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Dear Sharon

Accounting by Limited Liability Partnerships Statement of Recommended Practice Exposure Draft (draft LLP SORP)

Deloitte LLP is pleased to respond to the Consultative Committee of Accountancy Bodies' draft LLP SORP. We have set out our detailed responses to the consultation questions in the Appendix to this letter.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Kate Kabanova on 020 7303 8440 or kakabanova@deloitte.co.uk

Yours sincerely



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Appendix

Question 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, the draft SORP overall provides useful guidance on the application of FRS 102 requirements to limited liability partnership accounting. Some specific comments are provided under the more detailed questions below.

We have, however, an additional comment on the current requirement carried over into the draft SORP for LLPs to produce a Members' Report. The need to produce a separate Member's Report (contained in paragraph 25) arises neither from the legislation nor from the requirements of FRS 102. We believe that the disclosures required by paragraphs 30 and 69 represent useful information and should be retained. However, presenting this information in a separate report, required only for this purpose, creates confusion in the absence of any legal requirement for LLPs to present the equivalent of a strategic report or directors' report. We recommend moving the disclosures required by paragraphs 30 and 69 to form part of the financial statements, where they provide necessary context for the other information presented.

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

Yes, subject to our comments set out in response to subsequent questions.

Question 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?

While we generally agree with the proposed guidance, we have a concern about the application of the group reconstruction criteria defined in paragraph 19.27 to LLPs with no interests accounted for as equity. For example, some LLPs may have all capital classified as debt, as is illustrated in example 2 of Appendix 2 of the draft LLP SORP. The wording of paragraph 19.27 (b) requires that the ultimate equity holders remain the same and the rights of each equity holder relative to the others remain unchanged as a result of the transaction. We believe that in the context of LLPs with no equity accounted for as capital, the paragraph 19.27 reference to 'equity holders' should include such LLP members and the 'rights of each equity holder' should extend to include member profit sharing rights. Indeed the 2010 LLP SORP considered the application of FRS 6.13 to such situation in paragraph 112 concluding that the transfer of all or the majority of assets, liabilities and business of a partnership into an LLP incorporated for that purpose should be accounted for as a group reconstruction. We believe the application of paragraph 19.27 of FRS 102 was not intended to introduce a difference from this treatment. An illustrative example distinguishing between transfers that meet the conditions of paragraph 19.27 of FRS 102 and those that do not would be helpful.

Question 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?

We believe the revised guidance adequately reflects the requirements of FRS 102 and FRS 103 in relation to accounting for members' post-retirement benefits. In the absence of a specific section of FRS 102 dealing with members' post-retirement benefits (similar to section 28 for employee post-employment benefits) other requirements of FRS 102 and FRS 103 need to be considered. The resulting analysis, while complex, appropriately reflects the nature of the various members' post-retirement benefit arrangements and their respective accounting treatment.

However, we believe that the revised guidance could be enhanced by introducing additional subheadings to draw out the main messages of each subsection. For example, paragraphs 76-80 set the general context of the various possible types of post-retirement benefits and their accounting. These could be prefaced by a non-bold italic subheading 'retirement benefits – general'. New material introduced in paragraphs 80A-80C addressing whether the benefits fall within the scope of FRS 103 could be grouped under a 'Mortality risk' subheading. The remaining paragraphs 82-87 could be subtitled 'recognition and measurement' and paragraph 87A could have a 'constructive obligation' caption to better draw the reader's attention. It would also be helpful for paragraphs 76 and 76A of the draft LLP SORP to use the same order of scope sections.

Further in referring to unconditional contractual liabilities in paragraph 80 it would be helpful to clarify that financial liabilities outside the scope of section 21 also include insurance liabilities in the scope of FRS 103. This could be done in a footnote.

Additionally, we believe further clarification is required of the interaction of the FRS 102 definition of 'puttable instruments' and the LLP SORP definition of 'post-retirement payments to members' to avoid a potential conflict in application of the accounting guidelines to some situations. A puttable instrument is defined as 'a financial instrument that gives the holder the right to sell that instrument back to the issuer for cash or another financial asset or is automatically redeemed or repurchased by the issuer *on the occurrence of an uncertain future event or the death or retirement of the instrument holder.*' For example, consider an instrument that gives a member at retirement a right to put the instrument back to the LLP for cash at the value of the member's share of the LLP's net assets. Any decision to divide profits must be approved by majority of members and is pro-rata. The instrument meets the definition of a puttable instruments exemption in FRS 102 section 22.4(a) and would be accounted as equity. However, members' capital puttable to the LLP at retirement could also be interpreted as a post-retirement benefit. This is because the definition of members' post-retirement benefits includes '*any post-retirement payments [...] or any other benefits payable by the LLP as principal to former members of the LLP, [...]. Former members* are further defined as 'members who retire by or at the balance sheet date' (paragraph 22 of the draft LLP SORP). As drafted, this could be interpreted to mean that instruments redeemable on retirement and meeting 'puttables exception' definition, which would otherwise be presented as equity, form part of post-retirement benefits and could be accounted for as liability. We do not believe that this is the intention and the position should be made clear.

