

<p>Q&A CNC 21/024 (R)</p>	<p><u>QUESTIONS / ANSWERS:</u></p> <p>CHANGES IN ACCOUNTING POLICIES, IN MEASUREMENT BASIS AND IN ACCOUNTING ESTIMATES UNDER LUX GAAP AND LUX GAAP-FV REGIMES</p>
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Context:

Since the entry into force of the law of 10 December 2010¹, Luxembourg accounting law applicable to undertakings has been gradually converging with the international financial reporting standards as adopted by the European Union (IFRS – EU regime). In this context, new concepts such as the substance principle² and the fair value measurement model³ have been introduced, although on an optional basis. It should be noted, however, that the introduction of these new concepts was not accompanied by any transitional provisions governing the transition from the old to the new recognition, measurement or presentation models. This raises the question of how to account for the effect of the change in the annual accounts when, for example, an undertaking chooses to change its accounting policy by applying the fair value model to a category of assets instead of the historical cost model, or vice versa. The same applies to changes in accounting estimates.

In contrast, the IFRS – EU regime generally includes transitional provisions in each standard being issued or updated and, alternatively, it has IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, to which reference may or must be made depending on the case.

As Luxembourg accounting law currently stands, the following general principles deal indirectly with these issues:

- the principle of consistency of policies / methods referred to in Article 51, para. 1), point b) LRCS, which provides that "*accounting policies and measurement bases may not be modified from one financial year to another*";
- the principle of intangibility (immutability) of the opening balance sheet referred to in Article 51, para 1), point f) LRCS, which provides that "*the opening balance sheet for each financial year must correspond to the closing balance sheet for the preceding financial year*"; and
- the principle of matching of income and expenses referred to in Article 51, para. 1, point d) LRCS, which provides that "*account must be taken of income and charges relating to the financial year in respect of which the accounts are drawn up irrespective of the date of receipt or payment of such income or charges*".

While the consistency of methods is a key principle, there are exceptions⁴. This is particularly the case when laws and regulations introduce new concepts and options that the undertaking intends to use. However, a change in accounting policy or measurement basis must remain an extraordinary event that cannot be repeated too frequently. Furthermore, in accordance with the provisions of article 51, para. 2 LRCS, the undertaking is required to duly disclose in the notes to the accounts the reasons for the change in accounting policy or measurement basis.

In view of the above and considering the silence of the texts on these issues, the purpose of this Q&A is to develop proposals for the accounting treatments applicable to changes in accounting policies, measurement basis and accounting estimates under LUX GAAP and LUX GAAP – FV that remain consistent with the general principles of Article 51, para. 1 LRCS.

¹ Law of 10 December 2010 on the introduction of international accounting standards for undertakings. *Mem. A*, n°225 of 17 December 2010

² See: Q&A CNC 20/021 Optional principle of substance (art. 29 (3) LRCS)

³ See: Q&A CNC 14/001 Luxembourg accounting law applicable to undertakings: three distinct regimes

⁴ For example, when the business model of the undertaking changes or when accounting legislation evolves

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Questions:

This Q&A proposes to provide doctrinal solutions in relation to the accounting treatment under LUX GAAP and LUX GAAP – FV of:

- changes in accounting policies and measurement basis (point 1.);
- changes in accounting estimates (point 2.).

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Definitions:

In the absence of any guidance, it is proposed firstly to define the concepts on the basis of the definitions proposed by IAS 8 mentioned above:

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an undertaking in preparing and presenting its annual accounts.

Measurement basis are a subset of accounting policies that designate the techniques used to determine the amounts of items recorded in the annual accounts.

Accounting estimates are monetary amounts recognised in the annual accounts that are subject to measurement uncertainty.

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Answers:

1. Changes in accounting policies and measurement basis

1.1. Analysis and development of doctrinal solutions

As a general rule, the accounting policies and measurement basis are chosen by the administrative or management body at the latest when drawing up the annual accounts for the first financial year following the incorporation or creation of the undertaking, it being understood that these accounting policies and measurement bases must comply with the general principles and measurement models set out in sections 7 and 7bis of Chapter II of Title II LRCS. If the undertaking is durably bound by the choice of accounting policies and measurement bases initially made, it may be that at some point in its existence, the undertaking feels the need or is obliged to change one or the other accounting policies. By way of illustration, such changes may be motivated by the desire to provide users of the annual accounts with more relevant information and/or to better reflect the *business* model of the undertaking.

