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Ms Sharon Grant
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10 January 2014

Dear Ms Grant

Draft Statement of Recommended Practice: Accounting by LLPs.

We welcome the opportunity to comment on the Draft Statement of Recommended Practice (SORP) Accounting by LLPs.

Our responses to the questions raised in the invitation to comment are set out in Appendix 1 to this letter. We are supportive of the changes that have been made to update the SORP for FRS 102, but we also consider that the CCAB should take the opportunity to improve the guidance in respect of automatic division of profits and reflect the development of the use of LLPs in hybrid structures.

We have also noted some minor typographical, grammatical and similar matters which are included at Appendix 2.

If you wish to discuss anything further please do not hesitate to contact me.

Yours sincerely

Colin Burns
Technical Associate Director
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Encs – Appendices 1 and 2



APPENDIX 1

1. Do you agree that the guidance provided in this draft SORP is helpful in applying the requirements in FRS 102? If not, how do you think it could be improved?

Yes in general we do.

However we consider that in updating the SORP to reflect the changes to be brought about by FRS 102 the opportunity exists to improve the guidance on the automatic division of profits.

In our experience the profit sharing provisions in a number of members' agreements are not written using the terminology used in the LLP SORP i.e. they do not refer to automatic division, very often they simply refer to 'allocation' or to the debiting/crediting of profits to members' current accounts. Consequently, the interpretation of these provisions as to whether profit is automatically divided or not can prove challenging.

The examples in appendix 2 of the SORP are useful in illustrating; that there need not be symmetry between the treatment of amounts subscribed as capital and returns arising; demonstrating the principles for classification between equity and liability; and the application of the 'puttables exception', but they rely on knowing whether or not profits are automatically divided.

We believe the opportunity should be taken to improve the guidance in this area. A common provision we see in members agreements is simply that 'Profits [*and sometimes losses*] shall be divided between the members in the proportions set out in schedule x'. On occasion the agreement may go on to say 'and debited or credited to members current accounts with the LLP as soon as the accounts for the relevant year are approved by the members in accordance with clause x'. It would be useful in our opinion if the guidance could recognise such common provisions or incorporate them in its examples.

Further, we consider that the examples could be updated to reflect the increasing use of LLP's in hybrid structures which means that many LLPs now undertake all sorts of commercial activities and have corporate members rather than being traditional incorporated professional practices. Such structures present practical difficulties when determining the role that the corporate member has in the LLP.

2. Do you agree that changes to current UK GAAP have been adequately reflected in this draft SORP?

Yes. Overall we consider that changes to current UK GAAP have been adequately reflected in the draft SORP.

However, we note that the reference in the current SORP to designated members being considered related parties has been removed from paragraph 130. Similarly the



guidance in paragraph 131 that members acting in concert may be controlling parties has been removed. It is not clear why this guidance has been removed as we are not aware of any differences between current and new UK GAAP that would result in this guidance no longer being relevant.

The statements of comprehensive income at exhibits F and G in appendix 1 of the draft SORP should include the heading 'Other comprehensive income' immediately above the line item 'Revaluation of freehold property'.

3. The guidance on business combinations and group accounts in paragraphs 102-119 has been updated to reflect the fact that FRS 102 only allows merger accounting to be used for group reconstructions. Is the revised guidance clear? Does it adequately reflect FRS 102's new requirements? If not, why not?

We consider that the guidance is reasonably clear, subject to the points below, and that it adequately reflects FRS 102's new requirements.

Although it is unlikely to be relevant to many, if there are any LLPs that are considered to be public benefit entities, then for completeness we consider that the SORP should note that accounting for a business combination as a merger is also permitted for certain public benefit combinations.

We note that paragraphs 105 and 112 state that where the requirements of 19.27 of FRS 102 are met then merger accounting 'may' be used. Paragraph 112 explains that in respect of the transfer of the business of an existing partnership into an LLP incorporated for that purpose, such a transaction 'should' be dealt with as a group reconstruction where the requirements of 19.27 of FRS 102 are met and we believe this is clear. However, paragraph 112 then goes on to say that 'As such the merger method may be used'. We consider that the word 'may' should be 'must'.

