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Dear Ms Grant

2022 Draft Statement of Recommended Practice - Accounting by Limited Liability Partnerships

We welcome the opportunity to comment on the 2022 draft Statement of Recommended Practice Accounting by Limited Liability Partnerships ("LLPs") ("the SORP").

Our responses to the questions raised in the consultation are set out in Appendix 1 to this letter. We are supportive of the changes the CCAB has made to update the SORP to provide further guidance on interpreting whether a division of profits is automatic or discretionary and to clarify certain terms used within the SORP.

If you wish to discuss anything further do not hesitate to contact Danielle Stewart OBE.

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Appendix 1

Divisions of profit

Question 1:

Do you agree with the changes made to the definitions outlined in the SORP? In particular, the terms: division of profits, divided profits, discretionary division of profits and automatic division of profits. [Paragraphs 8 - 24]

We agree with the changes in paragraphs 8 to 24 and in particular welcome the new definitions of division of profits and divided profits. In our opinion these provide clarity and we expect will assist preparers of LLP accounts and reduce divergence in practice.

However, we question whether the change to the definition of drawings is needed and are concerned that diverging from the established meaning used in many LLP agreements may have unintended consequences.

We also note that the change to the definition of drawings has not resulted in consequential changes to paragraphs 30, 68, and 69. Without changes to paragraphs 30 and 69 the disclosures will only cover payments to members in advance of division of profits rather than including all cash payments to members as under the current SORP. If this was not the intention, we recommend these paragraphs are amended to include distribution of profits to members as well as drawings in the required disclosures.

We also note that in the table in paragraph 60 drawings appear to be included in the column "Loans and other debts due to members less any amounts due from members in debtors – other amounts". Under the new definition drawings cannot be a reduction in amounts due to members as they are payments in advance of a division of profits, which is what creates the debt to members. Thus, debts to members will be reduced by distribution of divided profit, not by amounts paid in advance of division of profit.

Question 2:

Do you agree with the proposed guidance to help determine when an LLP has an unconditional right to avoid delivering cash or other assets to members?

[Paragraphs 31B – 31D 45C - 45D, 48A, 49E - 49F, 50A-50F]

We welcome the clarification of the steps by which profit is allocated in paragraph 31B.

In our opinion paragraphs 31B and 32A could be confusing and paragraph 31B appears to conflict with paragraphs 32A, 45C and 50B. Paragraph 31B explains that profits could be divided under the terms of the LLP agreement, but that the LLP may still be able to retain cash for working capital needs. This could be interpreted to give the LLP the right to avoid delivering cash. According to paragraph 32A if at the year end the LLP has such a right the division of profits, which is what creates a debt to members according to the definition in paragraph 11B, will not have happened. It might be clearer to amend the final sentence in paragraph 31B to say, "Profits could be allocated and divided but not distributed, for example to keep cash in the business for managing until cash flow and working capital allow payment".

Where the LLP agreement requires a decision by the LLP to divide profits and such a decision has been made prior to the reporting date paragraph 32A might be interpreted to mean profits should be accounted for as members' remuneration charged as an expense as a debt to members has been created by the decision to divide, but we do not think this is the intention. Therefore, we suggest that the wording is amended to "However, the presentation in the profit or loss account is dependent on whether the LLP agreement gives the LLP the unconditional right to avoid delivering cash or other assets to members even if a decision to divide some or all profits has been made prior to the reporting date". The accounting treatment for division of profits subject to discretionary division is explained in paragraph 50A.

It would be helpful to have further clarity, especially in assessing whether the ability to retain profits to meet working capital needs should be considered an unconditional or conditional right. In our

experience it is not unusual for clauses giving the right to designated members to decide to retain profits to meet cash flow needs being interpreted by preparers of LLP accounts to mean division of profits is discretionary. This is because such clauses often do not contain specific conditions for when such retained profits will be distributed to members as agreements tend to focus on allocation, division and distribution of current year profits.