In this context, the question naturally arises of the accounting treatment of changes in accounting policies or measurement bases.

Broadly speaking, there are three technically possible solutions:

- (1) a first possibility would be to apply the change "retrospectively"⁵, i.e. as if the new accounting policy had always been applied, with the opening balance sheet and comparative figures being amended for comparability purposes. A major problem arises with the application of the retrospective change, namely non-compliance with the key principle of intangibility (immutability) of the opening balance sheet referred to in Article 51 para. 1 point f) LRCS.
- (2) a second option would be to apply the change – for the portion relating to previous financial years – in the accounts "at the very beginning of the financial year"⁶ in which the decision to make a change is taken. The effect of the change of accounting policies relating to the current financial year would be recognised at the end of the financial year. This option would ensure compliance with the principle of intangibility (immutability) of the opening balance sheet in respect of the closing balance sheet of the previous financial year, as well as compliance with the principle of matching income and expenses for the financial year.
- (3) a third option would be to apply the change "prospectively"⁷, i.e. to apply the new accounting policy as from the date of the change by recognising the effect of the change of accounting policy in the annual accounts for the year in which the decision to change was taken. The principle of intangibility (immutability) of the opening balance sheet would then be complied with, but the principle of matching income and expenses for the financial year would be derogated from.

⁵ In accordance with IAS 8 para. 5:

"Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied".

⁶ The opening balance sheet for the financial year will then correspond to the closing balance sheet for the previous financial year, with the change being recorded on the first day of the financial year in which the change takes place.

⁷ In accordance with IAS 8 para. 5:

"Prospective application of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

(a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

(b) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change".

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In view of the above, CNC is of the opinion that the first option should be ruled out, as retrospective application of a change in accounting policy would violate the key principle of the intangibility (immutability) of the opening balance sheet.

CNC considers that the **preferred solution** for accounting for a change in accounting policy and measurement basis under LUX GAAP and LUX GAAP – FV is the second option mentioned above (see illustrative example 1). The effect of the change of accounting policy would thus be recognised at the opening date of the financial year in which the decision to change was taken, for the portion relating to previous financial years. All balance sheet captions affected by the change would be adjusted and the resulting impact recognised directly in equity. Appropriate information would be provided in the notes to the annual accounts⁸. The portion of the change in accounting policy corresponding to the current financial year would be recognised at the end of the financial year. This treatment makes it possible to recognise the effects of the change as if the new accounting policy had always been applied, without derogating from the principle of intangibility (immutability) of the opening balance sheet, while ensuring a true and fair view of the profit and loss account for the current financial year. Indeed, the profit and loss account is not impacted by the cumulative effects of previous years, thereby complying with the principle of matching of income and expenses.

From a practical point of view, however, this preferred solution may be impracticable, for example when the undertaking is unable to break down the amounts relating to previous financial years and the current financial year. Having to carry out two appraisals during the same financial year, one on the opening date and the other on the closing date, may also prove prohibitive in terms of administrative burden. CNC therefore believes that an **alternative solution** could also be considered. This alternative solution would consist of the third possibility mentioned above, i.e. a prospective application of the change of accounting policy (see illustrative example 2). The effect of the change of accounting policy would then be recognised in the profit or loss for the financial year in which the decision to change is taken, whether it relates to previous financial years or to the current financial year. In such cases, the principle of matching of income and expenses would be derogated from on an extraordinary basis. If the figures for the previous financial year are not comparable with those for the current financial year in which the effect of the change of accounting policy is recognised, appropriate disclosures should be made in the notes to the annual accounts.

To further explain these doctrinal solutions, some illustrative examples are given below.

Note that if the change in accounting policy impacts the profit and loss account – for example, in the case of a change in the measurement basis for an investment property from the historical cost model to the fair value model – the adjustments relating to this change are then recognised in the profit and loss account (see point 1.2.). If equity is affected by the change – for example, in the case of a change in measurement model for an available-for-sale financial asset – the adjustments relating to this change are then recognised directly in equity in the annual accounts for the year (see point 1.3.).

⁸ This includes a presentation of the reasons justifying the undertaking's decision to change its accounting policy, in accordance with the provisions of Article 51, para. 2 LRCS. This requirement also applies when the undertaking opts for the alternative solution.

