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CCAB – LLP SORP
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By email: executive.office@ccab.org.uk

Dear Committee Members,

Draft Statement of Recommended Practice: Accounting by Limited Liability Partnerships

We welcome the opportunity to respond to the consultation on the Draft Statement of Recommended Practice: Accounting by Limited Liability Partnerships, published in August 2023 ("the consultation").

Overall, we believe that the proposed revisions are appropriate.

Our responses to the detailed questions in the consultation are set out in Appendix 1 and we set out our detailed drafting suggestions in Appendix 2.

If you have any questions, please contact Linda Riedel (020 7007 0227 or lriedel@deloitte.co.uk) or Robert Carroll (020 7303 2458 or rcarroll@deloitte.co.uk).

Yours sincerely

Veronica Poole

Vice-Chair and UK National Head of Accounting and Corporate Reporting
Deloitte LLP

Appendix 1: Responses to detailed questions

Question 1: Climate-related financial disclosures

Do you agree with the updates made to the SORP to reflect the new requirements for certain LLPs to provide climate-related financial disclosures in either the strategic report, if one is prepared, or in the energy and carbon report otherwise? The key relevant draft paragraph is 25D.

Yes, we agree with the proposal as set out. Moreover, we believe it would be useful to reference the non-binding guidance on mandatory climate related financial disclosures published by the Department for Business, Energy and Industrial Strategy (BEIS) (now the Department for Business and Trade (DBT)).

Question 2: Amounts payable to former members

Do you agree that guidance is needed in the SORP to address certain narrow scenarios when section 26 of FRS 102 might apply? Do you agree with the proposed change?

We agree that guidance is needed to address certain narrow scenarios when section 26 of FRS 102 may apply, and we agree with the proposed change. However, we believe the guidance could be clearer. The FRS 102 Glossary defines a share-based payment transaction as a transaction in which the entity: (a) receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement; or (b) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services. We believe it would be useful to clarify, in paragraph 87A, that the reason this arrangement meets the definition of a share-based payment arrangement is because the former members have provided services to the LLP. In addition, we believe it would be helpful to clarify that an equity-settled share-based payment arrangement is unlikely to arise for LLPs with no equity.

Question 3: Sharing of group profits – interests in subsidiaries

Do you agree that guidance on the appropriate treatment of members' debt and equity interests in the subsidiary LLP for the purposes of determining whether a non-controlling interest in the net assets of the group is recognised is needed in the SORP? Do you agree with the proposed changes?

Yes, we agree that guidance is needed and we agree with the proposed changes.

Question 4: Automatic division of profits to members who do not provide any substantive services to the LLP

Do you agree that guidance is needed for situations where there is an automatic division of profits to members who do not provide any substantive services to the LLP? Do you agree with the proposed changes?

We agree that additional guidance is needed for situations where there is an automatic division of profits to members who do not provide any substantive services to the LLP. We believe that clarification can promote consistency across LLPs and reduce diversity in practice.

We understand that:

- the additional guidance in Exhibit A and Exhibit D in Appendix 1 is intended to highlight that even where an LLP automatically divides all profits, it may still have equity (and a non-nil result for the financial year after members' remuneration charged as an expense) if the LLP does not have the right to recover losses (or other amounts) from its members; and

- example 11 in Appendix 2 is intended to highlight that the normal classification and measurement requirements for financial instruments apply to members' interests for members who do not provide substantive services but where there is an automatic division of profits.

There is an overlap between the additional guidance in Exhibit A and in Example 11 because it may be the remeasurement of a member's interest that gives rise to a gain or loss in the financial year after members' remuneration charged as expense (and a corresponding adjustment to 'Members' other interests – other reserves classified as equity'). However, the effect of such a remeasurement on other members' interests could be complex and will not always result in such a gain or loss after members' remuneration charged as expense. The linkage between these new areas of guidance, as well as its limits, should be clearly described. This could be achieved by emphasising the intention of the guidance in Exhibit A in Appendix 1 and the inclusion of some additional narrative (see Appendix 2 in this letter) in Example 11 in Appendix 2 with a cross reference back to Exhibit A and Exhibit D in Appendix 1.

The classification and measurement of financial instruments linked to an entity's profits are complex due to the interaction between the Small LLP Regulations, LLPs Regulations and FRS 102. While we agree that the additional proposed guidance on the application of these requirements for LLPs is beneficial, care should be taken not to oversimplify or generalise where this is not appropriate if any further guidance on the application of these requirements for the LLPs were to be included beyond that proposed in the consultation.

