

Draft Statement of Recommended Practice Accounting by Limited Liability Partnerships

Effective for periods commencing
on or after 1 January 2024
with early adoption permitted.

August 2023

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PREFACE

Background to the SORP

This SORP is issued by CCAB, the members of which are:

- The Institute of Chartered Accountants in England and Wales
- The Association of Chartered Certified Accountants
- The Chartered Institute of Public Finance and Accountancy
- The Institute of Chartered Accountants of Scotland
- The Institute of Chartered Accountants in Ireland

The FRC has approved the CCAB bodies for the purpose of issuing a recognised SORP for LLPs incorporated in Great Britain under the Limited Liability Partnerships Act 2000 (the 2000 Act). As part of the process for obtaining this approval, the CCAB bodies agree to follow the FRC's Policy on Developing SORPs. These procedures do not include a comprehensive review of the proposed SORP by the FRC, but a review focusing on those aspects relevant to the financial statements but also including aspects relevant to the FRC's broader responsibilities where appropriate.

SORPs issued by SORP-making bodies include a statement by the FRC that:

- outlines the nature of the review that the FRC has undertaken; confirms that the SORP does not appear to contain any fundamental points of principle that are unacceptable in the context of current financial reporting practice, or to conflict with an FRC standard; and
- when relevant, confirms that the SORP does not appear to undermine the FRC's broader objectives.

CCAB Steering Group

The SORP for LLPs differs from a number of other SORPs in that it does not apply to a specific industry or sector, but to a legal entity. The process of developing and reviewing the SORP is undertaken by a Steering Group. Membership of the Steering Group is drawn both from trades and professions that have member firms that commonly have LLP status, including the accountancy and legal professions, and from among users of LLP accounts. Prior to 2020, a separate Working Party operated alongside the Steering Group. The Steering Group dealt with strategy and high-level issues, while the Working Party concentrated on technical detail. In 2020, the decision was made to combine the two groups to form a single Steering Group in order to streamline the process for developing and reviewing the SORP. Membership of the Steering Group as at 30 June 2023 is set out below.

Kate Wolstenholme (Chair)	<i>PricewaterhouseCoopers LLP</i>
Phil Barden	<i>Deloitte LLP</i>
Nick Carter-Pegg	<i>BDO LLP</i>
Aster Crawshaw	<i>Association of Partnership Practitioners</i>
Emma Danforth	<i>The Law Society</i>
Kathy Greaves	<i>Simmons & Simmons LLP</i>
Ben Hamar	<i>Smith and Williamson LLP</i>
James Barbour	<i>The Institute of Chartered Accountants of Scotland</i>
Peter Crabbe	<i>KPMG LLP</i>

Ryan Ketteringham	<i>Crowe Clark Whitehill LLP</i>
Glenn Colins	<i>The Association of Chartered Certified Accountants</i>
Janet Milligan	<i>PricewaterhouseCoopers LLP</i>
Hywel Peglar	<i>RSM UK Tax and Accounting Limited</i>
Jonathan Shaw	<i>Grant Thornton UK LLP</i>
Kirsty Smith	<i>EY LLP</i>
Anne Warner	<i>Deloitte LLP</i>

The membership of the Steering Group is reviewed on an annual basis. If you would be interested in participating in the group please contact executive.office@ccab.org.uk for further details.

Review of the SORP

CCAB was first approved for the purpose of issuing a SORP on 2 March 2000. In keeping with the FRC's *Policy on Developing Statements of Recommended Practice*, CCAB regularly reviews the SORP for changes in accounting practice and new developments. As part of the review CCAB is required to consider new and revised accounting standards issued since the current edition of the SORP was published and to assess whether the SORP needs amending for these changes.

Current review and consultation questions

As part of the current review the Steering Group has taken account of the following:

- The amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland which introduce a temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, together with targeted disclosure requirements. No changes to the SORP are considered necessary in relation to these amendments to FRS 102.
- The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/46) which came into effect for financial years beginning on or after 6 April 2022. As a result of these new regulations, certain LLPs and groups are required to make climate-related financial disclosures aligned with the Taskforce for Climate-related Disclosures (TCFD) recommendations. The Steering Group concluded that the section of the SORP which outlines the contents of an LLP's annual report and financial statements should be updated for these new requirements. See question 1 below.
- Consideration has also been given to feedback received as part of the 2021 LLPs SORP consultation, when respondents were asked to provide details of any other areas where further guidance might be helpfully added to the SORP. The Steering Group considered all the matters raised by respondents and concluded that additional guidance could helpfully be added to the SORP for certain specific scenarios in relation to the sharing of group profits and amounts payable to former members. As the SORP is currently silent on the specific scenarios raised, it was concluded that further guidance would help reduce diversity in practice. See questions 2-5 below.

CCAB is not aware of any other developments which would require changes to the SORP.

In accordance with the FRC's *Policy on Developing Statements of Recommended Practice* the FRC carried out a review of the proposed SORP, focusing on those aspects relevant to the financial statements but also including aspects relevant to the FRC's broader responsibilities where appropriate.

Invitation to comment

CCAB requests comments on all the proposed revisions to the SORP. It would be helpful if respondents would specify the paragraph or paragraphs to which a comment relates, and support comments with reasons, and where applicable, preferred alternatives.

Some specific issues on which CCAB would particularly welcome views are set out below:

Question 1: Climate-related financial disclosures.

Do you agree with the updates made to the SORP to reflect the new requirements for certain LLPs to provide climate-related financial disclosures in either the strategic report, if one is prepared, or in the energy and carbon report otherwise? The key relevant draft paragraph is 25D.

Question 2: Amounts payable to former members.

As part of this review, the Steering Group considered whether it might be helpful to provide some guidance on certain narrow scenarios in which section 26 of FRS 102 might apply. One particular example that has been identified is when a former member will become entitled to a proportionate share of disposal proceeds in the event that the business of the LLP is sold within a specified timeframe after the member has retired. It is proposed that paragraphs 87A – 87C be added to the SORP and that changes are made to paragraphs 76, 76A, 76B, 78, 79C, 80, 80A and 80D (formerly paragraph 80A). The change to the flowchart in paragraph 76B, to refer to section 26 of FRS 102, does not appear as a marked-up change.

Do you agree that guidance is needed in the SORP to address certain narrow scenarios when section 26 of FRS 102 might apply? Do you agree with the proposed changes?

Question 3: Sharing of group profits – interests in subsidiaries.

The Steering Group identified the need for further guidance in cases where a parent LLP has a subsidiary that is also an LLP and that will therefore need to be consolidated into the parent's group accounts. Guidance is proposed on the appropriate treatment of members' debt and equity interests in the subsidiary LLP for the purpose of determining whether a non-controlling interest in the net assets of the group is recognised. It is proposed that paragraphs 119A – 119F be added to the SORP to address this matter.

Do you agree that guidance on the appropriate treatment of members' debt and equity interests in the subsidiary LLP for the purposes of determining whether a non-controlling interest in the net assets of the group is recognised is needed in the SORP? Do you agree with the proposed changes?

Question 4: Automatic division of profits to members who do not provide any substantive services to the LLP.

An LLP may have two distinct types of members, all providing capital to it: those that provide services in return for a share of profits and those that do not provide any substantive services, but still receive a share of profits. The Steering Group concluded that it would be helpful to provide guidance in the SORP on the treatment of profits which are automatically divided to members who do not provide any substantive services to the LLP. It is proposed that paragraph 34D be added to the SORP together with Example 11 in Appendix 2. On adding this guidance, the Steering Group also concluded that the distinction between members that provide services to the LLP and those that do not provide any substantive services to the LLP could be made clearer throughout the SORP. Therefore,

reference to when a member does not provide any substantives services to the LLP has been updated throughout the SORP for clarity and consistency.

Do you agree that guidance is needed for situations where there is an automatic division of profits to members who do not provide any substantive services to the LLP? Do you agree with the proposed changes?

Question 5: Effective date

Do you agree that the proposed changes outlined in this document should come into effect for periods commencing on or after 1 January 2024, with early adoption permitted? [Paragraph 133]

Question 6:

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

Comments should be submitted by 27 October 2023. They should be addressed to:

CCAB – LLP SORP
Moorgate Place
London
EC2P 2BJ
Email: executive.office@ccab.org.uk

Comments received will be published on the CCAB website unless there is an explicit request for a comment letter to be treated as confidential.

Future editions of the SORP

In keeping with the *FRC's Policy on Developing SORPs*, CCAB will keep the SORP under review for changes in accounting practice and new developments. However, users should be aware that any changes to accounting standards made subsequent to July 2023 have not been reflected in this SORP.

Note on legal issues

The SORP discusses a number of legal issues relating to LLPs. Such discussion is included solely to explain the principles adopted in the SORP and should not be relied upon for any other purpose.

INTRODUCTION

Accounting requirements

1. The detailed accounting requirements relating to LLPs are currently set out in the following Statutory Instruments:
 - The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (SI 2008/1911);
 - The Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); and
 - The Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

These are collectively referred to in this SORP as the 'LLP Regulations'. The LLP Regulations apply to accounts for financial years commencing on or after 1 October 2008, replacing the accounting provisions previously contained in the Limited Liability Partnerships Regulations 2001 and the Limited Liability Partnerships Regulations (Northern Ireland) 2004. The LLP Regulations apply, with modifications, the accounting and auditing provisions of the Companies Act 2006 to LLPs. The LLP Regulations apply to the whole of the United Kingdom, reflecting the scope of the Companies Act 2006. Financial Reporting Standards (FRSs) and other components of UK GAAP also apply to any financial statements of LLPs intended to give a true and fair view. LLPs adopting FRS 101 *Reduced Disclosure Framework* will apply the modified recognition and measurement requirements of IFRS but with reduced disclosures. Their financial statements are nonetheless UK GAAP financial statements because applying the disclosure exemptions prevents them from complying fully with IFRS. Therefore, such LLPs must ensure that their financial statements comply with the Companies Act and the LLP Regulations.

- 1A. The LLP Regulations were amended in May 2016 by The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 (SI 2016/575), which introduced similar changes to the financial reporting framework for LLPs as previously introduced for companies, including raising the size thresholds which determine when an LLP or group qualifies as small (SI 2008/1912 part 2 382 as amended by SI 2016/575) and the creation of a micro-entities regime for very small LLPs (SI 2008/1912 part 2 384A as introduced by SI 2016/575). These changes were effective for financial years beginning on or after 1 January 2016.
- 1B. While these changes do not fundamentally alter the financial reporting regime for LLPs, they allow LLPs – particularly small LLPs – to benefit from a less burdensome financial reporting regime and ensure that the legislative requirements for LLPs are aligned with those for limited companies. For a summary of the detail of all the changes refer to the explanatory note of SI 2016/575.
- 1C. The LLP Regulations were further amended in November 2018 by The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SI 2018/1155) which introduced the requirement for large LLPs and groups to include an energy and carbon report as part of their annual report. The requirement to produce an energy and carbon report is effective for financial years beginning on or after 1 April 2019.

1D. The LLP Regulations were further amended in January 2022 by The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/46) which introduced requirements for certain LLPs and groups to make additional climate-related financial disclosures aligned with the Taskforce for Climate-related Disclosures (TCFD) recommendations. These requirements are effective for financial years beginning on or after 6 April 2022.

1E. This SORP only includes changes in legislation made prior to its issue date. It is not designed to cover all legal requirements relevant to LLPs.

Scope and objectives

2. This SORP applies to LLPs incorporated in the United Kingdom under the Limited Liability Partnerships Act 2000, or which were incorporated prior to 1 October 2009 under the Limited Liability Partnerships Act (Northern Ireland) 2002, that report under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The SORP, therefore, does not apply to LLPs complying with IFRS, FRS 101 *Reduced Disclosure Framework* or FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. It does not seek to set out all of the reporting requirements that apply to LLPs reporting under FRS 102, and it is intended to complement, not replace, the standard. This SORP should, therefore, be used in conjunction with the LLP Regulations and FRS 102 rather than on a stand-alone basis. Where a more recently issued accounting standard or a change in legislation creates a conflict with any provisions of this SORP, the relevant provisions of the SORP will cease to have effect.
3. LLPs qualifying for and choosing to apply the micro-entities regime are not within the scope of this SORP. Such LLPs should apply FRS 105 only. As noted in paragraph 2 above, the SORP complements the requirements of FRS 102 not FRS 105. Where a micro-LLP enters into a transaction that is not covered by FRS 105, it is required to refer to the concepts and principles set out in Section 2 *Concepts and Pervasive Principles* of that standard when determining its accounting policies. Micro-LLPs applying FRS 105 are therefore not required to refer to this SORP.
- 3A. LLPs qualifying for and choosing to apply the small entities regime are within the scope of this SORP. See paragraphs 27-28 below for more details.
- 3B. The following table summarises the choices available to LLPs:

	Micro-LLPs <i>Turnover ≤ £632,000 Balance sheet total ≤ £316,000 Employees ≤ 10</i>	Small LLPs <i>Turnover ≤ £10.2m Balance sheet total ≤ £5.1m Employees ≤ 50</i>	Other LLPs <i>Breaches two of the three small entity thresholds</i>
Apply FRS 105 only	✓		
Apply the small entities regime (Section 1A of FRS 102) together with the recognition and measurement requirements of this SORP and the disclosure requirements of paragraphs 63 and 64 of this SORP	✓	✓	
Apply FRS 102 and all the	✓	✓	✓

requirements of this SORP ¹			
Apply FRS 101 only	✓ Qualifying entities only	✓ Qualifying entities only	✓ Qualifying entities only
Apply IFRSs only	✓	✓	✓

Measurement

4. Deleted

5. Deleted

Format and terminology

6. All the material in this SORP – other than Appendix 5 'Legal opinion' and Appendix 6 'Basis for conclusions' – is an integral part of the SORP. However, the central principles are printed in bold in order to distinguish them from explanatory paragraphs.

7. For simplicity, the term 'profits' has been used rather than 'profits or losses' where circumstances allow. Similarly, the term 'year' has been used rather than 'period'.

Definitions

8. The following definitions apply within this SORP. Different terminology may be used in members' agreements; accordingly, it is important to focus on the underlying principles of the agreement rather than the terminology used. This is discussed further in paragraph 31B.

9. Deleted

10. Moved to paragraph 11B

Designated members

11. Designated members are those members specified as such in the incorporation document or otherwise in accordance with an agreement with the other members, as required under section 8 of the 2000 Act. Designated members perform certain duties in relation to the legal administration of an LLP that would, for a company, be performed by the secretary or directors. If there would otherwise be no designated members, or only one, all members are deemed to be designated members.

Divided profits

11A. Debt due to members as a result of a division of profits (a debt due to members is a financial liability as defined in FRS 102's glossary). Note that, where a member already owes an amount to the LLP (eg, as a consequence of drawings on account), division may reduce that asset rather than giving rise to a separate liability. For ease of reading, when the SORP refers to a debt due to members arising as a result of a

¹ Qualifying entities may wish to take advantage of the reduced disclosure regime set out in paragraphs 1.8-1.13 of FRS 102.

division of profits, this is intended also to capture a reduction in such an asset.²

Division of profits

- 11B. A division of profits is the mechanism by which the profits of an LLP become a debt due to members. A division may be automatic or discretionary, may relate to some or all of the profits for a financial period, and may take place during or after the end of a financial period.

Automatic division of profits³

An automatic division of profits is one where the LLP does not have an unconditional right to avoid making a division of an amount of profits based on the members' agreement in force at the time. The fact that the actual amount to be divided is contingent on the existence of profits in the first place does not negate the LLP's unconditional obligation in respect of those profits nor the member's unconditional entitlement to those profits should they come into existence.

Discretionary division of profits

A division of profits that requires a decision to be made by the LLP⁴, which the LLP has the unconditional right to avoid making. It does not constitute an automatic division because the LLP has an unconditional right to avoid delivering cash or other assets to members in respect of those profits. When profits are divided on a discretionary basis the LLP could instead have chosen never to divide those profits.

Drawings on account⁵

12. The payment in cash (or kind) of amounts to members on account of profits that have not yet been divided. Drawings on account may consist of regular monthly payments or ad hoc payments.

Limited liability partnership (LLP)

13. An LLP incorporated in the United Kingdom under the 2000 Act, or incorporated prior to 1 October 2009 under the Limited Liability Partnerships Act (Northern Ireland) 2002.

Loans and other debts due to members

14. Members' interests that are debts of the LLP and are included in balance sheet item J in the accounts formats set out in the LLP Regulations (SI 2008 1913/1912 schedule 1, part 1, section B).

Members

15. On incorporation, the members of an LLP are the persons who subscribe their names to the incorporation document. Persons may become or cease to be members in accordance with an agreement between existing members.

Members' agreement

16. Any express or implied agreement between an LLP and its members that determines the mutual rights

² The decision to divide profits, which gives rise to a liability in respect of divided profits, must be distinguished from the arrangements for profit sharing. This is discussed further in paragraph 31B.

³ Refer Appendix 6 BC26.

⁴ Reference to a decision by the LLP includes decisions made by those that have delegated management authority. This will depend on the terms of the members' agreement and may include, for example, a management board, management committee, or all/some of the designated members.

⁵ The broader term of 'drawings' is used by different LLPs in different ways. Some may consider 'drawings' in the broadest sense to encompass all payments of cash (or kind) to members eg, payments on account of undivided profits and distributions of profits. Others may consider it to include only payments in cash (or kind) of amounts to members on account of profits that have not yet been divided. For the purpose of this SORP, only the term 'drawings on account' is defined, and payments to members as or after profits have been divided are referred to as distributions.

and duties of the members in their capacity as such and their rights and duties in relation to the LLP. The agreement may take a variety of forms and need not be in writing. An agreement between the members, to which the LLP is not party – for example, an agreement to guarantee a minimum or specified remuneration for a particular member – does not constitute a members' agreement for the purposes of the SORP.

Members' capital

17. Amounts subscribed or otherwise contributed by members that are classified as capital by the constitutional arrangements of the LLP. Such amounts will require analysis as to whether they are considered equity or debt in accordance with section 22 of FRS 102. Members' capital is a component of 'Members' other interests' or 'Loans and other debts due to members' depending on its classification under this section of FRS 102.

Members' other interests

18. Members' interests other than debt due to them by the LLP, which constitute equity in the LLP, are included in balance sheet item K in the accounts formats set out in the LLP Regulations (SI 2008 1913/1912 schedule 1, part 1, section B). Members' other interests include 'Members' capital' that is classified as equity in accordance with section 22 of FRS 102, 'Revaluation reserve' and 'Other reserves'.

Members' participation rights

19. All the rights of a member against the LLP that arise under the members' agreement (for example, in respect of amounts subscribed or otherwise contributed, remuneration and profits).

Members' remuneration

20. Any outflow of benefits to a member. It may include or comprise, but is not limited to, one or more of the following elements: salary, interest, bonus, risk premium and shares of profits (fixed or variable). The form that remuneration takes will be a matter of agreement between the members.

Members' remuneration charged as an expense

21. Remuneration that is payable to a member, which is treated as a charge against profits and not as a discretionary division of profits. The treatment of members' remuneration is determined by reference to the nature of the participation rights that give rise to the remuneration.⁶ If those rights were to give the members an unconditional right to the division of profits or to other forms of remuneration, for example those items set out in paragraph 20 above, then they give rise to a liability for that remuneration in accordance with section 22 of FRS 102, and the remuneration is charged as an expense. Members' remuneration charged as an expense is not restricted to amounts that are payable by the LLP regardless of the existence or extent of profits; it also includes, for example, any profits that are automatically divided between members by virtue of a members' agreement. Members' remuneration charged as an expense may in some exceptional circumstances be a negative amount. A member may also have a contract to provide services to the LLP, which may be referred to as a contract of employment⁷. Remuneration covered by such a contract is classified as members' remuneration charged as an expense, including amounts relating to pension obligations and share-based payments (if any). Where a member is also

⁶ This SORP only considers the **accounting** treatment of members' remuneration. The **tax** treatment of that remuneration will be determined on a different basis by reference to relevant tax legislation in force at the time. A member who is, for tax purposes, treated as an employee will not necessarily be treated as such for accounting purposes and vice versa.

⁷ While as a matter of law the current position seems to be that a member of an LLP cannot be an employee, in practice a member and the LLP may be party to a document describing itself as a contract of employment and which may give the member a right to remuneration.

taxed as though employed by the LLP, then any associated costs, such as employers' national insurance contributions, should also be included as members' remuneration charged as an expense.

Post-retirement payments to former members

22. Any post-retirement payments, whether in cash, in kind or any other benefits, including annuities and payments for goodwill, payable by the LLP as principal to former members of the LLP, other than where the payments are properly made in return for post-retirement services performed by the recipient for the LLP's benefit. Members who retire by or at the balance sheet date are regarded as former members. Such post-retirement payments include, but are not limited to, amounts payable to, for example, spouses, children and the estates of former members. In this context, former members may include former partners in a predecessor partnership of the LLP, where the LLP assumes responsibility for the post-retirement payments to the former partners.

Puttable instrument

23. The definition of 'puttable instrument' is contained in section 22 of FRS 102. A puttable instrument is a financial instrument that gives the holder the right to sell that instrument back to the issuer for cash or another financial asset or is automatically redeemed or repurchased by the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder (paragraph 22.4(a) of FRS 102). In practice for LLPs, puttable instruments may include certain types of capital or members' loans that carry rights for the member (or other holder) to obtain repayment from the LLP.

Undivided profit

24. Profits of the LLP which are not yet divided among the members. Undivided profits are shown under 'Other reserves' on the balance sheet, pending a discretionary decision to divide the profits. As explained in paragraph 48B below, by definition, the LLP will always have discretion over whether to divide undivided profits.

[Some text moved to paragraph 48B]

The contents of the annual report and financial statements

25. **The annual report should comprise:**
- **the financial statements (SI 2008/1911);**
 - **a statement of members' responsibilities in relation to the production of financial statements;**
 - **and**
 - **a report on the financial statements by a registered auditor, if required by the LLP Regulations (SI 2008/1911).**
- 25A. **For financial years beginning on or after 1 April 2019, large⁸ LLPs and groups are also required by the LLP Regulations (SI 2008/1911), as amended by The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SI 2018/1155), to include an energy and carbon report as part of their annual report. The report is required to be approved by the members and the name of the designated member signing the report on behalf of the LLP stated. Further guidance on how to apply the scope of the requirement to produce an energy and**

⁸ For the purpose of the carbon and energy report a large LLP or group is determined in accordance with size criteria as set out in Part 5A of the LLP Regulations.

carbon report, including the availability of certain exemptions, is available in the Government's Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance⁹.

- 25B. The energy and carbon report should also include the names of the persons who, at any time during the financial year, were members of the LLP. The Government's Environmental Reporting Guidelines¹⁰ state that LLPs 'may wish to consider whether they can comply' with the requirement to include the names of all persons who were members of the LLP during the financial year by 'referring to the online list published at Companies House, if one is available'. The Government's guidelines also provide further details and guidance on how to apply the scope and on the content of the energy and carbon report.
- 25C. There is not a requirement for an LLP to prepare a strategic report unless it is a traded LLP or banking LLP (SI 2017/1164).
- 25D. For financial years beginning on or after 6 April 2022, certain LLPs are also required by The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/46) to make additional climate-related financial disclosures aligned with the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations. LLPs within scope of the climate-related financial disclosure requirements, must report this information in the strategic report, if one is prepared, or in the energy and carbon report otherwise¹¹.
26. The financial statements, as defined by the LLP Regulations (SI 2008 1911/1912/1913) and accounting standards, should, subject to exemptions for small entities, comprise:
- a statement of financial position;
 - either:
 - a single statement of comprehensive income displaying all items of income and expense recognised during the period including those items recognised in determining profit or loss and items of other comprehensive income; or
 - a separate income statement and a separate statement of comprehensive income;
 - a statement of changes in equity;
 - a statement of cash flows;¹² and
 - notes, comprising a summary of significant accounting policies and other explanatory information.
- 26A. In certain circumstances, paragraph 3.18 of FRS 102 allows entities to present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity. However, this SORP does not recommend this approach for LLPs as it will be of little benefit to users of LLP financial statements in most cases.