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1.2. Change in accounting policy affecting the profit and loss account

In order to illustrate the case of a change in accounting policy affecting the profit and loss account, the example of a change in the measurement basis for an investment property from the historical cost model to the fair value model is given below, presenting successively the preferred solution (illustrative example 1) and the alternative solution (illustrative example 2).

Illustrative example 1: change in measurement basis for an investment property with recognition in equity on the first day of the financial year of the effect relating to previous financial years

A Luxembourg real estate company has held an investment property for rental / lease since 1st January 2016. The company has always applied the historical cost / depreciated cost model for the measurement of the investment property until 31 December 2020 (the closing date of the company's latest financial year).

During financial year 2021, the company decided to change its accounting policy and apply the fair value model (Q&A CNC 16/009⁹) for the measurement of its investment property.

The acquisition cost of the building is EUR 100 000 000 and at 31 December 2020, accumulated depreciation amounted to EUR 25 000 000, resulting in a net book value of EUR 75 000 000.

The fair value of the investment property is estimated at EUR 120 000 000 at 1st January 2021 and EUR 123 000 000 at 31st December 2021.

In accordance with the preferred solution, it is proposed to recognise the effect of a change in accounting policy relating to prior periods directly in equity on the first day of the financial year in which the decision to change is made and to recognise the effect of the change in accounting policy relating to the current financial year in the profit and loss account for the financial year.

In accordance with the chosen solution, it is therefore necessary to:

- recognise at 1st January 2021 a reversal of the value adjustment of EUR 25 000 000, an adjustment to the change in fair value compared with historical cost of EUR 20 000 000 and a deferred tax adjustment of EUR 13 500 000, assuming deferred taxation at a rate of 30%, and to present the net amount of EUR 31 500 000 in shareholders' equity on the line "A.IV. 4.b) *Other reserves not available for distribution*". At this same date, the investment property shows up as an asset on the balance sheet for an amount of EUR 120 000 000 under "C.II.1. *Land and buildings*";
- measure the investment property on the balance sheet at 31 December 2021 for an amount of EUR 123 000 000 following the change in fair value at 31 December 2021 compared with the fair value at 1st January 2021. This change in fair value for the year is recognised as income and presented on the line "7.a) *Value adjustments in respect of formation expenses and tangible and intangible fixed assets*" in the profit and loss account for 2021, i.e. an amount of EUR 3,000,000. Assuming deferred taxation on this amount at a rate of 30%, a deferred tax charge of EUR 900 000 is also recognised as a liability. The effect of this change, net of tax, is EUR 2 100 000 and shall be allocated / assigned to an unavailable reserve when the annual accounts are approved.

In order to accurately reflect this change in accounting policy, the following notes to the accounts seem appropriate.

⁹ See: Q&A CNC 16/009 Investment property under LUX GAAP and LUX GAAP – FV regimes: cost model vs. fair value model

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Extracts from the notes to the accounts impacted by the change in accounting policy and measurement basis:

Note X - General principles

(...)

Note X.X. Investment property

During the financial year, the Company decided to change its accounting policy in connection with the measurement of its investment property. The historical cost model is replaced by the fair value model in application of Article 64sexies LRCS on 1st January 2021. Adjustments relating to the change at that date are recognised in the balance sheet and include an allocation / assignment to an unavailable reserve within equity. The adjustment relating to the current year (2021) is recognised in the profit and loss account.

This change in accounting policy and measurement basis is motivated by the fact that the Board of Directors is of the opinion that the fair value of the investment property provides better information in terms of relevance for users of the annual accounts, as it reflects the real value of the investment property, which is the Company's principal asset and main source of income.

Note X - Fixed tangible assets

	Investment property (EUR)
Acquisition cost at the beginning of the financial year	100 000 000
Addition(s) during the financial year	-
Disposal(s) during the financial year	-
Transfer(s) during the financial year	-
Acquisition cost at the end of the financial year	100 000 000
Cumulative value adjustments at the beginning of the financial year	(25 000 000)
Reversal(s) of accumulated depreciation at 1 st January 2021	25 000 000
Cumulative value adjustments at the end of the financial year	-
Cumulative fair value adjustments at the beginning of the financial year	-
Fair value adjustment(s) at 1 st January 2021	20 000 000
Fair value adjustment(s) for the year 2021	3 000 000
Cumulative fair value adjustments at end of the financial year	23 000 000
Fair value at the end of the financial year*	123 000 000
Net book value at the beginning of the financial year*	75 000 000

* At 31 December 2021, the investment property is measured at fair value in accordance with the decision to change the accounting policy and measurement basis. As a result of this change, the annual accounts for the current financial year are not comparable with those for the previous financial year, as investment properties at 31 December 2020 were valued using the historical cost model.

