

Subject CB1

CMP Upgrade 2023/24

CMP Upgrade – revised following the IFoA announcement that the April 2024 exams will not be Objective Based Assessment (OBA)

This CMP Upgrade lists the changes to the Syllabus, Core Reading and the ActEd material since last year that might realistically affect your chance of success in the exam. It is produced so that you can manually amend your 2023 CMP to make it suitable for study for the 2024 exams. It includes replacement pages and additional pages where appropriate.

Alternatively, you can buy a full set of up-to-date Course Notes / CMP at a significantly reduced price if you have previously bought the full-price Course Notes / CMP in this subject. Please see our *2024 Student Brochure* for more details.

We only accept the current version of assignments for marking, *ie* those published for the sessions leading to the 2024 exams. If you wish to submit your scripts for marking but only have an old version, then you can order the current assignments free of charge if you have purchased the same assignments in the same subject in a previous year, and have purchased marking for the 2024 session.

This CMP Upgrade contains:

- all significant changes to the Syllabus and Core Reading
- additional changes to the ActEd Course Notes and Assignments that will make them suitable for study for the 2024 exams.

0 Changes to the Syllabus

In line with all subjects, the IFoA moved the CB1 syllabus to a new template which includes amended wording of many of the objectives in plain English. In a number of places, similar objectives have been combined or repetition removed. This section does not set out all of these changes. This section contains all the *non-trivial* changes to the syllabus objectives.

Chapter 2 (2023 chapter numbering)

Objective 2.1.4 (Discuss the economic advantages and disadvantages of a limited company as a business entity) has been removed. The current Objective 2.1.5 becomes 2.1.4 and a new Objective 2.1.5 has been added as follows:

2.1.5 Advantages to a company of limited liability.

Chapter 13 (2023 chapter numbering)

Objective 4.1.12 (Explain how goodwill may arise on the consolidation of group accounts) has been removed.

Chapter 14 (2023 chapter numbering)

The following objectives have been removed:

4.2.5 Explain net earnings per share.

4.2.7 Discuss the working capital position of a company.

Chapter 15 (2023 chapter numbering)

The following objectives have been removed:

4.2.8 Discuss the shortcomings of historical cost accounting.

4.2.9. Discuss the limitations in the interpretation of company accounts.

4.2.10 Discuss the ways that reported figures can be manipulated to create a false impression of a company's financial position.

Chapter 16 (2023 chapter numbering)

This chapter's syllabus objective has been removed:

4.2.11 Describe the function of forecasts and budgets as sources of management information.

Therefore, this chapter has been removed in the 2024 materials.

Chapter 17 (2023 chapter numbering)

The following objectives have been removed:

2.6.1 Describe the characteristics of a merger.

2.6.2 Discuss methods of evaluating a target company.

2.6.3 Discuss the steps that a buyer will usually take in a leveraged buyout.

1 Changes to the Core Reading and ActEd materials

This section contains all the *non-trivial* changes to the Core Reading and associated ActEd text. It does not contain details of changes to Practice Questions at the end of each chapter.

Chapter 2 (2023 chapter numbering)

Section 1.2

The Core Reading describing a partnership has had a new phrase added and now reads:

The partnership may be owned in equal or unequal amounts by the partners. Usually all the partners will be involved in the running of the business or any one of them acting for all, but some may just provide capital and take no part in the day to day operation of the business (such partners are sometimes called ‘sleeping partners’).

Chapter 13 (2023 chapter numbering)

Section 1.3

The Core Reading on pages 6 and 7 has been removed.

This section now finishes with the sentence ‘Non-current assets have a value of £15,000 that includes £1,000 of goodwill on consolidation’ below the example statements of financial position on page 7.

The Core Reading and ActEd text from ‘Splitting up goodwill’ to the end of Section 1.3 has been removed. The course continues from Section 1.4, Non-controlling interests.