Also, in our experience, it is common for LLP agreements to have provisions that require profits to be allocated and distributed to members unless a decision by designated members or equivalent management is made not to do so, rather than there being a requirement for a positive decision to divide profits. It would be helpful to provide guidance, linked to the definitions of discretionary and automatic division of profits, about whether such clauses result in the division of profits being automatic in the absence of such a decision having been made. Commonly LLP agreements containing such clauses do not include corresponding requirements for a positive decision to be made to divide profits among members in accordance with the profit-sharing arrangements in the agreement. In the situation described the LLP has the right to make a decision not to divide profits but may not have done so.

Where a decision not to divide all or part of the profits to allow an LLP to retain profits is required paragraph 48A suggests that until such a decision is taken the LLP does not have an unconditional right to avoid payment.

If it is concluded that the absence of a decision not to divide profits results in automatic division, since without such a decision (assuming no other contrary clauses within the LLP agreement) profits become debts due to members as earned, it would be useful to provide further guidance on whether a decision not to divide all profits among members that is made post year end but prior to the approval of the accounts is an adjusting post balance sheet event or not.

It would also be helpful to provide further guidance on what constitutes a decision by the LLP for the purpose of application of the SORP and whether such a decision may be made by designated members, an LLP management board or equivalent decision maker or whether, to be a decision of the LLP, it requires a resolution passed by members (in accordance with the relevant provisions in the LLP agreement).

Energy and carbon report

Question 3

Do you agree with the proposal to refer to the requirement for large LLPs and groups to produce an energy and carbon report? [Paragraphs 25A – 25B]

We agree with this proposal.

Cash flow statement presentation

Question 4

Do you agree with the proposed changes to the guidance on cash flow statement presentation in paragraph 74A?

In our opinion the proposed changes are helpful. However, we consider that the classification of payments of profits to members as operating or financing cash flows should follow from the nature of the profit-sharing arrangements and not from the nature of the cash flows from which they are paid. Therefore, classification should depend on whether members are being remunerated for services provided to the LLP or receiving what is in substance a financing return for providing capital. In many cases it will be clear from the LLP agreement, the nature of the LLP's activities and the nature of involvement of members in those activities, whether payments are in return for services or providing finance. We recognised that there may be situations where members are providing both a service and capital to finance the LLP and while in some of these it may be apparent from the nature of the profit-sharing arrangements how much, if any relates to the provision of finance, in others judgement may be needed to determine the nature of payments or to split them between operating and financing. We recommend additional disclosures are required to explain the judgements made.

Other considerations

Question 5:

Do you agree that the proposed changes outlined in this document should come into effect for periods commencing on or after 1 January 2022, with early adoption permitted? [Paragraph 133]

We agree with the proposed effective date and that early adoption should be permitted.

Question 6:

Are you aware of any other developments which might suggest that further guidance is needed in the SORP? In particular, where LLPs have wholly owned subsidiaries and prepare both group and solus accounts, the Steering Group is interested to hear views on whether there is a need for specific guidance in the SORP on how members' remuneration charged as an expense is measured in those accounts where members' agreements require group profits to be automatically divided and where members' agreements require only the LLP's own profits to be automatically divided.

In our experience LLP agreements only deal with the profit-sharing arrangements for the members of the LLP to which the agreement relates so we have not come across a situation where the parent LLP's members' agreement has provisions for the sharing of group profits. Nevertheless, we would welcome more guidance in relation to groups with an LLP parent.

It would be helpful to have additional guidance on the following:

- Accounting for the parent's share of subsidiary LLP profits that are classified as remuneration charged as an expense in the subsidiary but have not been distributed at the year end, in both the parent's solus accounts and the group accounts. We believe guidance is required specifically on the extent to which such divided but undistributed profits can/should be included in the parent's own members' remuneration charged as an expense.
- Accounting for non-controlling interests relating to individual members of subsidiary LLPs in the group profit and loss account depending on whether the profits of the subsidiary are automatically divided or available for discretionary distribution.
- Presentation of non-controlling interests in the group accounts when the members' interests in the parent LLP are all classified as liabilities. FRS102 requires non-controlling interests to be presented within equity in the statement of financial position and consistent presentation is used for the statement of changes in equity, with non-controlling interests being presented as a separate component of equity. LLPs are permitted by the SORP to present a reconciliation of members' interests in place of a statement of changes in equity. Non-controlling interests in the equity of a subsidiary LLP do not form part of the interests of the members of the parent LLP in that parent and therefore in our opinion there are circumstances where it is not appropriate for a reconciliation of members' interests to be presented in place of a statement of changes in equity and that it would be beneficial for the SORP to include guidance for such situations.

