Shareholders' Equity (or Shareholders' Funds, or Capital & Reserves)			
Share capital	375	375	375
Reserves (or Retained earnings)	300	340	360
Total Equity	675	715	735

Profit and Loss Account (or Income Statement)

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>
	<u>£000s</u>	<u>£000s</u>	<u>£000s</u>
Sales	1,800	2,160	2,520
Net purchases (or Cost of Sales)	720	920	1,150
Gross Profit	1,080	1,240	1,370
Distribution costs & Administration Expenses	635	720	810
Operating Profit	445	520	560

Interest payable	85	90	110
Profit before tax	360	430	450
Tax [not given in this example]			
Profit after tax			
Dividends [not given in this example]			
Retained profit			

Note: Depreciation of fixed assets and any amortisation (writing down the value of intangible fixed assets, like goodwill) will be included under Distribution Costs and Administration Expenses. These amounts will be separately disclosed in a Note to the Accounts.

Page 95

Gearing Ratio

“including preference shares” has been deleted from the calculation of this ratio.

Paragraph below the ratio: The sentence “Capital cannot ... sanction.” is deleted

A new paragraph is added before Question Time 8:

Notes

- 1 Some banks use all interest-bearing debt in the above ratio, thus including the amount of the overdraft and any other short term borrowings.
- 2 To express the gearing ratio as a percentage the calculation would be:
All interest-bearing debt (borrowings), divided by Proprietors’ funds (Capital & Reserves), and multiplied by 100.
- 3 Preference shares, if any, can be included as borrowing because they pay a fixed rate like interest.

Page 96

Interest cover ratio

Paragraph above Question Time 9 has been replaced with:

It is usual to include the fixed rate of dividend paid out on any preference shares in the interest cover ratio as this dividend needs to be paid just like interest on a loan.

Page 99

Operating/activity ratios

2nd paragraph: “such as Distribution Costs and Administration Expenses” is added after “... all fixed costs”

Page 100

Question Time 12: The 2nd sentence is deleted.

Breakeven ratio: ratio now reads "Gross margin %"

New sentence added to end of next paragraph:

In the case study, the fixed costs (overheads) detailed are Distribution Costs and Administration Expenses.

Page 101

Stock turnover ratio has been amended to read: **Stock/Cost of Sales x 365**

In the "reminder" below the ratio: "Cost of Goods Sold" is changed to "**Cost of Sales**"

2nd paragraph after this has been replaced with the following:

Generally, an increasing stock turnover shows that sales are rising which should be reflected in increased profits, but it could also be caused by a change in stockholding policy. For example, if a firm in the past always held two months' stock in hand, we would expect to find a stock days on hand of sixty or so days. Change the stockholding to one month and stock days on hand falls to 30. Such a decision would be beneficial to the firm in one major respect – less money tied up in stocks would lower costs and increase liquidity. This would have to be balanced against the risk of running out of stock more frequently which could result in loss of sales greater than the cost savings made by reducing stock levels.

Question Time 13: The 2nd sentence is deleted.

Page 102

Debtors and creditors ratios

1st paragraph, line 2 – after "customers" is added: "**of the business (its debtors)**".

Line 3 – after "suppliers" is added: "**(its creditors)**".

In **Creditors ratio** "Credit purchases" is changed to "**Cost of Sales**".

Paragraph before Quick Question is replaced by the following:

If sales are not split into credit and cash sales, then the credit sales figure will not be given separately. In these circumstances, it is common to use the total sales figure, if possible applying your knowledge or research of the type of business you are dealing with to make some assessment of the likely amount dealt with on credit. Although these two ratios are quite easy to calculate, they can tell you a lot about the way the business is being operated.

Paragraph below the Quick Question: the 2nd sentence ("The explanation... cash") is deleted.

In the 3rd sentence: the words "This would obviously...where the" are deleted. This (new) 2nd sentence now reads: "It could be that the business is not keeping ...customers."

3rd last paragraph, lines 1 & 2: the words "more cash sales or" are deleted.

Page 104

New information above the **Example**:

ROCE = Net Profit/Capital & Reserves. This is a common method of calculating ROCE.

Page 106

Yearly Analysis...: "Medium & Long term Liabilities" has been changed to:
"Debentures/Secured Loans"

"Preference Shares" has been deleted.

Page 107

Trading Results: replaced with the following:

Customer name.....

Profit and Loss Account for period to _____

	<u>£000s</u>	<u>£000s</u>	<u>£000s</u>
Sales			
Net purchases (or Cost of Sales)			
Gross Profit			
Distribution costs & Administration Expenses			
Operating Profit			
Interest payable			
Profit before tax			
Tax			
Profit after tax			
Dividends			
Retained profit			

Ratios

"Stock Turnover Raw Materials" and "Stock Turnover Finished Goods" have been deleted and replaced with "Stock Turnover".

