TECH 6/02

ACCOUNTING BY LIMITED LIABILITY PARTNERSHIPS

Statement of Recommended Practice on Accounting by Limited Liability Partnerships, issued by the Consultative Committee of Accountancy Bodies in May 2002.

The Consultative Committee
of Accountancy Bodies

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The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Chartered Institute of Public Finance and Accountancy

Statement of Recommended Practice

Accounting by Limited Liability Partnerships

May 2002

ISBN 1-84152-127-2

STATEMENT OF RECOMMENDED PRACTICE

ACCOUNTING BY LIMITED LIABILITY PARTNERSHIPS

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The ASB's Statement on the SORP

The aims of the Accounting Standards Board (the ASB) are to establish and improve standards of financial accounting and reporting, for the benefit of users, preparers, and auditors of financial information. To this end, the ASB issues accounting standards that are primarily applicable to general purpose company financial statements. In particular industries or sectors, further guidance may be required in order to implement accounting standards effectively. This guidance is issued, in the form of Statements of Recommended Practice (SORPs), by bodies recognised for the purpose by the ASB.

The Consultative Committee of Accountancy Bodies (the CCAB) has confirmed that it shares the ASB's aim of advancing and maintaining standards of financial reporting in the public interest and has been recognised by the ASB for the purpose of issuing SORPs. As a condition of recognition, the CCAB has agreed to follow the ASB's code of practice for bodies recognised for issuing SORPs. The code of practice sets out procedures to be followed in the development of SORPs. These procedures do not include a comprehensive review of the proposed SORP by the ASB, but a review of limited scope is performed.

On the basis of its review, the ASB has concluded that the SORP has been developed in accordance with the ASB's code of practice and does not appear to contain any fundamental points of principle that are unacceptable in the context of current accounting practice or to conflict with an accounting standard or the ASB's present plans for future standards.

May 2002

PREFACE

Background to the SORP

This Statement of Recommended Practice (SORP) is issued by the Consultative Committee of Accountancy Bodies (CCAB), the members of which are:

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

The Accounting Standards Board (ASB) has approved the CCAB for the purpose of issuing a recognised SORP for Limited Liability Partnerships (LLPs) incorporated in Great Britain under the Limited Liability Partnerships Act 2000 ('2000 Act'). As part of the process for obtaining this approval, the CCAB agrees to follow the ASB's Code of Practice for bodies recognised for issuing SORPs. The Code of Practice sets out procedures to be followed in the development of SORPs. These procedures do not include a comprehensive review of the proposed SORP by the ASB, but a limited review is performed.

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

(i) outlines the limited nature of the review that the ASB has undertaken; and

(ii) confirms that the SORP does not appear to contain any fundamental points of principle that are unacceptable in the context of current accounting practice, or to conflict with an accounting standard or the ASB's plans for future standards.

CCAB Steering Committee and Working Party

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 new form of legal entity. The process has been overseen by a Steering Committee, the membership of which is drawn from trades and professions which have member firms that can be expected to seek LLP status, including the accountancy and legal professions and the construction industry. The Steering Committee deals with strategy and high-level issues, while the Working Party concentrates on technical detail. Membership of these two groups during the development of the first edition of the SORP is set out below.

Steering Committee	
Graham Ward (Chairman)	The Institute of Chartered Accountants in England and Wales
Michael Foulds	The Association of Chartered Certified Accountants
James Gemmell	The Institute of Chartered Accountants of Scotland
Peter Graham	The Law Society
Nigel Llewellyn	Association of Partnership Practitioners
Andrew Nairn	Construction Industry Council
Frances Paterson	Construction Industry Council
Richard Turnor	Association of Partnership Practitioners
Observer	
David Dean	Department of Trade and Industry
Working Party	
Nigel Llewellyn (Chairman)	Deloitte & Touche
Jeremy Boadle	Smith & Williamson
James Carty	RSM Robson Rhodes
Kathryn Cearns	Herbert Smith
Fiona Crozier	
Ian Dinwiddie	Allen & Overy
John Oliver	Bacon & Woodrow
John Robinson	Barclays Bank plc
Michael Roden	KPMG
Peter Saunders	Deloitte & Touche
Desmond Wright	CCAB

Development of the SORP

The ASB approved the CCAB for the purposes of issuing a SORP on 2 March 2000. An Exposure Draft was published on 20 July 2001. As well as requesting comments on all aspects of the Exposure Draft, four issues on which the CCAB particularly sought views were also presented, as discussed in the Basis for conclusions in Appendix 2.

All responses to these questions and regarding other matters were carefully considered during the development of the final version of the SORP. The ASB approved the SORP for publication on 2 May 2002 and the first edition of the SORP *Accounting by Limited Liability Partnerships* was published on 29 May 2002.

Future editions of the SORP

In keeping with the ASB's Code of Practice, the CCAB will keep the SORP under review for changes in accounting practice and new developments. In particular, the status of SORPs may change if the UK Government decides to adopt international financial reporting standards wholesale; in which case, a substantial revision of the SORP may be required.

Any comments on this edition of the SORP may be addressed (in both hard-copy and electronic form) to:

The Consultative Committee of Accountancy Bodies
Moorgate Place
London EC2P 2BJ
Email: admin@ccab.co.uk

Comments will be regarded as on the public record unless confidentiality is requested by the commentator.

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.

STATEMENT OF RECOMMENDED PRACTICE
ACCOUNTING BY LIMITED LIABILITY PARTNERSHIPS

INTRODUCTION

Accounting requirements

1. The detailed accounting requirements relating to Limited Liability Partnerships (LLPs) are set out in the Limited Liability Partnerships Regulations 2001 (SI 2001/1090) (the 'Regulations'). The Regulations apply, with appropriate modifications, the accounts and audit provisions of the Companies Act 1985 for private limited companies to LLPs. Statements of Standard Accounting Practice (SSAPs), Financial Reporting Standards (FRSs), UITF Abstracts and other components of generally accepted accounting practice also apply to any financial statements of LLPs intended to give a true and fair view.