⁹ Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance

¹⁰ ~~Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance~~

¹¹ Reference should be made to The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/46) for details on the scope of the requirement to provide climate-related financial disclosures, the availability of any exemptions, and on the detailed content requirements.

¹² Qualifying entities (as defined by FRS 102) may wish to take advantage of the exemption from the requirement to produce a cash flow statement as set out in paragraph 1.12 (b) of FRS 102. Small LLPs are not required to prepare a cash flow statement.

- 26B. The 2008 Regulations as amended by SI 2016/575 (SI 2008 1913 schedule 1, part 1, paragraph 1A / SI 2008/1912 schedule 1 part 1 paragraph 1B) provides LLPs with the opportunity to adapt the formats of the balance sheet and profit and loss account, in a manner consistent with IAS 1. FRS 102 paragraphs 4.2A to 4.2D and 5.5B to 5.5C set out the requirements for large and medium sized LLPs and FRS 102 paragraphs 1AA.3 to 1AA.6 and 1AB.3 to 1AB.4 set out the requirements for small LLPs.
- 26C. An LLP choosing to adapt the formats is permitted to do so providing the information given is at least equivalent to the information required by the formats set out in the LLP Regulations. To meet this requirement this SORP requires separate disclosure in the balance sheet of 'Loans and other debts due to members' (balance sheet item J) and 'members' other interests' (balance sheet item K) and separate disclosure in the profit and loss account of 'Profit or loss for the financial year before members' remuneration and profit shares'.

Accounting by small LLPs

27. Section 1A *Small Entities* of FRS 102 sets out the information that must be presented and disclosed in the financial statements of small entities that qualify for and choose to apply the small entities regime. Small LLPs apply the recognition and measurement requirements of FRS 102 and this SORP. There are no recognition and measurement simplifications for small entities, except for the optional exemption provided in paragraph 11.13A of FRS 102, which applies to certain financing transactions. This is discussed further in paragraph 57A.
- 27A. Subject to paragraphs 27B and 27C, small LLPs qualifying for and choosing to apply the small entities regime are required to comply with the disclosure requirements of Section 1A of FRS 102 rather than the disclosure requirements of this SORP.
- 27B. The accounts of small LLPs must, however, give a true and fair view. Judgement will therefore be needed when considering whether further disclosures over and above those required by Section 1A of FRS 102 will be needed in order to ensure that the accounts give a true and fair view. Depending on the individual facts and circumstances, some or all of the disclosures included in this SORP and the rest of FRS 102 may be needed in order to ensure that the accounts give a true and fair view.
- 27C. This SORP requires small LLPs to make the disclosures about how loans and other debts due to members rank in relation to other unsecured creditors as required by paragraphs 63 and 64 of this SORP. Such disclosures are considered necessary in order to ensure that the accounts give a true and fair view as LLPs do not have any of the capital maintenance provisions that apply to companies.
- 27D. This SORP encourages small LLPs to include the reconciliation of movements in 'Members' other interests' and 'Loans and other debts due to members' detailed in paragraph 60 of the SORP, and that the reconciliation is provided for both the current and preceding period in line with paragraph 1A.10 of FRS 102.
28. As noted in paragraph 2 above, in the event of conflicting requirements, those in the LLP Regulations and accounting standards should take precedence over this SORP. Other than as set out in paragraph 27C, the SORP should not be interpreted as removing or not permitting exemptions for certain smaller entities in legislation or accounting standards, including those from the need to prepare group accounts or cash flow statements.

29. Deleted

Disclosures

30. This SORP requires LLPs to disclose the following information:
- the principal activities of the LLP and its subsidiary undertakings, indicating any significant changes during the year;
 - an indication of the existence of any branches¹³ outside the UK;
 - the identity of anyone who was a designated member during the year; and
 - the policy of the LLP regarding drawings on account and division of profits and the subscription and repayment of amounts subscribed or otherwise contributed by members (see paragraph 69 below).
31. These disclosures – together with any other non-financial performance matters that an LLP may wish to communicate to its members – may be presented anywhere in the annual report. Although not a statutory requirement, a separate Members' Report offers one possible vehicle for such communication.

¹³ As defined by s1046(3) Companies Act 2006 (CA 2006).

THE APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRACTICE (GAAP) TO LLPs

Members' Remuneration and Interests

General

31A. The interests of members in an LLP are typically governed by the LLP's members' agreement. Compared to the articles of association for limited companies, LLPs have considerable flexibility over how that agreement is drafted, and there is wide diversity in practice. The absence of standard arrangements makes it necessary to analyse each members' agreement with care so that members' equity and liability interests are properly reflected in the financial statements.

31B. Although members' agreements will all vary, and may use different terminology, for legal and practical purposes the payment of profits to members typically involves three separate steps:

- 1) Allocation (attribution or sharing) ie, allocating shares of profit to members, but without them having the right to receive those profits.¹⁴
- 2) Division ie, the mechanism by which profits become a debt due to members.
- 3) Distribution ie, actually paying the cash to the member. This is distinguished from drawings on account of profit.

The order of Steps 1 and 2 could be reversed, and they could happen simultaneously, but the steps will often not all be taken at the same time:

- Profits could be allocated but not divided, for example to determine tax liabilities.
- Profits could be divided but not allocated, for example to allow time to assess members' performance before allocation.
- Profits could be allocated and divided but not distributed, for example to enable the LLP to keep cash in the business on a temporary basis and not distribute until such time as cash flow and working capital requirements allow payment. In this circumstance the LLP does not have an unconditional right to retain the profits indefinitely.

31C. Members' agreements may not clearly identify the point of division, in which case advice may need to be taken to determine when division occurs. For example, a members' agreement might set out how profits are allocated amongst the members and say that once the accounts are finalised the profits are credited to the members' current accounts and then distributed in 12 monthly instalments. In this example, it is likely that allocation and division occur at the same time, creating a debt due to members, with distribution then happening across a 12-month period. Similarly, a statement in a members' agreement that profits which have been allocated to members are a debt due to them, even if distributions will occur later and/or subject to a further decision on timing of payment, is likely to indicate that the profits have been allocated and divided at the same time.

¹⁴ As discussed in Appendix 5, paragraph 3, a provision in an agreement between the members, which sets out the profit shares of the members, does not of itself constitute an agreement for the division of profits. It merely sets out the respective profit shares of the members that will apply to those profits that the members decide to divide among themselves. Accordingly, the default rule that is applied by virtue of Regulation 7(1) of the Limited Liability Partnerships Regulations 2001 (which provides for the members of an LLP to share equally in the capital and profits of an LLP in the absence of agreement to the contrary) does not constitute a default rule as to the automatic division of profits between the members.

- 31D. Where division of profit is not automatic, a decision after the year end to make a "distribution" (ie, to make a payment in respect of profits) once the profits for the period have been ascertained would likely be deemed to be a discretionary decision¹⁵ to divide those profits, and probably also to divide any drawings on account of profit taken during the relevant period. Such a decision would be a non-adjusting post balance sheet event.
- 31E. Where the LLP agreement is silent as to the mechanism by which the profits of the LLP become a debt due to members, all facts and circumstances should be considered. The profits of an LLP are only converted into a debt due to its members when the profits have been divided and it is a matter of construction of the members' agreement whether this happens on an automatic or discretionary basis. LLP agreements may take a variety of forms; as a matter of law they need not be in writing and may be amended by conduct. In each case, it will be necessary to construe the members' agreement to determine the enforceable rights of the parties.
- 31F. The LLP is a body corporate with legal personality separate from that of its members. The members' agreement in force at the time determines the contractual obligations of the LLP. When considering whether the LLP has an unconditional right to avoid payment, any collective rights of the members to vary the terms of the members' agreement are not relevant.

Analysing members' participation rights

- 32. Members' participation rights in the earnings or assets of an LLP should be analysed between those that give rise to, from the LLP's perspective, either a financial liability or equity, in accordance with section 22 of FRS 102. Members' different participation rights should be analysed separately into liability and equity elements. Depending on the terms of the members' agreement, members' participation rights may give rise to equity or liabilities or both.**
- 32A. Paragraphs 31B to 31C above explain that profits may in some cases not be divided by an LLP until some time after they have arisen. However, as explained below, the accounting treatment depends on whether or not the member's agreement gives the LLP the unconditional right to retain those profits indefinitely. If the LLP has this unconditional right, division of profit will be discretionary. Conversely, if it does not have such an unconditional right, division of profit is automatic.
33. Under section 22 of FRS 102, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to deliver either cash or another financial asset to another party. Critical, therefore, to determining whether the LLP has a financial liability to a member, or alternatively the member holds equity in the LLP, is whether there exists a contractual obligation on the part of the LLP to deliver cash (or other financial assets) to the member – for example, upon the member retiring from or otherwise leaving the LLP. Generally, a member's participation right will result in a liability unless the LLP has an unconditional right to avoid delivering cash or other assets to the member (ie, the right to any payment or repayment is discretionary on the part of the LLP). Two very limited exceptions, in which amounts are presented as equity even though the entity does not have discretion to avoid payment, are discussed in paragraphs 40 to 42F below. They are referred to hereafter

¹⁵ See also example 49C where the facts and circumstances are such that the decision to divide profits for the period once they have been ascertained is automatic.

as the 'puttables exception'.

- 33A. The members' agreement will specify what members are expected to provide to the LLP and what they will receive in return. Depending on the nature of the LLP and what has been agreed, members may or may not provide **any substantive** services or expertise to the LLP, and they may or may not be required to provide cash, or other assets, as members' capital. They may receive equity or liability interests in the LLP or a combination of the two. There need not be symmetry between the treatment of amounts subscribed as members' capital and the 'returns' arising. For example, a member may be able to demand repayment of capital subscribed (liability, unless the conditions for the puttables exception are met) but the LLP may have discretion over the division of profits (equity).
- 33B. It will generally be necessary when analysing members' interests between equity and liabilities, to ascertain the rights that may be exercised by an individual member against the LLP. For example, where the profits are only divided if the LLP¹⁶ so decides, an individual member will not be entitled to a share of those profits unless and until a decision to divide them is taken; accordingly, the division of those profits will be treated as an appropriation and deducted from equity when it occurs.¹⁷ By contrast, where the members have agreed in the members' agreement in force at the time to an automatic division of profits, the automatically divided profit will fall to be treated as an expense in profit or loss (and also as a liability in the balance sheet insofar as the profit remains unpaid at the balance sheet date).
34. Participation rights in respect of amounts subscribed or otherwise contributed should be analysed separately from participation rights in respect of members' remuneration except where the remuneration, or part thereof, is clearly identifiable as a return on amounts subscribed or otherwise contributed. To the extent that remuneration cannot be clearly identified as a return on amounts subscribed it is regarded, for accounting purposes, as separate from the instrument that consists of the amount subscribed and the return thereon. For example, profit share payable at the discretion of the LLP would be accounted for as an equity interest, even if the member's capital is treated as a liability. Where remuneration, or part thereof, is clearly identifiable as a return on the amounts subscribed – for example, non-discretionary interest payments – rather than a return for the services provided by the members, then the amounts subscribed and that part of the remuneration that is clearly identifiable as a return on the amounts subscribed would be analysed together for accounting purposes.
- 34A. For some LLPs, the terms of the members' agreement may result in all members' participation rights being classified as giving rise to financial liabilities ie, not equity participation rights. This may be the case if, for example, all profits are automatically divided (see paragraph 48 below), and if individual members have the right to demand payment of amounts subscribed or otherwise contributed to the LLP. The ability of a member to exercise a contractual right may be conditional on a future event, for example, a member may only be able to demand amounts subscribed or otherwise contributed on retirement. Despite the fact that the member's right is conditional on a future event, the LLP does not have an unconditional right to avoid making the payment, so, unless the conditions under the puttables exception are met, a financial liability exists.
- 34B. If the LLP does not have an unconditional right to refuse repayment of amounts subscribed (and the conditions under the puttables exception have not been satisfied), such amounts will be classed as

¹⁶ Members as whole or a committee of the members with relevant authority.

¹⁷ See Appendix 1 Exhibit E and Exhibit G.

liabilities and included within loans and other debts due to members. Conversely, if the LLP has an unconditional right to refuse repayment of members' capital, the appropriate classification is determined by the other rights that attach to the capital, for example, if the LLP has an unconditional right to refuse repayment to members of amounts subscribed or otherwise contributed by them then, providing there is no obligation to pay a return on those amounts, such amounts will be classed as equity. However, if interest is mandatorily payable on members' capital, then a liability will be recognised on subscription reflecting the present value of minimum non-discretionary outflows. In many cases, this will be the same as the relevant amount of members' capital. However, following the principle set out in paragraph 34 above, any other remuneration (salary, bonus, risk premium and shares of profits (fixed and variable) etc) would fall to be accounted for separately.

- 34C. As discussed in paragraph 34, remuneration and amounts subscribed (capital) may need to be treated separately for accounting purposes because there is no clearly identifiable return on capital and the substance of the arrangement makes it inappropriate to treat remuneration as a return on capital. This separate analysis will most often apply in situations where the members of the LLP provide services to that LLP (for example, professional services firms). In such situations remuneration and profit shares are often payable to members in return for participation in the business as well as representing a financial return on amounts invested by members, but the latter element might represent a relatively insignificant proportion of total remuneration.

34D. However, there may be situations where all members of the LLP contribute capital, but certain members may not provide any substantive services to the LLP. In these cases, the automatic right to a share of the LLP's profits (see paragraph 48) should be treated as a return on capital which is the right to share in future profits of the LLP. See example 11 in appendix 2 of this SORP.

35. Moved to paragraph 45A

36. Moved to paragraph 45B

36A. Deleted

37. Illustration of the principles being applied is given in the illustrative examples in Appendix 2.

38. Moved to paragraph 34A

39. Moved to paragraph 34B

Puttables exception

40. The puttables exception affects the classification of puttable financial instruments (instruments that give the holder the right to sell the instrument back or are automatically redeemed on the occurrence of an uncertain future event or on death or retirement) and obligations arising on liquidation. In certain limited circumstances, rights of members which meet the definition of a financial liability under paragraph 22.3 of FRS 102 will fall to be classified as equity provided the conditions for the puttables exception are met.
41. In considering whether members' participation rights fall under the puttables exception it is first necessary to consider how the principles set out in paragraph 34 above are being applied. Accordingly,

in cases where, under the principles of paragraph 34 above, participation rights in respect of remuneration are treated as separate instruments this does not in itself affect the classification of the capital under the puttables exception.

42. The requirements under the puttables exception are drafted so as to apply to individual classes of financial instrument. Depending on the structure of an LLP, members' interests may consist of one or more classes of financial instrument which themselves may comprise one or more 'components'. For example, members may invest in the capital of an LLP and may also be required to make loans to the LLP. If those loans are legally a separate financial instrument from the capital, then the LLP will have two classes of instrument with members. One of the requirements under the puttables exception is that the class of instruments is subordinate to all other instruments of the issuer. Accordingly, where members' interests include more than one class of instrument, equity classification under the puttables exception is only possible for the class of instrument that is subordinate to all others.
- 42A. A puttable financial instrument is classified as a liability rather than equity if it obliges the entity to make payments to the holder before liquidation, such as mandatory interest or other non-discretionary returns. This is because one of the conditions for that exception to apply is that, apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity. However, there is no equivalent restriction for instruments redeemable only on liquidation.
- 42B. In considering the puttables exception it is also necessary to distinguish those transactions between members and the LLP that are undertaken in their role as non-owners from those undertaken in their role as owners.
- 42C. One example is a profit or loss sharing arrangement that allocates profit or loss to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 22.4 of FRS 102. However, profit or loss sharing arrangements that allocate profit or loss to instrument holders based on the nominal amount of their instruments relative to others in the class may represent transactions with the instrument holders in their role as owners and should be considered further by applying the principles of paragraph 34.
- 42D. The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder may also be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as equity.
- 42D(1). For example, if certain members are remunerated for providing a guarantee to the entity this would be disregarded when considering the requirements under the puttables exception. If it is determined that the cash flows and contractual terms and conditions relate to the instrument holder as an owner of the entity then provisions of the puttable exception should be considered. In doing so it is first necessary to establish whether the capital and remuneration are being analysed together or separately (see paragraph 34 of the SORP).

- 42E. The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.
- 42E(1). Part or all of the capital subscribed by a member will be accounted for as a liability a) if the LLP is obliged to make payments to the member which are clearly identifiable as a return on that capital (eg, interest on an annual basis), or b) there are circumstances in which the member can demand repayment of capital (eg, on retirement) and the conditions under the puttables exception are not met.
- 42F. Appendix 2 contains a number of examples designed to demonstrate the impact of application of the puttables exception in various scenarios.
43. Deleted
44. Deleted
45. Deleted

Division of profits

- 45A. **Amounts becoming due to members in respect of liability participation rights following an automatic division of profits should be presented as an expense within profit or loss (within the heading 'Members' remuneration charged as an expense').**
- 45B. **Amounts becoming due to members in respect of equity participation rights, following a discretionary division of profits, should be debited directly to equity in the year in which the division occurs. Such amounts should not be presented as an expense within profit or loss. A discretionary division of profits that takes place after the balance sheet date is a non-adjusting event under section 32 of FRS 102 *Events after the End of the Reporting Period*.**
- 45C. Whether the division is automatic or discretionary depends on the mechanism by which the profits become a debt due to members and whether the LLP has an unconditional right to avoid delivering cash or other assets to members in respect of those profits.
- 45D. The profits of an LLP are only converted into a debt due to members when they have been divided, whether on an automatic or discretionary basis. It is not necessary to know the precise identity of the parties to whom the profits are owed (or how the profits are to be allocated) for a liability in respect of profits to exist at the balance sheet date whether that liability arises from an automatic or discretionary division of profits.

Automatic division of profits

46. Amounts becoming due to members in respect of participation rights in the profits of the LLP for the year that give rise to a liability might include, for example, salary, interest on capital balances and any automatic division of profits, to the extent that the LLP does not have an unconditional right to avoid delivering cash or other assets to a member in respect of such amounts.

47. Moved to paragraph 49A
48. Where profits are automatically divided as they arise or are determined, and the LLP does not have an unconditional right to avoid delivering cash or other assets based on the members' agreement in force at the time, the amounts arising that are due to members are liabilities. They should therefore be treated as an expense in profit or loss in the relevant year and, to the extent they remain unpaid at the year end, they should be shown as liabilities in the balance sheet. This will also be the case where there is a requirement to divide some or all profits but the basis upon which those profits are allocated between individual members is not determined until after the balance sheet date.
- 48A. If there are any circumstances in which an individual member can demand that profits are paid out, it must follow that an LLP does not have an unconditional right to avoid delivering cash or other assets in respect of those profits. This includes the situation in which an individual member can demand that profits are paid out upon retirement. Accordingly, unless the conditions under the puttables exception (as discussed in paragraphs 40 – 42F) are satisfied, those profits will give rise to liabilities and should be presented as an expense within profit or loss (within 'Members' remuneration charged as an expense').
- 48B. It is open to the members of an LLP to agree that all, or a proportion of, the profits of the LLP shall be automatically divided after they have been ascertained or after some other conditions have been met; in that event, the LLP will not have an unconditional right to avoid delivering cash or other assets in respect of those profits. This is a matter of construction of the members' agreement. Where this is the case, any amounts automatically divided will form part of members' remuneration charged as an expense ie, they will be deducted in arriving at retained profit or loss for the financial year available for discretionary division. Accordingly, where all the profits are automatically divided, a nil amount will be reported as profit or loss for the financial year available for discretionary division, and there will be no undivided profits.¹⁸
49. It is possible that a combination of these circumstances may arise, for example, if 50% of profits are automatically divided, but the remaining profits are only divided at the discretion of the LLP, then the former will be treated as an expense/liability and the latter as an appropriation/equity.
- 49A. Where there are no equity participation rights in the profits for the year, it follows that all amounts becoming due to members in respect of those profits will be presented within members' remuneration charged as an expense. In these circumstances, LLPs should refer to the presentational guidance given in paragraph 51 below and the illustrative examples in Appendix 1.
- 49B. The members' agreement may require that all profits are divided such that the LLP has no discretion as to how much profit is divided but does allow the LLP discretion as to how the divided profit is allocated between members. There may be different 'layers' in this sharing process whereby some members have a fixed share, others have a variable share and some have both fixed and variable shares. Even though the LLP has some discretion as to member's profit share entitlements it cannot avoid the obligation to divide all the profits as this decision is automatic. Such an arrangement is called automatic division. This would also be the case where there is a requirement to divide some or all profits but the basis upon which those profits are allocated between individual members is not determined until after the balance sheet

¹⁸ As explained in paragraph 48, where the agreement between the members provides for the automatic division of profits, those divided profits will form part of members' remuneration charged as an expense and will be credited directly to loans and other debts due to members without first being shown under the balance sheet heading 'Other reserves'. This is the case even if the divided profits have yet to be allocated to individual members.

date. This is because for an obligation to exist at the balance sheet date it is not necessary to know the precise identity of the parties to whom the obligation is owed or how the amounts to satisfy the obligation are to be allocated.¹⁹

- 49C. Another common example seen in practice is where the members' agreement specifies that the profit to be divided is that as stated in the LLP's audited accounts as approved by the members. Although the amount of the profits to be divided will not be known until the audit is complete, the LLP cannot avoid the obligation to divide all the profits reported in the LLP's audited accounts as this decision is automatic. In addition, the fact that members have to approve the audited accounts does not mean that the LLP can avoid the obligation to divide all the profits. Once the members approve the accounts the LLP has to divide all the profits as this decision is automatic. The LLP is a body corporate with legal personality separate from that of its members. The members' agreement in force at the time determines the contractual obligations of the LLP. Therefore, the requirement for members to approve the LLP's accounts does not enable the LLP to avoid its obligation.
- 49D. Some members' agreements specify that the profit to be divided is that as stated in a 'distribution account'; this being distinct from the statutory accounts. The basis of preparation of the 'distribution account' is usually set out in the members' agreement. Although the amount of the profits to be divided will not be known until the amount in the 'distribution account' is determined, the LLP cannot avoid the obligation to divide the profits in the 'distribution account' as this decision is automatic.
- 49E. In some cases, an LLP may make divisions based on some form of 'adjusted profits' rather than the profits reported in the LLP's financial statements. If the permitted adjustments only allow an LLP to defer the division of profits, and not indefinitely, it follows that the LLP does not have an unconditional right to avoid delivering cash or other assets. Accordingly, those profits will give rise to liabilities as they are automatically divided. See paragraphs 50E to 50F for further guidance.
50. Deleted

Discretionary division of profits

- 50A. Where there is no automatic division of profits because the LLP has an unconditional right to avoid delivering cash or other assets until those profits are divided by a decision taken by the LLP and a debt due to members created, they are therefore shown within equity as an undivided amount available for appropriation. Once the profits are divided, the amount of the divided profits is treated as an appropriation which is deducted from equity and, to the extent that any divided profits remain unpaid at the year end, the amount unpaid will be recorded as a liability.
- 50B. If an LLP has an unconditional right to avoid delivering cash or other assets, it must follow that in all circumstances the LLP will be entitled to retain the profits that it makes, for investment or other purposes, for as long as it wishes; therefore no liability exists and the profits represent amounts available for discretionary division among members. This will be true irrespective of whether individual members would prefer profits to be divided.
- 50C. If an LLP allocates an amount of profit to a member, it will be important to consider whether the LLP has

¹⁹ See Appendix 1 Exhibit A and Exhibit D

an unconditional right to avoid delivering cash or other assets to that member. If in all circumstances the LLP is entitled to retain profits for as long as it wishes (ie, until the LLP itself is liquidated), notwithstanding the fact that an amount of profit has been allocated to an individual member, then the LLP will have an unconditional right to avoid delivering cash or other assets in respect of that profit and will not have created a debt due to that member. However, if the LLP only has the right to withhold payment to the member in certain circumstances, for example to manage cash flow to preserve viability, that will be insufficient as the LLP's right is conditional. For there not to be a liability, it is essential that the LLP has an unconditional right to avoid delivering cash or other assets to the member indefinitely.