Similarly, we also believe clear referencing to the relevant requirements of FRS 102 is necessary to support the analysis in Example 11.

Example 11 includes some material relating to the accounting policy choice in FRS 102.11.2/12.2 and a limited description of the accounting treatment for an LLP that has chosen to adopt the recognition and measurement requirements of IFRS 9. We suggest including the accounting analysis for preparers under sections 11 and 12 of FRS 102 only, consistent with other areas in the LLP SORP where the application of recognition and measurement principles of IFRS 9 and IAS 39 is acknowledged but not included. This will avoid confusion in relation to the accounting for the interest due to members which meets the definition of a financial liability and will not detract from the key points in Example 11. We therefore suggest removing the detailed IFRS 9 requirements from proposed Example 11 and instead referencing the accounting policy choice in a footnote rather than the main body of the text.

We have set out a number of detailed drafting comments in Appendix 2 to this letter.

Question 5: Effective date

Do you agree that the proposed changes outlined in this document should come into effect for periods commencing on or after 1 January 2024, with early adoption permitted?

The proposed changes do not introduce any new requirements and only clarify existing requirements. Therefore, we agree with the proposed effective date of 1 January 2024.

Question 6: Do you have any other comments on the draft LLP SORP?

We have set out some detailed drafting suggestions in Appendix 2 to this letter.

Appendix 2: Drafting comments

Suggested additions to the proposed text are underlined, suggested deletions are struck through.

<table>
<tr><td colspan="2">Exhibit A in Appendix 1</td></tr>
<tr><td>Suggested edits</td><td>“…Note that the presentation above is only suitable for an LLP that has no equity. It should be noted even where all profits are automatically divided, an LLP may still be considered to have equity. In particular, if an LLP does not have the right to recover losses (or other amounts) from its members, this may result in recognised liabilities (including any member balances) in excess of recognised assets (including any member balances). ~~The presentation above will not be suitable for some LLPs. In particular, this presentation is only suitable when an LLP’s assets (including any member balances) are equal to its liabilities (including any member balances).~~ There are various scenarios in which this may ~~not~~ be the case. For example:

• An LLP may make cumulative losses. Unless the LLP has the right to recover those losses from its members, its recognised ~~reported~~ liabilities are likely to exceed its recognised ~~reported~~ assets.

• Some LLPs may make automatic distributions to members on the basis of a profit figure that differs from profits reported in the statutory financial statements (e.g. on the basis of management accounts that do not reflect certain accounting adjustments). This may result in cumulative distributions exceeding cumulative profits reported in the statutory financial statements. When this is the case, unless the LLP has the right to recover that excess from its members, its recognised ~~reported~~ liabilities are likely to exceed its recognised ~~reported~~ assets.

In those examples, a negative balance would be shown in ‘Members’ other interests – other reserves classified as equity’.”</td></tr>
<tr><td>Reason(s) for the suggested edits</td><td>We understand that the additional guidance is intended to highlight that even where an LLP automatically divides all profits it may still have equity if the LLP does not have the right to recover losses or (other amounts) from its members. The introduction to the additional guidance would benefit from referring explicitly to this as we believe the current wording could be misinterpreted.</td></tr>
<tr><td colspan="2">Exhibit D in Appendix 1</td></tr>
<tr><td>Suggested edits</td><td>“… Note that there are some scenarios in which the result for the financial year, after members’ remuneration charged as an expense, will not be nil. For example:</td></tr>
</table>