Paragraph 117A (c) deals with potential changes in members' rights on transition. We would suggest that the word 'will' in the third sentence is amended to 'may' given that the guidance is in respect of an example of what might happen rather than will happen.

4. The guidance on contractual or constructive obligations (paragraph 76) and annuities (paragraph 80) has been updated to reflect the fact that FRS 102's requirements relating to financial liabilities differ from current UK GAAP requirements. Is the revised guidance clear? Does it adequately reflect FRS 102's new requirements? If not, why not?

Overall we consider the revised guidance is clear. However we have the following observations in respect of its reflection of FRS 102's new requirements:

- For financial instruments within its scope FRS 102 also permits entities to choose to apply the recognition and measurement provisions of IAS 39 or IFRS 9 (as



adopted for use in the EU) so it would be appropriate to mention this option in paragraph 76A.

- The footnote to paragraph 76A (a) states that the accounting for unconditional contractual liabilities within the scope of FRS 102 Section 11 is broadly similar to that under FRS 4 Capital Instruments with some differences such as the treatment of issue costs which are expensed at the outset rather than forming part of the effective interest rate calculation. We are not clear how this conclusion has been reached as FRS 102 11.13 states that measurement of financial instruments at initial recognition, other than those measured at fair value through profit or loss, is transaction price including transaction costs. This is the carrying value to which the effective interest rate calculation required by FRS 102 11.16 is applied.
 - Paragraph 80B deals with unconditional contractual obligations to pay annuities where the LLP has not accepted significant insurance risk and so are within the scope of FRS 102 sections 11 or 12. In our opinion it could be confusing to mention the accounting for such contracts under FRS 103 where the LLP has accepted a significant insurance risk since this is dealt with in the previous paragraph.
 - We would welcome explanation of the basis for the conclusion in paragraph 80C for the conclusion that on transition to FRS 103 entities that have previously applied FRS 12 to their post retirement obligations will be able to continue with the same accounting policies.
- 5. Although it does not relate to the introduction of FRS 102, it was felt appropriate to update the guidance on analysing puttable instruments to reflect the fact that many of the issues associated with the introduction of FRS 25 and the subsequent ‘puttables amendment’ are now behind us. The basic accounting remains unchanged. As part of this process, the flowcharts in appendix 3 of the SORP have been removed. Is the revised guidance clear? Do you agree with the removal of the flowcharts? If not, why not?**

In our opinion the revised guidance is clear and we support the removal of the flowcharts.

As the flowcharts have been removed, we would recommend that the appendix heading on the contents page makes it clear that the appendix has been deleted.



APPENDIX 2

Minor typographical, grammatical and similar matters:

Paragraph	Matter
29	One of the commas at the end of the sentence on page 12, and the spacing before the full stop in the third line on page 13 need removing
42A	Insert ‘than’ so that the first sentence reads ‘classified as a liability rather than equity...’
42A	We suggest amending ‘dividends’ to something less ‘corporate’ and more relevant in the context of an LLP. The reference could be general such as ‘other non-discretionary return’.
121	Rather than ‘are incorporated’ we would suggest ‘convert or incorporate’ to make it clear that the SORP is dealing with a transition issue.
127	Was it intended for footnote 13 from the current SORP to be deleted?
132	Insert ‘the’ in the second sentence so that it reads ‘note to the financial statements’.
Example 4 in appendix 2	We suggest amending ‘they’ in the last sentence of paragraph 2 to ‘the tests’ for clarity.
Example 9 in appendix 2	Insert ‘it’ in the example description so that the second sentence reads ‘there is mandatory payment of interest...’
Example 10 in appendix 2	Delete ‘of’ at the end of the second sentence in the final paragraph so that it reads ‘then the entire amount...’