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Note X – Reserves not available for distribution

Movements in "A.IV.4.b) Other non-available reserves " were as follows:

	Other reserves not available for distribution (EUR)
At 31st December 2020	-
Movements during the financial year:	
Reversal of accumulated depreciation on investment property at 1 st January 2021	25 000 000
Cumulative fair value adjustment on investment property at 1 st January 2021	20 000 000
Deferred tax relating to the change in valuation / measurement method at 1 st January 2021	(13 500 000)
At 31st December 2021	31 500 000

The result for the current financial year comprises non-distributable amounts of EUR 2 100 000 corresponding to an increase in the value of the investment property carried at fair value on the balance sheet, net of deferred tax.

Note X - Value adjustments in respect of formation expenses and tangible and intangible fixed assets

	2021	2020
Investment property:	EUR	EUR
Fair value adjustment for the financial year	3 000 000	-
Depreciation charge for the financial year	-	(5 000 000)
Total	3 000 000	(5 000 000)

Note X - Deferred tax

A deferred tax liability of EUR 14 400 000 was recognised in the balance sheet at 31 December 2021 in respect of the fair value measurement of the investment property. An amount of EUR 13 500 000 was recognised directly in equity at 1st January 2021 in relation with the fair value measurement at this date. An expense of EUR 900 000 was charged to deferred tax liabilities at 31 December 2021 in connection with the change in fair value of the investment property relating to financial year 2021.

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Illustrative example 2: change in the measurement basis for an investment property with full recognition in the profit and loss account of the financial year of the effect of the change in accounting policy ("prospective application")

A Luxembourg real estate company has held an investment property for rental since 1st July 2017. The company has always applied the historical cost / depreciated cost model for the measurement of the investment property until 31 December 2020 (the closing date of the company's latest financial year).

During financial year 2021, the company decided to change its accounting policy and apply the fair value model ([Q&A CNC 16/009¹⁰](#)) for the measurement of its investment properties.

The acquisition cost of the building was EUR 20 000 000 and at 31 December 2020, accumulated depreciation amounted to EUR 3 500 000, giving a net book value of EUR 16 500 000.

The fair value of the investment property is estimated at EUR 25 000 000 at 31 December 2021.

Under the alternative solution, it is proposed to recognise in full the effect of the change in accounting policy in the profit and loss account of the financial year, without distinguishing the portion of the effect relating to prior years from that relating to the current year.

In accordance with the chosen solution, it is therefore necessary to:

- measure the investment property as an asset on the balance sheet at 31 December 2021 under "*C.II.1. Land and buildings*" for an amount of EUR 25 000 000;
- recognise as income the reversal of the value adjustment of EUR 3 500 000 and the change in fair value compared with historical cost of EUR 5 000 000 and present them on the line "*7.a) Value adjustments in respect of formation expenses and tangible and intangible fixed assets*" for financial year 2021, i.e. an amount of EUR 8 500 000. Assuming deferred taxation on this amount at a rate of 30%, a deferred tax charge of EUR 2 550 000 is also recognised as a liability. Consequently, the effect of this change, net of tax, amounts to EUR 5 950 000 and will have to be allocated / assigned to an unavailable reserve when the annual accounts are approved.

In order to accurately reflect this change in accounting policy, the following notes to the accounts seem appropriate.

Extracts from the notes to the accounts impacted by the change in accounting policy and measurement basis:

Note X - General principles

(...)

Note XX - Investment property

During the financial year, the Company decided to change the accounting policy in connection with the measurement of its investment property. The historical cost model is replaced by the fair value model in application of Article 64*sexies* LRCS. In accordance with the option provided for in article 64*septies* LRCS¹¹, the effect of this change in value is recognised directly in the Company's profit and loss account. In accordance with article 72*ter* LRCS, the effect of this change, net of tax, will be allocated / assigned to an unavailable reserve when the annual accounts are approved.

¹⁰ See footnote 9.

