Understanding the SORP

Its purpose and importance

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Understanding the SORP

The UK Statement of Recommended Practice (SORP) for Limited Liability Partnerships (LLPs) is an authoritative guide issued by the Consultative Committee of Accountancy Bodies (CCAB). It is specifically designed to address the unique issues faced by LLPs and aims to ensure that their financial statements are as comparable as possible with those of other entities.

The SORP is essential for interpreting LLP agreements in the context of applying UK Generally Accepted Accounting Practice (GAAP). It provides a structured framework for LLP accounting, thereby enhancing clarity and consistency in financial reporting.

The importance of the SORP is underscored by its role in enhancing transparency and accountability in the financial operations of LLPs. By standardising the presentation of financial statements, the SORP ensures improved understanding and comparability across various entities.

The Statement of Recommended Practice (SORP) is periodically revised to align with evolving accounting standards and practices. For instance, the most recent version, applicable to periods beginning on or after 1 July 2024, includes all amendments up to July 2023.

In conclusion, the UK SORP for LLPs is an invaluable resource for LLPs, accountants, and stakeholders. It offers a clear and consistent framework for accounting and financial reporting, highlighting a commitment to transparency, accountability, and best practices in financial management.

UK SORP for LLPs

The UK's SORP has undergone numerous significant amendments since its inception. Each revision has sought to enhance and refine the accounting and reporting standards for LLPs, ensuring clarity, transparency, and adherence to evolving financial regulations and economic conditions. This summary highlights the key changes and improvements across the various versions of the SORP, culminating in the most recent edition.

The initial SORP for LLPs was introduced to provide a framework tailored to the unique structure and requirements of LLPs, distinguishing them from other corporate entities.

The journey of the SORP: From inception to modern day

2002 SORP

- This was the first SORP specifically produced for LLPs that was released, it sought to provide guidance that aligned with the Limited Liability Partnerships Act 2000.
- Focused on the fundamental accounting principles for LLPs, including the treatment of members' interests, profit allocation, and financial disclosures.

2006 SORP

- **Amendments:** Updates to reflect the implementation of the International Financial Reporting Standards and UK Generally Accepted Acconting Practice (UK GAAP).
- **Enhancements:** Further improvements and clarifications in relation to areas of financial instruments, revenue recognition and the consolidation of financial statements.

2010 SORP

- **Amendments:** Updates to address economic conditions post the 2008 financial crisis.
- **Additions:** More definitive focus on transparency and need for robust disclosures to ensure that all LLPs presented financial statements that were comparable with this of other entities.

2014 SORP

- **Amendments:** Updated to align the SORP with revisions made to UK GAAP (FRS102).
- **Principal Modifications:** The update incorporated stipulations for the acknowledgement and quantification of financial instruments, alterations in accounting policies, and the handling of transactions involving related parties.
- The revisions augmented the uniformity and comparability in financial reporting across Limited Liability Partnerships (LLPs).

2018 SORP

- The 2018 SORP sought to align more closely with FRS 102, ensuring consistency with the broader UK GAAP framework.
- Sought to provide more detailed guidance on the classification and disclosure of members' remuneration, ensuring clearer differentiation between remuneration and profit shares.
- Sought to expand the disclosure requirements, particularly concerning related party transactions and financial risks, to improve transparency and stakeholder confidence.
- Sought to update the revenue recognition criteria to ensure consistency with IFRS 15, providing a more robust framework for recognising revenue from contracts with customers.
- Sought to provide enhanced guidance on the recognition and measurement of provisions and contingencies.

2022 SORP

- The purpose of the revised SORP was to provide clarification and additional guidance with regard to the treatment of transactions and balances with members. The CCAB noted that there was some inconsistency in many LLP's treatment of transactions and balances with members. Further guidance is provided further on page 6.

2024 SORP

- The objective of the 2024 iteration of the SORP is to address matters that are unique to LLPs and to ensure, to the greatest extent feasible, that LLPs produce financial statements that bear comparability with those of other entities. Further guidance is provided further on page 9.

Below we have detailed the UK SORP for LLPs for the years 2022 and 2024, aiming to enhance understanding of these versions.