Summary

The description of Goodwill now reads:

Goodwill represents the excess of the value paid for a subsidiary company over the book value of the equity of the subsidiary purchased.

Chapter 14 (2023 chapter numbering)

Section 2.6

This section (Net asset value per share) has been removed.

Section 7

All of the Core Reading in this section (Evaluation of working capital) has been removed. The only part of this section to be retained is on page 36 where the ActEd example should be retained, *ie*:

Suppose we have calculated these three efficiency ratios with the following results:

- inventory turnover period = 32 days
- trade receivables turnover period = 44 days
- trade payables turnover period = 39 days.

This suggests that the company takes 32 days to sell an item of inventory. If it is sold on credit, this will result in a trade receivable which will then take an average of 44 days for settlement. So, it takes a total of $32 + 44 = 76$ days from the acquisition of an item of inventory until there is cash flowing in from its subsequent sale and the customer's settlement.

However, the company only pays for goods on average 39 days after their purchase. This means that it does not have cash tied up in this sequence until day 39 and so the company only has cash committed for a total of $76 - 39 = 37$ days.

Summary

The definitions of net asset value per share and working capital have been removed.

Chapter 15 (2023 chapter numbering)

Sections 1, 2 and 3

These three sections have been removed.

Summary

The entire 'Limitations of accounts' section has been removed.

Chapter 16 (2023 chapter numbering)

This chapter has been removed.

Chapter 17 (2023 chapter numbering)

Section 4.2

The Core Reading describing both horizontal and vertical integration has had a new phrase added and so the bullet points now read:

This integration can take the same three forms as above:

- **horizontal integration involves two or more firms at the same stage of the production process in the same industry and aims to increase the size of business, eg two car manufacturers**
- **vertical integration involves two or more firms at different stages of the same production process in the same industry and aims to strengthen the supply chain, eg a car manufacturer and a supplier of car components, or a car manufacturer and a car retailer**
- **conglomerate integration involves two or more firms in completely different industries, eg a car manufacturer and a hotel chain.**

Section 6

This section has been removed.

Summary

The sections on evaluating a potential target, the steps involved in acquisition and LBOs have been removed.

2 Changes to the X Assignments

Overall

The more significant changes to the assignments are given below. The removal of Chapter 16 for 2024 and the reduction in the length of Chapters 15 and 17 for 2024 has resulted in the 2024 version of the course being slightly re-ordered and divided into 3 X assignments in a different way to the 2023 version. As a result, after making the changes below to the 2023 assignments, the number of marks for Assignment X3 will not be exactly 100.

If you wish to submit your scripts for marking but only have an old version, then you can order the current assignments free of charge if you have purchased the same assignments in the same subject in a previous year, and have purchased marking for the 2024 session. We only accept the current version of assignments for marking, *ie* those published for the sessions leading to the 2024 exams. Please note if you do order assignments for 2024 that Chapter 8, Use of Derivatives has been moved to be later in the course. You will therefore be tested on this material in Assignment X3.

Assignment X1

All of the existing questions remain appropriate for 2024.

Assignment X2

Question X2.18 has been removed and replaced by a new question. A replacement page (pages 3 and 4) is attached with this question and a replacement page (pages 7 and 8) with its solution.

Assignment X3

Question X3.4 has been removed and replaced by a new question. Replacement pages (pages 1 and 2 in both cases) are attached with this question and its solution.

Questions X3.11 and X3.12 have also been removed as they relate to material removed from the 2024 Syllabus and Core Reading. [As a result your updated version of the this assignment will have 90 marks.]

3 Other tuition services

In addition to the CMP you might find the following services helpful with your study.

3.1 Study material

We also offer the following study material in Subject CB1:

- Flashcards
- ASET (ActEd Solutions with Exam Technique)
- Mock Exam and AMP (Additional Mock Pack).

For further details on ActEd's study materials, please refer to the ActEd website at **ActEd.co.uk**.