¹¹ Article 64*septies* LRCS provides that:

*"Notwithstanding Article 51, paragraph (1), point c), undertakings may, where an asset is measured in accordance with Article 64*sexies*, include the resulting change in value in the profit and loss account".*

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This change in accounting policy and measurement basis is motivated by the fact that the Board of Directors is of the opinion that the fair value of the investment property provides better information in terms of relevance for users of the annual accounts, as it reflects the real value of the investment property, which is the Company's principal asset and main source of income.

Note X – Fixed tangible assets

	Investment property (EUR)
Acquisition cost at the beginning of the financial year	20 000 000
Addition(s) during the financial year	-
Disposal(s) during the financial year	-
Transfer(s) during the financial year	-
Acquisition cost at the end of the financial year	20 000 000
Cumulative value adjustments at the beginning of the financial year	(3 500 000)
Reversal(s) of accumulated depreciation	3 500 000
Fair value adjustment(s) for the financial year	5 000 000
Reversal(s) for the financial year	-
Transfer(s) during the financial year	-
Cumulative fair value adjustments at the end of the financial year	5 000 000
Fair value at the end of the financial year*	25 000 000
Net book value at the beginning of the financial year*	16 500 000

* At 31 December 2021, investment property is measured at fair value in accordance with the decision to change the accounting policy and measurement basis. As a result of this change, the annual accounts for the current financial year are not comparable with those for the previous financial year, as investment property at 31 December 2020 was valued using the historical cost model.

Note X – Value adjustments in respect of formation expenses and tangible and intangible fixed assets

	2021	2020
Investment property:	EUR	EUR
Reversal of accumulated depreciation	3 500 000	-
Fair value adjustment for the financial year	5 000 000	-
Depreciation charge for the financial year	-	(1 000 000)
Total	8 500 000	(1 000 000)

Note X – Deferred tax

A deferred tax charge of EUR 2 550 000 was recognised as a liability in the balance sheet at 31 December 2021 in relation to the fair value measurement of the investment property during financial year 2021.

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In accordance with Q&A CNC 16/009, the fair value option must be applied to a class of assets as a whole, i.e. in this case to all investment properties. For illustrative purposes, illustrative examples 1 and 2 assume that the company holds only one investment property.

1.3. Change in accounting policy affecting equity only

To illustrate the case of a change in accounting policy that only affects equity, the following is an example of a change in measurement basis for an available-for-sale financial asset from the historical cost model to the fair value model.

Illustrative example 3: change in measurement basis for an available-for-sale financial asset with direct recognition in equity in accordance with Article 64^{quater} para. 2 LRCS¹²

During financial year 2020, a Luxembourg company acquires 5 000 shares in a listed company for an amount of EUR 625 000. At the time of this acquisition, the company chooses to present the shares on the line "D. III. 3. Other investments" under current assets. In accordance with Articles 61 and 62 LRCS, securities are valued at the lower of their acquisition cost, including incidental expenses, determined using the FIFO method¹³ or their market value. A value adjustment is recorded when the market price is lower than the acquisition cost.

At 31 December 2020 (the closing date of the company's latest financial year), the value of the shares in the listed company amounted to EUR 660 000, and no value adjustment was recorded in the annual accounts, the shares being maintained at their historical acquisition cost.

During financial year 2021, the company determines that the securities are available-for-sale financial assets and decides to change its accounting policy in order to apply the fair value model for the measurement of its securities in accordance with Article 64^{quater}, para. 2 LRCS.

At 31 December 2021, the value of the shares in the listed company amounts to EUR 725 000.

In view of the above, it is proposed to recognise the effect of the change in the measurement basis of securities from the historical cost model to the fair value model directly in equity on the first day of financial year 2021 for the portion relating to the prior financial year and at the end of financial year 2021 for the portion relating to the current financial year.

N.B.: where applicable, the company is free to recognise at 31 December 2021 the total effect of the change in accounting policy for both the portion relating to the prior financial year and the portion relating to the current financial year. The information available to third parties would not be affected insofar as the change in fair value of available-for-sale financial assets is recognised directly in equity without flowing through the profit and loss account.