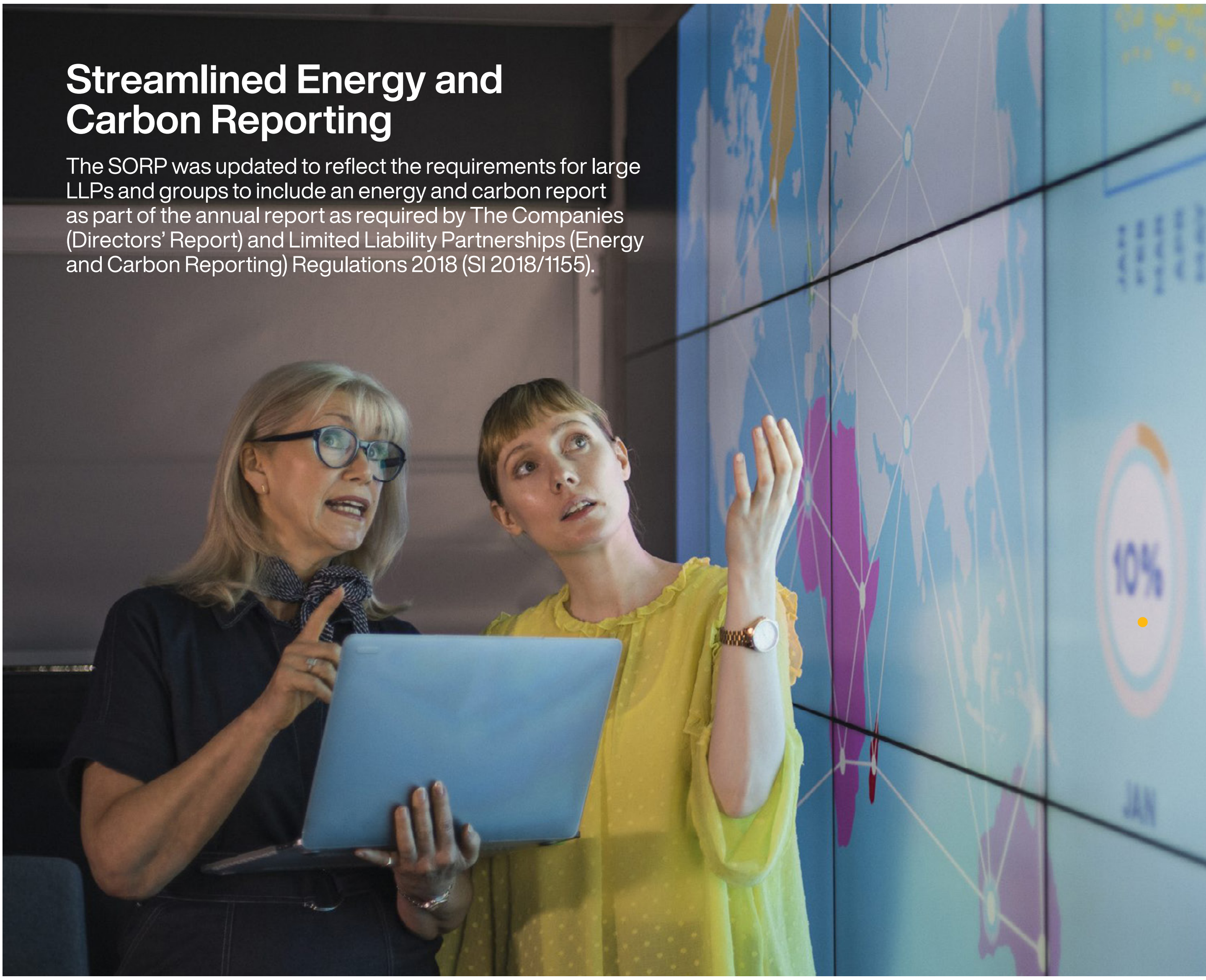
2022 SORP for LLPs

The 2022 SORP for LLPs underwent a significant revision to enhance clarity and understanding of existing principles and terminology. This update did not introduce new terms or alter existing ones; rather, it aimed to make current concepts more comprehensible.

Below are the critical points to note. While we have focused on key topics, additional clarifications have also been made in the SORP:

Streamlined Energy and Carbon Reporting

The SORP was updated to reflect the requirements for large LLPs and groups to include an energy and carbon report as part of the annual report as required by The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Reporting) Regulations 2018 (SI 2018/1155).



Automatic Profit Division

The revised 2022 SORP offered further clarifications on determining whether an LLP possesses an unconditional right to avoid transferring cash or other assets to its members. Supplementary guidance was offered regarding the automatic allocation of profits to members who do not contribute significant services to the LLP.

In the revised SORP, profit divisions within a LLP are classified as either discretionary or automatic. Discretionary divisions, which remain as equity until division, require a decision by the LLP, which retains the unconditional right to refrain from making such a decision.