Scope and objectives

2. This statement applies to LLPs incorporated in Great Britain under the Limited Liability Partnerships Act 2000. It does not seek to set out all of the reporting requirements that apply to LLPs reporting under UK financial reporting standards and is intended to complement, not replace, accounting standards, which comprise FRSs, SSAPs and UITF Abstracts. This statement should therefore be used in conjunction with the Regulations and accounting standards rather than on a stand-alone basis. In the event of conflict, the Regulations and accounting standards take precedence over this SORP.

3. The recommendations of this SORP are applicable to all LLPs, as defined in paragraph 10.

Format and terminology

4. All the material in this Statement is an integral part of the SORP. However, the central principles are printed in bold in order to distinguish them from explanatory paragraphs.

5. 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

6. The following definitions apply within this SORP.

Allocated profit

7. Profits that have been allocated as a result of the members deciding on a division of profits.[1]

Designated members

8. 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 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

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1 The decision to divide 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 that will apply to profits after the members have decided to divide them 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. If the members agree to the automatic division of profits, the divided profits can be credited directly to the current accounts of the members without being first shown under the balance sheet heading ‘Other reserves’. Allocated profits are debts due to members which, unless otherwise agreed by the members, rank *pari passu* with ordinary creditors in the event of a winding up. The total amount of profit allocated following a decision to divide may be less (or more) than the amount of profit earned by the LLP in the year. The members may also agree not to withdraw profits allocated to them and to redesignate such debts owed to them as capital within members' other interests.

be no designated members, or only one, all members are deemed to be designated members.

Drawings

9. The payment in cash (or kind) of amounts to members. Drawings may consist of regular monthly payments or *ad hoc* payments; for example, in respect of current year's and/or prior years' remuneration (as defined).

Limited liability partnership (LLP)

10. A limited liability partnership incorporated in Great Britain under the Limited Liability Partnerships Act 2000.

Loans and other debts due to members

11. Members' interests that are debts of the LLP and are included in balance sheet item K in the accounts formats set out in the Regulations.

Members

12. 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' capital

13. Amounts subscribed or otherwise contributed by members for longer-term retention in the business. Such amounts may be withdrawn or converted to debt by agreement between the members (unless the members choose to enter into a binding obligation which restricts their ability to do so). Members' capital is a component of 'Members' other interests'.

Members' other interests

14. Members' interests other than debt due to them by the LLP, which constitute equity in the LLP and are included in balance sheet item L in the accounts

formats set out in the Regulations. Members' other interests include 'Members' capital', 'Revaluation reserve' and 'Other reserves'.

Members' remuneration

15. 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 allocated share of profits. The form that remuneration takes will normally be a matter of agreement between the members.

Post-retirement benefits of former members

16. Any post-retirement benefits, whether in cash or in kind, 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. Retirement benefits include 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.

Salaried remuneration of members

17. Remuneration that is payable to a member such that it falls to be treated as a charge against profits and not an allocation of profits because it is an obligation which the member can claim from the LLP without any decision or agreement to divide profits having been taken. Generally, such amounts are determined without reference to the assets or profits of the LLP, are payable *pro rata* over a given period and are payable by the LLP regardless of the existence or extent of profits. These amounts will include associated employment costs. As a matter of law, a member can also be an employee of an LLP – in this case, there will be a contract of employment between the two parties – and such remuneration covered by the employment contract is salaried remuneration to the extent that it is not determined by reference to the existence or extent of profit of the LLP. Agreements between the members to guarantee a minimum or specified remuneration for a particular member are not agreements between the LLP and that member and so do not fall within this definition.

Unallocated profit

18. Profits of the LLP that have been ascertained but have not been allocated because there has been no decision to divide them. After the profits have been ascertained, in the absence of any agreement between members to the contrary, the balance on profit and loss account would be unallocated profit and would need to be shown under ‘Other reserves’ on the balance sheet, pending a decision to divide the profits among the members. 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. This is a matter of construction of the members’ agreement. If that is the case, there will be no unallocated profits.[2]

THE CONTENTS OF THE ANNUAL REPORT AND FINANCIAL STATEMENTS

19. The Annual Report should comprise:

- **the financial statements;**
- **a statement of members’ responsibilities in relation to the production of financial statements;**
- **a report on the financial statements by a registered auditor, if required by the Regulations; and**
- **a report to the members (the Members’ Report).**

20. The financial statements, as defined by the Regulations and accounting standards, should, subject to the exemptions for small and medium-sized entities referred to in paragraph 21 below, comprise:

- **a profit and loss account, consolidated in the case of a group preparing consolidated accounts;**

[2] See the legal opinion in Appendix 1.

- **a statement of total recognised gains and losses (STRGL) in accordance with FRS 3 *Reporting financial performance*, consolidated in the case of a group preparing consolidated accounts;**
- **a cash flow statement in accordance with FRS 1 *Cash flow statements*, consolidated in the case of a group preparing consolidated accounts;**
- **a balance sheet for the LLP and, if it prepares group accounts, a consolidated balance sheet; and**
- **notes to the above financial statements.**

21. Exemptions from disclosure applicable to small and medium-sized entities may be applied in preparing the Annual Report of an LLP. Such exemptions may be from the requirements of the Companies Act 1985 (CA 1985) as modified by the Regulations, and/or from full accounting standards in cases where an LLP is eligible to apply the Financial Reporting Standard for Smaller Entities (interpreted as appropriate for LLPs).