3.2 Tutorials

We offer the following (face-to-face and/or online) tutorials in Subject CB1:

- a set of Regular Tutorials (lasting a total of three days)
- a Block Tutorial (lasting three full days)
- an Online Classroom.

For further details on ActEd's tutorials, please refer to our latest *Tuition Bulletin*, which is available from the ActEd website at **ActEd.co.uk**.

3.3 Marking

You can have your attempts at any of our assignments or mock exams marked by ActEd. When marking your scripts, we aim to provide specific advice to improve your chances of success in the exam and to return your scripts as quickly as possible.

For further details on ActEd's marking services, please refer to the ActEd website at **ActEd.co.uk**.

3.4 Feedback on the study material

ActEd is always pleased to receive feedback from students about any aspect of our study programmes. Please let us know if you have any specific comments (*eg* about certain sections of the notes or particular questions) or general suggestions about how we can improve the study material. We will incorporate as many of your suggestions as we can when we update the course material each year.

If you have any comments on this course, please send them by email to **CB1@bpp.com**.

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X2.10 Unlike tangible assets, an intangible asset:

- A cannot suffer depreciation of its value over time.
- B does not have a value.
- C can be created when one company takes over another company.
- D cannot be sold.

[2]

X2.11 Explain how the accounting concept of materiality may improve the usefulness of the published financial statements.

[5]

X2.12 A large logistics company has a substantial fleet of trucks that it uses to provide transportation of goods by road. One of the company's major shareholders is concerned about the impact on the company of climate-related risks such as government policies designed to reduce carbon emissions. This shareholder has challenged the company to increase the extent to which it includes such issues in both its financial and non-financial reporting.

Comment on the shareholder's request and how implementing it might affect the company's reports.

[5]

X2.13 A quoted company's directors are discussing the company's draft financial statements with the external auditor. The external auditor believes that a key machine used in the production process should be depreciated more quickly than the company is currently depreciating it in the draft statements. The company's directors claim that their method is justifiable.

Assess the possible consequences for the company of not revising their draft statements to address the auditor's concerns.

[5]

X2.14 Sheldon plc's equity at 31 December 20Y6 was as follows:

	<i>£000s</i>
Share capital (25p shares)	200
Share premium account	70
Retained earnings reserve	<u>80</u>
Total equity	<u>350</u>

During 20Y7, the following occurred, all of which are reflected in the statement of financial position at 31 December 20Y7:

- payment of the 20Y6 dividend of £25,000 in April 20Y7 (unapproved at 31 December 20Y6 and approved on 31 March 20Y7)
- a 1-for-5 rights issue @ 55p in June 20Y7
- the company made a profit for the year to 31 December 20Y7 of £33,000
- the factory (which had a cost price of £475,000 and had suffered depreciation of £75,000 to date) was revalued to £500,000.

Prepare the company's statement of the changes in equity for the year ending 31 December 20Y7.

[5]

X2.15 Explain how a parent company Alpha would prepare a set of consolidated accounts in relation to a company Jet in its group. [5]

X2.16 The following information is available for Company X and Company Y:

	<i>Share price (p)</i>	<i>Earnings per share (p)</i>
Company X	100	5
Company Y	216	8

Comment on what the price earnings ratios of the two companies might reveal about the market's opinions of them. [5]

X2.17 The preparation of insurance company financial statements is complicated by the special features of insurance business.

Describe the main issues to be considered when determining the profit for the year to be reported in an insurer's accounts. [5]

X2.18 A company director has commented that there is no justification for requiring the company to publish its diluted earnings per share (EPS) and the basic EPS is sufficient. Comment on this statement. [5]

If the two companies are in a similar sector and there are no one-off distortions, possible reasons for this difference in price earnings ratio are:

- The earnings of Company Y are more attractive for some reason. For example they may be lower risk, more stable, or have a higher level of cover. [1]
 - The earnings of Company Y may be more attractive because the growth prospects for Company Y are better and so its earnings are expected to grow more rapidly than those of Company X. [1]
 - Alternatively, the higher price earnings ratio of Company Y may be an indication that the share price of Y is too high or that the share price of Company X is too low. [1]
- [Maximum 5]

Solution X2.17

Course Reference: Chapter 13.

