Studying the UK stream of Paper P2

ACCA has various streams available for students studying Paper P2, *Corporate Reporting*. The international stream is the dominant one, and is based on International Financial Reporting Standards (IFRS). The examiner writes this exam first and then tweaks the international exam to create the others.

The UK stream is now also based on IFRS. So, usually the examiner will make a few adjustments to the international exam before rebranding the exam as the UK streamed one. In the recent examiner conference in February 2011, Graham Holt, the Paper P2 examiner, explained that up to 20 marks might be different in the Paper P2 (UK) compared to the Paper P2 (INT). He also explained that the marks could be spread right across the paper with some UK marks in the compulsory case study question.

The UK syllabus is based on the international syllabus but includes extra details currently deemed of use to UK candidates. This means that the UK syllabus is bigger than the international syllabus. The difference is not huge, but it is certainly not easy either.

The following article is designed to give you a feel for what you are getting into should you decide that the Paper P2 (UK) is for you. Please note that the article represents my interpretation of the Paper P2 (UK) syllabus and should not be taken as an official guide to Paper P2 (UK). The official guide to Paper P2 (UK) is the study guide freely available on the ACCA website and this article should be read in conjunction with it.

Furthermore, an article has been written by ACCA in conjunction with Graham Holt (the Paper P2 examiner) and Steve Scott (the Paper F7 examiner) that outlines the differences between the International and UK streams. It is scheduled for publication shortly. However, I am hopeful that the following will give you a good grounding from which you can expand your studies.

REASONS FOR TAKING THE UK STREAM

Unless you have a very good reason for taking the UK stream, my advice would be to take the international stream. Soon there will be one form of accounting worldwide, based on IFRS, and any learning of local standards will quickly become redundant.

However, ACCA advises that if you wish to be a signatory audit partner in an ACCA practice, you must have studied Paper P2 (UK). The following are extracts from the ACCA website in April 2011:

'Should you wish to practise as a registered auditor within the UK (obtain the audit qualification/audit practising certificate), you must attempt the Paper P2 (UK) and Paper P7 (UK) papers from June 2011 onwards. This is not a retrospective ruling, so any International papers you have already passed will be unaffected by this ruling.'

'All UK professional accountancy bodies are governed by the requirements of the Statutory Audit Directive (SAD). In order to comply with the requirements of SAD – and to practise as an auditor – certain elements of UK legislation and regulation should be examined. The revised Papers P2 (UK) and P7 (UK) fully meet regulatory and business environment requirements for those wishing to obtain the UK audit qualification and, hence, practise as a registered auditor in the UK.'

Of course, you should also bear in mind that even if you do wish to become an audit partner and sign audit reports, by the time you actually get there it is possible there will be no UK financial reporting standards and the criteria for a registered auditor may have changed. If you feel Paper P2 may be useful to you, then make sure you carefully read the ACCA website for advice on this area, as it is possible that changes may be made regarding the applicability or content of Paper P2 (UK).

STREAM DIFFERENCES

As discussed above, both the international stream and the UK stream are based on IFRS. The UK syllabus simply adds extra requirements on to the international syllabus. So the UK syllabus is the international syllabus with extras bolted on. The extras comprise essentially of two forms:

- UK legislation for financial reporting
- UK financial reporting divergence.

The ACCA Paper P2 *Study Guide* gives detailed advice on the syllabus. All the extras are clearly labelled and fairly obvious within the Paper P2 *Study Guide* and the examinable documents. All of this is available online on the ACCA website. But I hope to be able to give you a feel for the differences. So the extras are also covered here in summary.

UK legislation for financial reporting

This is reference B3a in the Paper P2 (UK) *Study Guide*.

Entity financial statements

All UK companies must produce financial statements. The most significant element of the legislation on financial reporting in the UK applies to small companies. Small companies are defined by size criteria that are highly unlikely to be examined but, for completeness, an extract of the UK Companies House website is given below.

‘A small company must meet at least two of the following conditions:

- annual turnover must be not more than £6.5m
- the balance sheet total must be not more than £3.26m
- the average number of employees must be not more than 50.’

The main advantage of qualifying as small company in the UK is that they are exempt from filing a cash flow statement.

Group financial statements
A small group is exempt from producing group financial statements altogether. Of course, the individual entities must produce entity financial statements, but consolidation is not required by law. Again, it is highly unlikely that the small group criteria would be examined – the following is another extract from the UK Companies House website:

‘To qualify as small, a group of companies must meet at least two of the following conditions:

- aggregate turnover must be not more than £6.5m net (or £7.8m gross)
- the aggregate balance sheet total must be not more than £3.26m net (or £3.9m gross), and
- the aggregate average number of employees must be not more than 50.’

Also, sub-parents are not required to produce group financial statements; only ultimate parents are required to do so. So, for one group, only one group financial statement is required.

UK financial reporting divergence
The UK started the process of convergence with IFRS in 1990. In the period 1997 – 2003, the process became the primary aim of the UK Accounting Standards Board (UK ASB). During that period it was assumed that IFRS would be applicable to all companies by 2005. So, in order to make the crossover as painless as possible, the UK ASB put in all its efforts to making the UK system as close as possible to the IFRS system.