¹² Article 64^{quater}, para. 2 LRCS provides that:

"A change in the value on an available for sale financial asset, other than a derivative financial instrument, may be included directly in the equity account, in the fair value reserve"

¹³ For the purposes of this example, it is assumed that the company purchased the shares all at once

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In accordance with the chosen solution, it is therefore necessary to:

- to recognise at 1st January 2021 a fair value adjustment relative to historical cost of EUR 35 000 and a deferred tax adjustment of EUR 10 500, assuming deferred taxation at a rate of 30%, and to present the net amount of EUR 24 500 in shareholders' equity on the line "A.IV.4.b) *Other non-available reserves*". At the same date, transferable securities are measured for an amount of EUR 660 000 on the asset side of the balance sheet;
- to recognise transferable securities on the asset side of the balance sheet at 31 December 2021 for an amount of EUR 725 000 following the change in fair value at 31 December 2021 compared with the fair value at 1st January 2021. This change of EUR 65 000, net of deferred tax of EUR 19 500, is shown for a net amount of EUR 45 500 on the line "A.IV.4.b) *Other non-available reserves*" in the equity section of the balance sheet.

In order to accurately reflect this change in accounting policy, the following notes to the accounts seem appropriate.

Extracts from the notes to the accounts impacted by the change in accounting policy and measurement basis:

Note X - General principles

(...)

Note XX - Transferable securities

During the year, the Company decided to change the accounting policy in connection with the measurement of its transferable securities. The historical cost model is replaced by the fair value model in application of section 7bis of Chapter II of Title II LRCS.

This change in accounting policy and measurement basis is motivated by the fact that the Company has decided to classify securities as available-for-sale financial assets. In accordance with the option provided for in Article 64quater, para. 2 LRCS, the effect of this change is recognised directly in equity, in the fair value reserve.

Note X - Transferable securities

	EUR
Acquisition cost at the beginning of the financial year	625 000
Addition(s) during the financial year	-
Disposal(s) during the financial year	-
Transfer(s) during the financial year	-
Acquisition cost at the end of the financial year	625 000
Cumulative fair value adjustments at the beginning of the financial year	-
Fair value adjustment at 1 st January 2021	35 000
Fair value adjustment for the financial year 2021	65 000
Cumulative fair value adjustments at the end of the financial year	100 000
Fair value at the end of the financial year	725 000

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Note X – Reserves not available for distribution

Movements in "A.IV.4.b) Other non-available reserves" were as follows:

	Other reserves not available for distribution (EUR)
At 31st December 2020	-
Movements during the financial year:	
Cumulative fair value adjustments at 1 st January 2021	35 000
Deferred tax on fair value at 1 st January 2021	(10 500)
Fair value adjustments for 2021	65 000
Deferred tax on fair value for 2021	(19 500)
At 31st December 2021	70 000

Note X - Deferred tax

A deferred tax liability totaling EUR 30 000 is recognised in the balance sheet at 31 December 2021 in relation with the fair value measurement of available-for-sale financial assets.

2. Changes in accounting estimates

2.1. Analysis and development of a doctrinal solution

The determination of accounting estimates involves the exercise of judgement or of assumptions based on the latest reliable information available.

A change in accounting estimate occurs when there is a change in the circumstances on which the accounting estimate was based or as a result of new information, new developments or additional experience.

As a result, such a change will never relate to prior periods and cannot be considered as an error. **A change in accounting estimate will therefore always have a prospective effect.** The effect of a change in accounting estimate is recognised at the date of the change in the accounts of the financial year in which the new information becomes available.

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<p>2.2. <u>Prospective application of a change in accounting estimate</u></p> <p>To illustrate the case of a change in accounting estimate, the example of a change in the depreciation schedule for a machine is given below (illustrative example 4).</p> <p><u>Illustrative example 4: changing the depreciation schedule for an asset as a result of new information</u></p> <p>A Luxembourg company owns a drilling machine acquired on 1st January 2015 for EUR 500 000. In accordance with the company's accounting policy, this type of machine is depreciated on a straight-line basis over 10 years. During financial year 2020, following analyses, an extraordinary value adjustment of EUR 120 000 was identified and recognised in the annual accounts for 2020. Following this extraordinary value adjustment, at 31 December 2020, accumulated depreciation amounted to EUR 420 000 and the net book value to EUR 80 000. At 31 December 2020, after recognising the extraordinary value adjustment, the management body decided not to review the residual useful life of the drilling machine.</p> <p>During financial year 2021, the Company's management body, after attending a training course organised by the industry federation, learns that the drilling machine can also be useful for the Company's second line of business, and that it should substantially improve the performance of this line of business. Following this new development, the residual life of the drilling machine is estimated at 8 years at the start of financial year 2021, representing a 4-year extension of its initial useful life. It has also been determined that the extraordinary value adjustment recognised in 2020 is no longer necessary and should be reversed.</p> <p>In view of the above, it is proposed to recognise the effect of the change in depreciation as from financial year 2021 to reflect the extended useful life of the drilling machine.</p> <p>In accordance with the chosen solution, it is therefore necessary to:</p> <ul style="list-style-type: none"> • reverse the extraordinary value adjustment of EUR 120 000 ; • recognise a depreciation expense of EUR 25 000 for financial year 2021 instead of the previous annual expense of EUR 50 000; • present the drilling machine as an asset on the balance sheet with a net book value of EUR 175 000 at 31 December 2021. <p>In order to faithfully represent this change in accounting estimate, the following notes to the accounts seem appropriate.</p>

