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Dear Madam,

BDO LLP response to ‘Draft Statement of Recommended Practice - Accounting by Limited Liability Partnerships (LLPs SORP)’

We are pleased to have the opportunity to comment on the proposed amendments to the LLPs SORP set out in ‘Draft Statement of Recommended Practice - Accounting by Limited Liability Partnerships (LLPs SORP) August 2023’ (the ‘Draft SORP’).

We are supportive of the amendments proposed in the Draft SORP. In particular, we welcome the additional guidance in Appendix 2, Example 11, around the treatment of the automatic division of profits to members who do not provide substantive services to the LLP as this will help enhance consistency within the market.

Our responses to the specific questions asked in the Draft SORP are set out in an appendix to this letter.

If you wish to discuss any of the points further, please do not hesitate in contacting me directly.

Yours sincerely,

Anthony Appleton
Partner
For and on behalf of BDO LLP



Appendix: Responses to the questions asked in the consultation

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.

Yes, we agree with the proposed amendments in the Draft SORP.

Similar to paragraphs 25A and 25B, we recommend that paragraph 25D refers to the government guidance available in relation to these Regulations: BEIS non-binding guidance on [Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs](#).

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?

We have not seen the specific need for this guidance however we do not object to its inclusion within the LLP SORP. We agree with the proposed changes with the following observations:

- The question above (and BC94) refers to paragraph 80D. There is however no paragraph 80D in the Draft SORP.
- Paragraph 87B should say 'all profits have been divided' rather than 'distributed' to maintain a consistent use of terminology, inline with the definition in paragraph 11B.
- If retaining this additional guidance, greater clarity over when a transaction on an LLP's capital could be a share-based payment should be provided, explaining that section 26 of FRS 102 could only apply to an LLP if it has capital classified as equity. This is because if capital is wholly classified as a liability then the definition of a share-based payment arrangement in FRS 102 (which includes reference to the entity's equity instruments) would not be met.

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?

We agree that this guidance is needed and will help ensure consistency of treatment across LLPs, especially given the varied group structures in which LLPs are involved.

We agree with proposed changes although suggest that consideration is given to whether this guidance should also address how members remuneration charged as an expense within the subsidiary LLP entity accounts is presented within the parent's group accounts, both where the members of the subsidiary LLP and the parent LLP are different persons, and where the members of the subsidiary LLP are also members of the parent LLP.

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, Statement of Recommended Practice Accounting by Limited Liability Partnerships 6 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?

We strongly agree that this guidance is needed and will enhance consistency of treatment across LLPs.

We generally agree with the proposed changes but have the following comments:

1. Paragraph 34D

It is unclear why paragraph 34D references paragraph 48 which discusses the recognition of profit division as an expense in the profit or loss. If the reference is meant to be to the 'Automatic division of guidance' section of the SORP then the reference should be to paragraph 46.

2. Example 11 - Initial recognition, third paragraph

'Accordingly, the amount subscribed by the non-working members will be initially recognised as a financial liability.'

While we agree that in practice, classification of the capital subscribed as a financial liability in its entirety is likely to be the common appropriate accounting treatment, FRS 102.22 requires preparers to assess the classification of a financial instrument as a financial liability, equity or a compound instrument.

Dependent upon the terms of the contractual agreement between the LLP and the member, it could be possible for the capital subscribed to be classified as a compound instrument.

We recommend that this sentence is updated to reflect this accounting requirement and suggest the following:

The obligation to automatically divide profits represents a right to future profits which must be recognised as a financial liability. Whether the capital subscribed is recognised wholly as a financial liability (this is likely to be the case where the capital is repayable) or a compound instrument with both liability (the right to future profits) and equity characteristics must be determined in accordance with FRS 102.22. This will be dependent upon the facts and circumstances of the specific agreement between the LLP and the member.

3. Example 11 - Subsequent recognition, fourth paragraph

The guidance on subsequent treatment under FRS 102 refers to the financial liability (being the right to a share of future profits) as an ‘embedded derivative’. This reference is before the judgement of whether the definition of a derivative is met or not has been performed and so should instead refer to it as the financial liability.

‘...depending on the judgement over whether the embedded derivative, being the right to a share of future profits, meets the definition of a derivative...’

The guidance on subsequent treatment refers to the definition of a separable embedded derivative. Whether the instrument can be accounted for at fair value through profit or loss is dependent on whether it has the characteristics of a derivative as defined in IFRS 9 Appendix A. It is unclear why the Draft SORP specifically refers to ‘separable embedded’ derivatives and references IFRS 9.4.3.1 rather than referring simply to a derivative as defined in Appendix A of IFRS 9.

‘...would not meet the definition of a separable embedded derivative in IFRS 9 [IFRS 9.4.3.1].’

4. Example 11 - FRS 102 reference, fourth paragraph

The reference to [FRS 102.11 Example 10] should be to [FRS 102.11.9A Example 10].

5. Example 11 - Subsequent measurement, fourth and fifth paragraphs

The paragraph on subsequent measurement under IFRS 9 states that LLPs are most likely to measure the financial liability at amortised cost (IFRS 9.B5.4.6 relates to amortised cost measurement) while the paragraph on subsequent measurement under FRS 102.12 highlights that judgement may be required to determine whether the financial liability is measured at amortised cost or fair value through profit or loss.

As FRS 102.12.8(c) only permits subsequent measurement of a financial liability at fair value through profit or loss where this is permitted by the Regulations, which is broadly where this would be permitted under IFRS, the level of judgement under FRS 102 and IFRS 9 would be expected to be consistent. As currently drafted in the Draft SORP there appears to be greater judgement required under FRS 102 than IFRS 9. We question why the guidance is not as directional on subsequent treatment under FRS 102 as it is on subsequent treatment under IFRS 9.

‘...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...’

‘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.’

6. Example 11 - Illustrative journal entries

It would be useful to users of the SORP for the illustrative journal entries to clarify where the 'Cr Liability to member' entries would be expected to be presented within the LLP Balance Sheet (Appendix 1, Exhibit A/B) and within the movements in members' interests table per paragraph 60. This will help ensure consistency of presentation.

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]

Yes. As the changes are predominately clarifications rather than introducing new requirements, we agree with a 1 January 2024 effective date.

Question 6

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

We have no further comments on the draft LLP SORP other than to note:

- Appendix 1 - Exhibit D

The second bullet point says: 'exceeding the profits generated in that period'. To both be consistent with the wording used in Exhibit A, and to clearly differentiate between statutory profits and profits as calculated for the purposes of distributions, this should say 'exceeding the profits for that period reported in the statutory financial statements'.