- 50D. If a decision is made each year by the LLP over whether or not to divide profits, and if the LLP has full discretion never to divide profits, then it does not matter whether or not the 'default' position is to divide or not to divide. But it is essential that the LLP has full discretion not to divide profits, irrespective of the wishes of individual members.
- 50E. As noted in paragraph 49E, in some cases, an LLP may make divisions of profit based on some form of 'adjusted profits' rather than the profits reported in the LLP's financial statements. In such circumstances, it is important to consider the nature of the adjustments that are made in arriving at 'adjusted profits' and the extent to which the LLP has discretion over those adjustments. The focus continues to be on whether in all circumstances the LLP will be entitled to retain the profits that it makes for as long as it wishes.
- 50F. If an LLP has discretion over the adjustments made in arriving at 'adjusted profits', such that it will always be entitled to determine that the 'adjusted profits' required to be divided are zero, then the LLP will have an unconditional right to avoid delivering cash or other assets in respect of those profits.

Losses

- 50G. If the members' agreement is such that, in the event of the LLP making a loss, the loss shall be divided amongst the members, the loss would give rise to a credit amount of 'Members' remuneration charged as an expense'.
- 50GA. If the members' agreement is such that, in the event of the LLP making a loss, the loss shall not be automatically divided amongst the members, the loss would not give rise to a credit amount of 'Members' remuneration charged as an expense' but should be recognised as a debit within equity under 'Other reserves'.

Drawings on account and distributions

- 50H. Unless otherwise provided in a members' agreement, amounts drawn by members against future divisions of profit (ie, drawings on account) are loan assets repayable by members. A loan asset is extinguished when the member's drawing on account is offset by a debt due to that member further to a division of profits or, for example, when repaid or waived in accordance with the members' agreement. Drawings on account are accounted for as amounts due from members, as reduced by any provision for amounts that may not be recoverable, until being offset, settled or waived.
- 50I. Where the LLP does not have any rights to recover amounts paid to members, it follows that the amounts paid will be distributions and not drawings on account. It will be important to determine whether the

corresponding distribution forms part of members' remuneration charged as an expense or represents a discretionary division of profit made during the period. If the LLP could have chosen never to divide the associated profits, then the distribution will be accounted for as a discretionary division of profit, and not reported in profit or loss. Conversely, if the distribution is of profits that are subject to automatic division then a liability in respect of those profits will already have been recognised, with the corresponding expense forming part of members' remuneration charged as an expense, and the distribution will reduce that liability.

Members' remuneration: presentation and disclosure

50J. Under FRS 102, an entity has a choice whether to present total comprehensive income for the period in one statement (a statement of comprehensive income) or two statements (an income statement – which is the profit and loss account required by the LLP Regulations – and a statement of comprehensive income).

51. **The prescribed formats set out in LLP Regulations require disclosure on the face of the profit and loss account (or statement of comprehensive income) of a sub-total, being 'Profit or loss for the financial year before members' remuneration and profit shares' (SI 2008 1913/1912 schedule 1, part 1, section B). The total of members' remuneration charged as an expense, as defined in paragraph 21 above, should be disclosed separately and deducted from this balance. Disclosure on the face of the profit and loss account (or statement of comprehensive income) should be as follows:**

Profit or loss for the financial year before members' remuneration and profit shares	X
Members' remuneration charged as an expense	<u>(X)</u>
Profit or loss for the financial year available for discretionary division among members	<u>X</u>

52. **The basis on which each element of remuneration (as defined) has been treated in the accounts should be disclosed and explained by way of a note.**

53. Members' remuneration charged as an expense is defined in paragraph 21 above. The prescribed formats in the LLP Regulations require disclosure on the face of the profit and loss account (or statement of comprehensive income) of a sub-total 'Profit or loss for the financial year before members' remuneration and profit shares'. Therefore, after the sub-total required by the prescribed formats in the LLP Regulations, a line item described as 'Members' remuneration charged as an expense' should be deducted as an additional expense. This includes any related employment costs. This also applies where the formats are adapted (see paragraph 26C).

54. The treatment of members' remuneration in the profit and loss account (or statement of comprehensive income) is summarised in the following table.

Nature of element of a member's remuneration	Treat as
Remuneration that is paid under a contract to provide services to the LLP, which may be referred to as a contract of employment	Expense, described as 'Members' remuneration charged as an expense', and deducted after arriving at 'Profit for the financial year before members' remuneration and profit shares'
Other payments, arising from components of members' participation rights in the profits for the year that give rise to liabilities in accordance with section 22 of FRS 102, such as mandatory interest payments	
Automatic division of profits	
Any share of profits arising from a discretionary division of profits (ie, where the LLP can choose never to divide the profits, and the decision to divide the profits is taken after the profits have been made)	Distribution in equity

Where it is considered that it will assist an understanding of the financial performance of the LLP, members' remuneration charged as an expense should be further analysed within the notes to the financial statements, for example, between that which is paid under a contract of employment and that which relates to amounts arising from participation rights that give rise to a liability. In the case of a group, members' remuneration from all entities in the group that are consolidated into the parent LLP's group accounts should be considered.

Members' interests: presentation and disclosure

55. **'Loans and other debts due to members' (balance sheet item J in the prescribed formats set out in the LLP regulations) and 'Members' other interests' (balance sheet item K in the prescribed formats in the LLP regulations) should be disclosed separately on the face of the balance sheet (SI 2008 1913/1912 schedule 1, part 1, section B). Balance sheet item J includes 'Loans and other debts due to members' and 'Members' capital' in so far as it is classified as a liability. Balance sheet item K includes 'Members' capital', 'Revaluation reserve' and 'Other reserves', in so far as they are classified as equity, which are also each required to be disclosed separately on the face of the balance sheet.**
56. The prescribed formats in the LLP regulations require all amounts due to members to be presented within 'Loans and other debts due to members'. This heading will include any unpaid element of members' remuneration charged as an expense together with any unpaid amounts arising from discretionary division of profits made during the year or in prior years. It will also include members' capital classified as a liability.
57. Equity should not include members' capital that is classified as a liability in accordance with section 22 of FRS 102. For some LLPs, the terms of the members' agreement may result in all 'capital' subscribed by members being presented as financial liabilities.

- 57A. When members' capital is classified as a financial liability it may – depending on the terms of the members' agreement – constitute a financing arrangement and may therefore need to be discounted to present value in accordance with the requirements of paragraph 11.13 of FRS 102. However, discounting will not always be necessary as in many instances members' capital will be repayable on demand or at short notice eg, on termination of membership. In addition, there is an exemption for small companies and LLPs in paragraph 11.13A of FRS 102 from the requirement to discount basic loan financing transactions, provided it is a "...loan from a person who is within a director's group of close family members, when that group contains at least one [member of the LLP who is a person]." The meaning of director has not been defined in FRS 102 for an LLP. This SORP recommends that for the purposes of applying the exemption in paragraph 11.13A of FRS 102, a director is taken to mean a member, who is a person, with an equivalent role in the LLP. For some small LLPs that may be all members, for others, it may be a member who is part of a governing body or management board.
- 58. Whether an LLP presents its balance sheet and profit and loss account using either the prescribed formats in the LLP regulations or the adapted formats (see paragraph 26B) this SORP requires that the face of the balance sheet should show the net assets attributable to members of the LLP (that is, a balance sheet total before 'Loans and other debts due to members' and 'Members' other interests'). In addition, this SORP requires 'Total members' interests', being the total of items shown as 'Loans and other debts due to members' and 'Members' other interests' less any amounts due from members in debtors, should be disclosed as a memorandum item on the face of the balance sheet.**
- 59. A statement of the changes in equity should be presented as a primary statement (paragraph 6.3 of FRS 102) detailing the movements in 'Members' other interests' (Balance sheet item K in the prescribed formats set out in the LLP regulations).**
- 59A. A statement of changes in equity does not need to be prepared if the LLP has no equity. Where a statement of changes in equity is not included because the LLP has no equity and is not replaced as a primary statement by a reconciliation of members' interests, a statement should be made either on the face of one of the other primary statements or in the notes to the accounts that the LLP has no equity and consequently a statement of changes in equity is not given.
- 59B. Paragraph 4.12 of FRS 102 requires certain disclosures relating to an entity's share capital and reserves. For entities without share capital, such as an LLP, equivalent information is required by paragraph 4.13 of FRS 102, showing changes in the period for each category of equity, and the rights, preferences and restrictions attaching to each category of equity.
60. The Large and Medium sized LLP (Accounts) regulations require additional disclosures of movements in 'Loans and other debts due to members' (SI 2008/1913 schedule 1, part 3, 47). Disclosure should include the amount brought forward from the previous year, the changes arising in the financial year and the balance carried forward at the end of the year. This SORP requires that disclosure of movements in 'Members' other interests' and 'Loans and other debts due to members' should be in the following format (although additional categories of members' interests or types of movements should be disclosed where this aids clarity or circumstances require it):

	EQUITY Members' Other Interests ²⁰				DEBT Loans and other debts due to members less any amounts due from members in debtors ²¹			TOTAL MEMBERS' INTERESTS
	Members' Capital (Classified as equity)	Revaluation Reserve	Other Reserves	Total	Members' Capital (Classified as debt)	Other amounts	Total	Total 2XX1
Amounts due to members					X	X	X	
Amounts due from members						(X)	(X)	
Balance at [start of the period]	X	X	X	X	X	X	X	X
Members' remuneration charged as an expense, including employment and retirement benefit costs						X	X	X
Profit/(loss) for the financial year available for discretionary division among members			X	X				X
Members' interests after profit/(loss) for the year	X	X	X	X	X	X	X	X
Other divisions of profits			(X)	(X)		X	X	-
Surplus arising on revaluation of fixed assets		X		X				X
Introduced by members	X			X	X		X	X
Repayments of capital	(X)			(X)	(X)		(X)	(X)
Repayments of debt (including members' capital classified as a liability)					(X)		(X)	(X)
Drawings on account and distributions of profit						(X)	(X)	(X)
Other movements	X	X	X	X	X		X	X
Amounts due to members					X	X	X	
Amounts due from members						(X)	(X)	
Balance at [end of the period]	X	X	X	X	X	X	X	X

60A. The reconciliation of members' interests may be presented as a primary statement instead of a statement of changes in equity. Where this option is taken comparative amounts should be presented by way of the full table relating to the prior period.

61. Any undivided profits should appear under 'Other reserves' in 'Members' other interests' (balance sheet item K in the prescribed formats set out in the LLP regulations) (SI 2008 1913/1912 schedule 1, part 1, section B). Where the LLP makes a loss for the financial year that is not divided to the members, the amount should be deducted from 'Other reserves'.

²⁰ Balance sheet item K.

²¹ Balance sheet item J less any amounts due from members in debtors. 'Loans and other debts due to members' would include any members' capital classified as a liability. The analysis of amounts due to members is required in order to comply with the LLP Regulations.

62. Deleted
63. **This SORP requires the notes to the accounts to explain where amounts in 'Loans and other debts due to members' (other than members' capital classified as debt) would rank in relation to other creditors who are unsecured in the event of a winding up. The notes should disclose details of any protection afforded to other creditors in such an event which is legally enforceable and cannot be revoked solely by a decision of the members. The notes should also disclose what restrictions or limitations exist on the ability of the members to reduce the amount of 'Members' other interests' or state that there are no such restrictions.**
64. The capital (whether classified as a liability or equity) of an LLP may be reduced by agreement of the members either by repayment or by the conversion of equity capital into liability capital or other debt.²² In the absence of agreement to the contrary, unsecured debt due to members will rank equally with debts due to other unsecured creditors in a winding up.
65. **The Large and Medium sized LLP (Accounts) Regulations require disclosure in the notes of the amount of loans and other debts due to members falling due after more than one year (SI 2008/1913 schedule 1, part 3, 47).**
66. **The LLP Regulations require separate disclosure of the aggregate amount of money advanced by members by way of loan, the aggregate amount of money owed to members in respect of profits and any other amounts (SI 2008/1912/1913 schedule 1, part 1, section B (notes)).**
67. **This SORP requires the amount of debts owing to the LLP by members to be disclosed.**
68. Amounts owing to and from members should not be offset in the financial statements unless specifically required or permitted by FRS 102. Debits on members' balances (where, for example, drawings on account were made during the year in anticipation of a division of profits) should be reviewed for recoverability and shown separately in debtors.

Other disclosures

69. **This SORP requires LLPs to disclose the overall policy followed in relation to drawings on account and divisions of profit, including an indication of the policy applicable where the cash requirements of the business compete with the need to distribute cash to members. Such disclosures should include any transfers of members' interests from equity to debt (and vice versa) during the year and up to the date the accounts are approved. The policy under which members contribute or subscribe amounts to the LLP by way of equity or debt and the policy under which their contributions and subscriptions are repayable by the LLP, should also be disclosed.**
70. **In the case of large and medium-sized LLPs, the LLP Regulations require disclosure of the average number of members in the financial year. This is determined by dividing the aggregate number of members of the LLP for each month or part thereof in the financial year by the number of months in the financial year (rounded to the nearest whole number) (SI 2008/1913 schedule 1, part 3, 66 (1)(2)).**

²² Neither CA 2006 nor the LLP Regulations contain any provisions in relation to capital maintenance of an LLP, such as those in CA 2006 for limited liability companies.

71. **In the case of large and medium-sized LLPs, the LLP Regulations also require disclosure of the profit (including remuneration) that is attributable to the member with the largest entitlement to profit (including remuneration) where the amount of the profit of the LLP for the financial year before members' remuneration and profit shares exceeds £200,000 (SI 2008/1913 schedule 1, part 3, 66 (3)). The identity of this member need not be disclosed.**
72. When determining the disclosable amount, the LLP should take account of all the relevant factors and disclose the policy by which the amount was arrived at, as the LLP Regulations do not provide specific guidance as to how the disclosable amount should be determined. A consistent policy should be applied. Where the LLP has an unconditional right to avoid delivering cash or other assets to members in respect of profits, the policy for determining the disclosable amount should be disclosed and should explain how current year undivided profits and current year divisions of both current and prior year profits are treated.
73. Where LLPs choose to disclose average members' remuneration, this should be calculated by dividing the 'Profit before members' remuneration and profit shares' by the average number of members (as discussed in paragraph 70 above), these being the two items that are required to be disclosed by the LLP Regulations. If any other figure for average members' remuneration is given, it should be reconciled to the figure calculated in accordance with this paragraph.

Cash flow statement presentation

74. In accordance with section 7 of FRS 102, LLPs should present a cash flow statement which analyses cash flows during the period between operating, investing and financing cash activities.²³

74A. In some cases, judgement will be required to classify certain cash flows. However, for an LLP, transactions with members (and former members) will generally be classified as summarised in the following table.

Nature of transaction	Classification of cash flows
Remuneration that is paid under a contract to provide services to the LLP, which may be referred to as a contract of employment	Operating cash flow
Drawings on account and distributions of profits (discretionary or automatic)	Operating or financing cash flows
Post-retirement payments to former members	Operating cash flow
Capital introduced by members (classified as equity or liability)	Financing cash flow
Repayment of capital or debt to members	Financing cash flow
Payments to members that represent a return on amounts subscribed or otherwise contributed	Financing cash flow

74A(1). This SORP requires LLPs to disclose their accounting policy for classifying distributions of profits and to classify the cash flows consistently from period to period.

74A(2). Section 7 of FRS 102 does not dictate how automatic or discretionary distributions of profit should be classified in the cash flow statement. Accordingly, LLPs should determine the classification that is appropriate to their business. LLPs could classify automatic or discretionary profit distributions as operating cash flows, because they are paid out of operating cash flows or because they are in substance paid for services rendered to the LLP as part of its revenue generating activities. Alternatively, LLPs could classify automatic or discretionary distributions of profits as financing cash flows, because they represent costs of obtaining financial resources or claims on cash flows by the providers of capital to the LLP.

74B. In order to assist with an understanding of an LLP's ability to generate cash flows, and the needs of that LLP to utilise those cash flows, the LLP should disclose transactions with members (and former members) separately from transactions with non-members.

74C. Paragraph 7.22 of FRS 102 requires an entity to disclose the changes in net debt between the beginning and end of the reporting period. The glossary to FRS 102 defines net debt as consisting of the borrowings of an entity, together with any related derivatives and obligations under finance leases, less any cash and cash equivalents. Although 'loans and other debts due to members' would be considered borrowings for the purposes of the definition of net debt they are not external financing. This SORP

²³ Qualifying entities (as defined by FRS 102) may wish to take advantage of the exemption from the requirement to produce a cash flow statement as set out in paragraph 1.12 (b) of FRS 102. Small LLPs are not required to prepare a cash flow statement.

recommends therefore that LLPs present in the notes to the financial statements an analysis of the movements in net debt for the period, with appropriate subtotals to show the changes in net debt before members' debt separately from debt relating to members. An example presentation for the net debt reconciliation disclosure requirement is set out below:

Example presentation for the net debt reconciliation disclosure:

	Balance at beginning of period	Arising from cash flows	New finance leases	Other non-cash changes	Acquisition or disposal of subsidiaries	Changes in market value and exchange rate movements	Balance at end of period
Cash at bank	x	x	-	-	x	x	X
Overdrafts	(x)	x	-	-	x	x	(x)
Bank borrowings (less than one year)	(x)	x	-	(x)	x	x	(x)
Bank borrowings (more than one year)	(x)	-	-	x	x	x	(x)
Finance leases	(x)	x	(x)	-	x	x	(x)
Net debt (before members' debt)	(x)	x	x	-	x	x	(x)
<i>Loans and other debts due to members</i>							
Members' capital	(x)	x	-	-	-	x	(x)
Other amounts due to members	(x)	x	-	(x)	-	x	(x)
Net debt	(x)	x	x	(x)	x	x	(x)

Retirement Benefits

Retirement benefits of employees and members

75. Post-employment benefits provided for employees of the LLP should be accounted for as required by section 28 *Employee Benefits* of FRS 102. This will include post-employment benefits payable to members that are based on any salary paid to the member under an employment contract. Where members are not employees, section 28 of FRS 102 does not apply.

Other post-retirement payments to members

76. LLPs should analyse their contractual or constructive obligations (including any relating to early retirement options) to make payments to members in their capacity as members at and after the point of their ceasing to be members of the LLP, between:
- those that meet the definition of an insurance contract and, therefore, fall within the scope of FRS 103 *Insurance Contracts*;
 - those that give rise to financial liabilities falling within the scope of section 11 *Basic Financial Instruments* of FRS 102;
 - those that give rise to financial liabilities falling within the scope of section 12 *Other Financial Instruments* of FRS 102; **and**
 - those that give rise to non-financial liabilities of uncertain timing and amount falling within the scope of section 21 *Provisions and Contingencies* of FRS 102; **and**
 - those that give rise to share-based payments falling within the scope of section 26 *Share-based Payment* of FRS 102.

In the case of an unconditional contractual obligation that meets the definition of an insurance contract, this will fall within the scope of FRS 103. As explained further in paragraph 80A, this will be the case where, for example, the total amount payable by the LLP may be significantly affected by how long the former member lives.

In the case of an unconditional contractual obligation to deliver cash or other financial assets, this will give rise to a financial liability and will fall within the scope of either section 11 or section 12 of FRS 102 unless it meets the definition of an insurance contract **or a share-based payment**. In the case of a constructive obligation of uncertain timing or amount, or a contractual obligation that is conditional on further service from a member, any obligation **arising from** past service will fall within the scope of section 21 of FRS 102, **unless it meets the definition of a share-based payment**. For an LLP, an example of a share-based payment might be where a former member is entitled to a specified percentage of disposal proceeds if the business of an LLP is sold, to be paid by the LLP to the former member, within a specified period following the member's retirement.

In the case of a constructive obligation of certain timing and amount, this will fall to be accounted for as a liability under the general provisions of the Companies Act/GAAP.

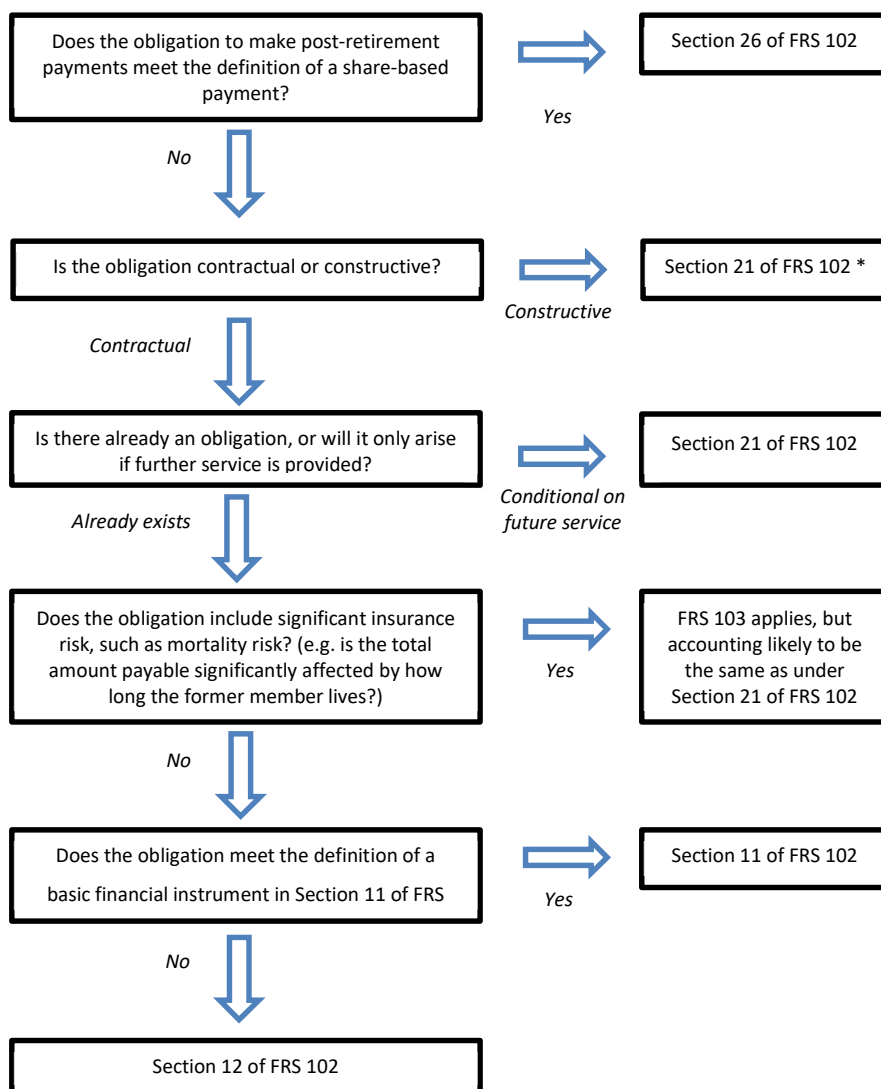
76A. The required accounting and disclosures will differ depending on whether an obligation falls within the scope of FRS 102 or FRS 103 and, if the former, depending on whether the obligation falls within the scope of section 11, section 12, section 21 or section 26.²⁴

- FRS 103 allows entities, generally, to continue with their existing accounting policies for liabilities within its scope, while permitting limited improvements to those policies.
- Section 11 of FRS 102 requires liabilities within its scope to be measured at amortised cost using the effective interest method.
- Section 12 of FRS 102 generally requires liabilities within its scope to be measured at fair value.
- Section 21 of FRS 102 requires liabilities within its scope to be measured at the best estimate of the amount required to settle the obligation at the reporting date, and gives further guidance on how this is to be determined.
- Section 26 of FRS 102²⁵ requires liabilities in respect of cash-settled share-based payments within its scope to be initially measured at fair value. If a cash-settled share-based payment arrangement relates to services received, the liability will reflect the extent to which services have been provided at the reporting date.