Then, in 2005, listed companies adopted IFRS and nothing of any significance has happened in UK financial reporting since. The UK standards, which in 2005 were right up to date, simply froze at that time. With each year, the IFRS have developed, improved and altered while the UK standards have remained frozen. As the UK standards get older, they become less aligned with IFRS. This is the process of UK divergence.

Also, the adoption of IFRS for all companies in the UK never happened. Of course, the quoted companies all adopted IFRS because they had to. The forward thinking unquoted companies adopted IFRS as well. But many UK small and medium companies are stuck in the time-warped setting of UK Financial Reporting Standards (UK FRS).

It is the differences between UK FRS and IFRS that forms the bulk of the extras in the Paper P2 (UK) syllabus. It is this UK divergence that is most likely to feature in a Paper P2 (UK) exam as a variation from the otherwise identical international exam.

NCA DIVERGENCE

The accounting for non–current assets in the UK FRS and the IFRS is essentially the same. The only substantial difference of note relates to investment properties.

Investment properties

Under IFRS, the gain on an investment property goes to the income statement. Under UK FRS, the gain goes to the UK Other Comprehensive Income (OCI), which itself is relabelled the Statement of Total Recognised Gains and Losses (STRGL).

Also, as a minor point, the value to which you revalue an investment property under IFRS is of course the fair value. This simply means the market value. Under UK FRS, the value to which you revalue is the Existing Use Value. This means the UK value could be lower if the asset is land and is being used inefficiently as a farm or a football pitch, for example.

This is reference C2f in the Paper P2 (UK) *Study Guide*.

LEASES DIVERGENCE

The accounting for leases under UK FRS and IFRS is almost identical. But there are two tiny differences.

The primary test for a finance lease in the UK FRS is risks and rewards, as it is in the IFRS. However, in the UK FRS there is a secondary test that is not in the IFRS. This secondary test is mathematical and states that a lease is likely to be a finance lease if the present value of minimum lease payments exceeds 90% of the fair value of the asset.

The other difference is a little superficial – it's more cultural interpretation than substance. But the IFRS on leases requires that property leases are split into land and buildings components, whereas the UK FRS implies that property leases are just leases for property, and so no split is required.

This is reference C4c in the Paper P2 (UK) *Study Guide*.

SEGMENT DIVERGENCE
Segment reporting in the UK is essentially the same whether using IFRS or UK FRS. But there is a difference in philosophy in that the IFRS uses the managerial philosophy. This argues that segmental divisions should be based on management analysis of conglomerates. The UK FRS is, of course, has existed longer and so uses the older risks and rewards philosophy. This means segmental divisions must be based on underlying differences in the businesses.

In practice this makes absolutely no difference, as obviously management is going to focus on underlying differences in businesses.

This is reference C5c in the Paper P2 (UK) *Study Guide*.

EMPLOYEE BENEFIT DIVERGENCE
The accounting for pensions under both streams is identical. The exception relates to the ‘corridor. Of course, the corridor will soon be removed from IFRS. UK FRS never had a corridor.

This is reference C6e in the Paper P2 (UK) *Study Guide*.

DEFERRED TAX DIVERGENCE
Both the IFRS and the UK FRS suffer from the same lack of underlying logic. Both contradict the Framework for Financial Reporting. Both are essentially number crunching exercises and applying either will give the same answer in almost all circumstances.

However, there is a difference in language. The IFRS on deferred tax refers to temporary differences. This idea, as you might remember, refers to the difference in carrying values carried by the financial accountant and the tax accountant.

The UK FRS refers to timing differences. This idea refers to the difference between accumulated costs recognised by the financial accountant and the tax accountant.

Both as you see look at the differences that arise because financial accountants use accounting standards and tax accountants use tax legislation.

This is reference C7e in the Paper P2 (UK) *Study Guide*.

RELATED PARTY DIVERGENCE
The UK ASB and the IASB developed their related party reporting standards together. So its hardly surprisingly there are almost no differences between the standards. Both are extremely detailed standards with reams of content. It is

in the detail where tiny differences may be found. However, there are no differences in the principles, and it is these principles that have been the subject of examination since the standards were issued.

This is reference C9c in the Paper P2 (UK) *Study Guide*.

SME DIVERGENCE

As you know, the relatively new *IFRS for SMEs* allows unquoted companies to produce financial statements using the less bulky version as opposed to the more detailed full IFRS.

The UK has had an equivalent standard for a number of years. It is called the Financial Reporting Standard for Small Entities (FRSSE). The FRSSE is based on the same economic idea as the *IFRS for SMEs*. This is the idea that reduced financial reporting for SMEs is good for the economy as a whole as it encourages entrepreneurs.

The two standards are similar, but it is probably fair to say the UK FRSSE is even less burdensome than the *IFRS for SMEs*. One notable difference is that the FRSSE does not require a cash flow statement.

The FRSSE is available for small companies as defined earlier in the article. This is reference C11f in the Paper P2 (UK) *Study Guide*.

GOODWILL DIVERGENCE

As discussed above, UK financial reporting is stuck in a time warp. So the calculation of goodwill is on the partial basis only. Furthermore, under the UK FRS, the partial goodwill is depreciated.

This is reference D1j in the Paper P2 (UK) *Study Guide*.

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