22. The Members' Report should 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 branches[3] outside the UK;**
- **the identity of anyone who was a designated member during the year; and**
- **the policy of the LLP regarding members' drawings and the subscription and repayment of members' capital (see paragraph 39).**

23. The financial statements and related notes cannot on their own describe in full the financial performance of an LLP, nor by definition will they encompass non-financial performance matters that some LLPs will wish to communicate to

[3] As defined by s 698(2) CA 1985.

the users of the Annual Report. Although not a statutory requirement, the Members' Report offers a vehicle for such communication, with the disclosures listed in paragraph 22 required as a minimum.

THE APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRACTICE TO LIMITED LIABILITY PARTNERSHIPS

MEMBERS' REMUNERATION AND INTERESTS

Members' remuneration

24. The Regulations require the profit and loss account to disclose a total, being 'Profit or loss for the financial year before members' remuneration and profit shares'. The total of 'Salaried remuneration of members', as defined in paragraph 17 and described in paragraph 26, should be disclosed separately and deducted from this balance. The nature of 'Salaried remuneration of members' should be explained in a note to the accounts, showing a breakdown of amounts paid under employment contracts and other amounts. Disclosure on the face of the profit and loss account should be as follows:

Profit or loss for the financial year before members' remuneration and profit shares	**X**
Salaried remuneration of members	**(X)**
Profit or loss for the financial year available for division among members	**X**

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

26. 'Salaried remuneration of members' is defined in paragraph 17. A member of an LLP may be entitled to remuneration which in substance is employee remuneration rather than an equity share of residual profits. This would arise where the member has an employment contract with the LLP, but a member can

have a right to remuneration of this nature by contract between the member and the LLP, within the LLP agreement or by some other arrangement, rather than an employment contract. Where any element of members' remuneration falls within the definition of 'Salaried remuneration of members', it should be treated as an expense in the profit and loss account. The Regulations require disclosure on the face of the profit and loss account 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 Regulations, a line item described as 'Salaried remuneration of members' should be deducted as an additional expense. This includes related employment costs. Where a member receives both salaried remuneration and other remuneration, only the salaried remuneration element should be treated as an expense.

27. The treatment of members' remuneration in the profit and loss account is summarised in the following table.

Nature of element of a member's remuneration:	**Treat as:**
Remuneration that is paid under an employment contract	Expense, described as 'Salaried remuneration of members', and deducted after arriving at 'Profit for the financial year before members' remuneration and profit shares'
Other payments, representing a debt of the LLP not arising from a division of profits	
Fixed (or first) share of profits, representing a debt arising from a division of profits	Allocation of profit
Profit-share, representing a debt arising from a division of profits	

Members' interests

28. 'Loans and other debts due to members' (balance sheet item K) and 'Members' other interests' (balance sheet item L) should be disclosed separately on the face of the balance sheet. Balance sheet item L includes 'Members' capital', 'Revaluation reserve' and 'Other reserves', which are also each required to be disclosed separately on the face of the balance sheet.

29. The face of the balance sheet should show the net assets of the LLP by including a sub-total of balance sheet items A to K. In addition, 'Total members' interests', being the total of items K and L less any amounts due from members in debtors, should be disclosed as a memorandum item on the face of the balance sheet.

30. 'Loans and other debts due to members' (balance sheet item K) , while legally liabilities of the LLP, do not form part of the external financing of the LLP and may be redesignated as capital by the members. Consequently, these amounts should not be included in net debt of the LLP in the analysis of changes in net debt required by FRS 1 *Cash flow statements.*

31. Disclosure should be made under 'Members' other interests' and 'Loans and other debts due to members' of the amount brought forward from the previous year, the change in the year arising from the profit or loss for the financial year available for division among members, the amount allocated to members during the year and the balance carried forward at the end of the year. Disclosure 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):

	Members' Other Interests[4]				Loans and other debts due to members less any amounts due from members in debtors[5]	Total
	Members' Capital	Revaluation Reserve	Other Reserves	Total		
Amounts due to members Amounts due from members					X (X)	
Members' interests: balance at [date]	X	X	X	X	X	X
Remuneration of salaried members, including employment and retirement benefit costs					X	X
Profit (loss) for the financial year available for division among members			X	X		X
Members' interests after profit/(loss) for the year	X	X	X	X	X	X
Allocated profits			(X)	(X)	X	
Surplus arising on revaluation of fixed assets		X		X		X
Retirement benefits due to former members			(X)	(X)		(X)
Introduced by members	X			X	X	X
Repayments of capital	(X)			(X)		(X)
Repayments of debt					(X)	(X)
Drawings					(X)	(X)
Other movements	X	X	X	X	X	X
Amounts due to members Amounts due from members					X (X)	
Members' interests [date]	X	X	X	X	X	X

32. Any unallocated profits should appear under 'Other reserves' (balance sheet item L). Where the LLP makes a loss for the financial year that is not

4 Balance sheet item L.

5 Balance sheet item K less any amounts due from members in debtors. The analysis of amounts due to members is required in order to comply with the Regulations.

allocated to the members, the amount should be deducted from 'Other reserves'.

33. The members of the LLP may agree to allocate to the members a sum different from the amount shown as profit or loss for the financial year available for division among members. Amounts may, for example, be designated as capital or otherwise retained in the business as unallocated profits.

34. The notes to the accounts should explain where amounts in 'Loans and other debts due to members' (balance sheet item K) would rank in relation to other creditors who are unsecured in the event of a winding up. Details of any protection afforded to creditors in such an event which is legally enforceable and cannot be revoked at will by the members should be included in a note to the accounts. Where no such protection is afforded in respect of items shown under balance sheet item L, that fact should be disclosed.

