

<p>Q&A CNC 21/025</p>	<p><u>QUESTIONS / ANSWERS:</u> CORRECTION OF ERRORS UNDER LUX GAAP AND LUX GAAP-FV REGIMES</p>
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Context:

Similar to the accounting directive 2013/34/EU¹, Luxembourg accounting law applicable to undertakings is silent on the procedures for correcting errors that may arise in the preparation and presentation of annual accounts.

In contrast, the IFRS – EU framework includes a standard IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which generally requires retrospective restatement of a prior-period error. Retrospective restatement means “correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred”². To this end, “an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by: (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented”³.

In this respect, CNC notes that it was highlighted in a previous Q&A⁴ that the retrospective restatement method is not admissible under LUX GAAP and LUX GAAP – FV insofar as it runs up against the key principle of intangibility (immutability) of the opening balance sheet referred to in Article 51 para. 1 point f) LRCS which states that “the opening balance sheet for each financial year must correspond to the closing balance sheet for the preceding financial year”. It is also accepted in the LUX GAAP and LUX GAAP – FV regimes that the option provided for in Article 29 para. 2 LRCS, which states 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”, should be interpreted restrictively. According to this restrictive interpretation, only line-by-line reclassifications within the comparative figures of the balance sheet or profit and loss account are permissible under LUX GAAP and LUX GAAP – FV without impacting the total amount of “equity” and “profit or loss for the year”.

In view of the above, it appears that the method adopted by IFRS – EU in connection with corrections of errors cannot be transposed as it stands to LUX GAAP and LUX GAAP – FV.

In this context, the objective of this Q&A is to come up with a doctrinal solution regarding correction of errors that is compatible with the general principles of LUX GAAP and LUX GAAP – FV and in particular with the principle of intangibility (immutability) of the opening balance sheet.

Question:

In the absence of legal provisions, the question arises as to the permissible accounting treatment for correction of errors under LUX GAAP and LUX GAAP – FV.

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 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.

² See IAS 8 paragraph 5.

³ See IAS 8 paragraph 42.

⁴ See: Q&A CNC 21/024 “Changes in accounting policies, measurement basis and accounting estimates under LUX GAAP and LUX GAAP-FV”.

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Definitions:

In the silence of the law, it is proposed firstly to define concepts taking inspiration from the definitions proposed by IAS 8 mentioned above:

- An **error** may occur in the recognition, measurement, presentation or disclosure of elements in the annual accounts. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts and fraud.
- **Prior period errors** are omissions from and misstatements in the entity's annual accounts for one or more prior periods arising from a failure to use or misuse of reliable information:
 - a) which were available when publication of the annual accounts for those periods was authorised; and
 - b) which could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those annual accounts.

Answers:

The true and fair view objective referred to in Article 26 para. 3 LRCS assumes the absence of material errors in the annual accounts as published. However, in exceptional cases⁵ errors may occur in the recognition, valuation / measurement or presentation of elements in the annual accounts, resulting in errors in the published accounts. In such cases, the question arises of how to correct the accounts.

As a preliminary point, it should be noted that only:

- errors that are "material" as defined by Article 26 para. 6 LRCS, i.e. *"the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the annual accounts of the undertaking. The materiality of individual items shall be assessed in the context of other similar items"*;
- errors arising from prior periods for which annual accounts have already been approved, filed and published. When an error is identified during a financial year for which the accounts have not yet been closed, it is presumed that the error is corrected as soon as it is identified and before the accounts for the financial year in question are approved and filed.

⁵ The recurring identification of errors in the annual accounts as published could give rise to liability on the part of the administrative or management bodies.

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1. Correction of errors: coming up with doctrinal solutions

1.1. The preferred solution: corrective filing of the annual accounts that contain an error

When a material error is identified⁶ and this error relates to a prior period for which the annual accounts have already been approved and filed with the Trade and companies register (RCS), CNC is of the opinion that the **preferred solution** for correcting said error is to do a corrective filing of the annual accounts previously published. Such a corrective filing is explicitly provided for by Article 8 of the amended Grand Ducal Regulation of 14 December 2011^{7/8}.

CNC is of the opinion that it is necessary to correct the annual accounts that were tainted by an error in order to inform and protect third-party users⁹. The notes to the annual accounts as rectified should mention this correction with reference to the previous filing. It is also recommended that the notes to the annual accounts for the current financial year include a reference to the rectified annual accounts filed for the previous financial year.