²⁴ As an accounting policy choice, paragraph 11.2 of FRS 102 allows that, rather than applying the recognition and measurement provisions of sections 11 and 12, an entity can choose to apply either (1) the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* or (2) the recognition and measurement provisions of IFRS 9 *Financial Instruments* (together with those provisions of IAS 39 that have not yet been superseded by IFRS 9). In all cases, the disclosure requirements of sections 11 and 12 continue to be applicable.

²⁵ Section 26 of FRS 102 distinguishes between equity-settled and cash-settled share-based payment arrangements. The former involve obligations to issue equity instruments and, as such, do not give rise to liabilities. Equity-settled share-based payments within the scope of Section 26 of FRS 102 are required to be measured at fair value at grant date with no subsequent measurement to fair value.

- 76B. The flowchart below summarises how to determine which guidance applies to a particular obligation. Further guidance on the matters summarised is included below the flowchart.



* unless the obligation is of certain timing and amount, in which case the general provisions of the Companies Act/GAAP apply

77. Payments by an LLP to members after they have retired, often referred to as annuities, can take many different forms. It will be necessary to examine the nature of the contractual or constructive obligations in order to determine the governing accounting requirements.
78. Annuity payments may be either 'pre-determined' or 'profit-dependent'.
- 'Pre-determined' annuity payments are amounts payable that ~~will become~~ are fixed at the time of retirement, for example, by reference to historical earnings (such as a percentage of the final year's profit share) or fixed at an amount, which may be index-linked or linked to a measure independent of the LLP's future profit. The period for which they are payable may or may not be pre-determined. The payment of the retirement benefit is thus not dependent on the LLP earning profits in the post-retirement period.

- 'Profit-dependent' annuity payments are amounts payable to former members that are, in effect, a share of the LLP's on-going profits, by way of a preferential first share, profit points, profit-dependent bonus or some other mechanism. Many different arrangements exist, and there may be no amount payable in a year in which no or insufficient profits are earned.

Constructive obligations

79. Deleted

79A. Arrangements whereby an LLP provides post-retirement benefits can arise from the actions of the LLP in the absence of a formal plan. Where post-retirement payments have been offered consistently to previous members at the point of, but not prior to, retirement this could build an expectation that all members would be offered this benefit at retirement. If such a constructive obligation were to arise, then the point of recognition of the liability would be earlier than retirement, in accordance with the principles of section 21 of FRS 102.

Conditional and unconditional obligations

79B. Often a member of an LLP will obtain an absolute entitlement to an annuity only on reaching a specific milestone, such as reaching a particular age or achieving a specified number of years' service. A member choosing to leave before reaching the milestone will not be entitled to an annuity. On reaching the milestone while remaining a member of the LLP, the member will be entitled to an annuity based on past service. The LLP cannot avoid the liability that is accruing through the service period through its own actions without the agreement of the member (unless it has the right to terminate their membership without compensation for the loss of annuity rights, which is unlikely to be the case). In these circumstances, therefore, a liability should be built up over the period of service rather than just recognised at the date on which the milestone is reached.

79C. A contractual obligation to deliver cash is a financial liability. An obligation to deliver cash that is conditional on a member providing further service is not a financial liability. Therefore, to the extent that post-retirement obligations arising in respect of current members are conditional on future service, the liability will fall within the scope of section 21 of FRS 102 or section 26 of FRS 102.

80. Annuities are likely in many cases to be subject to uncertainties. This will be the case, for example, where the payments are dependent on future profits or there is significant mortality risk. It should be noted that uncertainty of timing or amount per se is not the factor that determines whether a liability fails to meet the definition of a financial liability section 21 of FRS 102 is applicable. Instead, it is important to establish whether the liability is or is not an unconditional contractual liability. An unconditional contractual liability will meet the definition of a financial liability and will, therefore, be within excluded from the scope of either section 21 of FRS 102 or section 12 of FRS 102, or FRS 103.²⁶

²⁶ Financial liabilities outside the scope of section 21 of FRS 102 also include insurance liabilities within the scope of FRS 103.

Mortality risk

- 80A. An unconditional contractual obligation will meet the definition of an insurance contract under FRS 103 if the LLP accepts significant insurance risk (typically mortality risk). This will be the case if the total amount payable by the LLP may be significantly affected by how long the former member lives (eg, the LLP agrees to make payments only for as long as the former member is alive, and there is no terminal payment). For accounting purposes, such annuities fall within the scope of FRS 103, unless they are conditional on future service (in which case [either](#) section 21 [or](#) [section 26](#) of FRS 102 applies).
- 80B. In practice, obligations to make post-retirement payments to members will often be set out in the members' agreement, and will often reflect significant mortality risk²⁷ (eg, because the LLP agrees to make payments only for as long as the former member is alive, and there is no terminal payment). Where this is the case, the obligations will fall within the scope of FRS 103; however FRS 103 will permit the LLP to continue its previous accounting policies prior to the adoption of FRS 103.²⁸ Nevertheless, the LLP should consider whether it needs to provide any additional disclosures in order to meet the requirements of FRS 103.
- 80C. If an annuity is an unconditional contractual obligation for the LLP to deliver cash or a financial asset to a member, and the LLP has not accepted significant insurance risk, the annuity will meet the definition of a financial liability and will fall within the scope of section 11 or section 12 of FRS 102. Paragraphs 11.9 and 11.9A of FRS 102 specify the conditions that must be met for such a financial liability to fall within the scope of section 11. If these conditions are not met, the financial liability will fall within the scope of section 12. Profit-dependent annuity payments will not meet the conditions in paragraphs 11.9 and 11.9A of FRS 102. Therefore, if such annuity payments arise under a contract, and they do not expose the LLP to significant insurance risk, they will be accounted for in accordance with section 12 of FRS 102.

81. Deleted

Recognition and measurement – general

82. A liability in respect of an annuity is recognised when a member obtains an actual or constructive right to the annuity, which the LLP has no discretion to withhold.
- 83. If the rights to an annuity are earned over a period, then costs should be recognised over that period. This is consistent with the guidance on executory contracts in section 21 of FRS 102, under which the LLP has either an obligation or a constructive obligation to pay the annuity which builds up over time.**

84. Deleted

Recognition and measurement – applying section 21 of FRS 102²⁹

²⁷ Appendix II to FRS 103 gives guidance on the definition of an insurance contract. It explains how insurance risk can be distinguished from financial risk, and discusses mortality risk as a form of insurance risk).

²⁸ For practical purposes, the outcome is likely to be the entity applying section 21 of FRS 102.

²⁹ [If the obligation in respect of the annuity meets the definition of a share-based payment, section 26 of FRS 102 should be applied instead.](#)

85. **To the extent that the liability falls within the scope of section 21 of FRS 102 eg, because it is conditional on future service, the LLP should assess the probability of a future cash outflow applying the measurement requirements of that section. Any such liability for post-retirement payments to members earned to date and therefore recognised in the accounts should reflect the latest expectations in respect of:**
- **the likely date of ceasing to be a member; and**
 - **the amounts likely to be payable from that date.**
86. The value of the liability should be based on the best estimate of the present value of future cash flows. In practice, it will often be appropriate to value the liability on an actuarial basis consistent with the principles of section 28 of FRS 102 for the measurement of pension liabilities. Where, because of their nature and/or complexity, the arrangements are such that it is appropriate to apply the guidance in section 28, then that guidance should be applied in arriving at the measurement of the liability. In the case of profit-dependent payments, it will be necessary for the LLP to make a best estimate of the level of future profits of the LLP. Only in extremely rare cases will no reliable estimate be capable of being made. In these extremely rare cases, if accounting for the liability under section 21 of FRS 102, then a liability exists that cannot be recognised. This is disclosed as a contingent liability.
87. The liability should be recalculated annually to take account of changes in membership, eligibility for post-retirement payments, financial estimates and actuarial assumptions.

Recognition and measurement – applying section 26 of FRS 102

- 87A. There may occasionally be circumstances in which an LLP enters into an arrangement that meets the definition of a share-based payment and, accordingly, is accounted for by applying section 26 of FRS 102. One example might be when a former member will become entitled to a proportion of the disposal proceeds in the case of an exit event occurring, usually within a specified period after they cease to be a member. For example, on or prior to retirement, an LLP may have agreed to pay a proportion of the proceeds of an initial public offering to a former member if such an event occurs within five years of them ceasing to be a member. Such an arrangement might meet the definition of a cash-settled share-based payment, for example, if the amount payable to the former member will be based on the disposal proceeds or the value of the business of an LLP.
- 87B. When a cash-settled arrangement is within the scope of section 26 of FRS 102, it will be important to identify the grant date (i.e. the date at which the parties have a shared understanding of the terms and conditions of the arrangement) and whether or not the arrangement includes a service condition (i.e. the share-based payment is conditional on the individual completing a further specified period of service). If there is no service condition, the share-based payment expense will be recognised at grant date. If there is a service condition, a liability should be built up over the required period of service (the vesting period) with the debit going to remuneration expense. In situations where all profits have already been distributed, this would result in a loss being recognised. If the individual has already begun providing services to the LLP prior to grant date, the expense and the liability will initially need to be estimated and will be recognised from the earlier date when the individual began rendering the services.
- 87C. Unless and until a cash-settled share-based payment liability is settled, the LLP will remeasure the liability at each reporting date and up to the date of settlement, in accordance with section 26 of FRS 102, with

any changes in the value of the liability recognised in profit or loss for the period.

87A87D. The table below sets out examples of the applicable guidance for particular scenarios.

Example of post-retirement benefit	Applicable guidance
Former member is contractually entitled to an agreed percentage of annual LLP profits each year until death.	Obligation includes significant mortality risk, so FRS 103 applies (see paragraph 80C for discussion of accounting treatment).
Former member is contractually entitled to payment of pre-determined amounts annually for five years after retirement (amounts continue to be payable after death).	No mortality risk and liability qualifies as a 'basic financial instrument', so section 11 of FRS 102 applies.
Former member is contractually entitled to an agreed percentage of annual LLP profits for five years after retirement (amounts continue to be payable after death).	No mortality risk and liability does not qualify as a 'basic financial instrument', so section 12 of FRS 102 applies.
No contractual obligation to pay post-retirement benefits to members, but past practice has established a constructive obligation to do so.	Obligation does not qualify as a financial liability, so section 21 of FRS 102 applies.
An individual has to be a member for five years in order to become entitled to receive post-retirement benefits. A particular individual has only been a member for three years.	Obligation does not qualify as a financial liability during the initial five year period, because it is conditional on future service, so section 21 of FRS 102 applies in that period.
<u>A former member is entitled to a payout if there is an exit event within a specified period after they cease to be a member.</u>	<u>The appropriate accounting would depend on the individual facts and circumstances of each case. For example, if the amount payable will be based on the value of the LLP (e.g. a proportion of proceeds arising from disposal of the LLP's business), such an arrangement is likely to be a cash-settled share-based payment and, as such, would be within the scope of section 26 of FRS 102</u>

Post-retirement payments to members: presentation

- 88.** Amounts recognised in respect of current members should be charged to the profit and loss account (or statement of comprehensive income) within members' remuneration charged as an expense. This SORP requires that the recognition of and changes in the liability for post-retirement payments to or in respect of current members and to or in respect of former members should be shown separately. The change in the liability in respect of former members should be expensed in the relevant expense item (that is, not in members' remuneration) in the profit and loss account (or statement of comprehensive income). The change in the liability in respect of current members should be charged to the profit and loss account (or statement of comprehensive income) within members' remuneration charged as an expense.
- 89.** This SORP requires that the liability for post-retirement payments to or in respect of current members and to or in respect of former members should be shown separately. The liability in respect

of former members should be shown in the prescribed balance sheet formats set out in the LLP regulations under 'Provisions for liabilities'³⁰ or 'Creditors'³¹ as appropriate, as 'Post-retirement payments to former members'. The liability in respect of current members should be shown separately, if material, as a component of 'Loans and other debts due to members' in the prescribed balance sheet formats in the LLP regulations. In the year in which a member retires, a transfer should be made between the balance in respect of current members and the balance in respect of former members.

90. Where the liability has been discounted (for example, as required by section 21 of FRS 102 where the effect is material), this SORP requires that the unwinding of the discount should be presented next to the interest cost line in the profit and loss account (or statement of comprehensive income), to the extent that it relates to former members. Where it relates to current members it should be included in members' remuneration charged as an expense.
91. Additional annuities granted after the date of a member's retirement should be recognised in full in the profit and loss account (or statement of comprehensive income) within operating profit as soon as the award is granted to the former member.

Post-retirement payments to members: disclosure

92. This SORP requires that the LLP's accounting policy note should disclose the LLP's policy in respect of post-retirement payments to members.

On transition of a partnership or other undertaking to an LLP

93. Where an LLP makes post-retirement payments to members of a predecessor partnership or other organisation, the extent to which the LLP has an actual or constructive liability for such payments should be considered. Where an actual or constructive liability exists, this should be recognised in the balance sheet of the LLP. Where there is merely recourse to the LLP in the event of a default of a third party and such default has not occurred and is not probable, this should be disclosed as a contingent liability.
94. It is possible that an LLP which succeeds to the business of a partnership will not assume actual or constructive liability for post-retirement payments payable by the predecessor partnership or partners therein. However, it may, as agent for the members of the LLP, disburse the related cash to the former members.³² In such circumstances, the payments to the former members represent amounts in respect of their services to the former partnership which the LLP is distributing to the former members as agent of the continuing members and do not represent liabilities of the LLP. Reference to these arrangements is encouraged by this SORP where this would aid clarity.

³⁰ This classification will be appropriate if the liability arises from a constructive obligation (eg, it is within the scope of section 21 of FRS 102).

³¹ This classification will be appropriate if the liability is a contractual liability (ie, it is within the scope of FRS 103, or either section 11 or section 12 of FRS 102).

³² Whether such arrangements exist will depend on the terms of the agreement between the predecessor partners and the former members, as varied by any agreements entered into at the time the LLP succeeds to the business of the predecessor partnership.

Taxation

95. **Where tax (whether current or deferred) to be paid on members' remuneration is a personal liability of the members, it falls within 'Members' interests' on the balance sheet. It should not appear in the profit and loss account (or statement of comprehensive income).**
96. Amounts retained by an LLP in respect of a member's tax liability do not require separate disclosure. In such cases, the LLP is simply acting as agent of the member by settling the liability direct to the tax authorities. Amounts retained for tax should be included in 'Loans and other debts due to members'.
97. Tax withheld from members who subsequently retire from membership should be dealt with as any other balance due to former members.
98. **Where tax is not a personal liability of the members and the LLP itself is subject to tax on profits, then the LLP should report such taxes in their accounts as required by section 29 of FRS 102.**
99. **In the group accounts of an LLP which include entities or organisations that are not partnerships or LLPs, such as companies, the tax of such entities should be recorded in the profit and loss account (or statement of comprehensive income) under the relevant heading and any related liability carried as a creditor in the balance sheet.**

Inventories

100. **To the extent that an LLP has inventories carried at cost, the cost of members' time and related overheads should be accounted for in accordance with section 13 Inventories of FRS 102. Contracts should be accounted for in accordance with section 23 Revenue of FRS 102.**
101. When calculating the cost of inventories in accordance with section 13 of FRS 102, the cost of members' time should be considered. The cost of members' time will include only those elements that would be expensed in the profit and loss account (or statement of comprehensive income) ie, members' remuneration charged as an expense as defined in paragraph 21 above. However, regardless of whether the time input by a member is a cost to be included in inventories, any overhead related to that time should be included in the cost of inventories.

Business Combinations and Group Accounts

Entity and group accounts

102. **An LLP should follow the rules on the requirement to prepare group accounts (and the exemptions therefrom) and the contents of the group accounts (and on inclusion and exclusion of subsidiaries and consolidation of special purpose entities) set out in section 9 of FRS 102, together with the relevant sections of the LLP Regulations.**

Accounting for business combinations

- 103. Application of GAAP with respect to business combinations should be considered in the context of both the group accounts and the entity accounts of the LLP.**
104. When two LLPs combine, there may be only one surviving LLP, or a new LLP may be created or one LLP may become a member of the other. The recommended accounting treatment may therefore apply both to the entity accounts of an LLP and, if relevant, to its group accounts.
- 105. Consideration will be required to determine whether a particular business combination represents a group reconstruction because such transactions may be accounted for using the merger method instead of the purchase method. The LLP regulations (SI 2008 1912 schedule 4, 10 / SI 2008 1911 schedule 4, part 1, 7) allow an acquisition to be accounted for as a merger if adoption of the merger method of accounting accords with generally accepted accounting principles or practice ('GAAP'). FRS 102's glossary sets out the arrangements that meet the definition of a group reconstruction and paragraph 19.27 sets out conditions that must be met for a group reconstruction to be accounted for using the merger method. One of the conditions in paragraph 19.27 is that the use of the merger accounting method is not prohibited by company law or other relevant legislation. The LLP regulations do not prohibit the use of the merger method and refers to 'GAAP' as the authoritative guidance on whether use of the merger method is appropriate.**
- 105A. The circumstances of business combinations will vary greatly. Where a business combination is not simply the granting of membership to one or more individuals, it will need to be assessed against section 19 of FRS 102.

Acquisition accounting

- 106. The purchase method is required for all business combinations except for:**
- group reconstructions where the conditions in paragraph 19.27 of FRS 102 are met; and
 - certain public benefit entity combinations.³³
107. Where the purchase method is used, the fair value of the purchase consideration used in the calculation of goodwill arising on an acquisition should be assessed carefully. In particular, this SORP requires the profit share promised to the new members in the enlarged LLP to be assessed to determine whether any portion of that remuneration represents consideration for the business acquired, rather than future members' remuneration. For example, if members of the purchased entity were awarded an increased profit share for a limited period of time after the acquisition, falling back to 'normal' remuneration levels thereafter, this may suggest that the short-term excess amounts were part of the purchase consideration. In all cases, the sale and purchase agreement will need to be closely examined to determine the substance of the arrangement.
108. Where it is not possible to value the consideration given in accordance with the requirements of paragraph 19.11 of FRS 102, the best estimate of its value may be obtained by valuing the entity acquired.

³³ LLPs will rarely be public benefit entities as defined under FRS 102.

- 108A. Negative goodwill arises when the cost of a business combination is less than the fair value of the net amount of identifiable assets and liabilities recognised on acquisition. For example, a business combination that involves two independent LLPs coming together but where no cash is paid by either party and no additional amounts of purchase consideration are identified in accordance with paragraph 107. If significant intangible assets are recognised on acquisition this can result in negative goodwill. Paragraph 19.24 of FRS 102 sets out the requirements for accounting for negative goodwill.
- 108B. Intangible assets acquired in a business combination are required to be recognised separately from goodwill when the general recognition criteria in paragraph 18.4 of FRS 102 are met and the intangible assets arise from contractual/legal rights and are separable. Paragraph 18.8 of FRS 102 also allows an LLP to choose whether or not to recognise additional intangible assets if they meet the general recognition criteria in paragraph 18.4 and arise from either contractual/legal rights or are separable. The policy choice should be applied to all intangibles in the same class and be applied consistently to all business combinations. Taking up this policy choice could potentially increase the amount of negative goodwill recognised in certain business combinations, such as those outlined in paragraph 108A. In such circumstances, an LLP might conclude that it is preferable to have a policy of not recognising such additional intangible assets.
109. Deleted
110. Deleted
111. Deleted

Group reconstructions

112. **The transfer of all or the majority of the assets, liabilities and business of an existing partnership, limited company or other undertaking into an LLP incorporated for that purpose could be dealt with as a group reconstruction where the requirements of paragraph 19.27 of FRS 102 are met. Although FRS 102 provides a choice in these cases, this SORP recommends that the merger accounting method should be used where permitted, to reflect the substance of initial 'conversion' to LLP.³⁴ The initial 'opening' balance sheet should follow the accounting policies of the LLP.**

Considerations on transition from an existing undertaking (including from a partnership)

113. Deleted
114. Both start-up businesses and existing undertakings, including partnerships and limited companies, may choose to incorporate as LLPs. This SORP requires that where there is a transfer of an existing undertaking to an LLP, it should be accounted for using the merger accounting method provided that the transfer meets the definition of a group reconstruction and the conditions of paragraph 19.27 of FRS 102.

³⁴ Typically such transfers are transacted at book value not fair value and therefore the merger accounting method reflects the substance of the transaction.

- 115. Single-entity LLPs that are formed for the purpose of the transfer of existing undertakings or partnerships, which meet the definition of a group reconstruction and the requirements of paragraph 19.27 of FRS 102 should, as noted above use merger accounting for the initial transfer of business, and reflect the transfer of the assets and liabilities at book value. They should also disclose comparative pro-forma amounts in the financial statements of the first period after incorporation. Those comparative amounts should be stated on the basis of the accounting policies adopted by the LLP. The initial statutory reporting period may or may not be a 12-month period.**
116. In some cases there may be a hiatus between the formation of the LLP and the transfer of the existing undertaking. Where this occurs, and the merger accounting method is used, the principles of merger accounting are such that the net assets at book values should be reflected in the financial statements at the date of the transfer, and the results should be included for the period from the transfer to the end of the accounting period. A pro-forma profit and loss account (or statement of comprehensive income), including corresponding amounts, should be given for the whole of the original entity's accounting period spanning the transfer. These issues are considered in Appendix 4.
- 117. The restatement of comparatives to consistent accounting policies will often result in a difference between the amount reported as attributable to owners by the predecessor undertaking (eg, the total interests of partners in the predecessor firm shown by its final balance sheet), and the members' interests in the opening balance sheet of the LLP. This SORP requires that such differences are not dealt with in the financial statements of the LLP.**
- 117A. When identifying adjustments to comparatives that may be needed, this SORP requires that an entity should consider:
- whether any accounting policies applied by the predecessor undertaking need to be amended because they are not in accordance with FRS 102;
 - whether any other accounting policies applied by the predecessor undertaking are to be amended voluntarily; and
 - whether any changes to members' rights arise on transition and, if so, their effects. For example, profit distributions and repayments of capital may have been discretionary for the predecessor undertaking but may not be discretionary for the LLP. In this case, members' interests previously reported as equity by the predecessor undertaking may be reported as liabilities by the LLP.
118. The disclosures required by section 19 of FRS 102, SI 2008/1913 schedule 3, 7–16A and SI 2008/1912 schedule 4, part 1, 7–16A will be required.
- 119. Existing groups that use merger accounting for a group reconstruction that puts a new LLP at the top of the group should present corresponding amounts in the financial statements of the period of the merger, as required by paragraph 19.30 of FRS 102.**

Interests in subsidiary LLPs

- 119A. In some cases, a parent LLP may have a subsidiary that is also an LLP and that will therefore need to be consolidated into the parent's group accounts. In such instances, consideration will need to be given to the appropriate treatment of members' debt and equity interests in the subsidiary LLP for the purpose of determining whether a non-controlling interest in the net assets of the group is**

recognised.