35. The capital of an LLP may be reduced by agreement of the members either by repayment or by the conversion of capital into debt.[6] In the absence of agreement to the contrary, debt due to members will rank equally with debts due to ordinary creditors in a winding up. For these reasons, some LLPs may, in order to facilitate the obtaining of credit, decide to invest their capital with a degree of permanence by subordinating debt due to members to other ordinary creditors in a winding up.

36. The Regulations require disclosure of the amount of loans and other debts due to members falling due after more than one year.

37. The 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.

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6 Neither the 2000 Act nor the Regulations contain any provisions in relation to capital maintenance of an LLP, such as those in the Companies Act for limited liability companies.

38. The amount of debts owing to the LLP by members should be disclosed.

Other disclosures

39. **LLPs should disclose in the Members' Report the overall policy followed in relation to members' drawings, including an indication of the policy applicable where the cash requirements of the business compete with the need to allow cash drawings by members. Such disclosures should include any transfers of members' interests from capital to debt during the period and up to the date the accounts are approved. The policy under which members' capital is subscribed to, and repaid by, the LLP should also be disclosed.**

40. The 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). The Regulations also require disclosure of the profit (including remuneration) that is attributable (i.e., whether or not the profits have been divided) 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. The identity of this member need not be disclosed.

41. 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, these being the two items that are required to be disclosed by the Regulations, as discussed in paragraph 40. 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

42. **In the cash flow statement of the LLP, in place of the line item 'Equity dividends paid' required by FRS 1 *Cash flow statements,* the following should be shown as a minimum:**

Transactions with members and former members		
Payments to members	**X**	
Contributions by members	**X**	
Retirement benefits paid to former members*	**X**	
		X

* See the following section

RETIREMENT BENEFITS

Retirement benefits of employees

43. **Retirement benefits provided for employees of the LLP should be accounted for as required by FRS 17 *Retirement benefits.* This will include retirement benefits awarded to members that are based on the member's salary under an employment contract.**

Retirement benefits of former members: measurement and recognition

44. **The present value of the best estimate of the expected liability for future payments to a former member or in respect of a former member should be provided in the accounts at the date of the member's retirement, in accordance with FRS 12 *Provisions, contingent liabilities and contingent assets.***

45. Retirement benefits may be characterised as either 'pre-determined' or 'profit-dependent'.

(a) Pre-determined retirement benefits are amounts payable to former members that 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.

(b) Profit-dependent retirement benefits arise where former members receive, in effect, a share of the LLP's ongoing 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.

46. Whether retirement benefits are pre-determined or profit-dependent, the value of the liability should be based on the best estimate at the date of retirement of the current value of future cash flows relating to the retirement benefits. In the case of profit-dependent retirement benefits, it will therefore be necessary for the LLP to make a best estimate of the level of future profits of the LLP. Where there are many retirement benefits and/or the amounts are material, it may be necessary to take actuarial advice in calculating the liability.

47. Except in extremely rare cases, an LLP will be able to determine a range of possible outcomes for its post-retirement benefit obligations and will therefore be able to make an estimate that is sufficiently reliable to use in recognising the provision. In the extremely rare cases where no reliable estimate can be made, a liability exists that cannot be recognised, which should be disclosed as a contingent liability.

48. The liability should be recalculated annually to take account of changes in former members, financial estimates and actuarial assumptions.

Retirement benefits of former members: presentation

49. In the period in which a member retires, a transfer should be made from 'Members' interests' to 'Creditors: amounts falling due within one year', 'Creditors: amounts falling due after more than one year', and/or 'Provisions for liabilities and charges', as appropriate[7], within the balance sheet. The transfer should be recorded as a loss within the STRGL. The transfer from 'Members' interests' may be from general reserves or may be from a reserve that the members have chosen to set aside within 'Members' interests' for this purpose.

50. The amount of the liability in respect of retirement benefits due to former members is unrelated to current year performance of the LLP, representing rather the reorganisation of Members' Interests and the reflection of a continuing relationship with the members after their retirement. The loss represented by the liability should thus, when it is first recorded, be presented in the STRGL rather than the profit and loss account of the LLP.

51. Where, by choice of the members, amounts are set aside by the LLP before a member's retirement to provide for retirement benefits, these amounts should not be shown as a liability but should be included in a separate reserve within 'Members' interests' (part of balance sheet item L) and should be transferred from that reserve on the date of retirement (any further adjustments to make up the balance of the calculated liability being transferred from other reserves).

52. Investments in assets for the purposes of funding the post-retirement benefits of members should be disclosed separately either on the face of the balance sheet or in the notes to the accounts.

53. Subsequent changes in the amount of the liability, arising from changes in former members, financial estimates and actuarial assumptions, should be

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7 Depending on whether the amounts are fixed and when they fall due to be paid.

presented in the profit and loss account of the LLP within operating profit, and disclosed separately where material.

54. **Where the liability has been discounted (as required by FRS 12 where the effect is material), the unwinding of the discount should be presented next to the interest cost line in the profit and loss account.**

55. **Past service costs awarded after the date of a member's retirement should be recognised in full in the profit and loss account within operating profit as soon as the award vests in the former member. Settlement and curtailment gains and losses should also be recognised immediately in the profit and loss account.**

Retirement benefits of former members: disclosure

56. **The LLP's accounting policy note should disclose the LLP's policy in respect of provisions for retirement benefits and amounts due to former members. This should state that the liability is recognised as such only upon the member concerned ceasing to be a member and should state the basis for any amounts shown in the STRGL or the profit and loss account. Any actuarial assumptions used in the calculation of the liability should be disclosed.**

57. **A note to the accounts should be provided that gives an indication of the expected crystallisation of future retirement benefit liabilities in terms of likely timing and amounts.**

On transition to an LLP

58. **Where an LLP makes payments of retirement benefits to members of a predecessor partnership or other organisation, the extent to which the LLP has an actual or constructive liability (as defined by FRS 12) should be considered. Where an actual or constructive liability exists, this should be recognised in the balance sheet of the LLP as required by FRS 12. 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.

