

<p>Q&A CNC 15/006</p>	<p><u>QUESTIONS / ANSWERS :</u></p> <p>SUBSIDIARIES OF INVESTMENT ENTITIES (IFRS 10 § 27) AND CONTINUATION OF CONSOLIDATION EXEMPTIONS OF SUB-GROUPS (ART. 314, 315 AND 316 LSC)</p>
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Context:

In accordance with the Accounting Directive¹, the LUX GAAP and LUX GAAP – FV regimes² lay down as a general rule the principle that consolidated accounts must be prepared by any parent undertaking controlling – at least – one subsidiary undertaking. However, the LUX GAAP and LUX GAAP – FV regimes – like the Accounting Directives and subject to compliance with the conditions set out in articles 314³, 315⁴ and 316⁵ LSC – provide for the principle of exemption from the preparation of consolidated accounts for parent undertakings which are also subsidiary undertakings ("sub-groups"). The conditions for exemption include (i) the inclusion of the exempt undertaking and of its subsidiary undertakings in the consolidated accounts of a larger body of undertakings and (ii) the preparation of such consolidated accounts in accordance with Section XVI of LSC or in an equivalent manner⁶.

In this context, a parent undertaking governed by Luxembourg law may generally avail itself of one of the exemptions provided for in articles 314, 315 and 316 LSC – subject to compliance with all the conditions provided for in those articles – when it is itself controlled by a parent undertaking which includes it, together with its subsidiary undertakings, in its consolidated accounts prepared in accordance with the IFRS – EU regime. The IFRS – EU regime is in fact considered as equivalent to the accounting regimes resulting from the Accounting Directive pursuant to Article 23 paragraph 8 point b) of Directive 2013/34/EU.

However, the entry into force of the October 2012 "*Investment Entities*" amendments to IFRS 10 "*Consolidated Financial Statements*"⁷ for undertakings meeting the definition of "investment entities" (IFRS 10 § 27)⁸ has had the effect of changing the accounting paradigm.

¹ 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 undertaking, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

² 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).

³ Article 314 of LSC refers to cases of exemption where the parent undertaking controlling and consolidating the Luxembourg undertaking and its subsidiaries within its consolidated accounts is governed by the law of a Member State of the European Union and holds either all or 90% or more of the shares of the exempted company.

⁴ Article 315 LSC refers to situations where the parent undertaking controlling and consolidating the Luxembourg undertaking and its subsidiaries within its consolidated accounts is governed by the law of a Member State of the European Union or not and – while controlling the Luxembourg undertaking and its subsidiaries – holds less than 90% of the shares in the exempted company.

⁵ Article 316 of the LSC refers to cases of exemption where the parent undertaking controlling and consolidating the Luxembourg undertaking and its subsidiaries within its consolidated accounts is not governed by the law of a Member State of the European Union and holds either all or 90% or more of the shares in the exempted company.

⁶ See Q&A CNC 15/004 for developments on the concepts of conformity and equivalence (formerly Q&A 001/15).

⁷ 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 1st January 2014.

⁸ 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:

<p>Q&A CNC 15/006</p>	<p><u>QUESTIONS / ANSWERS :</u> SUBSIDIARIES OF INVESTMENT ENTITIES (IFRS 10 § 27) AND CONTINUATION OF CONSOLIDATION EXEMPTIONS OF SUB-GROUPS (ART. 314, 315 AND 316 LSC)</p>
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The effect of these amendments was to introduce a "consolidation exception" (IFRS 10 § 31)⁹ under which investment entities may no longer consolidate their subsidiaries – except those that provide services related to the investment activities of the investment entity (IFRS 10 § 32)¹⁰ – 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 consolidation prohibition regime raises several uncertainties, in particular as to whether or not the exemptions provided for in articles 314, 315 and 316 of LSC could be maintained for Luxembourg undertakings that are subsidiaries of investment entities using IFRS.

Question:

Does a Luxembourg parent undertaking held by an investment entity within the meaning of IFRS 10 benefit – following the entry into force of the "Investment Entities" amendments to IFRS 10 – from the continuance of the exemption from drawing up consolidated accounts pursuant to articles 314, 315 or 316 LSC?