Page 111

Cash Flow Report

Note 1 is amended to read "Retained earnings are profits after payment of **tax** and dividends"

Page 112

Paragraph 3 is replaced with:

A measure used in lending covenants, similar to interest cover, is cash cover. This is calculated by dividing "Cash from Operations after tax" by "Finance Costs". We saw above that in the specimen cash flow report the cash cover is 3.27 times.

Page 113

Review

Gearing ratio:
$$\frac{\text{Proprietors' funds}}{\text{Medium and long term borrowings}}$$

Breakeven ratio:
$$\frac{\text{Fixed costs}}{\text{Gross margin \%}}$$

Stock turnover ratio:
$$\text{Stock/Cost of Sales} \times 365$$

Creditors ratio:
$$\text{Creditors/Cost of Sales} \times 365$$

Chapter 6

Page 118

Introduction

2nd paragraph, last line: "alternative" is changed to "**primary**"

Need for security: "(a legal mortgage in England and Wales)" is added to point 1.

"(or a debenture in England and Wales)")" is added to point 3.

Page 119

1st line: "fully" is changed to "**legally**"

Page 121

Security over land and buildings

1st paragraph, line 1, after "Heritable property" is added: "**(a Scottish term)**".

2nd paragraph, line 3, after "obligation" is added: "**(or bond)**"

2nd paragraph, line 4, “the obligations” is changed to “**this obligation**”

2nd paragraph, line 5, “personal obligation” is replaced with “**bond**”; “**and Wales**” is added after “England”.

Page 123

Final paragraph: the second sentence has been deleted.

Page 124

Quote from the Business Banking Code has been deleted.

Advantages, number 4: after “sequestrated” is added: “(made bankrupt)”

Page 125

Case study: a final sentence is added:

We covered joint and several liability in chapter 3.

Page 127

Floating charge: a new second paragraph is added:

In Scotland the security is constituted by way of a bond and floating charge. In England and Wales banks take a debenture.

Advantages

1 now reads: The lender can take a charge over assets which would otherwise be difficult to charge, **such as stock**.

Page 130

Registration

1st paragraph, 3rd line, after “Edinburgh” is added: “**or Cardiff**”.

Security margins

2nd paragraph, 2nd last line: “in that the proceeds from the security might be” is deleted and replaced by: “**and its value proved...**”

Page 132

Commercial/business premises

2nd last line: “**approval**” is added after “change of use” and “**from the local authority**” is added after “circumstances”.

Page 133

Margins 1st bullet point now reads:

For domestic property being taken as security for business borrowing or in support of a letter of guarantee the margin would be in the range of 60% - 75%. Keep in mind that if we are being offered a second charge over a domestic property behind a mortgage provider then the first charge will require to be deducted from the discounted property value. In most cases, a professional valuation is required.

Page 135

Floating charge

2nd line: “as we saw earlier in Question Time 18” is added after “debt”.

A final sentence is added to the paragraph: “Each bank will have its own system for valuing floating charges.”

Page 136

Review

3 new points are added before the final one:

- Retention of title
- The importance of registering most securities granted by companies
- Assets held as security must be insured

Chapter 7

Page 140

Introduction

3rd paragraph, line 3: “if the expected funds do not materialise” is deleted.

Assessing credit risk

Paragraph below the first set of bullets, 2nd line now reads: “... lending of money is still essentially a matter of judgement”

2nd last line of above paragraph: “statements” is changed to: “**accounts**”

Page 142

Profitability

1st paragraph, last line: “will” is changed to “**can**”

Page 145

Covenants

The 2nd sentence now starts: "A covenant is a formal agreement..."

Page 146

1st paragraph, line 5: "Are they ..." is replaced by: "Is accounting information..."

1st paragraph, final sentence now reads:

All covenants must be tested on agreed testing dates and robust diary systems must be in place to ensure covenant testing takes place when due.

Page 154

Note is now **Notes** and the three sentences are listed as separate bullet points (content remains the same).

Page 159

1st paragraph, line 2: "However" is deleted.

Chapter 8

Page 170

1st bullet point, first line: "cheques **lodged**" replaces "cheques **issued**" and "to the drawer's bank to obtain payment more quickly" is added after "presented".

3rd bullet point is changed to read: "the bank receives a direct debit mandate in favour of a finance company"

Page 171

Letskip case study, 2nd paragraph, "standing order" is changed to "direct debit mandate".

Page 177

Additions to definitions:

Diligence

There is no equivalent collective term in English law to equate with the Scots law "diligence". The law in England uses various terms for different actions: "summons", "third party debt order" (formerly known as "garnishee orders"), "writs of sequestration", and "injunctions" to denote procedures which to some extent have similar effects to different types of Scots law diligences.

Bankruptcy

In England, the term covers the process by which an individual is declared by the courts unable to pay their debts and has their affairs administered by a trustee in bankruptcy with assets realised for the benefit of creditors.

Sequestration

Line 1, "in Scotland" is added after "bankruptcy". New sentence at the end: "Sequestration is not a term used in England and Wales, where bankruptcy is the term."