	• An LLP may make losses in a period. Unless the LLP has the right to recover those losses from its members, it is likely to report a net loss for the period. • Some LLPs may make automatic distributions to members on the basis of a profit figure that differs from profits reported in the statutory financial statements (e.g. on the basis of management accounts that do not reflect certain accounting adjustments). This may result in members’ remuneration charged as an expense for a period exceeding the profits generated in that period. When this is the case, unless the LLP has the right to recover that excess from its members, it is likely to report a net loss for the period. If the result for the financial year is negative, it would be appropriate to label it as ‘Loss for the financial year’.~~, and a~~ To the extent that the result for the financial year is either positive or negative, a corresponding adjustment would be made to the negative balance ~~would be~~ shown in ‘Members’ other interests – other reserves classified as equity’.”
Reason(s) for the suggested edits	The current wording does not contemplate that there might be a gain for the financial year (after members’ remuneration charged as expense) or that if there was already a cumulative loss that the gain or loss for the year would adjust the balance shown in ‘Members’ other interests – other reserves classified as equity’ rather than corresponding directly to it.
Example 11 in Appendix 2	
Paragraph 3	
Suggested edits	…In other words, the automatic division of profits to those members who do not provide any substantive service (non-working members) to the LLP is a return on their capital invested. The non-working member’s right to the automatic division of future profits is a contractual obligation for the LLP to deliver cash to the non-working member and therefore gives rise to a financial liability. The financial liability is a non-basic financial instrument in scope of section 12 of FRS 102 (See FRS 102.11.9A Example 10).
Reason(s) for the suggested edits	The fact that the non-working member’s interest is a non-basic financial liability drives both initial and subsequent measurement. We therefore suggest adding a brief paragraph before the detailed analysis stating this fact (i.e. before the third paragraph). It would also be helpful to include a reference to FRS 102.11.9A Example 10 in this paragraph to tie the

	conclusion in respect of classification directly to the underlying requirements of the standard, without further detailed discussion of basic/non-basic classification. As discussed below, this paragraph would also be the appropriate place to add a footnote referring to the accounting policy choice in FRS 102.11.2 and 12.2. Lastly, there is a typo in relation to the spelling of 'non-working' member.
Suggested edits	~~Accordingly, the amount subscribed by the non-working members will be initially recognised as a financial liability.~~ The financial liability to the non-working member will be recognised by an LLP on subscription of capital by that member. As a non-basic financial instrument, the financial liability is recognised initially at fair value in accordance with FRS 102.12.7. In an arm's length transaction, the fair value will be equal to the amount subscribed. It should be noted that there are many ways in which subscription of capital could arise including, as in this example, a capital payment made to and retained by the LLP. However, when the capital payment from the incoming member is paid either directly or indirectly to other members, the payment made by the new member should be analysed separately from the distribution to members. Specifically, when a new member will not be providing any substantive services, even if the capital subscribed by that new member is paid directly to existing members (and is never received in cash by the LLP), it will still be necessary for the LLP to recognise a liability in respect of the obligation to pay a share of future profits to that new member.
Reason(s) for the suggested edits	Both the first sentence of the third paragraph and the seventh paragraph relate to initial measurement and so we would suggest consolidating them. The first sentence in the third para does not mention the initial recognition requirements of Section 12 of FRS 102 and suggests that the financial liability to pay non-working members will always be recognised at the amount subscribed. A non-basic financial liability is required to be recognised initially at fair value in accordance with FRS 102.12.7 and the amount subscribed in an arm's length transaction will be its fair value. Therefore, the current proposed text is not an accurate articulation of the initial measurement of a financial liability.
Suggested edits	~~The obligation to automatically divide profits represents a right to future profits which must be recognised in the subsequent measurement of the amounts due to members.~~

Reason(s) for the suggested edits	We suggest removing this sentence. It is unclear how it ties in with the financial instruments recognition and measurement requirements of FRS 102. To the extent that this intended to explain that the obligation to pay a fixed share of profits to the non-working member is a financial liability, this should be covered by the new paragraph we have suggested above. The reference to subsequent measurement in this sentence is confusing as it suggests that expectations about future profits are not taken into account at initial recognition, which is incorrect.
Paragraph 4	
Suggested edits	~~Exactly how that financial liability is measured at subsequent reporting dates will depend on which accounting policy options are chosen when applying paragraphs 11.2 or 12.2 of sections 11 and 12 of FRS 102. For those LLPs reporting under sections 11 and 12 of FRS 102,~~
Reason(s) for the suggested edits	The accounting policy choice in FRS 102.11.2 and 12.2 affects both the initial and subsequent measurement of financial instruments and so we would recommend this is mentioned as part of the new paragraph we have suggested above. To be consistent with the level of prominence given to this policy choice elsewhere in the LLP SORP, we recommend that this is included as a footnote rather than in the main body of the text.
Suggested edits	Following initial recognition, the financial liability to the non-working member ~~this obligation to pay future profits will be a non-basic financial instrument in the scope of FRS 102.12 and, as such, may~~ will have to be accounted for either as at fair value through profit or loss or at amortised cost. The financial liability will need to be measured as at fair value through profit or loss unless this is prohibited by the Small LLP Regulations or the LLP Regulations, in which case it will be measured at amortised cost in accordance with FRS 102.12.8(c). For this type of liability, the key factor in determining whether fair value measurement is permitted by the Regulations is likely to depend on whether the variability due to future profits of the LLP is considered to be a 'non-financial variable specific to a party to a contract' in the context of the definition of a derivative (see the Glossary to FRS 102). If the variability due to future profits of an LLP is not considered to be a non-financial variable specific to a party to a contract, then the financial liability must be measured as at fair value through profit or loss.~~, depending on the judgement over whether the embedded derivative, being the right to a share of future profits, meets the definition of a derivative as defined in IFRS 9 [FRS 102.11 Example 10]. In this context, that judgement will be whether the right to the share of profits is deemed to be a non-financial variable specific to a party to the contract. If it is, then the non-basic financial liability would not be permitted to be recognised at fair value, as the right to future profits would not meet the definition of a separable embedded derivative in IFRS 9 [IFRS 9.4.3.1].~~