Key words: art. 314 LSC, art. 315 LSC, art. 316 LSC, section XVI LSC, IFRS 10, Investment entities, consolidation exception, sub-group exemption, 2002 IAS Regulation, Accounting Directive, Regulation (EC) No 1606/2002, Directive 2013/34/EU

- (a) obtains funds from one or more investors 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 substantially all of its investments on a fair value basis.

Paragraphs B85A to B85M provide relevant guidance.

⁹ Paragraph 31 of IFRS 10 prohibits consolidation by stating that:

" 31 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.

¹⁰ Paragraph 32 of IFRS 10 establishes the principle of continuation of the obligation to consolidate undertakings providing services related to the investment activities of the investment entity:

" 32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities, it shall consolidate that subsidiary in accordance with paragraphs 19-26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary".

Q&A CNC 15/006	<u>QUESTIONS / ANSWERS :</u> SUBSIDIARIES OF INVESTMENT ENTITIES (IFRS 10 § 27) AND CONTINUATION OF CONSOLIDATION EXEMPTIONS OF SUB-GROUPS (ART. 314, 315 AND 316 LSC)
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Answer:

1. Confirmation of the equivalence of IFRS 10 § 31 financial statements ("exception to consolidation") with the consolidated accounts required by the Accounting Directive¹¹

The European Commission services confirmed in a working document dated 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 7th Directive – Groups comprised of only investment entities*"¹² that the IFRS financial statements of an undertaking subject to the IAS Regulation of 2002 and meeting the definition of an investment entity under IFRS 10, meet the requirements of the Accounting Directive 2013/34/EU and that Member States must ensure that investment entities are permitted to publish those IFRS financial statements in place and stead of consolidated accounts prepared in accordance with the Accounting Directive¹³.

However, it should be noted that the Commission staff working paper does not directly address the issue of continuation of exemptions for sub-groups whose parent undertaking – Intermediate or ultimate – is an investment entity within the meaning of paragraph 27 of IFRS 10.

The recent amendments to IFRS 10 in December 2014 entitled "*Investment Entities: Applying the Consolidation Exception*" nevertheless tend to validate the assumption of continuation of the exemptions for sub-groups (see: point 2)¹⁴.

¹¹ See Q&A CNC 15/005 (formerly Q&A 002/15) for developments on the equivalence – for an investment entity – of IFRS financial statements with consolidated accounts prepared under LUX GAAP or LUX GAAP – FV.

¹² 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

¹³ 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.**"

¹⁴ The procedure for *endorsement* by the European Union is currently being completed and should be finalised in the 1st quarter of 2016 (http://www.efrag.org/Front/c1-306/Endorsement-Status-Report_EN.aspx).

**Q&A
CNC
15/006**

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**SUBSIDIARIES OF INVESTMENT ENTITIES (IFRS 10 § 27)
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2. The exemption from presenting consolidated financial statements in accordance with paragraph 4 (a) of IFRS 10: explicit confirmation by the IASB of continuation of the "sub-group" exemptions

Similar to the Accounting Directive 2013/34/EU and the exemptions in articles 314, 315 and 316 LSC, IFRS 10 paragraph 4 (a) provides an exemption from presenting consolidated financial statements for parent undertakings that meet certain criteria, including the presentation of consolidated financial statements by the parent undertaking – whether ultimate or intermediate – of the parent undertaking ("sub-group") prepared in accordance with IFRS and available to the public.

In this respect the *IFRS Interpretation Committee* received a request in 2013 concerning the continuation of the exemption provided for in paragraph 4(a) of IFRS 10 for a parent undertaking that is a subsidiary undertaking of an investment entity (but is not itself an investment entity) if the conditions set out in points (i) to (iii) of paragraph 4(a) of IFRS 10 are met but the parent undertaking and its subsidiary undertakings are not consolidated by the investment entity that controls them (IFRS 10 § 4 (a) (iv)), the latter presenting financial statements in which its subsidiary undertakings are measured at fair value in accordance with paragraph 31 of IFRS 10.

