

<p><b>Q&amp;A CNC 15/005</b></p>	<p><b><u>QUESTIONS / ANSWERS:</u></b></p> <p><b>INVESTMENT ENTITIES: COMPATIBILITY OF THE EXCEPTION FROM CONSOLIDATION (IFRS 10 § 31) WITH THE CONSOLIDATION OBLIGATION (SECTION XVI LSC)</b></p>
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**Context:**

In accordance with the Accounting Directive<sup>1</sup>, the LUX GAAP and LUX GAAP – FV regimes<sup>2</sup> lay down the general rule that consolidated accounts must be drawn up by any parent undertaking controlling – at least – one subsidiary undertaking.

However, the entry into force – with effect from financial years starting in 2014 – of the so-called "Investment Entities" amendments<sup>3</sup> to IFRS 10 "Consolidated Financial Statements" has changed the accounting paradigm applicable to investment entities<sup>4</sup> within the meaning of paragraph 27 of IFRS 10. Paragraph 31 of IFRS 10 stipulates that investment entities may no longer consolidate their subsidiaries (except those which – In accordance with paragraph 32 – provide services related to the investment activities of the investment entity) but must measure their investments in subsidiaries at fair value through profit or loss in accordance with IFRS 9.

This transition – for investment entities – from a mandatory regime to a prohibition<sup>5</sup> of consolidation raises a number of uncertainties as to the effects of the apparent incompatibility between the IFRS – EU regime and the accounting regimes resulting from the Accounting Directive 2013/34/EU.

**Question:**

Does a parent undertaking governed by Luxembourg law which meets the definition of an "investment entity" within the meaning of paragraph 27 of IFRS 10 and which applies the IFRS – EU regime – either by obligation (art. 4 of the IAS Regulation) or by option (art. 5 point b) of the IAS Regulation and art. 341bis LSC) – satisfy the obligations laid down by the Accounting Directive 2013/34/EU and by section XVI LSC?

**Key words:** Section XVI LSC, IFRS 10, Investment entities, consolidation exception, sub-group exemption, IAS Regulation 2002, Accounting Directive, Regulation (EC) No 1606/2002, Directive 2013/34/EU, art. 341bis LSC

<sup>1</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

<sup>2</sup> The LUX GAAP and LUX GAAP – FV regimes are defined in Q&A CNC 14/001 "Luxembourg accounting law applicable to undertakings: three distinct regimes" (formerly Q&A 01/2014).

<sup>3</sup> On 31 October 2012, the IASB published the "Investment Entities" amendments to IFRS 10, IFRS 12 and IAS 27. These amendments were adopted ("endorsed") by the European Union on 20 November 2013 (OJEU 21 November 2013) with application to financial years beginning on or after 1<sup>st</sup> January 2014.

<sup>4</sup> Paragraph 27 of IFRS 10 sets out the criteria for determining whether an undertaking is an investment entity:

"27 A parent shall determine whether it is an investment entity (...) an entity that:

(a) obtains funds from one or more for the purpose of providing those investor(s) with investment management services;  
(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and  
(c) measures and evaluates the performance of almost all of its investments on a fair value basis.

Paragraphs B85A to B85M provide related application guidance".

<sup>5</sup> Paragraph 31 of IFRS 10 prohibits consolidation, stating that "Except as described in paragraph 32, **an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9**".

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**Answer:**

**1. For undertakings covered by Article 4 of the IAS Regulation<sup>6</sup> : the special law takes precedence over the general law of the Accounting Directive**

In 2013, the European Commission was alerted to the apparent incompatibility between the provisions of the Accounting Directives and those of the IAS Regulation of 2002 for investment entities. After analysis and for the purposes of legal certainty, the European Commission published a working document on 6 June 2013 entitled "*Commission services' views on the interaction between the amendments to IFRS 10, IFRS 12 and IAS 27 regarding investment entities and the 7<sup>th</sup> Directive – Groups comprised of only investment entities*"<sup>7</sup>.

In essence, the issue was to determine whether a publicly traded investment entity<sup>8</sup> subject – by obligation – to the IAS Regulation of 2002 met the requirements of the Accounting Directive. Some Member States were concerned about the potential duplication that could result from this situation, i.e. the obligation to prepare simultaneously IFRS 10 compliant financial statements under the IAS Regulation of 2002 and consolidated accounts under the Accounting Directives.

At the end of their analysis, the European Commission confirmed that, in application of the rule known as "*lex specialis derogat lex generalis*", special accounting law – that of the IAS Regulation of 2002 – takes precedence over general accounting law – that of the accounting directives<sup>9</sup>.

<sup>6</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards

<sup>7</sup> The working document is available on the European Commission's website at the following address: [http://ec.europa.eu/internal\\_market/accounting/docs/arc/2013-07-05-staff-working-paper-ifs10\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/arc/2013-07-05-staff-working-paper-ifs10_en.pdf)

<sup>8</sup> Undertaking whose securities are admitted to trading on a regulated market in a Member State of the European Union.

<sup>9</sup> See in particular recital (7) of Directive 2013/34/EU:

"(7) *The provisions of this Directive [2013/34/EU] should apply only to the extent that they are not inconsistent with, or contradicted by, provisions on the financial reporting of certain types of undertakings or provisions regarding the distribution of an undertaking's capital which are laid down in other legislative acts in force adopted by one or more Union institutions.*"

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Accordingly, an investment undertaking preparing financial statements in accordance with IFRS 10 and with the consolidation exception (IFRS 10 § 31) in application of the IAS Regulation of 2002 is deemed to meet the requirements of Directive 2013/34/EU<sup>10</sup>.