It should be noted that such a corrective filing implies, in particular, re-approval of the annual accounts as rectified by the decision-making body (e.g. the general meeting) and a new filing with the RCS.

1.2. The alternative solution: correction of the error in the annual accounts for the current financial year

Without calling into question the preferred solution mentioned above, it should be noted that from a practical point of view, a corrective filing may require a significant amount of work, particularly in cases where the error dates back several years. For example, an error identified during the 2021 financial year but relating to the 2016 financial year would require a corrective filing of the annual accounts for the 2016, 2017, 2018, 2019 and 2020 financial years.

Considering the potentially high administrative burden associated with the correction, closing, auditing, re-approval of the annual accounts as rectified and their corrective filing with the RCS, CNC is of the opinion that **an alternative** but not a preferred **solution** may be considered. Under this alternative practice and insofar as the accounts previously filed are not or cannot be amended, the correction of the error is then recognised in the accounting period in which the error was identified. If the original transaction impacted the profit and loss account, then the correction would also impact it. If the error relates to the company's equity (e.g. distributable reserves vs. non-distributable reserves), the correction will be made directly to equity. Specific information relating to this correction must be provided in the notes to the accounts. The specific information should include at least (i) a description of the nature of the error corrected during the financial year and (ii) an indication of the balance sheet and profit and loss account elements affected by the error, including the tax impact where applicable.

⁶ A material error may be identified during the course of the financial year, when the annual accounts are being prepared, when the annual accounts are being closed and during the audit of the annual accounts, among other things.

⁷ Grand-ducal regulation of 14 December 2011 determining the procedure for filing the accounting package with the manager of the Trade and companies register, the conditions for arithmetic and logical checks concerning the annual accounts and amending the amended Grand-ducal regulation of 23 January 2003 implementing the amended law of 19 December 2002 on the Trade and companies register as well as the bookkeeping and annual accounts of undertakings.

⁸ Article 8 of the Grand Ducal Regulation of 14 December 2011:
*"The documents included in the accounting package may be the subject of a supplementary or corrective filing in accordance with the procedures laid down in article 6bis of the amended Grand Ducal Regulation of 23 January 2003 implementing the law of 19 December 2002 on the Trade and companies register as well as the bookkeeping and annual accounts of undertakings.
 In this case, the accounting package, which may need to be prepared again on the eCDF platform, must be re-filed with the Trade and companies register in its entirety."*

⁹ The company may apply before the Courts in order to claim the withdrawal of annual accounts filed in error (see note 11).

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This alternative solution allows the error to be corrected transparently and ensures that users of the annual accounts have all the relevant and necessary information.

An illustrative example is provided (see point 2).

2. Correction of errors and alternative solution: illustrative example

While the preferred solution does not call for any particular comment (corrective filing(s) with the RCS of all the annual accounts containing errors), the alternative solution does. An illustrative example is provided below.

Illustrative example: correction of an error relating to the failure to recognise an invoice in connection with the purchase of a tangible fixed asset (incorrect payment made by an affiliated undertaking)

During the financial year 2021, an unrecognised invoice dated 1st January 2019 was identified in relation to the acquisition of a machine tool to be capitalised for an amount of EUR 100 000¹⁰. Said machine tool was delivered and put into service on 1st January 2019. It was noted that the related invoice had been incorrectly paid by an affiliated company.

In accordance with the company's accounting policies, this type of machine tool is depreciated on a straight-line basis over 10 years.

Under the alternative solution, it is proposed to recognise the effect of correcting the error in the financial year in which the error was identified, i.e. the financial year 2021.

Firstly, it should be noted that this transaction should, in principle, have been recognised in the amount of EUR 100 000 in the annual accounts for the 2019 financial year, and depreciation of the asset should have started when it was brought into service during that year. This acquisition should therefore have had a negative impact on the results for 2019 and 2020 via the depreciation charge of EUR 10 000 per year.

However, under the alternative solution, the correction of the error, recognised during the 2021 financial year, will have a negative impact on income for the 2021 financial year only as a result of the depreciation charge for prior years (2019 and 2020) and for the current year (2021).