59. It is possible that an LLP which succeeds to the business of a partnership will not assume actual or constructive liability for retirement benefits 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.[8] 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 where this would aid clarity.

TAXATION

60. 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.

61. 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 are treated as other profits of the LLP, in that they should be included in 'Members' interests' or in 'Loans and other debts due to members', depending on whether or not division has occurred.

62. Tax withheld from members who subsequently retire from membership should be dealt with as any other balance due to former members.

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8 Whether such arrangements exist will depend on the terms of the agreement between the predecessor partners and the former member, as varied by any agreements entered into at the time the LLP assumes any specified other assets and liabilities of the predecessor partnership.

63. **In the group accounts of an LLP which include entities or organisations that are not partnerships or LLPs, such as companies, the tax liabilities of such entities should be recorded in the profit and loss account under the relevant heading and any related liability carried as a creditor in the balance sheet.**

STOCKS AND LONG-TERM CONTRACTS

64. **In respect of stock, the cost of members' time and related overheads should be accounted for in accordance with SSAP 9** ***Stocks and long-term contracts.***

65. When calculating the cost of stock or work in progress in accordance with SSAP 9, 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, i.e. 'Salaried remuneration of members' as defined in paragraph 17. However, regardless of whether the time input by a member is a cost to be included in stock, any overhead related to that time should be included in the cost of stock or work in progress.

BUSINESS COMBINATIONS AND GROUP ACCOUNTS

Entity and group accounts

66. **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) set out in FRS 2** ***Accounting for subsidiary undertakings*** **and FRS 5** ***Reporting the substance of transactions*****, modified where necessary to comply with the Regulations.**

Accounting for business combinations

67. The accounting treatment for business combinations which include one or more LLPs should have regard to the substance of the combination. Application of generally accepted accounting principles (GAAP) with respect to mergers and acquisitions should be considered in the context of both the group accounts and the entity accounts of the LLP.

68. 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. Consideration will be required to determine whether a particular business combination represents:

- an acquisition;
- a merger; or
- the granting of membership to one or more individuals.

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 be treated as either an acquisition or a merger in accordance with FRS 6 *Acquisitions and mergers.*

Acquisition accounting

69. Acquisition accounting is required when the conditions set out in FRS 6 to use merger accounting are not met.

70. Where acquisition accounting 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, the profit share promised to the new members in the enlarged LLP should 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 could indicate that the short-term excess amounts were part of the purchase consideration.

71. **Where it is not possible to value the consideration given in accordance with the requirements of FRS 7 *Fair values in acquisition accounting*, the best estimate of its value may be obtained by valuing the entity acquired.**

72. **Where the fair value of stock and work in progress used in acquisition accounting by LLPs cannot be ascertained from market value, consideration should be given to paragraphs 52–57 of FRS 7; in which case, the current cost would include only the cost of members' time, as discussed in paragraph 65 above.**

Merger accounting

73. **Merger accounting is required when all five of the specific criteria set down in FRS 6 indicate that a merger, rather than an acquisition, has taken place.**

74. When applying the five criteria to combinations involving LLPs, it may not be clear how to apply the guidance on size criteria set out in paragraph 68 of FRS 6. Accordingly, suitable alternatives for establishing relative sizes may need to be considered, such as respective revenues, number of members, profits, employees, relative voting rights, etc. Finally, the nature of the combination should be considered, to determine whether circumstances indicate that the size criterion should be rebutted.

Group reconstructions

75. **The transfer of all or the majority of the assets, liabilities and business of a partnership into an LLP incorporated for that purpose should be dealt with as a group reconstruction, except where the requirements of**

paragraph 13 of FRS 6 are not met, after taking account of the different legal nature of an LLP. The initial 'opening' balance sheet should follow the accounting policies of the LLP.

Considerations on transition from an existing partnership

76. Where existing undertakings are transferred into an LLP, the transfer should be accounted for as a group reconstruction, as noted in paragraph 75, where the conditions of paragraph 13 of FRS 6 are met.

77. Both start-up businesses and existing undertakings, including partnerships, may choose to incorporate as LLPs. Where there is a transfer of an existing undertaking to an LLP, it will be accounted for as a group reconstruction where the conditions of FRS 6 are met.

78. Single-entity LLPs that are formed by the transfer or incorporation of existing undertakings, including partnerships, should present corresponding *pro forma* amounts in the financial statements of the first period after incorporation where the cost and time involved in obtaining and collating such information is not excessive.[9] Where such corresponding amounts are disclosed, they should be stated on the basis of the accounting policies adopted by the LLP.

79. The restatement of comparatives to consistent accounting policies will often result in a difference between 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. Such differences should not be dealt with in the financial statements of the LLP.

[9] In relation to the required disclosure of corresponding amounts, LLPs are, in principle, no different from limited companies. A new limited company acquiring the existing business of a sole trader or partnership is not required to provide corresponding amounts for the previous year in its financial statements, although, in practice, *pro forma* amounts are often disclosed.

80. Pre-existing single (i.e. non-group) entities seeking to transfer their existing undertakings into LLPs may find that adopting GAAP, including the accounting recommendations set out in this SORP, will lead to a number of changes in accounting policy. Under such circumstances, LLPs should, where cost/benefit considerations permit, present *pro forma* corresponding amounts at the first balance sheet date together with a *pro forma* profit and loss account for the previous year, applying the same accounting policies as those adopted for the new LLP. The initial statutory period need not be a 12-month period.