Consequently, it must be considered that **the IFRS financial statements of an undertaking governed by Luxembourg law, subject to the IAS Regulation of 2002 and meeting the definition of an investment entity within the meaning of IFRS 10, meet the requirements of the Accounting Directive 2013/34/EU** and should therefore be filed with the Trade and companies register (RCS) for publication in place and stead of the consolidated accounts drawn up in accordance with the Accounting Directive<sup>11</sup>.

**2. For undertakings exercising the option under Article 341bis LSC provided for in Article 5(b) of the IAS Regulation: same treatment for same regime**

In the Luxembourg context, as in other Member States which have exercised the options provided for in Article 5 of the IAS Regulation 2002<sup>12</sup>, the uncertainties as to the effects generated by the apparent incompatibility between the IFRS – EU regime and the regimes resulting from the Accounting Directive 2013/34/EU are not limited solely to publicly traded undertakings.

The uncertainty extends to all undertakings which – although not covered by Article 4 of the IAS Regulation of 2002 (undertakings publicly listed) – prepare their consolidated accounts in accordance with IFRS – EU pursuant to national measures taken in implementation of Article 5 point b) of the IAS Regulation of 2002. This is the case for undertakings formed under Luxembourg law exercising the option provided for in article 341bis LSC in Luxembourg.

<sup>10</sup> See in particular paragraph 4.6 of the European Commission staff working paper:

" 4.6. *Based on the above analysis, **a group that would prepare separate financial statements as a result of the situation described in this note once amendments have been made to IFRS 10, 12 and IAS 27 should be deemed to be compliant with the Seventh Directive and the IAS Regulation.** Since the application of the IAS Regulation cannot subsequently change the conditions which gave rise to this application, such group should not be required to prepare consolidated accounts in addition to those separate financial statements. This would be the same with the new Accounting Directive*".

<sup>11</sup> See in particular paragraph 4.7 of the European Commission staff working paper:

" 4.7. **Member States are encouraged** to examine in the light of their national schemes how to ensure a smooth application of this new situation. In particular, specific measures may be needed **to ensure that investment entities in this situation are allowed to publish the separate financial statements as a proxy to the consolidated financial statements which are to be filed under the Seventh Directive.**"

<sup>12</sup> See the document entitled "Overview of the use of options provided in the IAS Regulation (1606/2002) in the EU" available on the European Commission website (dec.-2013):

[http://ec.europa.eu/internal\\_market/accounting/docs/legal\\_framework/20140718-ias-use-of-options\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/legal_framework/20140718-ias-use-of-options_en.pdf)

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For these undertakings, the situation appears distinct insofar as, unlike publicly listed undertakings, they are not prohibited from consolidating their subsidiaries since the IFRS regime does not apply to them on a mandatory basis. In fact, they are free not to use the IFRS regime (special accounting law) and to apply only the accounting directive (general accounting law), which requires the consolidation of undertakings using the full consolidation method.

However, such reasoning does not seem appropriate insofar as it amounts to applying a distinct treatment to a regime that is nonetheless identical. In other words, IFRS – EU financial statements would then be considered as "equivalent" to consolidated financial statements drawn up in accordance with the Accounting Directive for publicly listed undertakings, but "not equivalent" for other undertakings. Such a difference in treatment does not seem justified, particularly given that the European Commission encourages Member States to authorise or require their undertakings to use IFRS<sup>13</sup>. However, the absence of equivalence could be perceived as an obstacle to this objective.

Consequently, it must be considered that **the IFRS financial statements of an undertaking governed by Luxembourg law exercising the option under article 341bis LSC to use international accounting standards and meeting the definition of an investment entity within the meaning of IFRS 10, meet the requirements of the Accounting Directive 2013/34/EU** and are therefore filed with the Trade and companies register (RCS) for publication in place and stead of consolidated accounts prepared in accordance with the Accounting Directive.

<sup>13</sup> See in particular the Communication from the Commission to the Council and the European Parliament entitled "EU Financial Reporting Strategy: the way forward", Brussels, 13 June 2000 (COM(2000)359 final).

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### 3. Conclusion

Further to the above analysis, it must be considered that **the financial statements of a parent undertaking governed by Luxembourg law which meets the definition of an "investment entity" within the meaning of paragraph 27 of IFRS 10 and which applies the IFRS – EU regime – either by obligation (art. 4 of the IAS Regulation) or by option (art. 5 point b) of the IAS Regulation and art. 341bis LSC) – meet the requirements laid down by the Accounting Directive 2013/34/EU and by section XVI LSC with regard to the preparation of consolidated accounts.**

As a result, these financial statements prepared in accordance with IFRS 10 are being filed with the Trade and companies register (RCS) for publication in place and stead of the consolidated accounts prepared in accordance with the Accounting Directive.

#### Disclaimer

**This document – provided as a courtesy – is an unofficial translation of the French original document entitled “Entités d’investissement: compatibilité de l’exception à la consolidation (IFRS 10 § 31) avec l’obligation de consolidation (section XVI LSC)”. In case of discrepancy in interpretation, the French version shall prevail.**

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- are of a general nature and do not refer to the specific situation of any natural or legal person;
- are intended to contribute to the development of accounting doctrine in accordance with Article 73(b) of the amended Law of 19 December 2002 on the trade and companies register, as well as on the bookkeeping and annual accounts of undertakings;
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