The IASB noted that the exemption in paragraph 4 (a) of IFRS 10 has historically been justified by cost considerations. Requiring parent undertakings located at an intermediate level of a group to present consolidated financial statements is likely to generate additional costs that exceed the benefits produced by said consolidated financial statements. In this respect, the IASB has reiterated that the combination of the information available in the separate financial statements of a parent undertaking exempted from presenting consolidated financial statements and in the consolidated financial statements of its parent undertaking located at a higher level is likely to provide sufficient consideration for users in terms of useful information available.

On the specific question relating to the exception from consolidation for investment entities and its effect on whether or not subsidiary undertakings retain the exemption from consolidated financial statements (paragraph 4 (a) of IFRS 10), the IASB noted that when an investment entity measures its interests in subsidiary undertakings at fair value, the disclosures required by IFRS 12 "*Disclosures of interests in other entities*" are supplemented by those required by IFRS 7 "*Financial Instruments: Disclosures*" and IFRS 13 "*Fair Value Measurement*". The IASB therefore concluded that this combination of information available in the IFRS financial statements of the parent undertaking prepared in accordance with IFRS 10 § 31 is sufficient to justify the continuation of the exemption from presentation of consolidated financial statements by a parent undertaking that is a subsidiary of an investment entity.

Q&A CNC 15/006	<u>QUESTIONS / ANSWERS :</u> SUBSIDIARIES OF INVESTMENT ENTITIES (IFRS 10 § 27) AND CONTINUATION OF CONSOLIDATION EXEMPTIONS OF SUB-GROUPS (ART. 314, 315 AND 316 LSC)
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The December 2014 amendment to IFRS 10¹⁵ thus explicitly confirms (paragraph 4 (a) (iv)¹⁶) that the exemption from preparing consolidated accounts continues to apply to a subsidiary undertaking of an investment entity that is itself a parent undertaking, even if that subsidiary undertaking is measured at fair value through profit or loss in the financial statements of the investment entity.

3. Conclusion

It may be inferred from the foregoing (points 1 and 2) that **an undertaking governed by Luxembourg law which is a subsidiary undertaking of an investment entity presenting its financial statements by applying the "consolidation exception" provided for in paragraph 31 of IFRS 10 and which is itself a parent undertaking ("sub-group") may validly claim the exemption from the preparation of consolidated accounts provided for in articles 314, 315 and 316 of the LSC, subject to compliance with all the conditions referred to in those articles.**

¹⁵ **Disclaimer:** at the time of writing the present document, the *endorsement* process by the European Union of the December 2014 amendments to IFRS 10 entitled "*Investment Entities: Applying the Consolidation Exception*" has not yet been completed. While these amendments only explicitly confirm the previous interpretation, it should nevertheless be noted that – until they are formally adopted by the European Union – they do not form part of the "IFRS – EU" framework. No specific difficulties are anticipated in the process of adoption by the European Union, as EFRAG – the European Commission's technical advisor on the adoption of IFRS – has issued a favorable opinion on these amendments ("*endorsement advice*" dated 22 July 2015).

¹⁶ IFRS 10 § 4 (a) (iv) as amended in December 2014.

"(a) a parent need not present consolidated financial statements if it meets all the following conditions:

(...)

(iv) *its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit and loss in accordance with this IFRS.*"

Q&A CNC 15/006	<u>QUESTIONS / ANSWERS :</u> SUBSIDIARIES OF INVESTMENT ENTITIES (IFRS 10 § 27) AND CONTINUATION OF CONSOLIDATION EXEMPTIONS OF SUB-GROUPS (ART. 314, 315 AND 316 LSC)
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Disclaimer

This document – provided as a courtesy – is an unofficial translation of the French original document entitled “Filiales d’entités d’investissement (IFRS 10 § 27) et maintien des exemptions de consolidation des sous-groupes (art. 314, 315 et 316 LSC)”. In case of discrepancy in interpretation, the French version shall prevail.

The “questions and answers” published by the “Commission des normes comptables (CNC)” (Accounting Standards Board):

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- represent only the opinion of the GIE CNC on a number of doctrinal and interpretative issues.

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