81. Existing groups that, using merger accounting under a group reconstruction, put a new LLP at the top of the group (whether in order to convert to an LLP or as part of a group reconstruction) should present corresponding amounts in the financial statements of the period of the merger, as required by FRS 6.

PROVISIONS AND OTHER IMPLICATIONS OF FRS 12

82. FRS 12 *Provisions, contingent liabilities and contingent assets* applies in all respects to LLPs.[10]

83. While the application of FRS 12 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.

84. The basis of allocation of profits between members is a private matter and will usually be governed by the members' agreement referred to in the LLP

10 Professional services firms will apply FRS 12 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.

legislation. There is no reason why the determination of profits to be allocated to members cannot be based on different accounting policies from those applied to the financial statements of the LLP.

85. 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 where material should either be disclosed as a note to the accounts (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 FRS 12 and it is probable that the guarantee or indemnity will be called.

86. It is common practice within partnerships for partners to borrow to fund their capital and similar interests in a firm. Such arrangements may involve the firm entering into guarantees, indemnities or undertakings toward the lender concerned. Broadly similar arrangements may occur with regard to members of LLPs and the LLP itself.

87. 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.

88. 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.[11] Where a provision of this nature has been made in relation to a member who is a related party (see paragraphs 89–92), further disclosures should be given in accordance with FRS 8.

[11] 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

89. The provisions of FRS 8 *Related party disclosures*, 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 determines this. Predecessor partnerships of LLPs should be treated as related parties of the LLP.

90. 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.

91. 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. FRS 8 includes directors of companies as related parties by definition and the key management of a reporting entity is presumed to be a related party of that entity. Key management consists of those persons in senior positions having authority or responsibility for directing or controlling the major activities and resources of the group. Designated members are therefore likely to be related parties of the LLP.

92. The controlling party and ultimate controlling party of an LLP, if one exists, should be disclosed in accordance with FRS 8. This includes an individual or entity which has the ability to direct the financial and operating policies of the LLP, although that party may not be entitled to the majority of profits or have invested the majority of capital. It will also be necessary to consider the extent to which members are acting in concert in such a way as to be able to exercise control or influence over the LLP.

COMPLIANCE STATEMENT

93. **The note to the financial statements which deals with accounting policies should refer to the LLP's compliance with this SORP, or detail areas of non compliance and any reasons therefor, in accordance with FRS 18 *Accounting policies*.**

APPENDIX 1: LEGAL OPINION

The Consultative Committee of Accountancy Bodies has consulted Robin Potts QC on certain matters relating to the profits of a Limited Liability Partnership and has 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 2: BASIS FOR CONCLUSIONS

Introduction

1 The Exposure Draft of the Statement of Recommended Practice *Accounting by Limited Liability Partnerships* was published in July 2001. Some 30 letters of comment were received on the Exposure Draft. This summary sets out the main comments of substance that were considered by the CCAB Working Party and indicates how they were dealt with. It does not deal with:

(a) the many (and very helpful) detailed drafting comments that were received, most of which have been adopted in the redrafted SORP; and

(b) comments made by respondents that have no substance in relation to the SORP within the ASB's framework for financial reporting and for SORPs.[12]

2 The summary deals first with the specific questions raised in the Exposure Draft (and, for convenience, related comments received and issues raised) and then deals with other comments of substance. Any additional redrafting of the SORP represents attempts to:

(a) reorder the text in a more logical and user-friendly way;

(b) clarify the black/grey letter distinction; and

(c) bring wording more closely into line with relevant accounting standards.

Post-retirement benefits

Question 1(a)

Paragraph 44 of the draft SORP proposes that the present value of the best estimate of the expected liability for future payments to a former member should be provided in the accounts at the date of the member's retirement.

(a) Do you agree that this treatment should be applied to profit-dependent retirement benefits, where the retirement benefit is payable only to the extent that the relevant profits are earned?

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12 For example, one or two respondents stated that the accounting treatment recommended in the SORP should follow the tax treatment. As this does not represent the ASB's view of accounting as laid out in the Statement of Principles, it was not considered to be of great relevance to the Working Party's deliberations. Another example was that the comment that the accounting requirements should not make LLPs less attractive as a corporate vehicle.

3 The Working Party found this the hardest aspect of the SORP to deal with and intensive consultations took place with the ASB. Respondents expressed a wide range of views on the proper treatment of post-retirement benefits and this range of views was reflected in both the Working Party and the Steering Committee. A majority of the respondents did not agree that profit-dependent retirement benefits should be treated as liabilities.

4 The views and concerns of the respondents on this issue were made known to the ASB and the question was raised as to whether a liability for profit-dependent retirement annuities comes into existence under the conceptual framework on the retirement of a member, or whether a 'sleeping partner' equity arrangement continues to exist, i.e. so the amounts payable should be treated as analogous to dividends rather than payments for services. In addition, the Working Party was concerned about what an 'obligating event' is in relation to profit-dependent annuities and when the obligating event actually occurs.

5 The Working Party's view was that if, as required by the Regulations, all members' remuneration is not taken through the profit and loss account during members' tenure, it is anomalous to treat post-retirement payments in a different way. Several respondents suggested that the ideal theoretical solution was to make an allocation of the cost of members' time in the profit and loss account, i.e. that part relating to the generation of revenues, but it was suggested (and agreed by the Working Party) that this would be too difficult and arbitrary.

6 However, the ASB focused on the balance sheet and pointed out that, once a member retires and relinquishes his or her equity relationship with the LLP, then a liability for all remaining payments to the past member exists as defined by the conceptual framework and FRS 12 and this would include any obligations by the LLP to make payments in relation to retirement to the former members, whether this was determined as a fixed amount or measured in relation to profit achieved in any particular period.