Page 178

2nd last paragraph: after *Edinburgh Gazette* is added "(*London Gazette* for England)".

Page 179

Powers and duties of the administrator, 1st paragraph, final line: "rates and taxes" is deleted.

Page 181

Creditors' voluntary winding-up: *London Gazette* is added after *Edinburgh Gazette*.

Sole traders and partnerships

A new paragraph is added:

The bankruptcy procedure in England and Wales begins with a petition to the County Court, or in some cases the High Court, under the same requirements for the creditor as we have seen above.

Chapter 9

Page 193

In paragraph beginning "Compounding these problems" (mid page), "Separate Investment Companies" has been replaced with "**Special Investment Vehicles**"

Page 196

Stages of the Crisis: 2006 - 2009 is now **Stages of the Crisis from 2006**

Start of this text has been relocated to page 195

Page 195

Note 1 is relocated as a footnote and referenced to paragraph beginning "Failure of 2 large hedge funds ... **RMBS¹ funding** ...".

Notes 2 - 4 have been relocated to page 196 as footnotes and referenced to right-hand paragraphs 3 and 4 of the Stages of the Crisis text (**mark-to-market, SIVs, Fannie Mae and Freddie Mac**).

Page 201

Regulation

3rd last paragraph now reads:

However, this structure will change in the near future as the Coalition Government has announced its proposed new regulatory framework as set out in chapter 1.

Page 204

MCQ4 has been rewritten and now says:

When discussing products and services with customers, it is good practice to:

- A listen
- B ask questions
- C discuss products and services that fulfil the customer's needs
- D all of the above.

Answers to Question Times

Page 208

Question time 8

$$\text{Gearing ratio} = \frac{\text{Proprietors' stake}}{\text{Medium and long term borrowings}}$$

("including preference shares" is deleted)

Question time 9

Interest cover ratio

Calculation is now:

<u>20X1</u>	<u>20X2</u>	<u>20X3</u>
<u>445,000</u>	<u>520,000</u>	<u>560,000</u>
85,000	90,000	110,000
= 5.23	= 5.78	= 5.09

Page 209

1st paragraph: all of this paragraph is deleted apart from the final sentence.

Question time 12

Operating ratio: below the ratio, a sentence is added:

Use Distribution Costs and Administration Expenses in this case.

Calculation is now:

<u>20X1</u>	<u>20X2</u>	<u>20X3</u>
<u>635,000</u>	<u>720,000</u>	<u>810,000</u>
1,800,000	2,160,000	2,520,000
= 35.27%	= 33.33%	= 32.14%

A sentence is added below this: No cause for concern here.

Question time 13

The opening paragraph and remaining calculations are deleted.

The following is inserted:

Stock ratio = Stock / Cost of Sales x 365

Stock	330,000	20X1
	360,000	20X2
	380,000	20X3
Cost of Sales	720,000	20X1
	920,000	20X2
	1,150,000	20X3
Stock turnover in days =	167	20X1
	143	20X2
	121	20X3

Question time 14

Creditors ratio is amended to: Creditors/Cost of Sales x 365

No change to the calculations.

Question time 15

Gross profit ratio

Calculation is now:

<u>20X1</u>	<u>20X2</u>	<u>20X3</u>
<u>1,080,000</u>	<u>1,240,000</u>	<u>1,370,000</u>
1,800,000	2,160,000	2,520,000
= 60%	= 57%	= 54%

Return on capital employed

A new sentence is added below the calculations:

Here the intangible asset goodwill has been deducted from Owners' stake.

Replace "Trading Results" with:

Customer Name: W Smith plc

Profit and Loss Account (or Income Statement)

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>
	<u>£000s</u>	<u>£000s</u>	<u>£000s</u>
Sales	1,800	2,160	2,520
Net purchases (or Cost of Sales)	720	920	1,150
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Distribution costs & Administration Expenses	635	720	810
Operating Profit	445	520	560
Interest payable	85	90	110
Profit before tax	360	430	450
Tax [not given in this example]			
Profit after tax			
Dividends [not given in this example]			
Retained profit			

Ratios

Interest coverage:

20X1	5.23
20X2	5.78
20X3	5.09

“Stock Turnover Raw Materials” and “Stock Turnover Finished Goods” are deleted and replaced with:

Stock turnover in days	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>
	167	143	121

Answers to Multiple Choice Questions

Chapter 9

- 1 D
- 2 B
- 3 D
- 4 **D**
- 5 A

Glossary

Page 219

Definition of **Collateral security** is changed to:

Security usually given in support of a guarantee.

Covenants - First sentence has been amended to:

Formal agreements made at the time of **granting of** the loan.

Page 220

Forward Contract

Final sentence has been amended to:

A contract between two parties to undertake an exchange **in the future** at a price agreed now.

Page 224

Stock turnover ratio: Stock/Cost of Sales x 365

The terms **Limited Partnership** and **Private Finance Initiative/Public-Private Partnership** have been removed.