Question 7:

Do you have any other comments on the draft LLP SORP?

We would welcome guidance on the following:

Changes in the treatment of profits as a result of the revisions to the SORP

Applying the revised definitions and guidance in the SORP may result in some LLPS reaching a different conclusion on the treatment of profits under the terms of their LLP agreement and therefore needing to revise the presentation and classification in the financial statements as set out in the following paragraph. We would welcome guidance on whether any change in the presentation of profits, including those not yet distributed, should be accounted for as a change in accounting policy or as the correction of an error. While FRS 102 requires both to be accounted retrospectively the disclosures required will be different.

We have experience of a recent example where the revisions to the SORP could result in a different conclusion being reached on the presentation of profits by an LLP. In this example the LLP agreement states that the corporate member has absolute discretion to make a decision about whether residual profits, after the payment of fixed profit shares, are distributed to members or retained by the LLP. Applying the 2018 SORP members have concluded that the LLP does not have an obligation to distribute any residual profits until such a decision is made. This seems consistent with the definition in paragraph 10 of the 2018 SORP, as the LLP does not have an unconditional obligation to divide these profits until the corporate member makes the decision that it should. Applying the definitions in the 2022 draft SORP could lead to the conclusion the LLP does not have an unconditional right to retain profits as the corporate member could at any time make the decision that residual profits should be divided. This could lead to a change in presentation with residual profits accounted for as members' remuneration charged as an expense.

We recommend the CCAB consider allowing a choice so that such changes could be dealt with by an adjustment to opening members' interests, with appropriate disclosure, or by full retrospective restatement. We consider it is possible such a choice on adoption of changes to accounting standards could be included in the next periodic review of FRS 102 as this would be consistent with the transition provisions of recent International Financial Reporting Standards. In our opinion, where there is a change in the treatment of members' interests as a result of the clarification of the definitions in the SORP the information provided to users of LLP accounts will be no less useful if a modified retrospective approach to transition is permitted.

Group reconstructions

In our experience the incorporation of a partnership into an LLP is often combined with retirement of partners without new members joining the LLP. FRS 102 only permits the use of merger accounting when the ultimate equity holders remain the same and their relative rights are not changed.

In our opinion where the business of a partnership is transferred to an LLP and other than the retirement of a member there are no changes, and in particular no new capital introduced to the LLP, it is likely the use of the merger method of accounting as set out in paragraphs 112 to 115 of the draft SORP will be more appropriate than the use of acquisition accounting and the recognition of goodwill in what is essentially a continuing business. Therefore, we would welcome further guidance on this particular scenario as both FRS 102 and the legal requirements only apply to the use of merger accounting in group accounts.

Amounts payable to former members

While the guidance on payment of post-retirement benefits to former members is generally clear we have come across situations recently where further guidance would be beneficial. We have seen LLP agreements which, as well as providing for the distribution of profits arising from the activities of the LLP, also allow members to earn points or units that will determine the share of future proceeds or capital profits arising on an exit event of some kind to which individual members are entitled. It is not uncommon for such rights accrued by individual members to be retained on retirement from the LLP. We would welcome guidance on the accounting for these and similar arrangements, both for continuing members and where rights accrued at the point of retirement have been retained but the payment to both members and former members is contingent on a future event.

There are two main areas where guidance would be helpful:

- The accounting for the services received in exchange for these units or points. The profits from which members' entitlements will be paid are yet to be earned but the service (where members provide services to the LLP) is provided as the rights to units or points accrue. It is not uncommon for all profits from the business activities of the LLP to be automatically divided. Therefore, to recognise additional service would result in accounting losses arising on the activities of the LLP which do not reflect the reality of the performance of the business activities.
- The accounting for amounts that will be payable to former members if the relevant capital profits are earned. Should provision be made for such payments on retirement of members, which could also result in losses being reported, or could it be determined that the share payable to former members is not a liability of the LLP itself but an agreement by continuing members to share their interests in the relevant profits or proceeds with former members?