The timing of the reporting of profit is very different for an insurance company compared with a normal trading company. The insurance contracts are often long-term, longer than the accounting period. [1]

The insurer receives a premium for a policy that might last a number of years. It might have no claims in the first year but this does not mean that all of the premium received is classed as profit, because the company must make provision, *ie* set up reserves, for future claims from this policy. [1]

Future claims are unknown and so reserves need to be estimated based on past history and/or expert judgement. [1]

If the insurer underestimates reserves required and so declares profit early and transfers it to the shareholders then it may not be able to meet its future liabilities. [1]

In order to avoid becoming insolvent, the insurance company may be prudent in its approach to estimating future liabilities and this would understate the current profit. [1]

An accounting approach that understates the profit in the year when a policy is sold would, all else being equal, result in higher profits in subsequent years. [1]

This issue of when profits should be reported in an insurer's accounts will be influenced by relevant accounting standards and the purpose of the accounts. [1]

[Maximum 5]

Solution X2.18

Course Reference: Chapter 14.

The basic EPS takes into account only those issued shares that were actually in existence during the period for which the EPS is quoted. [1]

However, a company may have entered into obligations that could dilute the EPS in the future, *eg* employee share option schemes and the issue of convertible loan stock capital. [1]

The diluted EPS is required to be published because it enables current shareholders to see the impact of such obligations, *eg* it may be that existing shareholders would be adversely affected by the exercise of some options. [1]

It is therefore *particularly* important to require quoted companies to publish their diluted EPS to remove any potential distortions, *eg* when comparing EPS across companies. [1]

However, there are drawback to the measure, for example it reflects the worst case scenario, and in practice some option holders may not choose to convert. [1]

Also some convertible shares are not convertible until a date many years out, so viewing the impact of their conversion is misleading. [1]

[Maximum 5]

For Questions 3.1 to 3.10 indicate on your answer sheet which one of the answers A, B, C or D is correct.

Having your assignment marked? Your marker will be happy to give you help on your approach to answering the multiple-choice questions if you include your workings.

- X3.1** A share has a beta of 1.5 relative to the diversified market portfolio. If the risk-free rate of interest over the previous year has been 3%, and the market index has risen 5%, by how much would the share price be expected to have risen?
- A 3%
 - B 5%
 - C 6%
 - D 8%
- [2]
- X3.2** The structure of company XYZ is such that the company has \$75 million of shareholders' capital and reserves and \$25 million market value of outstanding debt. These funds are invested in a diversified portfolio of assets, which are expected to earn a return no more or less than the market. The risk-free rate of return in the market is 6% and investors expect the market to give a return of 12%.
- Assuming that the company can borrow at the risk-free rate and that there are no taxes, the return expected from the equity shares in XYZ is:
- A 10.5%.
 - B 12%.
 - C 14%.
 - D 15.5%.
- [2]
- X3.3** Which of the following statements relating to the payback period approach to assessing cashflows is correct?
- A A project with a longer payback period will be preferred.
 - B The payback period is of most value when payback periods are greater than 3 years.
 - C Payback period tends to be most important for larger companies.
 - D none of the above
- [2]
- X3.4** A wind farm installation company has made a takeover bid for a mining company that mines titanium and aluminium. Which of the following correctly describes this type of acquisition?
- A A reverse takeover
 - B A conglomerate merger.
 - C A horizontal takeover
 - D A vertical takeover
- [2]