The SORP highlights that the default position on profit division within an LLP is irrelevant. The crucial factor is the LLP's unconditional right to indefinitely retain profits. If the LLP's right to withhold payment is conditional, such as due to short-term cash flow issues, it may still have an unconditional right to avoid cash delivery once these issues are resolved. However, this may vary depending on the specific terms outlined in the LLP Deed.

Discretionary profit divisions are debited directly to equity in the year they occur. As stated in paragraph 45B of the SORP, a discretionary profit division occurring after the balance sheet date is classified as a non-adjusting event under section 32 of FRS 102.

Automatic profit divisions, recognised as liabilities, are obligations that the LLP cannot unconditionally avoid. These typically include:

- Salaries: Regular payments to members as stipulated in the LLP agreement;
- Interest on capital balances: Payments on members' capital contributions as agreed in the LLP deed.

These items are treated as liabilities because the LLP is contractually obligated to make these payments, regardless of its financial performance.

While the SORP amendment does not generally alter how LLPs account for profit divisions, there may be instances where a division is deemed automatic rather than discretionary, or vice versa.

The interpretation of various clauses in the LLP agreement often presents challenges in determining the application of accounting requirements. As classification depends on the terms of the LLP's members' agreement, LLPs may wish to review whether their existing agreement clearly addresses these points considering the revised SORP.

In a LLP, the automatic division of profits typically refers to a pre-established agreement among the partners regarding the distribution of profits, generally incorporated into the LLP's operating agreement.

Division, Distribution, and Allocation: Key Insights from the new SORP for UK LLPs

Division

Definition: The mechanism by which the profits of an LLP become a debt due to members.

Key Points

- **Automatic Divisions:** Recognised as liabilities if the LLP does not have an unconditional right to avoid them (e.g., salaries, interest on capital).
- **Discretionary Divisions:** Debited directly to equity and treated similarly to equity dividends. Discretionary divisions occurring after the balance sheet date are non-adjusting events under section 32 of FRS 102.

Distribution

Definition: The actual payment of profits to members, either in cash or other assets.

Key Points

- **Timing:** Distributions are made periodically based on the LLP agreement.
- **Accounting Treatment:** Distributions reduce Loans and other debts due to members and are not recognised as expenses.

Allocation

Definition: The method of assigning profits or losses to individual members based on the LLP agreement..

Key Points

- **Basis:** Allocations are typically based on members' capital contributions, agreed profit-sharing ratios, or other criteria specified in the LLP deed.
- **Impact:** Allocations have no impact on the financial statements of an LLP as they impact the amounts due to individual members and not the aggregate amounts disclosed within the statement of changes in equity incorporating members interests.

In reality, many LLP agreements use the terminology above interchangeably, or in some instances may not specifically address the specific mechanisms. LLPs may look to revisit the terminology used within their agreements to align with this terminology to aid transparency and mitigate potential disputes.

Member Payment Classifications

The SORP now requires clarity on categorising member payments in cash flow statements. There are alternative classifications within the cash flow statement relating to distributions to members (operating or financing cashflows), and a requirement for LLPs to disclose their accounting policy for classifying such distributions and apply this policy consistently from year to year.

This modification enables LLPs to categorise these cash flows as either payments for services provided to the LLP as part of its revenue-generating activities (operating), or as expenses incurred in securing financial resources or entitlements to cash flows from the LLP's capital providers (financing), depending on the LLP's specific circumstances.

2024 SORP for LLPs

Executive Summary

In May 2024 the CCAB issued a revised SORP for LLPs, effective for periods commencing on or after 1 July 2024. The new edition incorporates several updates and clarifications to ensure that LLPs' financial statements are comparable with those of other entities. Similar to the 2022 iteration, the 2024 edition aims to enhance consistency, comprehensiveness, and transparency in financial reporting.

The amendments and clarifications in the revised 2024 SORP respond to the dynamic commercial environment and evolving regulatory landscape in the UK. These changes are designed to ensure that LLPs provide their stakeholders with relevant and reliable financial information.

Key updates

- **Climate-Related Financial Disclosure Regulations:** The SORP now reflects the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/46), requiring certain LLPs and groups to make climate-related financial disclosures in line with the Taskforce for Climate-related Disclosures (TCFD) recommendations.
- **Automatic Division of Profits:** A new paragraph (34D) has been added to clarify that an automatic right to a share of the LLP's profits, without providing any substantive services, should be treated as a return on capital. Additionally, Example 11 in Appendix 2 has been added to clarify this position.
- **Clarification on Members' Rights:** The SORP provides guidance on analysing members' participation rights in the earnings or assets of an LLP between a financial liability or equity, as per section 22 of FRS 102.
- **Guidance on Post-Retirement Obligations:** The flowchart on paragraph 76B has been updated to provide guidance applicable to a particular obligation, including the uncommon circumstances in which FRS 103 Insurance Contracts applies, as well as when the requirements of section 26 Share-based Payment of FRS 102 apply.
- **Guidance on Interests held in Subsidiary LLPs**: New paragraphs (119A to 119H) have been added to provide guidance on the appropriate treatment of members' debt and equity interests in a subsidiary LLP.

