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27 October 2023

Dear Sir/Madam

**Invitation to comment on the Draft Statement of Recommended Practice - Accounting by Limited Liability Partnerships**

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Draft Statement of Recommended Practice - Accounting by Limited Liability Partnerships (“LLP SORP”) which is proposed to have an effective date of 1 January 2024 with earlier adoption permitted.

Grant Thornton UK LLP is a leading financial and business adviser with offices in 26 locations nationwide and more than 25,000 individual and 15,000 corporate and institutional clients. The Grant Thornton global organisation is one of the world’s leading organisations of independent assurance, tax and advisory firms. Grant Thornton member firms operate in over 100 countries.

In summary we are supportive of the proposed amendments to the LLP SORP. However, we have raised in our detailed responses several substantive challenges to the proposed amendments, including the following:

- Regards the proposed amendments to paragraph 119E. We do not believe that the example provided, where an expense is only recognised in the group accounts upon the division of the subsidiary profits, is consistent with the substance of either a profit-sharing arrangement or a remuneration scheme. Our view is that an expense should be recognised in the group accounts as the services are provided where the substance of the transaction is a remuneration scheme. Alternatively, if the profit-sharing arrangement is (in substance) a transaction with the members of the parent and the division of profits is at the discretion of the parent, the amount of the divided profits should be treated as an appropriation from equity.
- We believe further clarification of the subsequent accounting entries added to Example 11 of Appendix 2 is required. We do not agree that the fair value remeasurement of the obligation to pay future profits to members who do not provide services should result in the LLP recognising an expense. In our view, this is not reflective of the economic substance. We believe there is a requirement to record a corresponding “residual” entry which is currently not considered in Example 11 of Appendix 2.

We set out our detailed responses to each of the questions raised in the attached Appendix.

Yours faithfully

A handwritten signature in black ink, appearing to read 'J Shaw', with a horizontal line under the 'w'.

Jonathan D Shaw

Director, NAS- Financial Reporting

Enc: Appendix with detailed responses

**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.

We support the inclusion of draft paragraph 25D in the SORP as it will be a helpful reminder of the new requirement for climate-related financial disclosures to be included in the annual report of an LLP.

**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 consider that arrangements within the scope of Section 26 are likely to be rare, but we agree that it is helpful to provide guidance should such scenarios arise.

We have the following detailed comments on the proposed guidance:

- The foot note at the bottom of page 34 refers to “no subsequent measurement to fair value”. We believe this should say no subsequent “remeasurement” to fair value.
- Paragraph 87B states “In situations where all profits have already been distributed, this would result in a loss being recognised”. It is not clear what is intended by this, and whether it is referring to a situation where profits before annuities are subject to automatic division. The reference to profits already being distributed is unclear. As defined in 31B, a distribution is paying cash to the member, as opposed to ‘Division’ which is the point at which profits become a debt due to members. It is consequently unclear why profits previously being distributed would impact whether there is a loss.
- Paragraph 87D – the example should make it clear that it is the LLP who is required to pay the former member, for the arrangement to be cash settled. The Applicable guidance could be updated as shown:
 

“The appropriate accounting would depend on the individual facts and circumstances of each case. For example, if the amount payable **by the LLP to the former member** 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.”

**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?

Paragraph 119D appears to be referring to a situation where profits in the subsidiary LLP are not automatically divided, and all members are providing services. We consider it would be helpful to clarify this.

We further suggest that paragraph 119D be updated to refer to 'Members' other interests – other reserves classified as equity of the subsidiary' rather than referring to the profit and loss reserve of the subsidiary.

We note that paragraph 119E refers to parent 'shareholder' interests. As there are no shareholders of an LLP we recommend, for consistency, that 'shareholder' is replaced with 'equity'.

Our reading of the first part of the example in paragraph 119E is that, in substance, there is no non-controlling interest ("NCI") i.e., the equity balances are parent shareholder interests only.

The second part of the paragraph suggests that remuneration is only recognised in the group accounts when the equity balances of the subsidiary are subsequently divided. This implies that, in the group accounts, an income statement charge (members' remuneration charged as an expense) would be recognised at the point the profits of the subsidiary are divided (which could be in a period after the services were rendered). We do not believe this is consistent with the substance of either a remuneration scheme or a profit-sharing arrangement where there is discretion over the division of profits. However, if the intention of paragraph 119E is that the profit share arrangement should be accounted for as a remuneration scheme under Section 28, then we would expect the expense for the profit-sharing arrangement or the remuneration scheme to be recognised in the group accounts as the services are rendered, as opposed to when amounts are paid to members.

However, we note that if the intention of this paragraph is for the accounting to "look through" the subsidiary's equity structure, i.e., account as though the group's profits are being allocated to the members of the parent, at the discretion of the parent in return for services, we would expect the liability to members to be recognised in the group accounts at the point the subsidiary's profits are divided, and the amount of the divided profits to be recognised as an appropriation deducted from equity in accordance with paragraph 50A.

We would appreciate clarification as to why it is deemed appropriate to record an expense in the Group accounts at the point that the division of profits occurs in the subsidiary.

**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?

We agree that guidance is required in the SORP to deal with the accounting treatment that should be applied to the automatic distribution of profits to members of an LLP who do not provide any substantive services.

Example 11 – The reference FRS 102.11 Example 10 could more helpfully be given as FRS 102.11.9A Example 10.