- 119B. In the group accounts of the parent LLP, members' debt interests in the subsidiary LLP will not give rise to non-controlling interests. Only members' equity interests in the subsidiary LLP, not attributable directly or indirectly to the parent, are recognised as non-controlling interests.
- 119C. If members of the parent LLP are also members of the subsidiary LLP and those members hold equity interests in that subsidiary, it will be important to consider whether the equity interests the members hold are in substance attributable to the parent, for example in nominee arrangements. If they are, in the parent's group accounts, the members' equity interests in the subsidiary LLP are reported as parent shareholder interests but if they are not, the interests are reported as non-controlling interests.
- 119D. Members' equity participation rights in the profits of a subsidiary LLP might be considered attributable to the parent where the member has contributed little capital and their equity participation rights in the profits are not commensurate with limited amount of personal investment at risk. Such scenarios may be indicative of the profit-sharing arrangement being a remuneration scheme from a group perspective, particularly when it is the parent that has sole power to determine how much of the subsidiary LLP's profits are divided and how that profit is allocated amongst the members of the subsidiary LLP. Often in these scenarios the allocation decisions are linked to each member's performance. In such cases, judgement will be required over whether, and to what extent, the subsidiary LLP's profit and loss reserve balances are recognised as non-controlling interests in the group accounts.
- 119E. For example, in fact patterns where it is the parent alone that determines how much of the subsidiary LLP's profits to divide and the parent alone that makes allocation decisions, primarily based on members' performance and not members' ownership rights (because members have contributed limited capital to the subsidiary LLP), it might be concluded that the balances are parent shareholder interests. This is because, in substance, the members' equity participation rights in the profits of the LLP are simply a mechanism for the parent to pay members' remuneration for services from a group perspective. When the equity balances are subsequently divided, the parent, in its group accounts, accounts for the payments as remuneration and not as payments to non-controlling interests. In practice, there will be a spectrum of fact patterns with some being less obvious in the analysis and requiring more judgment.
- 119F. Such a conclusion however does not change the equity classification of the balances in the entity accounts of the subsidiary LLP as from the entity's perspective, the subsidiary LLP has an unconditional right to avoid delivering cash or other assets in respect of those equity balances. When the equity balances are subsequently divided, the subsidiary LLP, in its entity accounts, recognises the payments as a debit to equity.
- 119G. Parent LLPs (or members that hold interests attributable to the parent in nominee arrangements) may receive distributions from their corporate and LLP subsidiaries. The amounts received may subsequently be distributed to the members of the parent LLP. In the standalone financial statements of the parent LLP, the amounts received are recognised in the parent LLP's income statement as income from group undertakings.

Provisions and Other Implications of Section 21 of FRS 102

120. Section 21 of FRS 102 applies in all respects to LLPs.³⁵

121. While the application of section 21 of FRS 102 is unlikely to present any unusual problems for LLPs, applying it fully may require a significant change in practice for existing partnerships that are incorporated as an LLP. Historically, partnership accounting has focused heavily on what was perceived as equitable between partners and different year groups of partners, since there are often different partners and/or differing profit shares in successive years. By agreement, major liabilities may have been spread over several years, often to match cash flows, rather than being fully provided immediately.

122. When considering section 21 of FRS 102, an LLP should have regard to all contracts and all relevant circumstances, including side agreements and promises whether or not in writing.

123. Deleted

124. **If the LLP has entered into any guarantee or indemnity with respect to the borrowings of a member or members personally, the existence of such a guarantee or indemnity should either be disclosed as a note to the accounts (SI 2008/1913 schedule 1, part 3, 60 and SI 2008/1912 schedule 1, part 3, 55) (where it is unlikely that the guarantee or indemnity would be called) or provided for in the primary statements where there is an actual or constructive liability as defined under section 21 of FRS 102 and it is probable that the guarantee or indemnity will be called.**³⁶

125. It is common practice within LLPs for members to borrow to fund their capital and similar interests in a LLP. Such arrangements may involve the LLP entering into guarantees, indemnities or undertakings with the lender concerned.

126. Of itself, the extent to which members' interests have been financed by lenders, who have lent funds to the member or members concerned, is not a matter for disclosure. Similarly, any undertaking that the LLP may give to act as agent for a member, in remitting funds from members' interests to a lender or other third party, need not be disclosed.

127. A provision would be required where, for example, an LLP has undertaken to repay a loan of a member, such that the LLP is under a legal or constructive obligation to ensure that the full liability to the lender is settled, and it is more likely than not that the guarantee will be called upon.³⁷ Where a provision of this nature has been made in relation to a member who is a related party (see paragraphs 128 – 131 below), further disclosures should be given in accordance with section 33 Related Party Disclosures of FRS 102.

³⁵ Professional services firms will apply section 21 of FRS 102 in relation to claims against them and associated insurance reimbursements. Such matters are not specific to LLPs and so are not addressed in this SORP.

³⁶ LLPs applying the recognition and measurement provisions of IFRS 9 or IAS 39 (as allowed by paragraphs 11.2 and 12.2 of FRS 102) will need to follow the recognition and measurement rules for financial guarantees set out in those standards. Entities may also choose to apply FRS 103 to financial guarantee contracts.

³⁷ The LLP will need to consider the extent to which it has the legal right to offset the aggregate 'capital' and undrawn profits of the member concerned against the outstanding debt.

Related Parties

128. The provisions of section 33 of FRS 102, including the definition of related parties, apply to LLPs. An LLP which is under the control of another LLP, partnership, company or other entity will be a related party of that other entity. The fact that some members of an LLP are members of another LLP or another partnership does not in itself make the businesses related parties: the extent of common control and/or influence determines this. This SORP requires that predecessor partnerships of LLPs should be treated as related parties of the LLP.
129. The nature and extent of members' involvement in the management of the LLP should be considered, to determine whether a member is a related party.
130. In the case of smaller LLPs, where all members play a part in the management of the entity, it will frequently be the case that all members are related parties. However, in larger LLPs, it may not be appropriate for all members of an LLP to be considered as related parties. Section 33 of FRS 102 includes directors of companies as key management personnel by definition, and the key management personnel of a reporting entity are defined as related parties of that entity. Key management personnel of an LLP are those persons – whether designated members, members or employees – having authority and responsibility for planning, directing and controlling the activities of the LLP, directly or indirectly.
- 130A. Paragraph 33.7 of FRS 102 requires the disclosure of the total of compensation paid to key management personnel which may comprise elements of employee remuneration and divided profits.
131. The controlling party and ultimate controlling party of an LLP, if different, should be disclosed in accordance with section 33 of FRS 102. This includes an individual or entity which has the ability to direct the financial and operating policies of the LLP so as to obtain benefits from its activities even though that party may not be entitled to the majority of profits or have invested the majority of capital represented by equity or debt.

Compliance Statement

132. Paragraph 6 of FRS 100 Application of Financial Reporting Requirements requires an LLP, other than a small LLP applying the small entities regime, to provide certain disclosures regarding the application of the SORP or of any areas of non-compliance. Although small LLPs applying the small entities regime are not required to provide the disclosures outlined in paragraph 6 of FRS 100 they are encouraged to do so.

Effective Date and Transition

133. The revised SORP should be applied for accounting periods beginning on or after 1 January 2024~~2~~, with early adoption permitted.

APPENDIX 1: EXAMPLES SHOWING THE PRESENTATION OF MEMBERS' INTERESTS³⁸

(The LLP has no retirement benefit arrangements for current members in these examples)

EXHIBIT A – LLP Balance Sheet

LLP WITH NO EQUITY	20X5 £'000	20X4 £'000
Fixed assets		
Tangible assets	9,500	8,200
Current assets		
<i>Debtors</i>		
Amounts recoverable on contracts	8,000	7,500
Trade debtors	17,500	16,000
Amounts due from members	1,500	1,200
Other debtors and prepayments	4,000	3,800
Cash at bank and in hand	6,000	4,500
Current assets	37,000	33,000
Creditors: amounts falling due within one year		
Bank overdraft and loans	3,000	2,800
Other creditors and accruals	6,500	6,000
Current liabilities	9,500	8,800
Net current assets	27,500	24,200
Total assets less current liabilities	37,000	32,400
Creditors: amounts falling due after more than one year		
Bank loans	4,000	3,200
Provisions for liabilities		
Post-retirement payments to former members	4,500	4,800
Other provisions	2,000	1,900
	6,500	6,700
NET ASSETS ATTRIBUTABLE TO MEMBERS	26,500	22,500

³⁸ The exhibits in this appendix do not reflect the increased flexibility in balance sheet and profit & loss formats introduced by SI 2016/575. See paragraph 26B for more details.

REPRESENTED BY:	20X5 £000	20X4 £000
Loans and other debts due to members within one year		
Members' capital classified as a liability	8,000	6,000
Other amounts	18,500	16,500
	<hr/> 26,500	<hr/> 22,500
TOTAL MEMBERS' INTERESTS		
Amounts due from members	(1,500)	(1,200)
Loans and other debts due to members	26,500	22,500
	<hr/> 25,000	<hr/> 21,300

Note: In this example, Members' other interests are nil.

Note that the presentation above will not be suitable for some LLPs. In particular, this presentation is only suitable when an LLP's assets (including any member balances) are equal to its liabilities (including any member balances). There are various scenarios in which this may not be the case. For example:

- An LLP may make cumulative losses. Unless the LLP has the right to recover those losses from its members, its reported liabilities are likely to exceed its reported assets.
- Some LLPs may make automatic distributions to members on the basis of a profit figure that differs from profits reported in the statutory financial statements (e.g. on the basis of management accounts that do not reflect certain accounting adjustments). This may result in cumulative distributions exceeding cumulative profits reported in the statutory financial statements. When this is the case, unless the LLP has the right to recover that excess from its members, its reported liabilities are likely to exceed its reported assets.

In those examples, a negative balance would be shown in 'Members' other interests – other reserves classified as equity'.

EXHIBIT B – LLP Balance Sheet

LLP WITH SOME EQUITY	20X5 £'000	20X4 £'000
Fixed assets		
Tangible assets	9,500	8,200
Current assets		
<i>Debtors</i>		
Amounts recoverable on contracts	8,000	7,500
Trade debtors	17,500	16,000
Amounts due from members	1,500	1,200
Other debtors and prepayments	4,000	3,800
Cash at bank and in hand	6,000	4,500
Current assets	37,000	33,000
Creditors: amounts falling due within one year		
Bank overdraft and loans	3,000	2,800
Other creditors and accruals	6,500	6,000
Current liabilities	9,500	8,800
Net current assets	27,500	24,200
Total assets less current liabilities	37,000	32,400
Creditors: amounts falling due after more than one year		
Bank loans	4,000	3,200
Provisions for liabilities		
Post-retirement payments to former members	4,500	4,800
Other provisions	2,000	1,900
	6,500	6,700
NET ASSETS ATTRIBUTABLE TO MEMBERS	26,500	22,500

REPRESENTED BY:	20X5 £000	20X4 £000
Loans and other debts due to members within one year		
Members' capital classified as a liability	5,000	4,000
Other amounts	9,000	8,000
	<hr/> 14,000	<hr/> 12,000
Members' other interests		
Members' capital classified as equity	3,000	2,000
Members' other interests – other reserves classified as equity	9,500	8,500
	<hr/> 26,500	<hr/> 22,500
TOTAL MEMBERS' INTERESTS		
Amounts due from members	(1,500)	(1,200)
Loans and other debts due to members	14,000	12,000
Members' other interests	12,500	10,500
	<hr/> 25,000	<hr/> 21,300

EXHIBIT C – LLP Profit and Loss Account (Format 2)

LLP WITH AUTOMATIC DIVISION OF PROFIT EQUIVALENT TO SALARIED REMUNERATION	20X5 £'000	20X4 £'000
Turnover	55,500	49,500
Other operating income	3,500	2,000
	<hr/>	<hr/>
	59,000	51,500
Other external charges	(8,500)	(7,500)
Staff costs	(21,500)	(18,500)
Depreciation	(2,000)	(2,000)
Other operating expenses	(11,000)	(9,000)
	<hr/>	<hr/>
Operating profit	16,000	14,500
Interest receivable and similar income	1,000	1,000
Interest payable and similar charges	(500)	(750)
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares	16,500	14,750
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares	16,500	14,750
Members' remuneration charged as an expense	(3,000)	(2,500)
	<hr/>	<hr/>
Profit for the financial year available for discretionary division among members	13,500	12,250
	<hr/>	<hr/>

Note 1: This example may apply to an LLP which has a members' agreement or other arrangement which gives members the equivalent of a salary. It is not intended to suggest that all LLPs should impute notional salaries.

EXHIBIT D – LLP Profit and Loss Account (Format 2)

LLP WITH AUTOMATIC DIVISION OF ALL PROFITS	20X5 £'000	20X4 £'000
Turnover	55,500	49,500
Other operating income	3,500	2,000
	<hr/>	<hr/>
	59,000	51,500
Other external charges	(8,500)	(7,500)
Staff costs	(21,500)	(18,500)
Depreciation	(2,000)	(2,000)
Other operating expenses	(11,000)	(9,000)
	<hr/>	<hr/>
Operating profit	16,000	14,500
Interest receivable and similar income	1,000	1,000
Interest payable and similar charges	(500)	(750)
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares	16,500	14,750
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares	16,500	14,750
Members' remuneration charged as an expense	(16,500)	(14,750)
	<hr/>	<hr/>
Result for the financial year available for discretionary division among members	–	–
	<hr/>	<hr/>

This example may apply to an LLP which has a members' agreement or other arrangement which automatically divides the full amount of the profit among members.

Note that there are some scenarios in which the result for the financial year, after members' remuneration charged as an expense, will not be nil. For example:

- An LLP may make losses in a period. Unless the LLP has the right to recover those losses from its members, it is likely to report a net loss for the period.
- Some LLPs may make automatic distributions to members on the basis of a profit figure that differs from profits reported in the statutory financial statements (e.g. on the basis of management accounts that do not reflect certain accounting adjustments). This may result in members' remuneration charged as an expense for a period exceeding the profits generated in that period. When this is the case, unless the LLP has the right to recover that excess from its members, it is likely to report a net loss for the period.

If the result for the financial year is negative, it would be appropriate to label it as 'Loss for the financial year', and a corresponding negative balance would be shown in 'Members' other interests – other reserves classified as equity'.

EXHIBIT E – LLP Profit and Loss Account (Format 2)

LLP WITH NO AUTOMATIC DIVISION OF ANY PROFIT	20X5 £'000	20X4 £'000
Turnover	55,500	49,500
Other operating income	3,500	2,000
	<hr/>	<hr/>
	59,000	51,500
Other external charges	(8,500)	(7,500)
Staff costs	(21,500)	(18,500)
Depreciation	(2,000)	(2,000)
Other operating expenses	(11,000)	(9,000)
	<hr/>	<hr/>
Operating profit	16,000	14,500
Interest receivable and similar income	1,000	1,000
Interest payable and similar charges	(500)	(750)
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares available for discretionary division among members	16,500	14,750
	<hr/> <hr/>	<hr/> <hr/>

This example may apply to an LLP which has a members' agreement or other arrangement which has no element of automatic division of profit and does not give members any rights to profits until divided.

EXHIBIT F – LLP Statement of Comprehensive Income (single statement) (Profit and loss account Format 2)

LLP WITH SOME AUTOMATIC DIVISION OF PROFIT	20X5 £'000	20X4 £'000
Turnover	55,500	49,500
Other operating income	3,500	2,000
	<hr/>	<hr/>
	59,000	51,500
Other external charges	(8,500)	(7,500)
Staff costs	(21,500)	(18,500)
Depreciation	(2,000)	(2,000)
Other operating expenses	(11,000)	(9,000)
	<hr/>	<hr/>
Operating profit	16,000	14,500
Interest receivable and similar income	1,000	1,000
Interest payable and similar charges	(500)	(750)
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares	16,500	14,750
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares	16,500	14,750
Members' remuneration charged as an expense	(3,000)	(2,500)
	<hr/>	<hr/>
Profit for the financial year available for discretionary division among members	13,500	12,250
<u>Other comprehensive income:</u>		
Revaluation of freehold property	2,500	1,000
Actuarial loss on defined benefit pension scheme	(3,000)	(1,500)
	<hr/>	<hr/>
Total comprehensive income	13,000	11,750
	<hr/>	<hr/>

EXHIBIT G – LLP Statement of Comprehensive Income (single statement) (Profit and loss account Format 2)

LLP WITH NO AUTOMATIC DIVISION OF ANY PROFIT	20X5 £'000	20X4 £'000
Turnover	55,500	49,500
Other operating income	3,500	2,000
	<hr/>	<hr/>
	59,000	51,500
Other external charges	(8,500)	(7,500)
Staff costs	(21,500)	(18,500)
Depreciation	(2,000)	(2,000)
Other operating expenses	(11,000)	(9,000)
	<hr/>	<hr/>
Operating profit	16,000	14,500
Interest receivable and similar income	1,000	1,000
Interest payable and similar charges	(500)	(750)
	<hr/>	<hr/>
Profit for the financial year before members' remuneration and profit shares available for discretionary division among members	16,500	14,750
<u>Other comprehensive income:</u>		
Revaluation of freehold property	2,500	1,000
Actuarial loss on defined benefit pension scheme	(3,000)	(1,500)
	<hr/>	<hr/>
Total comprehensive income	16,000	14,250

APPENDIX 2: LIABILITY AND EQUITY ELEMENTS OF MEMBERS' INTERESTS

1. Moved to paragraph 31A
2. Moved to paragraph 33A
3. Moved to paragraph 33B
- 3A. Moved to paragraph 49B
- 3B. Moved to paragraph 49C
- 3C. Moved to paragraph 49D

Capital and remuneration

4. The examples set out below, which are provided for guidance only, illustrate how the principles set out in the SORP should be applied to participation rights.
5. Moved to paragraph 34C
6. When considering whether a particular payment to a member is a return on capital subscribed or, for example, a payment in relation to services, an entity should apply paragraph 34 of the SORP. Accordingly this SORP requires:
 - where a member provides both capital and services to an LLP and no element of the return to the member is clearly identifiable as a return on the amount subscribed or otherwise contributed, no part of the return to the member (which may include inter alia salary, bonus, risk premium and shares of profits (fixed and variable)) will be regarded as a return on capital;
 - where a member provides both capital and services to an LLP but an element of the return to the member is clearly identifiable as a return on amounts subscribed or otherwise contributed, only that element will be regarded as a return on capital; and
 - where a member **does not** provides ~~no~~ **any substantive** services to an LLP then the whole of the return to the member will be regarded as a return on capital.
7. Moved to paragraph 42D(1)
8. Moved to paragraph 42E(1)

Example 1 – Discretionary repayment of capital and discretionary division of profits

The analysis in this example applies irrespective of whether the members provide services to the LLP.

An LLP has ten members. Under the terms of the members' agreement, each member subscribes £100,000 as initial capital and will receive a 10% share of any profits that are divided. Upon retirement of a member, the LLP is required to pass a resolution before any capital is repaid. If no such resolution is passed, the LLP is entitled to retain the capital indefinitely. Any decision to divide profits must be approved by a majority of the members.

All cash outflows to members are at the discretion of the LLP. For example, a positive resolution is required to repay capital, and without it the LLP has no obligation to repay the amounts. Accordingly:

- the capital subscribed of £1,000,000 is presented within equity; and
- discretionary divisions of profit are reported as equity appropriations and deducted from equity when they occur (whether during or after the end of the period).

Thus, if the LLP made profits of £500,000, and £300,000 was paid out to members as drawings on account during the year, the profit reported for the year would be £500,000. The drawings on account of £300,000 would be included in debtors as required by paragraph 68 of this SORP, because they are made before the approval to divide any profits has occurred, and the £500,000 of undivided profits would be included within equity at the year end, assuming that at that point in time, the decision to divide profits had not been made. Once the profits are divided, the amount of drawings on account in debtors would be offset against the liability then created.

Example 2 – Discretionary repayment of capital and mandatory interest payment

~~The analysis in~~ In this example ~~applies irrespective of whether~~ members provide services to the LLP.

An LLP's constitution requires that members subscribe capital to the LLP. Upon retirement, the LLP is required to pass a resolution before any capital is repaid. If no such resolution is passed, the LLP is entitled to retain the capital indefinitely. Interest at a market rate is automatically payable on all capital subscribed. Any decision to divide the balance of profits must be approved by a majority of the members.

In this example, although a positive resolution is required to repay capital, the LLP is obliged to pay a return on that capital. Accordingly, a liability will be recognised on subscription to reflect the present value of the minimum non-discretionary outflows. In this case, as the return is at a market rate at the time the capital is subscribed, the entire capital will be classified as a liability.

Example 3 – Discretionary repayment of capital and remuneration for services provided

An LLP's constitution requires that members subscribe capital to the LLP. Members provide services to the LLP. Upon retirement, the LLP is required to pass a resolution before any capital is repaid. If no such resolution is passed, the LLP is entitled to retain the capital indefinitely. The membership agreement specifies that all profits made during a year will be divided automatically. No element of members' remuneration is clearly identifiable as a return on amounts subscribed or otherwise contributed. Accordingly, no part of the return to the members is regarded as a return on capital and their remuneration is considered separate from the capital for accounting purposes.

In this example, a positive resolution is required to repay capital, and without it the LLP is neither obliged to repay the amounts nor to pay any return on that capital. Accordingly, the capital is presented as equity. An expense is charged in profit or loss (under the heading 'Members' remuneration charged as an expense') and a liability recognised equal to the amount of profits.

Example 4 – Mandatory repayment of capital (but puttables exception applies) and discretionary division of profits

An LLP has been set up as an investment vehicle, and has ten members. Members do not provide **any substantive** services to the LLP. Hence the whole of the return to the members is regarded as a return on capital. The LLP's investments are managed by a third party who is not a member. Under the terms of the members' agreement, each member subscribes £1,000,000. The agreement specifies certain dates on which a member can require the LLP to repurchase their interest. On repurchase the member will receive the £1,000,000 originally subscribed, adjusted for the member's share of any losses or any profits not yet divided. Any decision to divide profits must be approved by a majority of the members. On such a division, the profits are divided equally between all ten members.

The LLP has no discretion over cash outflows in respect of the repurchase of members' interests. However, it considers the conditions under the puttables exception and because the total cash flows attributable to the instrument over its life are based on profit and loss/net assets, it concludes that they are met in relation to the members' initial capital. Accordingly:

- the capital subscribed of £10,000,000 is presented within equity; and
- any divisions of profit are reported as equity appropriations and deducted from equity when they occur (whether during or after the end of the period).

Thus, if the LLP made profits of £500,000, of which £300,000 was paid out to members as drawings on account during the year, the profit reported for the year would be £500,000. Members' remuneration charged as an expense would be nil and the drawings on account of £300,000 would be included in debtors. The undivided balance of £500,000 would be included within equity at the year end, assuming that at that point in time, the decision to divide profits had not been made.