<table>
<tr>
<td>Reason(s) for the suggested edits</td>
<td>The proposed wording does not clearly articulate, or link back to the standard, how to determine the appropriate measurement basis for a non-financial variable in accordance with the requirements of Section 12 of FRS 102. We have suggested extensive changes to this section. Points taken into account in our suggested amendments include:

• The member’s interest will be measured either as at fair value through profit or loss or at amortised cost. May suggests there may be other alternative measurement bases available.

• For clarity, the link to the Small LLP Regulations or the LLP regulations via FRS 102.12.8(c) should be explicit. Reference to FRS 102.11.9A Example 10 is not sufficiently clear.

• The regulations are more complex than presented here. It is not correct to say that “…if it [the variability due to future profits of the LLP] is [a non-financial variable specific to a party to a contract] then the non-basic financial liability would not be permitted to be recognised at fair value…” because there are theoretically other circumstances which could result in measurement at fair value being permitted (e.g. if measurement at fair value would eliminate or significantly reduce an accounting mismatch). However, it would be correct to say that for this type of liability the key factor in determining whether fair value measurement is permitted by the Regulations is likely to be whether the variability due to future profits of the LLP is considered to be a ‘non-financial variable specific to a party to a contract’ and we agree that the importance of this consideration should be highlighted.

• We also note that the suggested statement “If the variability due to future profits of an LLP is not considered to be a non-financial variable specific to a party to a contract, then the financial liability must be measured as at fair value through profit or loss.” is true and would not require further caveats.

• We believe that there is an accounting policy choice in relation to how ‘non-financial variable specific to a party to the contract’ should be interpreted, in addition to some judgement in relation to the application of the accounting policy selected. We therefore think that it is more appropriate to say ‘considered to be’ rather than ‘judgement as to whether’ in this context.

• The current wording refers to embedded derivatives. We note that if an LLP’s only obligation is to deliver a share of profits to the member, then there is no obvious host liability and it is likely that the contract would be considered either to be a derivative or a non-derivative in its entirety. The key consideration in identifying either a derivative or a non-derivative for this type of liability would be the nature of the underlying variable (i.e. is it a non-financial variable specific to a party to the contract) in the definition of a derivative. We would therefore recommend that the explicit reference to embedded derivatives is removed.</td>
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</table>

	• We think it would be useful to include a reference to the definition of a derivative. We note that the accounting regulations permit derivatives to be measured at fair value without needing to consider the requirements of IFRS, and therefore (linked to the bullet above) we believe it is not inappropriate for the reference used to be to the Glossary of FRS 102. • The current wording refers to the requirements of IFRS 9 without any explanation for the reason. Rather than significantly expanding the analysis (as would be necessary to properly explain the finer points of the interaction of the Small LLP Regulations/LLP Regulations and FRS 102, and the onward link to IFRS 9 in certain circumstances which may not apply in respect of this example) our preference would be not to mention the linkage to IFRS 9 as this detail may distract from the key messages.
Suggested edits	~~However, if the liability has to be measured at amortised cost [FRS 102.12.8 (c)], it will still be necessary to remeasure the liability at each reporting date, and there may still be significant volatility in that measurement.~~ There may be significant volatility in the measurement of the financial liability irrespective of the measurement basis. Both fair value and amortised cost measurements would be updated to reflect the latest estimates of future cash flows as at the reporting date; the main measurement difference is that, under amortised cost, those cash flows would be discounted at the original effective rate (see FRS 102.11.20), whereas a current discount ~~market interest~~ rate would be used to measure fair value.
Reason(s) for the suggested edits	We have suggested separating the points in relation to how to apply the measurement bases into a separate paragraph from those in relation to how to determine the appropriate measurement basis. We think these points are sufficiently important to warrant the additional emphasis a separate paragraph provides. For clarity, we would suggest replacing the fifth sentence with a more straightforward statement that "There may be significant volatility in the measurement of the financial liability irrespective of the measurement basis.". The current wording only explicitly covers amortised cost measurement. In the sixth sentence "market rate of interest" should be replaced with "discount rate" as there may be factors other than interest rates that feed into the appropriate discount factor applied in a discounted cash flow model to obtain a fair value. In addition, it would be useful to refer to FRS 102.11.20.
Paragraph 5	