7 The Working Party accepted that, under the existing conceptual framework, a liability exists for such retirement benefits, but suggested that the issue should be revisited once the debt/equity project under consideration by the International Accounting Standards Board (IASB) and the ASB is brought to a conclusion. The Working Party's view was that there is a change in the relationship of an LLP with a member on the date of the member's retirement, but that this is not adequately reflected in the SORP under the current model. In particular, the issue of when an obligating event occurs in relation to a profit-dependent annuity is a difficult conceptual one.

8 Given the need to reflect the existing framework, however, the SORP was redrafted to remove the distinction between pre-determined and profit-dependent post-retirement benefits, and hence in the final SORP both are treated in the same way (although both types are still mentioned, to show that the SORP requirements apply to both). The SORP requires a best-estimate liability to be recognised for all post-retirement benefits at the date of retirement of the member.

Question 1(b)

Paragraph 44 of the draft SORP proposes that the present value of the best estimate of the expected liability for future payments to a former member should be provided in the accounts at the date of the member's retirement.

(b) Do you agree that the liability should be calculated in accordance with the principles of FRS 17 Retirement benefits*?*

9 Commentators generally agreed with this proposal, although in the context of a majority who believed that there is no liability, at least for profit-dependent payments. Some commentators suggested that the recognition requirements of FRS 17 were also applicable, so that the liability should be recognised over the working life of the member.

10 FRS 17 is designed to deal with employer-employee relationships and how the costs of making a pension promise (for a defined benefit scheme) should be reflected in an entity's accounts. Where a member of an LLP is also an employee and receives retirement benefits under that employment contract, then FRS 17 will be applied in full and this is reflected in the redrafted SORP.

11 In the case of an LLP and a member, however, that employer-employee relationship does not exist (where the member does not receive salaried remuneration as defined in the SORP); consequently, no costs are taken through the accounts until the member retires and the liability to pay the retirement annuity is not built up over time. Moreover, the amount of post-retirement annuity payable is not based on a proportion of final 'salary' that is 'earned' over time, but is measured in relation to events and profits arising after the retirement date. The Working Party decided that, on this basis, FRS 17 was too detailed and its requirements for defined benefit schemes did not match the circumstances of the type of post-retirement benefits paid by LLPs to former members. FRS 12 was considered the more appropriate standard to apply for the measurement and recognition of the liability for post-retirement annuities at the date of the member's retirement and the SORP was redrafted accordingly.

The treatment of the debit on recognition of the liability; subsequent remeasurement; amounts 'set aside'

12 A number of commentators highlighted the failure of the draft SORP to deal with the debit entry arising from the creation of a provision for post-retirement benefits at the date of a member's retirement. Depending on the point at which the liability is established, it could apparently be either an allocation of profit or a charge to the profit and loss account. A number of commentators called for clarification of the meaning of the phrase amounts 'set aside' in paragraph 52 of the Exposure Draft, to explain whether such amounts are an obligation of the LLP (in a segregated fund) or should be simply retained within Members' interests.

13 The Working Party view was that, to comply with the Regulations, no amount should be recognised in the profit and loss account of an LLP before the date of retirement of the member, in line with the treatment of all other members' remuneration (other than where an employer-employee relationship exists: see 'Salaried members' remuneration' below). On the date of retirement, the entire amount of the post-retirement benefits should be recognised as a liability and the debit entry should be recorded in the STRGL as a movement on reserves, rather than the profit and loss account. This reflects the view that this transaction represents a reorganisation of the members' interests and is unrelated to current year performance as shown in the profit and loss account; a reasonable analogy might be the treatment of a prior period adjustment, with the 'catch up' cost here recording the reclassification of members as third-party creditors. This avoids the distorting effect of a charge to the profit and loss account that could swamp the annual operating results. All subsequent changes in the estimate of the liability would be taken to the profit and loss account, as usual with an FRS 12 liability.

14 An LLP may choose to 'set aside', within 'Members' interests', amounts out of profits to meet the future liabilities for post-retirement benefits. Because no cost is recorded until the date of retirement, this will be an appropriation from the general to a specific reserve, from which the ultimate liability may be transferred. It does not represent a charge to profits in the year it is made. However, by treating the debit on recognition of the post-retirement liability as a movement on reserves and an entry in the STRGL rather than the profit and loss account, the accounting treatment is the same whether amounts have been 'set aside' in advance or not.

15 The SORP was redrafted on the above lines. Other matters were addressed in response to comments made by respondents, including the treatment of assets held to fund members' post-retirement benefits, the treatment of past service costs as an immediate charge to profits and the effect of discounting. In addition, the SORP now calls for additional disclosure of the LLP's policy in relation to post-retirement benefits and some indication of the likely crystallisation of the liability. The Working Party believes that prescribing this treatment will lead to greater consistency between the accounts of different LLPs.

Work in progress and revenue recognition

Question 2(a)

Do you agree that the application of SSAP 9 Stocks and long-term contracts *set out in the proposed SORP is:*

(a) correct in not requiring an amount for members' time to be allocated to stocks, except to the extent that it would otherwise be treated as a cost in the profit and loss account (paragraph 64)?

16 This proposal was generally accepted by respondents, but this should be viewed in light of the criticism of the distinction between salaried members' remuneration and other remuneration, discussed below.

Question 2(b)

Do you agree that the application of SSAP 9 Stocks and long-term contracts *set out in the proposed SORP is:*
(b) correct in its recommended treatment of long-term contracts (paragraph 66)?

17 The proposals in the Exposure Draft in effect suggested that most professional services would constitute long-term contracts under SSAP 9, and should therefore be accounted for by including an appropriate amount of profit.

18 A majority of commentators disagreed with the proposed treatment, mainly on the grounds that the inherent interpretation that most professional service contracts would be long-term contracts for accounting purposes was wrong. SSAP 9 states that where the duration of a contract does not exceed one year, it is only necessary to account for it as a long-term contract if not to do so would distort the 'turnover and results' for the period; the effect on the balance sheet is not mentioned.