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Extracts from the notes to the accounts impacted by the change in accounting estimate:

Note X - General principles

(...)

Note X.X. - Machinery

During financial year 2021, the Company obtained new information on the drilling machine it owns, namely that this drilling machine could also be useful for its second line of business and that it should substantially improve the performance of this line of business. As a result of this new development, the Company has decided to extend the remaining useful life of the drilling machine from 4 years to 8 years and to start recognising the new depreciation charge during financial year 2021. It has also been determined that the extraordinary value adjustment recognised in 2020 should not be maintained, given that the reason for it has ceased to exist.

Note X – Tangible fixed assets

	Machinery (EUR)
Acquisition cost at the beginning of the financial year	500 000
Addition(s) during the financial year	-
Disposal(s) during the financial year	-
Transfer(s) during the financial year	-
Acquisition cost at the end of the financial year	500 000
Cumulative value adjustments at the beginning of the financial year	(420 000)
Allowance(s) for the financial year *	(25 000)
Reversal(s) for the financial year	120 000
Transfer(s) during the financial year	-
Accumulated value adjustments at the end of the financial year	(325 000)
Net value at the end of the financial year	175 000
Net value at the beginning of the financial year	80 000

* Calculation of the allowance for the year: $[(500\ 000 - 420\ 000 + 120\ 000) / 8] = 25\ 000$

Note X – Value adjustments in respect of formation expenses and tangible and intangible fixed assets

	2021	2020
	EUR	EUR
Machinery :		
Reversal of exceptional value adjustment	120 000	-
Allowance for the financial year	(25 000)	(50 000)
Extraordinary value adjustment	-	(120 000)
Total	95 000	(170 000)

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3. Conclusion

In the absence of explicit provisions dealing with changes in accounting policies, measurement basis and accounting estimates, CNC considers that there is no reason to retrospectively restate the opening balance sheet. In fact, CNC is of the opinion that – for the issues addressed in this Q&A – the principle of intangibility (immutability) of the opening balance sheet referred to in Article 51, para.1, point f) LRCS should prevail over other principles.

In this respect, CNC notes that Article 29, para. 2 LRCS admittedly provides that "(...) *Where the figures from one year are not comparable to figures of the next year and where the figures of the preceding year have been adjusted, this must be disclosed in the notes to the accounts, with relevant comments*", but it notes that Luxembourg accounting practice has adopted a restrictive interpretation of this text. In this respect, it appears to be widely accepted that Article 29, para. 2 LRCS applies exclusively to reclassifications from line to line within the balance sheet or within the profit and loss account, provided that the total amount of "shareholders' equity" and that of the "result for the financial year" cannot be altered as a consequence. An alternative interpretation of Article 29, para. 2 LRCS would result in a change to the comparative figures and to the opening balance sheet which – in CNC's view – would violate Article 51, para. 1, point f) LRCS.

Ultimately, the doctrinal solutions proposed in this Q&A make it possible to respect the key principle of the intangibility (immutability) of the opening balance sheet. In the case of changes in accounting policies, a preferred solution is suggested that also complies with the principle of matching of income and expenses for the financial year, by recognising the effect of the change in accounting policy relating to previous financial years directly in equity on the first day of the current financial year. As for changes in accounting estimates, it seems to be accepted nowadays both at international and at European levels that these should be applied exclusively on a prospective basis.

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Disclaimer

This document – provided as a courtesy – is an unofficial translation of the French original document entitled “Changements de méthodes comptables, de modes d’évaluation et d’estimations comptables en régimes LUX GAAP et LUX GAAP-JV.”. In case of discrepancy in interpretation, the French version shall prevail.

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