- X3.5** Which of the following influences is most likely to result in a company having relatively low financial gearing?
- A intangible assets being a high proportion of total assets
 - B high corporation tax rates
 - C high taxable profits
 - D expensive share issue costs [2]
- X3.6** Which of the following statements is false?
- A If a project has a large amount of systematic risk, then the discount rate used to value the cashflows should be raised to reflect the risk.
 - B A large, well-diversified portfolio of projects should have little or no specific risk.
 - C No amount of diversification can remove the systematic risk involved in a project.
 - D Specific risk arises because of the volatility of the market as a whole. [2]
- X3.7** ABC is a house builder in the UK market. Which of the following is correct about the risks that ABC faces?
- A The risk that the UK central bank raises interest rates is a specific risk that can be diversified away.
 - B The risk that a local authority takes away ABC's permission to build on a certain plot is a specific risk that can be diversified away.
 - C The risk that building materials rise in cost due to high inflation in the economy is a systematic risk that can be diversified away.
 - D The risk that ABC is sued for inadequate build quality by several customers is a systematic risk that cannot be diversified away. [2]
- X3.8** Which of the following is least likely to be a constraint on a company's expansion plans?
- A high cost of capital to finance the expansion
 - B high demand for the company's shares when the plans are announced
 - C insufficient management resources on top of the demands of business as usual
 - D lack of shareholder confidence in the plans [2]
- X3.9** Which of the following is NOT a likely consequence of an increase in a company's gearing?
- A The company will benefit from the tax advantages of debt finance.
 - B The company's credit rating will improve.
 - C The return to shareholders of the company will increase.
 - D The company's weighted average cost of capital will fall. [2]

Assignment X3 Solutions

Answers to multiple-choice questions

The following table gives a summary of the answers to the multiple-choice questions. The answers are repeated below with explanations.

1	C
2	C
3	D
4	D
5	A

6	D
7	B
8	B
9	B
10	C

Solution X3.1

Answer = C

The return on the share would be described by the following formula:

$$\begin{aligned} r_i &= r_f + \beta_i(r_m - r_f) \\ &= 3\% + 1.5 \times (5\% - 3\%) \\ &= 6\% \end{aligned}$$

[2]

Solution X3.2

Answer = C

In a tax-free world, the following formula links the returns:

$$\text{return on assets} = \frac{D}{D+E}(\text{return on debt}) + \frac{E}{D+E}(\text{return on equity})$$

$$\Rightarrow 12\% = (0.25 \times 6\%) + (0.75 \times \text{return on equity})$$

Thus: return on equity = 14%

Alternatively, we could calculate the return on equity directly as $r_f + \beta_g(r_m - r_f)$.

We know that $r_m = 12\%$, $r_f = 6\%$. We also know that the assets of the company are invested to give a market return.

Therefore, we can say that the beta of the assets must be 1 and β_u , the ungeared beta, is also

1. However, since there is debt, we adjust the beta according to the following formula:

$$\beta_g = \beta_u \times \left[1 + \frac{D}{E}(1-t) \right] = 1 \times \left[1 + \frac{25}{75}(1-0) \right] = 1.333$$

where β_g is the geared equity beta.

So, the return on the geared shares is:

$$r_f + \beta_g \times (r_m - r_f) = 6\% + 1.333 \times (12\% - 6\%) = 14\% \quad [2]$$

Solution X3.3

Answer = D

A project with a *shorter* payback period will be preferred. The payback period approach is of most value when payback periods are less than 3 years due to the impact of discounting. The payback period approach tends to be most important for *small* companies which often struggle most with cashflow issues. So all of answers A to C are incorrect. [2]

Solution X3.4

Answer = D

The company being acquired produces material required for wind farm manufacture, but is in a different stage of the manufacturing and business process. It is therefore best described as a vertical takeover. [2]

Solution X3.5

Answer = A

A company that has a high proportion of intangible assets is likely to have relatively few tangible assets to act as security for a loan.

All of B, C and D would lead to debt being more attractive and so tend to suggest a higher level of gearing. Increased debt interest reduces taxable profits and therefore reduces the tax paid by the company. This becomes more important as tax rates rise. [2]

Solution X3.6

Answer = D

Systematic risk arises because of the volatility of the market as a whole. [2]