Question 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 flowcharts? If not, why not?

While we agree with the CCAB that in many instances the basic accounting remains unchanged, there is one specific scenario where we envisage the application of the FRS 102 requirements to result in a different classification of members' interests. This relates to the application of the 'puttables exception' and the effect of paragraphs 16B and 16D of FRS 25 not being carried into the text of FRS 102. These paragraphs in FRS 25 meant that the puttables exception was not met where the entity had other instrument that had total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity and this had the effect of substantially restricting or fixing the residual return to the puttable instrument holders. In the LLP context the 2010 LLP SORP interpreted this to mean that where all the remuneration was considered separately, as there was no clearly identifiable return on capital, this had the effect of being treated as a separate instrument substantially restricting return to the holders of capital. Therefore both remuneration and capital were treated as debt even if capital met all other puttable criteria (see 2010 LLP SORP paragraph 41 and footnote 4, as well illustrative example 5). The draft LLP SORP seems to acknowledge that the impact of FRS 102 not having the same restriction changes the classification outcome for such instruments by amending the text of paragraph 41, removing footnote 4 and adding paragraph 42A. However without an illustrative example this point can be easily overlooked. For example, LLPs where members provide services, have automatic division of all profits and have their interest puttable on retirement (meeting all criteria in FRS 102 22.4) previously would have had no equity, but now would be required to classify capital as equity. We therefore recommend providing an example with a fact pattern similar to example 5 of the 2010 LLP SORP illustrating the new treatment and highlighting the change from the old accounting requirements.

We agree with the CCAB that the flowcharts were always intended only as an illustrative guidance and to the extent they are not used by preparers their continued inclusion within the SORP is not warranted. We therefore agree with the removal of the flowcharts provided that the body of the SORP reflects all the principles necessary for accounting analysis. We also agree with the analysis and the examples included in Appendix 2 of the draft LLP SORP. We note however, that some of the elements of the flowchart referred to certain paragraphs of FRS 25 that are still relevant to the draft LLP SORP analysis used in the Appendix 2. However these principles expressed in these paragraphs are currently not included in the main text of the SORP. In particular, FRS 102 has simplified some of the wording of the 'puttables amendment' from FRS 25.16 and did not carry over the application guidance of FRS 25 AG14F-AG14I. This application guidance does not contradict the FRS 102 requirements and overall the application of the new standard is expected to preserve existing treatment (except for the change mentioned above). Just as paragraphs 6 and 9 of Appendix 2 interpret paragraph 34 of the draft LLP SORP it would be helpful if paragraphs 7 and 8 of the Appendix were also interpreting the SORP text. We therefore recommend inserting additional paragraphs after paragraph 41 of the draft LLP SORP, helping to distinguish which elements should be considered in a puttable instrument analysis. Suggested drafting is set out below based on the paragraphs of FRS 25 amended as necessary. Paragraphs AG14G and AG14H have been omitted as not being relevant to LLPs.

41A (FRS 25.AG14H)

~~Another~~ One example is a profit or loss sharing arrangement that allocates profit or loss to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 22.4 of FRS 102-16A or ~~paragraph 16C~~. However, profit or loss sharing arrangements that allocate profit or loss to instrument holders based on the nominal amount of their instruments relative to others in the class

may represent transactions with the instrument holders in their roles as owners and should be considered further by applying principles of paragraph 34~~when assessing the features listed in paragraph 16A or paragraph 16G.~~

41B (FRS 25.AG14F)

The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder may also be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as equity. ~~under paragraph 16A or paragraph 16G.~~

41C (FRS 25.AG14I)

The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

These principles are then illustrated by examples in the appendix, and in particular example 5 of the draft LLP SORP.

A definition of 'clearly identifiable return on amounts subscribed' would also be helpful. Perhaps it could be explained that this refers to a specified return, for example a percentage or similar, and to be clearly identifiable it should not include a compensation for service. It could be further expanded to distinguish between restricted amounts (such as absolute amounts and percentages of amount subscribed) and unrestricted amounts such as share of net assets and net profits. In applying the guidance in paragraph 6 (c) of appendix 2, it could be added that return on capital could be a return on debt or equity.

Additional editorial comments

Definitions

There is currently no formal definition of members' services. The 2010 LLP SORP in the flow chart in Appendix 3 defines members' services as including any arm's length transaction with LLP, e.g. provision of guarantee or supply of goods. Retaining this definition and placing it within the main body of the SORP would be helpful.

Meaning of significant insurance risk

It would be helpful if paragraph 80C in referring to significant mortality risk either cross referred to the relevant guidance in FRS 103 or included it in the LLP SORP itself.

Cross references

Paragraph 102 in referring to Section 9 Consolidated and Separate Financial Statements needs to refer to section 9 of FRS 102.

Transitional guidance

The meaning of the final sentence in paragraph 134 is unclear in its reference to the impact of accounting policy changes on the current and previous periods' division of profits decisions.

Basis of conclusions

Basis of conclusions is still referring to FRS 25. While this is important historical reference material it would be helpful if links were made to the new requirements of FRS 102 to make it more relevant in the context of the new standard.