Example 5 – Mandatory repayment of capital (but puttables exception applies), automatic division of profits to one member for services rendered and discretionary division of the remainder

An LLP has been set up as an investment vehicle, and has ten members. Apart from the one member noted below, members do not provide **any substantive** services to the LLP. Under the terms of the members' agreement, each member subscribes £1,000,000. The agreement specifies certain dates on which a member can require the LLP to repurchase their interest. On repurchase the member will receive the £1,000,000 originally subscribed, adjusted for the member's share of any losses or any profits not yet divided. One of the members, Company X, is responsible for managing the LLP's investments. It has been agreed that 5% of the reported profits for each period will be paid to Company X, as compensation for providing these investment management services. The LLP does not have an unconditional right to avoid dividing 5% of the reported profits as this decision is automatic. Any decision by the LLP to divide the remaining balance of profits must be approved by the members. On such a division, the balance of profits is divided equally between all ten members ie, including Company X. This decision is not an automatic division of profits.

As noted above, the LLP has no discretion over the 5% profit share payable to Company X. In order to assess whether the capital should be presented as equity or liability, the LLP considers, as one of the tests, whether the profits payable to Company X represent remuneration for services provided. The LLP judges that the non-discretionary amounts payable to Company X each year are purely for Company X's investment management services to the LLP and of an amount that is equivalent to what would have been payable to a non-member for such services. Therefore (as explained in paragraph 34 of the SORP) the remuneration should, for accounting purposes, be regarded as separate from the capital subscribed by Company X and disregarded in the analysis under the puttables exception.

As far as the capital of all ten members is concerned, the LLP considers the tests under the puttables exception. Because the total cash flows attributable to the capital over its life are based on profit and loss/net assets, it concludes that the tests are met in relation to the members' initial capital. Accordingly:

- the capital subscribed of £10,000,000 is presented within equity;
- an expense is charged in profit or loss (under the heading 'Members' remuneration charged as an expense') and a corresponding liability recognised equal to the amount of profits (5%) automatically payable to Company X each year; and
- any further divisions of profit are reported as equity appropriations and deducted from equity when they occur (whether during or after the end of the period).

Thus, if the LLP made profits of £500,000, of which £25,000 (5%) was divided automatically to Company X, and a further £300,000 was paid out to members as drawings on account during the year, the profit reported for the year would be £475,000. Members' remuneration charged as an expense would be £25,000 (ie, 5% of available profits) and the additional drawings on account of £300,000 would be included in debtors. The undivided balance of £475,000 would be included within equity at the year end, assuming that at that point in time, the decision to divide profits had not been made.

Example 6 – Mandatory repayment of capital and interest, discretionary division of profits

An LLP has ten members who provide services to the LLP. Under the terms of the members' agreement, each member subscribes £100,000 as initial capital and has a 10% share of any profits that are divided. Capital is returned automatically when a member retires or otherwise leaves the LLP, except that the LLP can refuse the return of capital in certain defined circumstances which are outside its control, for example, when a retiring member is a 'bad leaver'. Interest at a market rate of 6% is automatically payable on the capital subscribed. Any decision to divide the balance of profits must be approved by a majority of the members.

The LLP has no discretion over the return of capital. It can only refuse the return of capital in certain circumstances, but these are outside its control for leavers and the LLP is unable to control the actions of members so as to 'force' bad leaver status. In addition, the tests under the puttables exception are not met because the payment of interest is a non-discretionary return on the capital. Cash outflows to members in respect of profits after interest, however, are at the discretion of the LLP. Accordingly:

- the capital subscribed of £1,000,000 is presented within liabilities; and
- interest expense of £60,000 is charged in profit or loss (within the heading 'Members' remuneration charged as an expense'), and a corresponding liability recognised; but
- any other divisions of profit are reported as an equity appropriation and deducted from equity when they occur (whether during or after the end of the period).

Example 7 – Two distinct classes of capital

An LLP has twelve members. Two members ('non-working members') only provide capital of £200,000 each to the LLP and receive a fixed return on the capital provided. That capital is not redeemable at the holder's option and is subordinate to all other classes of instruments of the LLP. Accordingly:

- given that the LLP has an unconditional right to refuse repayment of the non-working members' capital, the appropriate classification of that capital is determined by the other rights attaching to it; and
- since the capital attracts a fixed mandatory return, the LLP must recognise a liability on subscription reflecting the present value of the minimum non-discretionary outflows. In many cases, this will be the same as the relevant amount of members' capital. Interest expense is charged in the profit or loss account and a corresponding liability recognised.

The other ten members ('working members') provide both capital and services to the LLP. Under the terms of the members' agreement, each of these ten members subscribes £100,000 as initial capital and has a 10% share of profits (after payment of the fixed return to the two non-working members). Any decision to divide profits must be approved by a majority of the members, but a working member may demand the return of initial capital (for example, upon retirement). No element of the working members' remuneration is clearly identifiable as a return on amounts subscribed or otherwise contributed. Accordingly, no part of the return to the working members is regarded as a return on capital.

The LLP has no discretion over cash outflows to working members in respect of capital redemption. In addition, the tests under the puttables exception are not met because working members' capital is not in the class of instruments that is subordinate to all other classes of instruments. Accordingly:

- the working members' capital subscribed of £1,000,000 is presented within liabilities; but
- divisions of profit between the working members are reported as equity appropriations (not an expense) and deducted from equity when they occur (whether during or after the end of the period).

Example 8 – Limited life LLP, discretionary repayment of capital and profits during the life of the LLP, pro rata return of net assets on liquidation

An LLP has been set up as an investment vehicle, and has ten members. Members do not provide **any substantive** services to the LLP. The LLP's investments are managed by a third party who is not a member. Under the terms of the members' agreement, each member subscribes £1,000,000. No member can require the LLP to repurchase their interest, but the LLP has been set up with a limited life of ten years at which point it will be liquidated. On liquidation, each member will receive a pro rata share (ie, 10%) of the LLP's net assets.

During the LLP's life, any decision to divide profits must be approved by a majority of the members. On such a division, the profits are divided equally between all ten members.

The LLP has no discretion over cash outflows on liquidation in respect of the members' interests in its net assets. However, it considers the tests under the puttables exception (paragraph 22.4(b) of FRS 102) and concludes that they are met in relation to the members' initial capital. Accordingly:

- the capital subscribed of £10,000,000 is presented within equity; and
- any divisions of profit are reported as equity appropriations and deducted from equity when they occur (whether during or after the end of the period).

Example 9 – Limited life LLP with pro rata return of net assets on liquidation. During the life of the LLP there is mandatory payment of interest but discretionary repayment of capital and profits

An LLP has been set up as an investment vehicle, and has ten members. Members do not provide any substantive services to the LLP, and hence the whole of the return to members is regarded as a return on capital. The LLP's investments are managed by a third party who is not a member. Under the terms of the members' agreement, each member subscribes £1,000,000. No member can require the LLP to repurchase their interest, but the LLP has been set up with a limited life of ten years, at which point it will be liquidated. On liquidation, each member will receive a pro rata share (ie, 10%) of the LLP's net assets.

During the LLP's life, interest at a rate of 1% is automatically payable on the capital subscribed. Any decision to divide the balance of profits must be approved by a majority of the members. On such a division, the profits are divided equally between all ten members.

The LLP has no discretion over cash outflows in respect of interest payable on members' interests. It therefore recognises a liability reflecting the present value of the future interest payments.

The LLP then considers the remaining components of the instrument (capital plus discretionary division of profit). Although the LLP has no discretion over cash outflows on liquidation, it considers the tests under the puttables exception (paragraph 22.4(b) of FRS 102) and concludes that they are met in relation to the members' capital. Accordingly:

- that component of the capital subscribed that corresponds to the interest payable is presented within liabilities (this will be the present value of the future interest payments ie, the present value of ten annual payments of £100,000), and the remaining balance of the capital subscribed is presented within equity;
- each year an expense is charged in profit or loss (under the heading 'Members' remuneration charged as an expense') and a liability recognised equal to the unwinding of the discount on the liability component; and
- any further divisions of profit are reported as equity appropriations and deducted from equity when they occur (whether during or after the end of the period).

Example 10 – Repayment of capital permitted on retirement only if replacement capital from continuing members is contributed.

An LLP's constitution requires that members subscribe capital to the LLP. Upon retirement of a member, the LLP is required to repay capital to the retiring member to the extent that replacement capital is contributed by continuing members.

In this situation, the LLP has the unconditional right to refuse repayment of capital below the total amount of capital currently subscribed. It has, in effect, a permanent layer of capital because the level of capital will never fall below a certain amount. Accordingly, this amount of permanent capital will be shown as equity in accordance with the principle set out in paragraph 22.6 of FRS 102. To the extent that the level of replacement capital required is below the amount to be repaid on retirement, that excess will be classified as a liability (unless the tests under the puttables exception are met).

If, in another fact pattern, a resolution of the LLP is required to repay the capital to the retiring member – whether or not replacement capital is contributed – then the entire amount of existing capital contributed will be classified as equity since the LLP has discretion to repay the amount.

Example 11 – LLP which has to automatically divide profits has certain members who do not provide any substantive services to it.

An LLP may have two distinct types of members, all providing capital to it: those that provide services in return for a share of profits and those that do not provide any substantive services, but still receive a share of profits. For example, an LLP that has been set up for property development may have a partner who is carrying out the development work and another who is only funding the project; or a professional services firm might have members who are not working for it but nevertheless share in the profits as a result of introducing capital.

Paragraph 34 of the SORP says that 'where remuneration, or part thereof, is clearly identifiable as a return on the amounts subscribed – for example, non-discretionary interest payments – rather than a return for the services provided by the members, then the amounts subscribed and that part of the remuneration that is clearly identifiable as a return on the amounts subscribed would be analysed together for accounting purposes'. In other words, the automatic division of profits to those members who do not provide any substantive service (non-working members) to the LLP is a return on their capital invested.

Accordingly, the amount subscribed by the non-working members will be initially recognised as a financial liability. The obligation to automatically divide profits represents a right to future profits which must be recognised in the subsequent measurement of the amounts due to members.

Exactly how that financial liability is measured at subsequent reporting dates will depend on which accounting policy options are chosen when applying paragraphs 11.2 or 12.2 of sections 11 and 12 of FRS 102. For those LLPs reporting under sections 11 and 12 of FRS 102, this obligation to pay future profits will be a non-basic financial instrument in the scope of FRS 102.12 and, as such, may have to be accounted for either at fair value through profit or loss or amortised cost, depending on the judgement over whether the embedded derivative, being the right to a share of future profits, meets the definition of a derivative as defined in IFRS 9 [FRS 102.11 Example 10]. In this context, that judgement will be whether the right to the share of profits is deemed to be a non-financial variable specific to a party to the contract. If it is, then the non-basic financial liability would not be permitted to be recognised at fair value, as the right to future profits would not meet the definition of a separable embedded derivative in IFRS 9 [IFRS 9.4.3.1]. However, if the liability has to be measured at amortised cost [FRS 102.12.8 (c)], it will still be necessary to remeasure the liability at each reporting date, and there may still be significant volatility in that measurement. Both fair value and amortised cost measurements would be updated to reflect the latest estimates of future cash flows as at the reporting date; the main measurement difference is that, under amortised cost, those cash flows would be discounted at the original effective rate, whereas a current market interest rate would be used to measure fair value.

For those LLPs that, under FRS 102, have taken the option to apply the recognition and measurement provisions of IFRS 9, the remeasurement of the change in the liability to pay future profits will, most likely, be accounted for by applying the guidance in IFRS 9.B5.4.6.

In all cases, the balancing entry that reflects the change in the liability to pay future profits should be included as a component of members' remuneration charged as an expense because of the LLP having to automatically divide profits with its members.

It should be noted that there are many ways in which this situation could arise including, as in this example, a capital payment made to and retained by the LLP. However, where the capital payment from the incoming

member is paid either directly or indirectly to other members, the payment made by the new member should be analysed separately from the distribution to members. Specifically, when a new member will not be providing any substantive services, even if the capital subscribed by that new member is paid directly to existing members (and is never received in cash by the LLP), it will still be necessary for the LLP to recognise a liability in respect of the obligation to pay a share of future profits to that new member.

Illustrative journal entries

Suppose that a new member, who will not be providing any substantive services to the LLP, subscribes £1,000 in exchange for a right to a share of future profits each year. Profits are automatically divided.

During the year, drawings of £90 are paid to the member, which are recoverable to the extent that they exceed the profit share for the year.

At the subsequent year end, the total amount automatically divided and allocated to the member in respect of the year (including the £90 already paid) is calculated as £200.

In addition, subsequent to the automatic division of profits, the liability is remeasured in accordance with the guidance discussed above. As at the year end, the recalculated liability in respect of future years is £1,080 which, together with the amount not yet distributed of £110 (£200 – £90), gives a total liability of £1,190.

On subscription of capital

Dr Cash	1,000	
Cr Liability to member		1,000

On payment of drawings

Dr Liability to member	90	
Cr Cash		90

At subsequent reporting date

Dr Members' remuneration (P&L) *	280	
Cr Liability to member		280

* This represents the amount allocated for the year (£200) as adjusted by the remeasurement of the liability for future years (£1,080 – £1,000 = £80)

APPENDIX 3: FLOWCHARTS FOR ANALYSING THE APPLICATION OF THE PUTTABLES EXCEPTION

(This appendix forms part of the SORP)

Deleted

APPENDIX 4: MERGER ACCOUNTING ON INITIAL TRANSITION OF AN EXISTING UNDERTAKING TO A SINGLE-ENTITY LLP FORMED FOR THE PURPOSE

Introduction

1. This note explains how the SORP applies section 19 of FRS 102 in certain special circumstances that arise when merger accounting is adopted on initial transition of an existing undertaking to a single-entity LLP formed for the purpose.
2. Paragraph 115 of the SORP states that a single-entity LLP formed by the transfer or incorporation of existing undertakings should present corresponding pro-forma amounts.
3. Paragraph 116 of the SORP deals with a situation that is common in LLP incorporations, where the undertaking is transferred to the LLP part way through an accounting period and the LLP is not itself a parent undertaking. Paragraph 116 states that where there is a hiatus between formation of the LLP and the transfer, the net assets at book values should be reflected in the accounts at the date of the transfer, and results should be included for the period from the transfer to the end of the accounting period. This is the commonly adopted practice.
4. Paragraph 116 also suggests that a pro-forma profit and loss account (or statement of comprehensive income), including corresponding amounts, should be given for the whole of the original entity's accounting period spanning the transfer.

Illustrative scenario and analysis

5. The owners of entity A (a partnership) establish a new LLP with the same owners (partners) on 1 April. The business of the partnership is then transferred to the new LLP on 1 July. The LLP has a 31 December year end and prepares entity-only accounts.

The transfer of a business to a new entity whose equity holders are the same as those of the entity transferring the business meets the definition of a group reconstruction in FRS 102.

Therefore, assuming the conditions in paragraph 19.27 of FRS 102 are met; the merger accounting principles of reflecting the transfer at book value (as set out in paragraph 19.29 of FRS 102) may be applied to the entity-only accounts of the LLP in the above scenario. There are potentially two alternative ways of presenting its results:

- a) bring in the net asset book values at the date of the transfer of trade and assets, and only recognise profits arising in the LLP from the date of incorporation – 1 April – which will, in effect, only include transactions from 1 July to 31 December since the LLP had no trade before the date of transfer; or
- b) bring in the net asset book values at 1 January and include the results for the 12-month period 1 January to 31 December, to be consistent and comparable with entity A's reporting period.

6. Deleted
7. From a statutory viewpoint, the accounting period being reported on is for the nine months to 31

December, and therefore profits and losses relating to the period before that should not be recognised in the LLP's first statutory accounts.

8. In addition, for companies combining with a trade and assets, common practice is to adopt option (a) and only bring in profits from the date of the transfer of trade. One rationale for this is that SI 2008/410 schedule 1 paragraph 13(a) only permits profits realised at the balance sheet date to be included in profit or loss. For companies the pre-transfer profits are not profits and certainly not realised profits, of the company and therefore should not be included in the entity profit and loss account (or statement of comprehensive income).
9. On that basis, CCAB sees no reason for the accounting in LLP entity accounts to be any different. In addition, SI 2008/410 schedule 1 paragraph 13(a) also applies to LLPs under the LLP Regulations (SI 2008/1912 schedule 1 paragraph 13 (a) for small LLPs and SI 2008/1913 schedule 1 paragraph 13 (a) for large and medium-sized LLPs), even though the concept of realised and unrealised profits is not relevant for distribution purposes for LLPs.
10. In view of the above considerations, the SORP recommends that LLPs should present alternative (a) as the statutory profit or loss set out in paragraph 5 above.
11. However, as paragraph 19.30 of FRS 102 states that the results of all the combining entities should be brought into the financial statements of the combined entity from the beginning of the financial year in which the combination occurred, then alternative (b) is also a relevant presentation assuming that the 'financial year' is the accounting period of the underlying business.
12. Furthermore, on the basis that the concept of realised profits is irrelevant to LLPs for distribution purposes and that paragraphs 19.29–19.32 of FRS 102 should be complied with then the SORP also recommends disclosure of the 12-month profit or loss (ie, option (b)) and comparatives as pro-forma numbers. This approach is in line with the general requirement of section 19 of FRS 102 to present such transactions as group reconstructions using merger accounting.
13. LLPs in their first accounting period may choose to use a three column profit and loss account (or statement of comprehensive income) format, or include the statutory profit and loss account (or statement of comprehensive income) in the form of alternative (a) as set out in paragraph 5 above as a separate statement for legal reasons, but give equal prominence to the pro-forma numbers (alternative (b)).

APPENDIX 5: LEGAL OPINION

Note: Although the opinion below was given prior to the introduction of FRS 102 and the implementation of the 2008 LLP Regulations, the advice given nonetheless remains relevant. Although the opinion is repeated in its entirety, only paragraphs 1 to 5 relate to accounting matters dealt with by this SORP. Paragraphs 6 to 8 deal with legal matters that are not addressed by this SORP.

In paragraphs 6 and 7, the opinion deals with the distinction between capital and debt. In FRS 102 the equivalent accounting distinction is between equity and financial liability. Although the test for distinguishing between the two is somewhat different, the references in the opinion to the fact that it is the division of profits, automatic or otherwise, that converts profits into debt, are nevertheless consistent with the general principles of the amended SORP and specifically those in paragraphs 24 and 48B.

In June 2001, before the issue of FRS 25 and UITF 39, CCAB consulted Robin Potts QC on certain matters relating to the profits of a limited liability partnership, and received the following advice.

- 1. The profits of a limited liability partnership (LLP) are only converted into a debt due to its members when the members have agreed to divide the profits among themselves. The division of profits is a matter of the internal management of the LLP, as it is in the case of a company and a partnership (Stevens v South Devon Railway Company [1851] 9 Hare 313 and 21 LJ Ch 816 and Burland v Earle [1902] AC 83).**
- 2. The Limited Liability Partnership Regulations do not provide for an LLP (unlike a company) to include in its balance sheet the balance on its profit and loss account under the separate heading of 'Profit and loss account'. Accordingly, after the profits have been ascertained and in the absence of any agreement between the members to the contrary, the balance on profit and loss account would need to be included under the balance sheet heading 'Other reserves' pending an agreement to divide the profits among the members. The heading of 'Other reserves' is wide enough to encompass the balance on profit and loss account.**
- 3. It is open to the members of an LLP to agree that the profits of the LLP shall be automatically divided between the members after they have been ascertained. Whether or not an agreement between the members has this effect is a matter of construction. The division of profits must be distinguished from the arrangements for profit sharing. A provision in an agreement between the members which sets out the profit shares of the members does not of itself constitute an agreement for the division of profits. It merely sets out the respective profit shares of the members which will apply to profits after the members have decided to divide them among themselves. Accordingly, the default rule which is applied by virtue of Regulation 7 (1) of the Limited Liability Partnerships Regulations 2001 (which provides for the members of an LLP to share equally in the capital and profits of an LLP in the absence of agreement to the contrary) does not constitute a default rule as to the automatic division of profits between the members.**
- 4. If the members agree to the automatic division of profits, then albeit that there is a scintilla of time between the ascertainment of the profits and their division among the members and notwithstanding that the balance sheet is contemporaneous with the profit and loss account, it would be acceptable to credit the profits directly to the current accounts of the members without first including the profits under the balance sheet heading 'Other reserves'.**
- 5. An LLP could only have a revaluation reserve if there was no agreement between the members for**

the automatic division of profit. This is because the old common law rules regarding distributions would apply to LLPs and under these rules a revaluation reserve was distributable.

6. Whether a contribution made by the members to an LLP constituted capital or debt was a matter of construction of the intention of the members. For a contribution to constitute capital it must clearly be designated as capital. Otherwise the presumption will be that it constitutes debt.
7. Where the members make a contribution of capital to an LLP, they can subsequently convert the capital into debt by agreement. What constitutes an agreement between the members and in particular what majority is required to convert capital into debt is a matter of construction of the agreement between the members.
8. On an insolvency of an LLP amounts credited to capital and reserves in its books immediately prior to the commencement of the winding up would disappear and would not constitute debt which could be proved for in the winding up.

Robin Potts, QC

27 June 2001

APPENDIX 6: BASIS FOR CONCLUSIONS

Introduction

- BC1. This 'Basis for conclusions' summarises CCAB's considerations in reaching its conclusions on revising the SORP *Accounting by Limited Liability Partnerships* in 2006, 2010, 2013, 2016, 2018, and 2021 and has been updated to reflect the deliberations for all five revisions.
- BC2. The first edition of the SORP was published on 29 May 2002 ('SORP 2002'). In accordance with the FRC's *Policy on Developing SORPs*, CCAB reviews the SORP annually for changes in accounting practice and new developments.
- BC3. In September 2005 CCAB published its proposals in an exposure draft of a revised SORP ('ED SORP 2005') and a revised SORP was published in March 2006 ('SORP 2006'). The subsequent changes made to SORP 2006 as a result of the amendment to FRS 25 (IAS 32) *Financial Instruments: Disclosure and Presentation* in 2008 (the puttables amendment) are also referred to in the text below where appropriate and, in particular, in BC15–19. The amended SORP was issued in March 2010 ('SORP 2010').
- BC3A. Because of the significance of the changes made by SORP 2006 and SORP 2010, in particular the former, this 'Basis for conclusions' retains much of the text from the bases of conclusions in those versions of the SORP so that an explanation of the development of the SORP is retained in one document.
- BC3B. Following the publication of FRS 102 in March 2013, CCAB proposed further changes to this SORP in an exposure draft ('ED SORP 2013') issued in October 2013. A revised SORP ('SORP 2014') was issued in July 2014. The changes made by this update to the SORP are discussed further in paragraphs BC39–BC48 below.
- BC3C. Changes to this SORP were proposed in an exposure draft ('ED SORP 2016') issued in July 2016. A revised SORP ('SORP 2017') was issued in January 2017. The changes made by this update to the SORP are discussed further in paragraphs BC50 – BC68 below.
- BC3D. Changes to this SORP were proposed in an exposure draft ('ED SORP 2018') issued in August 2018. A revised SORP ('SORP 2018') was issued in December 2018. The changes made by this update to the SORP are discussed further in paragraphs BC69 – BC77 below.
- BC3E. Changes to this SORP were proposed in an exposure draft ('ED SORP 2021') issued in July 2021. A revised SORP ('SORP 2022') was issued in December 2021. The changes made by this update to the SORP are discussed further in paragraphs BC78 – BC90 below.