Suggested edits	~~For those LLPs that, under FRS 102, have taken the option to apply the recognition and measurement provisions of IFRS 9, the remeasurement of the change in the liability to pay future profits will, most likely, be accounted for by applying the guidance in IFRS 9.B5.4.6.~~
Reason(s) for the suggested edits	As noted in our comment above, we suggest acknowledging the accounting policy to apply recognition and measurement principles of IFRS 9 and IAS 39 but not including this in the accounting analysis in Example 11. We also note that if this were to be included it would require modification. In particular: • It would need to refer to both IFRS 9 and IAS 39 (at least noting that the requirements are the same). • The reference to IFRS 9.B5.4.6 (the IFRS 9 equivalent of FRS 102.11.20 and IAS 39:AG8) is unlikely to be understood without further research unless the reader is already very familiar with the requirements of IFRS 9. It would be better to refer to measurement at amortised cost. • Measurement at amortised cost under IFRS 9 (and IAS 39) is no more or less likely than under Sections 11 and 12 of FRS 102. If the example is also to cover the determination of the appropriate measurement basis under IFRS, we would suggest following the same approach as for the analysis above under FRS 102 or to explain the similarities and differences.
Paragraph 6	
Suggested edits	~~In all cases, t~~ The balancing entry that reflects the change in the liability to pay future profits in respect of the new non-working member's interest should be included as a component of members' remuneration charged as an expense because of the LLP having to automatically divide profits with its members. This example does not seek to address the effect of the remeasurement of the liability for the new non-working member's interest on other members' interests.
Reason(s) for the suggested edits	The effect of the remeasurement of the new non-working member's interests on other members' interests could be complex and may in some circumstances (as set out in Exhibit A and Exhibit D), but not all, result in a gain or loss for the period (after members' remuneration charged as expense). We suggest not attempting to cover this in proposed example 11, as we believe this would be an unnecessary complication and risk obscuring the key messages. However, it would be helpful to highlight this limitation in scope.
Illustrative journal entries	

Suggested edits	The illustrative journal entries are in respect of the new non-working member's interest only. They do not address the effect of the remeasurement of the liability for the new non-working member's interest on other members' interests. However, where the remeasurement of the liability results in a loss for the financial year after members' remuneration charged as expense (see Exhibit D), the corresponding debit will be to 'Members' other interests – other reserves classified as equity' and the entity will not be able to adopt the presentation set out in Exhibit A.
Reason(s) for the suggested edits	In line with the previous point, it would also be helpful to highlight the limitation in the scope of this example with the relevant numerical entry. However, in addition we would suggest using this final paragraph to explain the overlap between Example 11 and Exhibits A and D.

We have set out the additional guidance in Exhibit A and Exhibit D and Example 11 if the changes we have suggested above are reflected:

EXHIBIT A – LLP Balance Sheet

LLP WITH NO EQUITY

…Note that the presentation above is only suitable for an LLP that has no equity. It should be noted even where all profits are automatically divided, an LLP may still be considered to have equity. In particular, if an LLP does not have the right to recover losses (or other amounts) from its members, this may result in recognised liabilities (including any member balances) in excess of recognised assets (including any member balances). ~~The presentation above will not be suitable for some LLPs.~~ ~~In particular, this presentation is only suitable when an LLP's assets (including any member balances) are equal to its liabilities (including any member balances).~~ There are various scenarios in which this may ~~not~~ be the case. For example:

- An LLP may make cumulative losses. Unless the LLP has the right to recover those losses from its members, its recognised ~~reported~~ liabilities are likely to exceed its recognised ~~reported~~ assets.
- Some LLPs may make automatic distributions to members on the basis of a profit figure that differs from profits reported in the statutory financial statements (e.g. on the basis of management accounts that do not reflect certain accounting adjustments). This may result in cumulative distributions exceeding cumulative profits reported in the statutory financial statements. When this is the case, unless the LLP has the right to recover that excess from its members, its recognised ~~reported~~ liabilities are likely to exceed its recognised ~~reported~~ assets.