Conceptually, we do not agree with the proposed accounting in Example 11 which implies that a “loss” should be recognised. The following narrative is included:

*“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 is unclear, but our understanding is that the resulting loss would be allocated to “other amounts” in the equity section of the LLP balance sheet. In our view this is not consistent with the underlying accounting. The requirement to recognise a liability to pay future profits is required by Sections 11 and 12 of FRS 102 to account for the contractual obligation to pay to members a share of the LLP’s future profits. However, despite the accounting treatment required by the accounting standards, in substance, the LLP itself has not incurred any economic loss.

For example, if we take the following scenario:

- A newly incorporated LLP purchases a car park, which is financed by amounts advanced by members. All profits are automatically allocated to members as a return on their investment. Both members are corporate entities who do not provide any substantive services.
- The initial purchase price was £1 million.
- At year end, due to several new office blocks being erected in the vicinity significantly increasing the expected future revenue the car park will generate, the fair value of the obligation to pay future profits is £2 million.
- The LLP reported a profit for the year of £ 590,000.

Based on the guidance in example 11, we believe the proposed members section of the P&L and Balance sheet would be as follows:

Car Park LLP Annual report and accounts – Year ended 31 December 2023	Before £'000	Adjustment £'000	Final £'000
<b>Income statement (extract)</b>			
Profit for the year before members' remuneration	590	-	590
Members' remuneration charged as an expense	(590)	(1,000)	(1,590)
<b>Loss for the year for discretionary division amongst members</b>	<b>-</b>	<b>(1,000)</b>	<b>(1,000)</b>
<b>Balance sheet (extract)</b>			
Net assets attributable to members	1,590	-	1,590
Represented by:			
Members' capital classified as a liability	1,000	-	1,000
Other amounts	590		590
Liability for future profits	-	1,000	1,000
	1,590	1,000	2,590
Members' other interests			
Members' other interests – other reserve classified as equity	-	(1,000)	(1,000)
	1,590	-	1,590
Total members' interests			
Loans and debts due to members	1,590	1,000	2,590
Members' other interests	-	(1,000)	(1,000)
	1,590	-	1,590

We do not believe the above is representative of the economic substance because in this instance the LLP has recognised a loss due to the remeasurement of the obligation to pay future profits to members. This is not an economic loss which will be borne by the LLP i.e., there is no actual cost to the LLP. In other words, if these future profits are not earned by the LLP, they will not be able to be divided and allocated to members. Or put another way, if the LLP sold the car park for £2 million which represented the fair value of that asset, the LLP would be able to divide the gain on the sale of the asset with members as well as distributing the balance of the proceeds. It would not 'recover' the £1 million that is proposed to be reported as a deficit within the LLP's equity balances and just return to members their capital invested of £1 million.

In our view, the correct amount to report for total members' interests is £2,590,000 which because of the legally required format of the balance sheet requires the recognition of a 'residual' balancing entry of:

Dr Amounts due to members (residual)	£1,000,000
Cr Members' remuneration charged as an expense	£1,000,000

In the light of our comments above, we consider that it would be helpful to expand the double entries in Example 11 to demonstrate the need for a residual entry within members' interests (as described above).

*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 the subsequent reporting date*

Dr Members' remuneration (P&L) \* 280  
Cr Liability to member 280  
Dr Liability to member (residual) 80  
Cr Members remuneration (P&L) \*\* 80

\* 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)

\*\* This represents the allocation to members of losses arising from recognising the remeasurement of the liability for future years (£1,080 – £1,000 = £80))

**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]

We agree that the SORP requires some means of identification so that preparers know what version to refer to. However, the use of an effective date may imply that the changes required are resulting from either a change in GAAP or some new interpretation which is not within the mandate of a SORP setting body.

We recommend that the basis for conclusions provides an explanation of the purpose of the effective date. For example, it would be inappropriate for a preparer to conclude that the new guidance proposed only applies to accounting periods commencing on or after 1 January 2024.

**Question 6:**

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

We acknowledge the revisions that have been made to the SORP to help preparers to determine whether or not the division of profits is automatic or at the discretion of the LLP. Despite these changes, we are aware of diversity in practice in the interpretation of members' agreements such that LLPs that internally describe themselves as, for

example, a full distribution partnership find clauses in their agreements that enable them to conclude that there is no obligation to divide profits despite that not reflecting the underlying substance of the intent of those clauses.

However, in the absence of a publicly available members' agreement it's virtually impossible for a reader of a set of LLP accounts to assess whether the judgement made by the LLP concerning the division of profits is appropriate. We recommend that the SORP setting body reflects about how it assesses whether there is widespread diversity in the application of its guidance.

In addition, we consider that clarification and guidance could helpfully be provided in relation to the classification of cashflows in the cashflow statement:

The current guidance in Paragraph 74 A States "Drawings on account and distributions of profits (discretionary or automatic)" are classified as Operating or financing cash flows. We consider that it would be helpful to provide additional guidance with regard to automatic distributions of profits, clarifying that where substantive services are provided this would normally be classified as operating, and that if substantive services are not provided this would be a return on capital, and consequently classified as financing.

The current guidance in paragraph 74A suggests that repayment of debt to members would be classified as financing (without defining what is meant as debt). We note that as profits become a debt due to members when divided, this could be read as requiring all distributions of divided profits to be classified as financing.

We note that paragraph 75 of the SORP states 'Where members are not employees, section 28 of FRS 102 does not apply. However, it's not clear to us how this reflects the substance of the arrangement with members who are providing services as though they are employees yet, in law, are not employees because of the legal structure of an LLP. In our view, the application of Section 28 would reflect the economic substance of the transaction and doing so would be consistent with the requirements of paragraph 8 of section 2 of the standard.