The distinction between debt and equity

- BC4. ED SORP 2005 proposed that members' participation rights in the assets of an LLP should be analysed between those that are, from the LLP's perspective, either a financial liability or equity, in accordance with FRS 25 and UITF Abstract 39 Members' Shares in Co-operative Entities and Similar Instruments.³⁹ The accounting implications of this requirement, as set out in the SORP, are considered in paragraphs BC5–BC11 below. The majority of respondents to ED SORP 2005 who considered this issue agreed that a revision of the SORP was required and that the proposals were consistent with the standards.
- BC5. SORP 2002 distinguished between debt due to members and 'Members' interests other than debt due to them by the LLP, which constitute equity in the LLP'. 'Members' capital' is a subset of 'Members' other interests', comprising 'amounts subscribed or otherwise contributed by members for longer-term retention in the business'. The term 'Members' capital' is used in the relevant legislation. This distinction was considered no longer appropriate in the light of FRS 25 and UITF 39, but applying these standards to LLPs is not straightforward. The constitutions and capital structures of LLPs can vary significantly. Amounts subscribed or contributed by members as 'capital' of an LLP may be withdrawn or converted to debt by agreement between the members. Accordingly, whether or not an instrument is debt or equity will depend entirely on the specific terms of the members' agreement.
- BC6. The basis for the accounting required in the SORP is that the members' agreement, in dealing with the financial arrangements between an LLP and its members (for example, in respect of amounts subscribed or otherwise contributed and remuneration (discussed in paragraphs BC20 et seq below)), will give rise to rights against the LLP. Such members' rights against the LLP are referred to for the purpose of this analysis as 'participation rights'. Participation rights may meet the definition in FRS 25 of a financial instrument: that is, 'a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity'.⁴⁰ Participation rights that are financial instruments will be within the scope of FRS 25 and, by extension, UITF 39.
- BC7. Under FRS 25 and UITF 39, prior to any consideration of the amendment made to FRS 25 in August 2008 dealing with puttable instruments ('the puttables amendment'), members' shares would be equity only 'if the entity has an unconditional right to refuse redemption of the members' shares' (paragraph 7 of UITF 39).⁴¹ The implication of this for LLPs is that, subject to consideration of the impact of the puttables amendment, members' interests will always be debts of the LLP unless the LLP has an unconditional right to refuse to pay the related amount. (There are also implications for the profit and loss account, including remuneration and profit shares, discussed in paragraphs BC20 et seq below.) There may be instances, therefore, where members will have no interests classified as equity in the LLP.
- BC8. Following the above analysis, the SORP requires members' participation rights in the assets of an LLP to be analysed between those that are, from the LLP's perspective, either a financial liability or equity, in accordance with FRS 25 and UITF 39. For the purpose of this analysis, the SORP requires participation rights in respect of amounts subscribed or otherwise contributed and remuneration (which may include

³⁹ FRS 25 and UITF 39 have since been superseded by FRS 102, but the approach taken by FRS 102 to distinguishing between debt and equity is the same.

⁴⁰ The same definition is included in FRS 102.

⁴¹ The same requirement is reflected in paragraph 22.6 of FRS 102.

salary, interest, bonus, risk premium and shares of profits – fixed or variable) to be analysed separately, except where the remuneration is clearly identifiable as a return on amounts subscribed or otherwise contributed – for example, non-discretionary interest payments (see paragraph 39 of the SORP). As set out in the SORP, this means that, for example, a profit share payable at the discretion of the LLP would be accounted for as an equity appropriation even if the member's capital is treated as a liability because the LLP cannot refuse repayment of that capital (and the tests for equity treatment in the puttables amendment are not met). This reflects the reality that in many cases members' remuneration is based on participation in the activity of the business rather than providing a return on the capital invested (see paragraph BC23 below). Unless the tests for equity treatment in the puttables amendment are met, a member's participation rights will result in a liability of the LLP, except to the extent that the right to any payment or repayment is discretionary on the part of the LLP; that is the LLP has an unconditional right to refuse payment until the LLP has taken a decision to divide profits. This will depend on the construction of the members' agreement and the policy and mechanism for the LLP to divide profits.

- BC9. ED SORP 2005 suggested pro-forma balance sheets for use by LLPs, based on examples in FRS 25.⁴² This format was intended to allow LLPs to designate balances with members correctly as debt or equity, but also encourages presentation in a manner that provides useful information regarding the members' net interests in the LLP at the balance sheet date. Respondents to ED SORP 2005 welcomed this presentation, which was retained in SORP 2006.
- BC10. The classification of capital and other members' interests in an LLP is not straightforward and will differ from one LLP to another. CCAB believes it is likely, however, that many 'traditional' LLPs will need to classify capital as a liability. This issue was complicated further following the amendment to FRS 25 in August 2008 (see BC15–BC19 below).
- BC11. Applying the principles of FRS 25 and UITF 39, a critical issue was whether the LLP retains discretion to withhold some or all of the profits to members, irrespective of whether it intends to, and invariably does, distribute all the profits to members. CCAB accepted that any amounts that the LLP has no discretion to withhold should be classified as liabilities, unless the tests for equity treatment in the puttables amendment are met. It is possible therefore, that profits may be shown as liabilities in an LLP balance sheet, where the members' agreement provides for profits to be automatically divided. This will be the case where the LLP does not have an unconditional right to refuse paying the profits to members under the terms of the LLP agreement and therefore decision to divide profits is automatic. Any rights of the members to vary the terms of the LLP agreement are not relevant: see further in BC26.
- BC12. Although some respondents to ED SORP 2005 expressed concern at the outcomes set out in paragraphs BC10 and BC11, CCAB concluded that they followed inevitably from applying FRS 25 and UITF 39 to LLPs.
- BC13. There was some concern that the distinction drawn in ED SORP 2005 between debt and equity was spurious, because members of the LLP control the LLP and can therefore control whether or not the LLP has discretion to make payments to members. According to this view, members' interests would always be equity interests. However, this ignored the fact that, unlike a partnership, an LLP is a legal entity separated from its members by a 'corporate veil'. It is therefore correct to impute discretion to the LLP, even though this can be countermanded by the members.
- BC14. Some respondents to ED SORP 2005 felt that the SORP should deal with FRS 26 Financial Instruments:

⁴² The FRS 25 examples are not reproduced in FRS 102.

Measurement. Given that FRS 26 was not mandatory in many cases and that the standard itself contains a significant amount of implementation guidance, CCAB concluded that the SORP should not deal with this standard in any detail. However, paragraphs 4 and 5 were included to provide guidance on which accounting standard is relevant when considering how to measure the type of financial liabilities, provisions and other financial instruments dealt with in the SORP.⁴³ These paragraphs have, however, since been deleted following the publication of FRS 102.

- BC15. One of the more difficult aspects of applying UK GAAP to LLPs is accounting for the interests of members in the profit or loss of the LLP and of the members' interests in the assets and liabilities of the entity. For the purposes of the guidance provided by the SORP, these interests are described as 'participation rights'. The analysis of members' interests in the assets and liabilities of an LLP needed to be reassessed as a result of revisions to FRS 25 effective for accounting periods commencing on or after 1 January 2010 ('the puttables amendment'). The amendment was made following a similar amendment to the equivalent International Financial Reporting Standard which arose following comments that certain types of entity may, under the previous version, have no equity shown in their balance sheet. The result of applying the amendment to LLPs was that certain members' interests which would otherwise have been classified as liabilities were subsequently classified as equity, particularly in situations where members do not provide **any substantive** services to the LLP. However, the criteria for reclassification are detailed and complex.⁴⁴ In practice, CCAB concluded that it would be likely that many LLPs would not be affected by the amendment.
- BC16. The exposure draft of a revised SORP published on 29 July 2009 ('ED SORP 2009') contained further guidance on the application of the amended FRS 25 in the context of classification of members' interests as debt or equity, together with a flowchart and examples to illustrate some, but not all, possible scenarios.
- BC17. The number of responses to ED SORP 2009 was small. A theme of some of the responses was that the guidance in the SORP was highly technical, and was for some considered difficult to interpret and use in a practical sense. CCAB had a great deal of sympathy with this view, but was ultimately constrained by the highly technical and complex underlying amendment to FRS 25 which was itself not simple to understand or apply in practice. However, the role of the SORP was to apply that standard to UK LLPs and a degree of technical analysis was inevitable. The two most substantive responses focused on the same issue: a potential inconsistency between the principles in the SORP on members' participation rights, in particular paragraph 34, and the approach to analysing the members' interests in an LLP as financial instruments.
- BC18. A member of an LLP can interact with the LLP in a number of capacities, and throughout the development of the SORP there has been a consistent principle that those different capacities (for example, service provider, investor, lender) should, where appropriate, be viewed separately and the accounting for any resulting transactions should follow the capacity in which the member acts. Respondents to ED SORP 2009 felt that some of the material on puttable financial instruments, particularly in some of the examples in Appendix 2, contradicted this principle and had sought to treat,

⁴³ FRS 26 has since been superseded by FRS 102. The requirements of FRS 102 are simplified compared to those of FRS 26 but are nevertheless more complex and more prescriptive than previous UK GAAP for entities that had not adopted FRS 26. The SORP has been updated where necessary to reflect the changes made by FRS 102.

⁴⁴ Very similar criteria, but with small differences, are reflected in FRS 102.

for example, a members' agreement as a single financial instrument. CCAB debated these responses and agreed that this underlying principle should still apply ie, participation rights in respect of amounts subscribed or otherwise contributed should be analysed separately from participation rights in respect of remuneration except where the remuneration, or part thereof, is clearly identifiable as a return on amounts subscribed or otherwise contributed.

- BC19. The final SORP published on 31 March 2010 ('SORP 2010') therefore made it much clearer that the interests of a member in an LLP are likely in many cases to be viewed as more than one 'instrument'. This is particularly likely in, for example, professional services LLPs where members are not simply investors or funders of the business, but also work in the business and provide services. Accordingly, SORP 2010 required the remuneration to members in respect of services provided to be viewed separately from the remuneration in respect of capital or funding provided except where the remuneration, or part thereof, is clearly identifiable as a return on amounts subscribed or otherwise contributed. This approach is in many respects simpler and avoids a number of potentially complex accounting issues such as compound instrument accounting for amounts subscribed. It would in many cases (particularly for professional services LLPs) lead to there being no change in the designation of capital from liability to equity as a result of the puttables amendment. Given that the main change from ED SORP 2009 was to align more closely the examples and flowcharts with the principles set out in the body of the ED and that the expected result of SORP 2010 would be less change in some cases than previously expected, the Steering Group concluded it was not necessary to submit the revised SORP to a further exposure period.

Profit and loss account implications

- BC20. ED SORP 2005 recommended that the treatment of the members' remuneration element in the profit and loss account should be based on the same principles as are used for determining debt and equity in the balance sheet. This means that participation rights in respect of amounts subscribed or otherwise contributed should be analysed separately from participation rights in respect of remuneration except where the remuneration is clearly identifiable as a return on amounts subscribed or otherwise contributed. Members' remuneration is 'any outflow of benefits to a member', and may include or comprise, inter alia, salary, interest, bonus, risk premium and allocated share of profits. This principle, set out in ED SORP 2005, would mean that remuneration comprising a profit share payable at the discretion of the LLP should be accounted for as an equity appropriation even if the member's capital is treated as a liability. Respondents to ED SORP 2005 broadly agreed with this approach as a practical solution to a difficult problem, in line with the analysis set out below.
- BC21. Some respondents to ED SORP 2005 felt there should be a closer link between the balance sheet classification of the capital instrument (debt or equity) and the way in which members' remuneration is dealt with in the profit and loss account. This is akin in the corporate situation to the linkage of a debt instrument with interest in the profit and loss account and an equity instrument with dividend payments. In addition, some respondents to ED SORP 2005 felt that members' participation rights had certain features of compound instruments.
- BC22. However, it was extremely difficult to apply to an LLP the provisions in FRS 25 on compound financial instruments (paragraphs 28–32 of FRS 25) and 'interest, dividends, losses and gains' (paragraphs 35–36 of FRS 25). The relationship between capital introduced and remuneration in an LLP is very different to that in a company, where there would normally be a clearly identifiable relationship between return on the investment and the investment itself. At one extreme, for example, there may be LLPs that have no

members' capital, being entirely funded from external sources, in which case the profit and loss account treatment of remuneration must be assessed in isolation from any balance sheet amount.

- BC23. In this respect, paragraph 36 of FRS 25 stated that the classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss.⁴⁵ However, while it may be possible to consider that the remuneration and profit shares of members amount to 'interest, dividends, losses and gains' as a result of the amounts invested by members in an LLP, in many or most cases this does not reflect the substance of the arrangements in LLPs. Remuneration and profit shares are often payable to members in return for participation in the business, as well as representing a financial return on amounts invested by members. In many LLPs, the latter will represent a relatively insignificant proportion of the total remuneration.
- BC24. Because, in many cases members' remuneration constitutes a share of profits based on participation in the activity of the business, and given the difficulty of identifying the specific capital to which participation rights might attach, CCAB considers that to treat all shares of profit in an LLP as some form of return on a financial instrument, even where the share of profit is a financial liability of the LLP once divided, would result in misleading and inappropriate accounting presentation. Accordingly, CCAB decided to retain the principle that participation rights in respect of amounts subscribed or otherwise contributed should be analysed separately from participation rights in respect of remuneration, except where an element of the remuneration is clearly identifiable as a return of capital (see paragraph 34B of the SORP). As a result of comments received on ED SORP 2009, this principle has continued to be applied subsequently to the puttables amendment to FRS 25.
- BC25. With regard to compound instrument accounting, while members' participation rights might include both equity and liability elements, and thus be thought of as 'compound instruments' under FRS 25, it will often be impossible to ascribe these rights to identifiable elements of members' capital, which itself will vary over time.
- BC26. A minority of respondents to ED SORP 2005 expressed concern at the line taken in the exposure draft with regard to automatic division of profits. The view was expressed that automatic division is, in effect, dependent on the agreement of the members, and so it is not correct to charge it as an expense. However, CCAB continues to believe that an agreement for automatic division of profits does have the substance of establishing profits of the LLP as debts due to the members as they accrue. Although the members could agree among themselves to terminate the agreement, the accounting must be on the basis of the agreement that is in fact in force at the time which would be binding on the parties unless and until terminated or varied.
- BC27. The position whereby an LLP had no agreement for the automatic division of profits, but had divided some of the profits during the accounting year was considered. Some views had been expressed that since at the time the accounts were drawn up the LLP had already divided the profit, it was therefore no longer discretionary and should be accounted for in the same way as an automatic division of profit; that is, shown as members' remuneration charged as an expense rather than as an equity appropriation of profit. CCAB is of the view that this is not the correct position. The position is no different in principle from that of a limited company declaring an interim dividend on ordinary shares. The LLP has an unconditional

⁴⁵ Although an equivalent paragraph is not reflected in FRS 102, the same logic is equally valid under FRS 102.

right to avoid dividing the profits and therefore any decision to divide the profits is an equity appropriation. Accordingly, CCAB considers that the discretionary division of profit during the year that is not clearly identifiable as a return on capital should be accounted for as an appropriation of profit in the year in which it occurs in line with the treatment of an interim dividend paid by the company on its ordinary shares.

- BC28. Appendix 1 to the SORP sets out example balance sheets and profit and loss accounts for an LLP. Appendix 2 provides illustrations of how the principles set out in the SORP would be applied to some simple LLP membership arrangements.
- BC29. Some respondents to ED SORP 2005 suggested that FRS 20 *Share-based Payment* is applicable to members' remuneration because any share of profits a member receives is at least in part consideration for services rendered to the LLP.⁴⁶ While the SORP cannot cover all remuneration arrangements, and it may be that in some circumstances FRS 20 is relevant, CCAB concluded that typically members' remuneration arrangements would be outside the scope of FRS 20. The standard defines a share-based payment as 'a transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of an entity's shares or other equity instruments of the entity'.⁴⁷ CCAB believes that what the member receives in exchange for any services given ie, typically a share of one year's profits, does not meet the definition of an equity instrument, which is 'a contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities'.⁴⁸ In this respect, an equity instrument is representative of the total value of the entity (for example, the price of an equity share in a corporate entity is representative of both the value of the existing assets and also of future cash flows). Accordingly, CCAB believes that a share of one year's profits does not meet the definition of an equity instrument because it reflects only one year's earnings rather than a share in the overall value of the entity.

Post-retirement payments to members ('Annuities')

- BC30. SORP 2002 required the present value of the best estimate of the expected liability for or in respect of payments to a former member to be provided in the accounts at the date of the member's retirement, in accordance with FRS 12 Provisions, Contingent Liabilities and Contingent Assets. (Such post-retirement payments are often described as 'annuities'.)
- BC31. The introduction of FRS 25 led to developments in the thinking behind the treatment of annuities by LLPs. The previous treatment, of recognising a liability only on the retirement of the member, was consistent with the principle of not reflecting transactions with members in the profit and loss account (except in the limited instance of salaried remuneration). However, FRS 25 brought members' remuneration within the scope of the profit and loss account, and it would be inconsistent to treat annuities differently. Furthermore, an annuity to which a member has a contractual entitlement is a contractual obligation to deliver cash or another financial asset to another entity, and so met the definition of a financial liability under FRS 25, although if it contains a life-contingent element it was

⁴⁶ FRS 20 has since been superseded by FRS 102. The current requirements in respect of share-based payment are set out in section 26 of FRS 102.

⁴⁷ The definition included in FRS 102 is different in certain respects but does not alter the rationale here.

⁴⁸ Similarly, FRS 102 defines equity as 'the residual interest in the assets of the entity after deducting all its liabilities'.

scoped out of FRS 25 and would fall to be accounted for under FRS 12, as would annuities in respect of which the LLP only has a constructive obligation.⁴⁹ Whichever is the relevant standard, the obligation in respect of the annuity should be accounted for at the time the member becomes entitled to a future payment that the LLP has no discretion to withhold (in line with the distinction between discretionary and non-discretionary participation rights, discussed in paragraphs BC7 et seq above). As regards an unconditional annuity right, the granting thereof is the obligating event and it will normally be correct to recognise a liability at the time of such grant. As regards a conditional annuity obligation (for example, conditional on continuing future service), this should be accrued as the rights to that annuity accrue (whereas SORP 2002 required the liability to be crystallised at the time of the member's retirement).

- BC32. The appropriate accounting guidance for an annuity will depend on the characteristics of the annuity. The detailed guidance in FRS 102 differs from that in previous UK GAAP, and some LLPs will find that the appropriate accounting for an annuity changes as a consequence. As noted in the above paragraph, there may be cases in which the LLP considers that the right to an annuity meets the definition of a financial instrument and falls within the scope of sections 11 or 12 of FRS 102. A life-contingent annuity is likely to be an insurance contract and outside the scope of FRS 102 (such an annuity will instead fall within the scope of FRS 103). Annuities that have not yet vested will fall within the scope of section 21 of FRS 102. In this respect, the SORP deals in paragraphs 76 to 84A with the relationship and boundaries between sections 11, 12 and 21 of FRS 102 and FRS 103.
- BC33. FRS 17 *Retirement Benefits* explicitly defined retirement benefits as 'consideration given by an employer in exchange for services rendered by employees ...'.⁵⁰ It was thus designed to deal with employer-employee relationships and how the costs of a pension liability for a defined benefit scheme should be reflected in an entity's accounts. However, the relationship between an LLP and a member is not generally an employer-employee relationship, and it therefore requires a distinct accounting treatment. Furthermore, the amount of post-retirement annuity payable is not likely to be based on a proportion of final 'salary' that is 'earned' over time, but, in the case of profit-dependent annuities at least, is normally measured in relation to events and profits arising after the retirement date. For these reasons, CCAB believes that these types of arrangement of post-retirement payments paid by LLPs to former members fall outside the scope of FRS 17.⁵¹
- BC34. However, measurement of the liability raises a number of issues. Although CCAB was of the view that FRS 17 was not the governing standard, where, because of their nature and/or complexity, the arrangements were such that it was appropriate to apply the guidance in FRS 17, then that guidance should be applied in arriving at the measurement of the liability. In order to arrive at the best estimate of the expected liability (ie, just for measurement purposes), CCAB believes that it will often be necessary to adopt actuarial principles and techniques.

⁴⁹ Different sections of FRS 102 apply to different types of annuity, but the rationale here in respect of timing of recognition is unaltered.

⁵⁰ FRS 17 has since been superseded by FRS 102. The corresponding requirements are set out in section 28 of FRS 102.

⁵¹ Section 28 of FRS 102 instead deals with 'employee benefits' and FRS 102 defines a retirement benefit plan in relation to employees, but the rationale here is unaffected.

- BC35. However, where a member of an LLP is also an employee⁵² and receives retirement benefits under their employment contract, then FRS 17 was required to be applied in full, as reflected in the SORP.⁵³

Merger accounting on initial transition of an existing undertaking

- BC36. Appendix 4 to the SORP explains the reasoning behind the treatment the SORP adopts for applying FRS 6 *Acquisitions and Mergers* in certain special circumstances that arise when merger accounting is adopted on initial transition of an existing undertaking to a single-entity LLP formed for the purpose.⁵⁴ Commentators on ED SORP 2005 generally welcomed this approach.

Revenue recognition

- BC37. Paragraph 65A of ED SORP 2005, which stated that revenue on service contracts should be recognised in accordance with UITF Abstract 40 *Revenue recognition and service contracts*, was deleted on the grounds that it was not specific to LLPs.

Losses

- BC38. Certain commentators on ED SORP 2005 requested guidance on the accounting treatment of losses. This was felt to be impracticable, as the treatment will vary depending on the precise provisions of the members' agreement. Further discussion on this matter was carried out as part of ED 2021 resulting in guidance on the accounting treatment of losses being added to SORP 2022 in paragraphs 50G and 50GA.

Changes made by SORP 2014

- BC39. The publication of FRS 100 *Application of Financial Reporting Requirements*, FRS 101 *Reduced Disclosure Framework* and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* ushered in a new reporting regime for UK entities.
- BC40. Deleted
- BC41. The FRC stated the continued need for supplementary guidance, where relevant, in the form of SORPs. Therefore, this SORP – and many of the other SORPs – were updated to bring it into line with the requirements of FRS 102.
- BC42. Many of the changes made were straightforward. For example, references to extant SSAPs, FRSs and UITF abstracts were replaced with references to the relevant sections or paragraphs of FRS 102. Similarly, the terminology used throughout was updated to reflect the language used by FRS 102.
- BC43. However, some more substantive changes were made following the publication of FRS 102. These included:

⁵² See BC53 which outlines later changes made to the definition of 'members' remuneration charged as an expense' in SORP 2017 to outline that while, as matter of law, the current position seems to be that a member of an LLP cannot be an employee, in practice a member and the LLP may be party to a document describing itself as a contract of employment and which may give the member a right to remuneration.

⁵³ By the same logic, section 28 of FRS 102 should be applied where a member receives retirement benefits under an employment contract.

⁵⁴ FRS 6 has since been superseded by FRS 102. The corresponding requirements are set out in section 19 of FRS 102.

- updating the guidance on business combinations and group accounts (paragraphs 102–119) to reflect the fact that FRS 102 only allows merger accounting to be used for group reconstructions and some public benefit entity combinations;
- updating the guidance on contractual or constructive obligations (paragraph 76) and annuities (paragraph 80) to reflect the fact that FRS 102's requirements relating to financial liabilities differ from old UK GAAP requirements; and
- updating references throughout to reflect the introduction of the option to produce a single statement of comprehensive income, including adding an additional exhibit in Appendix 1.

BC44. The section of the SORP on retirement benefits – which includes the revised requirements on contractual or constructive obligations and annuities referred to above – applies the requirements of FRS 102. While it is not a simple solution, it is in accordance with the standard. While a simpler, more pragmatic solution was considered, it was rejected as our role as a SORP-making body is not to override the requirements of the standard but to apply them to the LLP sector.