In those examples, a negative balance would be shown in ‘Members’ other interests – other reserves classified as equity’.

EXHIBIT D – LLP Profit and Loss Account (Format 2)

LLP WITH AUTOMATIC DIVISION OF ALL PROFITS

… Note that there are some scenarios in which the result for the financial year, after members’ remuneration charged as an expense, will not be nil. For example:

- An LLP may make losses in a period. Unless the LLP has the right to recover those losses from its members, it is likely to report a net loss for the period.

- Some LLPs may make automatic distributions to members on the basis of a profit figure that differs from profits reported in the statutory financial statements (e.g. on the basis of management accounts that do not reflect certain accounting adjustments). This may result in members’ remuneration charged as an expense for a period exceeding the profits generated in that period. When this is the case, unless the LLP has the right to recover that excess from its members, it is likely to report a net loss for the period.

If the result for the financial year is negative, it would be appropriate to label it as ‘Loss for the financial year’.~~, and a~~ To the extent that the result for the financial year is either positive or negative, a corresponding adjustment would be made to the negative balance ~~would be~~ shown in ‘Members’ other interests – other reserves classified as equity’.

Example 11 – LLP which has to automatically divide profits has certain members who do not provide any substantive services to it.

An LLP may have two distinct types of members, all providing capital to it: those that provide services in return for a share of profits and those that do not provide any substantive services, but still receive a share of profits. For example, an LLP that has been set up for property development may have a partner who is carrying out the development work and another who is only funding the project; or a professional services firm might have members who are not working for it but nevertheless share in the profits as a result of introducing capital.

Paragraph 34 of the SORP says that ‘where remuneration, or part thereof, is clearly identifiable as a return on the amounts subscribed – for example, non-discretionary interest payments – rather than a return for the services provided by the members, then the amounts subscribed and that part of the remuneration that is clearly identifiable as a return on the amounts subscribed would be analysed together for accounting purposes’. In other words, the automatic division of profits to those members who do not provide any substantive service (non-working members) to the LLP is a return on their capital invested.

The non-working member's right to the automatic division of future profits is a contractual obligation for the LLP to deliver cash to the non-working member and therefore gives rise to a financial liability. The financial liability is a non-basic financial instrument in scope of section 12 of FRS 102[1] (See FRS 102.11.9A Example 10).

~~Accordingly, the amount subscribed by the non-working members will be initially recognised as a financial liability.~~ The financial liability to the non-working member will be recognised by an LLP on subscription of capital by that member. As a non-basic financial instrument, the financial liability is recognised initially at fair value in accordance with FRS 102.12.7. In an arm's length transaction the fair value will be equal to the amount subscribed. It should be noted that there are many ways in which subscription of capital could arise including, as in this example, a capital payment made to and retained by the LLP. However, when the capital payment from the incoming member is paid either directly or indirectly to other members, the payment made by the new member should be analysed separately from the distribution to members. Specifically, when a new member will not be providing any substantive services, even if the capital subscribed by that new member is paid directly to existing members (and is never received in cash by the LLP), it will still be necessary for the LLP to recognise a liability in respect of the obligation to pay a share of future profits to that new member. ~~The obligation to automatically divide profits represents a right to future profits which must be recognised in the subsequent measurement of the amounts due to members.~~