Key Modifications and Amendments in the 2024 UK SORP for LLPs

This summary highlights the significant changes and updates that have been incorporated into the latest version of the SORP, ensuring clarity, transparency, and compliance with current financial regulations and economic contexts.

Climate-Related Financial Disclosures

According to the new SORP for UK LLPs, certain LLPs are required to apply the Taskforce for Climate-related Financial Disclosures (TCFD) regulations. These requirements are primarily aimed at larger LLPs and those with significant public interest.

Category	Thresholds
Large LLPs	▪ Turnover > £500 million (on a consolidated basis, if applicable)
Public Interests LLPs	▪ LLPs with more than 500 employees and either: ▫ Listed on a regulated market (for example, London Stock Exchange) ▫ Banking or insurance companies
Other LLPs	▪ LLPs that voluntarily choose to adopt TCFD recommendations

Summary

- **Large LLPs**: Must apply TCFD if their turnover exceeds £500 million;
- **Public Interest LLPs:** Must apply TCFD if they have more than 500 employees and are either listed on a regulated market or are banking/insurance companies;
- **Other LLPs:** May choose to adopt TCFD recommendations voluntarily.

Members’ Interests in Subsidiary LLPs

New sections clarify the treatment of members’ debt and equity interests in subsidiary LLPs. In group accounts, only members’ equity interests that are not attributable to the parent LLP are recognised as non-controlling. Ref: Paragraph 119A – 119H.

The guidance has been updated to address the presentation of members’ remuneration charged as an expense within the subsidiary LLP entity accounts in the parent’s group accounts. This applies to both scenarios where the members of the subsidiary LLP and the parent LLP are different individuals, and where the members of the subsidiary LLP are also members of the parent LLP.

Overview of Members’ Remuneration in Parent LLP Consolidated Accounts

There are two interpretations regarding the inclusion of members’ remuneration in the consolidated accounts of a parent LLP:

Option 1

Interpretation: Only includes amounts payable to members of the parent LLP.

Implications:

- subsidiary members’ remuneration is treated as a staff cost or interest cost in the parent LLP’s consolidated accounts, unless the member is also a member of the parent LLP
- this approach may simplify the parent LLP’s financial statements but could obscure the total remuneration costs within the group.

Option 2

Interpretation: Includes subsidiary members’ remuneration charged as an expense.

Implications:

- reflects a more comprehensive view of the group’s total remuneration costs
- aligns with the requirement that group accounts should comply with Schedule 1 provisions of the Companies Act as if the undertakings were a single LLP.
- this approach may provide greater transparency but could complicate the parent LLP’s financial reporting.

Post-Retirement Obligations

The SORP now encompasses updated flowcharts and guidance on determining the applicable accounting treatment for post-retirement obligations, incorporating scenarios where FRS 103 Insurance Contracts or Section 26 of FRS 102 are applicable. Ref: Paragraph 87A – 87D.

Implementation and Compliance

The 2024 SORP for LLPs introduces significant modifications aimed at enhancing the transparency and comparability of financial statements. These changes may necessitate updates to LLPs' accounting practices and systems to ensure compliance. The revisions are designed to provide stakeholders with a clearer understanding of LLPs' financial health and sustainability practices.

Key Updates and Clarifications

The latest SORP includes additional disclosure obligations, particularly in the notes accompanying the accounts. These obligations cover several critical areas:

- **positioning of member loans and debts:** The SORP clarifies how member loans and debts should be treated relative to other unsecured creditors during a winding-up petition
- **safeguards for creditors:** Ensures that certain protections are extended to creditors, making them immune to revocation by members
- **quantification of member debts:** Requires a detailed account of the debts owed by members to the LLP
- **policies on fund contributions and repayments:** Mandates clear policies governing the contribution of funds by members and the corresponding repayments by the LLP.

Furthermore, LLPs must provide explicit details of their policies concerning account drawings and profit distribution. This requirement aims to ensure transparency and accountability in the financial operations of the LLP. Adhering to these guidelines is crucial for maintaining the integrity of the financial reporting process.

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Start the conversation

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