BC45. Deleted

BC46. Further changes were made to clarify SORP 2010's existing requirements where there were known issues or misunderstandings, including:

- clarifying the requirements in relation to automatic division of profits to make it clear that payment is unavoidable where profits are automatically divided among members in accordance with the LLP agreement in force at the time, and that in such instances a liability should be recognised;
- clarifying that if a reconciliation of members' interests is to be shown as a primary statement in place of the statement of changes in equity then comparatives must be shown for all figures presented;
- improving the table that follows paragraph 60 to ensure the recommended format not only provides a reconciliation of members' interests but also meets related Companies Act requirements;
- providing more guidance on cash flow statement presentation to reduce divergent practices; and
- refining the examples in Appendix 2 to focus on more commonly encountered scenarios and to eliminate some duplication.

BC47. In addition, changes were made to reflect the fact that SORP 2010 included a significant amount of guidance on the debt vs. equity debate that resulted from the fundamental changes introduced by FRS 25 and the subsequent 'puttables amendment' to that standard. While the basic accounting was unchanged under the new regime, it was nonetheless felt appropriate to amend some of the wording – and delete the flowcharts in Appendix 3 – to reflect the fact that what once was new and unfamiliar accounting practice was now the accepted norm.

BC48. Previous versions of the SORP required LLPs to produce a separate Members' Report. However, this is not a requirement of the LLP Regulations and some respondents commented that mandating such a report was therefore 'gold plating' the legal requirements. While the October 2012 exposure draft did not specifically consult on this point, as it does not relate to the introduction of FRS 102, the SORP was nonetheless updated in response to the feedback received and this requirement was removed. However, the disclosures that were previously included in the Members' Report were retained as they were considered helpful. LLPs may still wish to produce a Members' Report, but the SORP allows them to include these disclosures elsewhere in the financial statements if they prefer.

BC49. Some respondents also pointed out that paragraphs 63 and 64 of the SORP, which require disclosure of

how loans and debt due to members would rank in relation to other creditors in the event of a winding up and any restrictions on the ability of the members to reduce the 'members other interests', were onerous and overly burdensome in comparison to financial reporting by other types of entities. This matter was considered again as part of the changes made by SORP 2017 as discussed in BC58.

Changes made by SORP 2017

- BC50. Amendments were made to UK accounting standards in July 2015 that resulted in:
- the withdrawal of the FRSSE;
 - amendments being made to FRS 102 to add a new section outlining presentation and disclosure requirements for small entities and making other changes necessary for continued compliance with company law; and
 - the publication of FRS 105, a new standard available to entities choosing to apply the micro-entities regime.
- BC51. The LLP Regulations were amended in May 2016 by The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 (SI 2016/575), which introduced a number of changes, including raising the size thresholds which determine when an LLP or group qualifies as small and the creation of a new micro-entities regime for LLPs.
- BC52. Consequential amendments to FRS 105 were issued in May 2016 to align the standard with changes to UK company law and to make the micro-entities regime available to LLPs and qualifying partnerships.
- BC53. SORP 2017 incorporated a number of amendments arising as a consequence of these changes. Other minor changes were also made, one of which was to reflect the findings in *Reinhard vs. Ondra* – which clarified that an individual cannot be both a member and an employee of an LLP – in the definition of members' remuneration charged as an expense⁵⁵.
- BC54. Section 1A *Small Entities* of FRS 102 sets out the information that must be presented and disclosed in the financial statements of small entities that qualify for and choose to apply the small entities regime.
- BC55. Section 1A goes on to explain that a small entity may need to provide additional disclosures to those set out in this section of the standard in order to ensure that their financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the entity for the reporting period.
- BC56. Rather than prescribing which disclosures are required to ensure that the financial statements give a true and fair view, CCAB concluded that such LLPs – like other small entities – should be allowed to apply their own judgement when determining what, if any, additional disclosures are needed over and above those required by the standard. Depending on the individual facts and circumstances, some or all of the disclosures included in the LLPs SORP may be needed in order to ensure that the accounts give a true and fair view.
- BC57. The Small LLP (Accounts) regulations as amended by SI 2016/575 do not require additional disclosure of movements in 'Loans and other debts due to members'. As a consequence, CCAB concluded that there was no need to require all small LLPs to include such a reconciliation in their financial statements.

⁵⁵ See footnote 49 in relation to BC35.

However, it should be noted that Section 1A of FRS 102 encourages small entities to present a statement of changes in equity. The LLPs SORP therefore encourages small LLPs to include the reconciliation of the movement in members' other interests detailed in paragraphs 59 of the SORP.

- BC58. As noted in paragraph BC49 above, some respondents to ED SORP 2013 said that they felt the disclosures about how loans and other debts due to members rank in relation to other unsecured creditors required by paragraph 63 and 64 of the SORP were onerous and overly burdensome in comparison to financial reporting by other types of entities. However, as LLPs do not have any of the capital maintenance provisions that apply to companies, CCAB's view is that such disclosures are necessary in order to ensure a true and fair view regardless of the size of the LLP. These are the only disclosures that small LLPs are required to make by the SORP over and above those required by Section 1A of FRS 102.
- BC59. There was some variation in views among respondents to ED SORP 2016 about which additional disclosures should be required by small LLPs to ensure a true and fair view and which should be encouraged. For example, one respondent suggested that disclosures about the ranking of loans and other debts should be encouraged rather than required while another suggested that a reconciliation of members' interests should be required rather than encouraged. However, most respondents were supportive of the approach proposed. Consequently no changes were made to the proposals made in the draft SORP.
- BC60. One respondent suggested that further clarity was needed about the extent to which small LLPs should comply with paragraph 69's requirements in relation to the policy for members' drawings. While this disclosure will sometimes be needed to ensure a true and fair view, CCAB does not believe that it is necessary for the SORP to either require or encourage it.
- BC61. FRS 105 is available to entities choosing to apply the micro-entities regime. The new standard allows qualifying entities – including the smallest LLPs – to follow a far simpler reporting regime.
- BC62. FRS 105 is based on FRS 102, but it has been adapted significantly to accommodate the legal requirements of the micro-entities regime. For example, the standard reflects the new regime's prohibition of fair values and its very limited disclosure requirements. In addition, further simplifications – over and above those required by law – have been made in order to reflect the smaller size and simpler nature of micro-entities. For example, there are no accounting policy options and accounting for deferred tax is not permitted. Moreover, micro-entity accounts that include the statutory minimum accounting items are presumed by law to give a true and fair view.
- BC63. When deciding whether or not LLPs applying FRS 105 should be included within the scope of this SORP, CCAB were guided by The Accounting Council's Advice to the FRC to issue FRS 105 which was published alongside the standard. Paragraph 31 of which states:

A micro-entity that enters into a transaction that is not specifically covered by FRS 105 is required to refer to the concepts and pervasive principles set out in Section 2 Concepts and Pervasive Principles in determining its accounting policies. The Accounting Council notes that micro-entities are not required to refer to other accounting standards or authoritative guidance because these requirements may be inconsistent with the legal requirements of the micro-entities regime.

- BC64. The significant differences between FRS 105 and FRS 102 – the standard upon which this SORP is based –

lead CCAB to conclude that LLPs applying the former standard should be scoped out of this SORP. Instead, such LLPs should simply follow the relevant requirements of FRS 105.

- BC65. Two respondents raised concerns about the lack of guidance for micro-LLPs applying FRS 105. CCAB concluded it is not, however, appropriate to include any specific guidance for micro-LLPs in this SORP as it is based on the recognition and measurement requirements of FRS 102 rather than FRS 105. Moreover, following the SORP's requirements will not necessarily result in a solution that is in compliance with the requirements of FRS 105. Micro-LLPs applying FRS 105 can, nonetheless, refer to the SORP's requirements if they wish but they must satisfy themselves that in doing so they are also complying with the relevant requirements of FRS 105.
- BC66. CCAB was made aware of some inconsistencies in how 'automatic divisions' of profits are accounted for in practice. Some minor clarifications were therefore made to paragraph 48 and paragraph 3A of appendix 2. Although the wording has been clarified, no changes to existing requirements were intended. Paragraph 48 and paragraph 3A of appendix 2 were subsequently amended and relocated as part of the changes made by the SORP 2022 – see BC85.
- BC67. CCAB was made aware that there was some confusion around whether or not a statement of changes in equity needs to be prepared if an LLP has no equity. The SORP was therefore updated to explicitly state that where the LLP has no equity, and the reconciliation of members' interests is not presented as a primary statement, a statement should be made either on the face of one of the other primary statements or in the notes to the accounts that the LLP has no equity and consequently a statement of changes in equity is not given.
- BC68. As part of this review of the SORP, consideration was also given to amendments made to FRS 102 in July 2014, February 2015 and March 2016. It was concluded that no changes were needed as a consequence of these amendments as they do not create any issues that are specific to LLPs.

Changes made by SORP 2018

- BC69. In December 2017, amendments were made to FRS 102 as a result of the 2017 Triennial review. As part of the 2018 annual review of the SORP, consideration was given to whether the amendments to FRS 102 create any issues specific to LLPs, and whether any other consequential amendments are needed to align the SORP to the revised standard. A number of amendments were made to the LLPs SORP as a consequence of the changes to FRS 102. Details of these amendments are set out in paragraphs BC71 – 76.
- BC 71. The guidance on accounting by small LLPs (paragraph 27) was updated to refer to the fact that paragraph 11.13A of FRS 102 provides the option for small LLPs to adopt simpler recognition and measurement requirements for certain financial transactions ie, basic loans from a person within a director's group of close family members when that group contains at least one member of the LLP who is a person. The guidance on the accounting for members' capital classified as a financial liability (paragraph 57A) was also updated to refer to this simplification for small LLPs. The meaning of director is not defined in FRS 102 for an LLP. Therefore, CCAB concluded that further guidance should be given to clarify that for the purpose of applying the exemption in paragraph 11.13A of FRS 102, the term 'director' should be taken to mean a member, who is a person, with an equivalent role in the LLP. CCAB notes that further guidance on the application of the relief is given in paragraphs B11.32 to B11.39 of the Basis for Conclusions

accompanying FRS 102.

- BC 72. FRS 102 was updated to require that an entity presents the tax income (or expense) effects of distributions to owners in profit or loss. CCAB considered whether or not it should update paragraph 36A of the LLPs SORP but concluded that, on reflection, this matter did not create any specific issue for LLPs, and that paragraph 36A should instead be deleted.
- BC 73. The guidance on cash flow statement presentation (paragraphs 74A - 74C) was updated to reflect the new requirement for an entity to disclose the changes in net debt between the beginning and end of the financial period. CCAB concluded that guidance on this requirement was needed to address the fact that although 'loans and other debts due to members' would be considered borrowings for the purposes of the definition of net debt they are not external financing. It was concluded that it would be helpful for the SORP to include an example of how this information could be presented by an LLP.
- BC 74. CCAB considered whether paragraph 130A should be updated to reflect the fact that FRS 102 has been updated to include an exemption from disclosing key management personnel compensation when an entity is subject to a legal or regulatory requirement to disclose directors' remuneration (or equivalent) and the key management personnel and directors are the same. CCAB concluded that it did not expect this exemption to have the effect of reducing the amount of information disclosed by LLPs and that the SORP, therefore, did not need to be updated for this amendment.
- BC 75. A new paragraph 108A was added to the Business Combinations and Group Accounts section to reflect the new recognition rules for intangible assets acquired as part of a business combination. As a result of the Triennial review 2017 amendments, intangible assets must be recognised separately from goodwill if they are separable and arise from contractual or other legal rights, subject to the general recognition requirements for all intangibles being met. However, those entities wishing to recognise more intangibles separately from goodwill may still do so by way of accounting policy choice. To qualify for separate recognition, an intangible asset must still meet the general recognition criteria for all intangibles but need only be separable or arise from contractual or legal rights. CCAB noted that this amendment might be particularly relevant for certain business combinations involving LLPs, for example, when two LLPs come together but where no cash is paid and no additional amounts of purchase consideration are identified. In this situation, if substantial intangible assets are recognised on acquisition it can give rise to negative goodwill. CCAB concluded that further guidance on the new accounting policy choice would be helpful as taking up this policy choice could potentially increase the amount of negative goodwill recognised in such situations.
- BC 76. The definition of a group reconstruction in FRS 102 was extended to include the transfer of the business of one group entity to another; and the transfer of the business of one group entity to a new entity that is not a group entity but whose equity holders are the same as those of the parent. Although the extended definition does not alter the accounting treatment set out in Appendix 4 (paragraph 5) of the SORP, the appendix was updated to reflect the amended definition.
- BC 77. Two respondents raised concerns about inconsistencies in how 'automatic divisions' of profit are accounted for in practice. While no clarifications to the SORP were made as part of the 2018 LLP SORP, CCAB concluded that this matter would be specifically considered as part of the 2019 annual review with any proposed amendments consulted on when the SORP was next updated.

Changes made by SORP 2022

- BC78. The 2018 annual review of the LLPs SORP highlighted potential diversity in practice over interpreting whether a division of profit is automatic or not in certain situations. CCAB reviewed this matter and concluded that further guidance should be added to the SORP to help determine whether a division of profits is made on a discretionary basis, as opposed to on an automatic basis. In addition, CCAB concluded that confusion has arisen over the meaning and use of certain terms within the SORP. In particular, the meaning (within the SORP) of the terms relating to the allocation, division, and distribution of profits. CCAB concluded that a review of the terms relating to the allocation, division and distribution of profits should be carried out to ensure that defined terms are clear and accurate, and that all terms (both defined and undefined) are used consistently throughout the SORP.
- BC79. As part of its deliberations, CCAB also noted that part of the confusion is likely to have arisen from the fact that terms are often used in members' agreements interchangeably and, in some cases, in a way that is different to the usage in the SORP. CCAB concluded it would be helpful for the SORP to highlight in paragraph 31B how different terminology may be used in members' agreements compared to the SORP, and that accordingly it is important to focus on the underlying principles set out in the drafting of the agreement rather than the terminology used within members' agreements.
- BC80. In deciding what additional guidance might be needed and the terms that should be used and defined in the SORP, CCAB first considered the process for the payment of profits by LLPs to members. CCAB concluded that for legal and practical purposes, the payment of profits by LLPs to members typically involves the following three separate steps:
- 1) Allocation (attribution or sharing) ie, allocating shares of profit to members, but without them having the right to receive those profits.
 - 2) Division ie, the mechanism by which profits become a debt due to members.
 - 3) Distribution ie, actually paying the cash to the member. This is distinguished from drawings on account of profit.
- BC81. CCAB concluded that it would be helpful to include the guidance outlined in BC80 in the SORP and to make clear that the first two steps may not happen sequentially ie, steps 1 and 2 could be reversed or happen simultaneously. Having set out these steps, CCAB further concluded that improvements could be made to the terminology and definitions used to describe divisions of profit occurring in Step 2 as this is the key step in determining the appropriate accounting. As a result, the LLPs SORP has been updated to define 'divided profits', 'division of profits' and 'discretionary division of profit' in the definitions section. CCAB concluded that the existing definition of 'automatic division of profits' was sufficiently clear but made some minor consequential amendments and repositioned the definition so that all defined terms relating to divisions of profit appear together in the SORP. The new and revised definitions relating to divisions of profit appear in paragraphs 11A and 11B.
- BC82. In the 2018 version of the SORP, the term 'allocated profit' was defined as 'Profits (after deducting members' remuneration charged as an expense) that have been allocated during the year as a result of the members deciding on a division of profits.' CCAB noted that when considering the three steps outlined in BC80 and the proposed new terminology outlined in BC81, the term 'allocated profit' is no longer appropriate as it is essentially referring to profits divided on a discretionary basis. As CCAB has updated the LLPs SORP for a new definition for 'discretionary division of profits' the term 'allocated profits' has been deleted as a defined term. In the few instances that the term 'allocated profits' was referred to in the main body of the previous version of the LLPs SORP it now refers to allocating (or sharing) profits

to members, but without them having the right to receive those profits ie, in accordance with Step 1 outlined in BC80.

BC83. Further consequential amendments have been made to the definitions set out in paragraphs 8-24 in order to reflect the terminology used to describe the three steps for payment of profits as outlined in BC80. This includes the previous term 'unallocated profits' which CCAB has amended to 'undivided profits'. CCAB also took the opportunity to propose some minor amendments to other definitions in the SORP with the objective of improving overall understanding of the defined terms. A further review of the SORP was carried out to ensure that the new and revised definitions are used consistently throughout the SORP. This resulted in a number of minor proposed amendments throughout the SORP.

BC84. As noted in BC78, the 2018 annual review of the LLPs SORP highlighted potential diversity in practice over interpreting whether a division of profit is automatic or not in certain situations. CCAB concluded that while the SORP already includes guidance on determining whether profits are divided on an automatic or discretionary basis it would be helpful to expand this guidance to consider different scenarios that CCAB understands arise in practice. As a result, additional guidance setting out the relevant accounting considerations when determining whether a division of profits is discretionary has been added to the SORP. The additional guidance is intended to supplement existing guidance in the SORP and does not change underlying requirements or guidance.

BC85. In addition, the Steering Group decided to take this opportunity to streamline the SORP to ensure that the guidance on the division of profits is presented together, to reduce duplication of any guidance, and to improve the overall flow of the document. The table below outlines which guidance has moved, noting the previous and proposed paragraph numbers.

New paragraph number	Previous paragraph number
Paragraph 11B	Paragraph 10
Paragraph 31A	Appendix 2, paragraph 1
Paragraph 31F	Paragraph 48 (footnote)
Paragraph 33A	Appendix 2, paragraph 2
Paragraph 33B	Appendix 2, paragraph 3
Paragraph 34A	Paragraph 38
Paragraph 34B	Paragraph 39
Paragraphs 34C	Appendix 2, paragraph 5
Paragraph 42D(1)	Appendix 2, paragraph 7
Paragraph 42E(1)	Appendix 2, paragraph 8
Paragraph 45A	Paragraph 35
Paragraph 45B	Paragraph 36
Paragraphs 48B	Paragraph 24 (part of)
Paragraph 49A	Paragraph 47
Paragraph 49B	Appendix 2, paragraph 3A

Paragraph 49C	Appendix 2, paragraph 3B
Paragraph 49D	Appendix 2, paragraph 3C
Paragraph 50A	Paragraph 48 (part of)

As a result of the re-ordering and paragraph number changes, paragraph 50A under the previous version of the SORP (within 'members' remuneration: presentation and disclosure') has been updated to paragraph 50J, although its location remains unchanged.

- BC86. CCAB has also taken this opportunity to make a small number of additional minor amendments throughout the SORP. These proposed amendments are intended to clarify existing guidance, for example in relation to drawings on account, and to maximise consistency in the terminology, particularly when referring to profits. These minor proposed amendments do not change the existing requirements or guidance and are not intended to change the meanings of terms used in the SORP.
- BC87. During the course of the 2022 update to the SORP, CCAB identified some diversity in practice for how divisions of profit (automatic and discretionary) are presented in the cash flow statement. This diversity arises when divisions of profit are in effect a combination of payments for services rendered to the LLP and returns on capital provided. CCAB noted that determining whether profit distributions should appear as operating or financing cash flows will depend on the business of the LLP and requires judgement. CCAB considered whether it would be helpful to provide more prescriptive guidance on this matter but concluded that this might result in arbitrary splits being made in the cash flow statement, which would not provide useful information to users of the accounts. Instead, CCAB concluded that the SORP should set out the basis for alternative classifications of cash flows relating to profit distributions. The SORP has been amended to require LLPs to disclose their accounting policy for classifying distributions of profits in the cash flow statement and that cash flows be classified consistently from period to period.
- BC88. In November 2018, The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SI 2018/1155) introduced the requirement for large LLPs and groups to include an energy and carbon report as part of their annual report. As paragraph 25 of the SORP summarises the required elements of an LLP's annual report, CCAB concluded that the SORP should be updated to reflect this new requirement. The requirement to produce an energy and carbon report is also referred to in proposed paragraph 1C of the SORP.
- BC89. No changes are proposed to this draft SORP as a result of the amendments to FRS 102 for multi-employer defined benefit plans, interest rate benchmark reform (phases 1 & 2) and COVID-19-related rent concessions.
- BC90. Two respondents to ED SORP 2021 noted that the changes made by SORP 2022 may require some LLPs to revisit members' agreements and that in some instances this may result in different conclusions being reached on the treatment of profits in the LLPs accounts. It was suggested that the LLPs SORP might provide guidance on the appropriate accounting treatment for any adjustments required as a result of any changes in interpretation. The LLPs SORP Steering Group deliberated this matter and concluded that the changes made by SORP 2022 are not intended to change the underlying accounting requirements for the treatment of LLP profits. Rather, the amendments provide guidance on the application of the underlying requirements, for example, by setting out the relevant accounting considerations when determining whether a division of profits is discretionary or automatic. If, on consideration of the

additional guidance, an LLP reaches a different conclusion regarding the treatment of profits, it should follow the relevant accounting requirements as set out in Section 10 *Accounting Policies, Estimates and Errors* of FRS 102. Therefore, the Steering Group concluded that it would not be appropriate for the LLPs SORP to provide any further guidance on this matter.

Changes proposed in the draft LLPs SORP 2024

- BC91. When the draft 2022 LLPs SORP was issued for public comment in 2021, respondents were asked to provide details of any other areas where further guidance might be helpfully added to the SORP. In response, a number of matters were raised for consideration by the Steering Group. Each of these matters was deliberated by the Steering Group and while in some cases it was concluded that no changes should be made to the SORP, it was agreed that additional guidance could be helpfully added to address specific concerns about certain scenarios relating to the sharing of group profits and amounts payable to former members. As the SORP is currently silent on the specific matters raised the Steering Group concluded that further guidance would help reduce diversity in practice in these cases.
- BC92. The two matters relating to sharing of profits include:
- Cases where a parent LLP has a subsidiary that is also an LLP and that will therefore need to be consolidated into the parent's group accounts. The Steering Group concluded that it would be helpful to add guidance on the appropriate treatment of members' debt and equity interests in the subsidiary LLP for the purposes of determining whether a non-controlling interest in the net assets of the group is recognised. This additional guidance is outlined in paragraphs 119A – 119F.
 - Situations where an LLP may have two distinct types of members, both providing capital to it: those that provide services in return for a share of profits and those that do not provide any substantive services to the LLP, but still receive a share of profits. The Steering Group concluded that it would be helpful to provide guidance in the SORP on the treatment of profits which are automatically divided to members who do not provide any substantive services to the LLP. The additional guidance is outlined in paragraph 34D together with Example 11 in Appendix 2. The addition of paragraph 34D prompted the Steering Group to conclude that the distinction between members that provide services to the LLP and members that do not provide any substantive services to the LLP could be made clearer throughout the SORP. Therefore, reference to when a member does not provide any substantive services to the LLP has been clarified throughout the SORP.
- BC93. Having updated the guidance in relation to the sharing of profits as noted in BC92, the Steering Group also concluded it would be helpful to add notes below Exhibits A and D to provide additional clarity as to when the illustrative presentations might not be appropriate in scenarios where profits are automatically divided.
- BC94. The Steering Group also concluded that it would be helpful to provide guidance on certain narrow scenarios in which section 26 of FRS 102 might apply. One particular scenario that was identified is when a former member will become entitled to a proportionate share of disposal proceeds in the event that the business of the LLP is sold within a specified timeframe after the member has retired. Guidance has been added in paragraphs 87A – 87C and changes are proposed to paragraphs 76, 76A, 76B, 78, 79C, 80, 80A and 80D (formerly paragraph 80A).
- BC95. The draft LLPs SORP 2024 has also been updated to reflect the new requirements for certain LLPs to provide climate-related financial disclosures in either the strategic report, if one is prepared, or in the

energy and carbon report otherwise.

- BC96. The changes proposed in the draft LLPs SORP 2024 do not introduce new accounting requirements but rather provide guidance on existing accounting requirements or reflect regulatory requirements that have already come into effect.

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