~~Exactly how that financial liability is measured at subsequent reporting dates will depend on which accounting policy options are chosen when applying paragraphs 11.2 or 12.2 of sections 11 and 12 of FRS 102. For those LLPs reporting under sections 11 and 12 of FRS 102,~~ Following initial recognition, the financial liability to the non-working member ~~this obligation to pay future profits will be a non-basic financial instrument in the scope of FRS 102.12 and, as such, may~~ will have to be accounted for either as at fair value through profit or loss or at amortised cost. The financial liability will need to be measured as at fair value through profit or loss unless this is prohibited by the Small LLP Regulations or the LLP Regulations, in which case it will be measured at amortised cost in accordance with FRS 102.12.8(c). For this type of liability the key factor in determining whether fair value measurement is permitted by the Regulations is likely to depend on whether the variability due to future profits of the LLP is considered to be a 'non-financial variable specific to a party to a contract' in the context of the definition of a derivative (see the Glossary to FRS 102). If the variability due to future profits of an LLP is not considered to be a non-financial variable specific to a party to a contract, then the financial liability must be measured as at fair value through profit or loss.~~, depending on the judgement over whether the embedded derivative, being the right to a share of future profits, meets the definition of a derivative as defined in IFRS 9 [FRS 102.11 Example 10]. In this context, that judgement will be whether the right to the share of profits is deemed to be a non-financial~~

[1] As an accounting policy choice, paragraph 11.2 of FRS 102 allows that, rather than applying the recognition and measurement provisions of sections 11 and 12, an entity can choose to apply either (1) the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement or (2) the recognition and measurement provisions of IFRS 9 Financial Instruments (together with those provisions of IAS 39 that have not yet been superseded by IFRS 9). In all cases, the disclosure requirements of sections 11 and 12 continue to be applicable.

~~variable specific to a party to the contract. If it is, then the non-basic financial liability would not be permitted to be recognised at fair value, as the right to future profits would not meet the definition of a separable embedded derivative in IFRS 9 [IFRS 9.4.3.1].~~

~~However, if the liability has to be measured at amortised cost [FRS 102.12.8 (c)], it will still be necessary to remeasure the liability at each reporting date, and there may still be significant volatility in that measurement.~~ There may be significant volatility in the measurement of the financial liability irrespective of the measurement basis. Both fair value and amortised cost measurements would be updated to reflect the latest estimates of future cash flows as at the reporting date; the main measurement difference is that, under amortised cost, those cash flows would be discounted at the original effective rate (see FRS 102.11.20), whereas a current discount ~~market interest~~ rate would be used to measure fair value.

~~For those LLPs that, under FRS 102, have taken the option to apply the recognition and measurement provisions of IFRS 9, the remeasurement of the change in the liability to pay future profits will, most likely, be accounted for by applying the guidance in IFRS 9.B5.4.6.~~

~~In all cases, t~~ The balancing entry that reflects the change in the liability to pay future profits in respect of the new non-working members interest should be included as a component of members' remuneration charged as an expense because of the LLP having to automatically divide profits with its members. This example does not seek to address the effect of the remeasurement of the liability for new non-working member's interest on other members' interests.

~~It should be noted that there are many ways in which this situation could arise including, as in this example, a capital payment made to and retained by the LLP, However, where the capital payment from the incoming member is paid either directly or indirectly to other members, the payment made by the new member should be analysed separately from the distribution to members. Specifically, when a new member will not be providing any substantive services, even if the capital subscribed by that new member is paid directly to existing members (and is never received in cash by the LLP), it will still be necessary for the LLP to recognise a liability in respect of the obligation to pay a share of future profits to that new member.~~

Illustrative journal entries

Suppose that a new member, who will not be providing any substantive services to the LLP, subscribes £1,000 in exchange for a right to a share of future profits each year. Profits are automatically divided.

During the year, drawings of £90 are paid to the member, which are recoverable to the extent that they exceed the profit share for the year.

At the subsequent year end, the total amount automatically divided and allocated to the member in respect of the year (including the £90 already paid) is calculated as £200.

In addition, subsequent to the automatic division of profits, the liability is remeasured in accordance with the guidance discussed above. As at the year end, the recalculated liability in respect of future years is £1,080 which, together with the amount not yet distributed of £110 (£200 – £90), gives a total liability of £1,190.

On subscription of capital

Dr Cash	1,000	
Cr Liability to member		1,000

On payment of drawings

Dr Liability to member	90	
Cr Cash		90

At subsequent reporting date

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

* This represents the amount allocated for the year (£200) as adjusted by the remeasurement of the liability for future years (£1,080 – £1,000 = £80).

The illustrative journal entries are in respect of the new non-working member's interest only. They do not address the effect of the remeasurement of the liability for the new non-working member's interest on other members' interests. However, where the remeasurement of the liability results in a loss for the financial year after members' remuneration charged as expense (see Exhibit D) the corresponding debit will be to 'Members' other interests – other reserves classified as equity' and the entity will not be able to adopt the presentation set out in Exhibit A.