19 Commentators also noted that a SORP has no remit or authority to change or extend the requirement of an accounting standard, which it would be doing were it to impose additional interpretations of SSAP 9 on LLPs over and above that required for companies. Indeed, it would have a deleterious effect on financial reporting by reducing comparability between companies and LLPs. Commentators also considered that the SORP was wrong to anticipate, in the material on contingent and conditional contracts, the results of what was, at the date of consideration, the ASB's discussion paper on revenue recognition.

20 The Working Party agreed that it was not appropriate for the SORP to suggest that all professional services work consisted of long-term contracts, and that it should not make pronouncements on revenue recognition or contingent and conditional fees that went further than existing accounting standards. Accordingly, the SORP was redrafted and much of the material removed. However, since this is an issue for other entities, such as partnerships and companies as well as LLPs, the Working Party recommended to the Steering Committee that it should write to the ASB, possibly directed to the UITF, to suggest that some kind of pronouncement should be made on the matter in advance of a full revenue recognition standard, which could be some years away.

Mergers and acquisitions

Question 3

Paragraph 77 of the proposed SORP sets out the main principles for applying acquisition accounting to LLPs. However, the SORP does not address specific difficult issues that may be encountered in practice. Do you believe that further guidance is required on acquisition accounting by LLPs?

21 Commentators favoured additional guidance, but few practical examples of what this might consist of were offered. Various other minor points were raised; for example, on the extent to which existing partnerships were presently following proper consolidation procedures.

22 Firstly, a paragraph was added to the SORP to indicate that the principles of FRS 2 and FRS 5 should be followed in relation to the rules to prepare group accounts and the inclusion and exclusion of subsidiaries. This was in response to the suggestion that partnerships that might convert to LLPs were not doing so at present; it was thought worthwhile to make the point clear. Second, the SORP was altered to make clear that a combination must be assessed to determine whether it is a merger, an acquisition or simply the granting of membership to one or more individuals. In addition, a new paragraph was added on assessing the fair value of stock and work in progress acquired.

23 All other matters were considered generic to all business combinations, not just those carried out by LLPs, and so not appropriate for inclusion in the SORP. However, the Working Party considered that the development of industry practice in accounting for mergers and acquisitions of LLPs should be kept under review, so that further guidance might be added in future editions of the SORP.

Illustrative examples

Question 4

Do you believe that the SORP would benefit from the inclusion of examples illustrating the practical effects of applying the SORP and the Regulations? If so, please specify which issues the illustrations should deal with.

24 Of those commentators who responded to this questions, a majority favoured the inclusion of some additional examples.

25 The Working Party did not favour the inclusion of a specimen full set of financial statements, but explored the possibility that numerical examples could be included in the text by way of illustration in relation to particular aspects of LLP accounts that are unique; for example, the disclosure of members’ interests. However, it was eventually concluded that the SORP should not anticipate the development of practice for such a corporate vehicle, particularly as the temptation would be to concentrate on professional services firms, to the detriment of other

types of business using an LLP structure. This issue would be reviewed in the development of future editions of the SORP.

Salaried members' remuneration and members' interests

Salaried vs equity members

26 A number of commentators were concerned about the distinction between a member and a salaried member. Some believed that treating salaried members' remuneration in the same way as other allocations of profit would result in a better presentation of the profit and loss account and the calculation of stocks and work in progress. Concern was expressed that the definition of salaried members' remuneration was flawed, in that it should not depend on whether the remuneration is contractually payable, but on how it is determined and in any case the distinction between members who are employees and other members was likely to be uncertain and lead to inconsistent treatment. Moreover, such a distinction is not contemplated by the Regulations. Others suggested that there is no difference in substance between the two types of remuneration, as indicated by the legal advice that members' profit shares can be a liability of the LLP.

27 In a company situation, it is possible to distinguish between payments made to employees and directors in their capacity as employees and directors, i.e. charges on profits, from payments made to equity owners as owners, i.e. allocations of profit (dividends). In an LLP situation, this distinction is not possible, even though members act as employees, expending their time and skills on generating revenue for the LLP, for which they are remunerated. However, where a member of an LLP has a contract of employment, payments made under that contract are easily distinguished as being in the nature of salary rather than profit share and the Working Party believes that these should be shown as such insofar as permitted by the Regulations. In other words, the amounts have to appear at the bottom of the profit and loss account because the Regulations require a total at the end of the profit and loss account that is drawn before all members' remuneration and profit shares.

28 The SORP has been redrafted to indicate that it is this type of remuneration that is being singled out in this way, not particular members, so the definition and text now deals with 'Salaried remuneration of members' rather than 'Salaried members' remuneration'. It would in fact be possible for a member to receive both salaried remuneration and other remuneration. This type of salaried remuneration may also exist outside an employment contract, but where the substance of the arrangement is for a contracted salary given to the member without division of profits and the definition of 'Salaried remuneration of members' reflects this view.

Presentation of members' remuneration and interests

29 A number of commentators objected to the presentation of salaried members' remuneration in a separate line in the profit and loss account. Some also asked for guidance on the treatment of losses and the presentation of debit balances on members' current accounts.

30 As noted above, if the distinction was to be made between the different types of remuneration, then the Regulations restrict how it can be presented in the profit and loss account. In any case, the full note disclosure of members' interests will pull all elements of members' remuneration into one place.

31 The SORP was redrafted to deal with losses, such that it indicates that losses may or may not be allocated to members but, if they are not, they should be deducted from 'Other reserves'. The SORP was also amended to state that debits on current accounts (where, for example, drawings were made during the year in anticipation of profits) should be shown in debtors as a separate line item.