In view of the foregoing, CNC is of the opinion that the notes to the annual accounts for the financial year 2021 should indicate that these annual accounts include a correction of a material prior-period error and that consequently:

- "C.II.2 *Plant and machinery*" on the assets side of the balance sheet was incorrectly reduced by EUR 90 000 at 31 December 2019 and EUR 80 000 at 31 December 2020,
- the caption "C. 6. *Amounts owed to affiliated undertakings*" on the liabilities side of the balance sheet was incorrectly reduced by EUR 100 000 at 31 December 2019 and 2020 and,
- the caption "7.a) *Value adjustments in respect of formation expenses and tangible and intangible fixed assets*" in the profit and loss account was incorrectly reduced by EUR 10 000 for financial year 2019 and by EUR 10 000 for the financial year 2020.

The notes to the accounts should also indicate that the value adjustment charge for property, plant and equipment recognised in 2021 for a total amount of EUR 30 000 includes a correction of an error for prior periods for an amount of EUR 20,000, of which EUR 10 000 relates to financial year 2019 and EUR 10 000 relates to financial year 2020.

¹⁰ For the purposes of this example, it is assumed that the invoice was paid by an affiliated undertaking and the VAT implications are disregarded.

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In order to fairly present the correction of errors recognised during financial year 2021, the following notes to the accounts appear appropriate, it being understood that it is the responsibility of the administrative or management body to determine the position and extent of the information to be provided in the notes.

Extracts from the notes impacted by the correction of errors:

Note X - General principles

(...)

Note XX - Correction of errors

The annual accounts at 31 December 2021 include the correction of an error identified during the current financial year and relating to financial year 2019. The recognition of an invoice for EUR 100 000 relating to the purchase of a machine tool to be capitalised on 1st January 2019 has been omitted, as have the related depreciation charges for 2019 and 2020. Further information on this correction can be found in the notes to the accounts relating to property, plant and equipment, liabilities as well as value adjustments on formation expenses and on tangible and intangible assets.

Note X - Property, plant and equipment

	Plant and machinery (EUR)
Gross value at the beginning of the financial year	300 000
Recognition of the invoice dated 1 st January 2019*	100 000
Addition(s) during the financial year	70 000
Disposal(s) during the financial year	-
Transfer(s) during the financial year	-
Gross value at the end of the financial year	470 000
Cumulative value adjustments at the beginning of the financial year	(90 000)
Depreciation charges relating to the recognition of the invoice dated 1 st January 2019 (financial years 2019 and 2020)*	(20 000)
Charge(s) for the financial year**	(43 500)
Reversal(s) during the financial year	-
Transfer(s) during the financial year	-
Cumulative value adjustments at the end of the financial year	(153 500)
Net value at the end of the financial year	316 500
Net value at the beginning of the financial year	210 000

* see note XX - Correction of errors

** includes EUR 10 000 of depreciation charge for the machine tool not recognised in 2019

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Note X - Liabilities

	Less than one year EUR	Between one and five years EUR	More than five years EUR	Total 2021 EUR	Total 2020 EUR
Amounts owed to credit institutions	5 000	-	37 000	42 000	58 000
Amounts owed to affiliated undertakings*	100 000	60 000	-	160 000	56 000
Other liabilities	4 815	-	-	4 815	4 815
Total	109 815	60 000	37 000	206 815	118 815

* see note XX - Correction of error

Note X - Value adjustments

	2021 EUR	2020 EUR
Plant and machinery:		
Depreciation charges relating to the recognition of the invoice dated 1 st January 2019 (financial years 2019 and 2020)*	(20 000)	-
Charge(s) for the financial year**	(43 500)	(50 000)
Total	(63 500)	(50 000)

* see note XX - Correction of error

** includes in 2021 an amount of EUR 10 000 of depreciation charge for the machine tool not recognised in 2019

3. Conclusion

In the absence of legal provisions, CNC is of the opinion that correction of errors under LUX GAAP and LUX GAAP – FV cannot be restated retrospectively unlike what is suggested by the aforementioned IAS 8 standard, as such a restatement would run counter to the key principle of the intangibility (immutability) of the opening balance sheet referred to in Article 51 para. 1 point f) LRCS.

In view of this, CNC considers that the **preferred solution** for the correction of errors under LUX GAAP and LUX GAAP – FV is to amend the annual accounts impacted by the error and to do a corrective filing of them with the RCS¹¹.

In view of the administrative burden involved in amending and correcting annual accounts, sometimes relating to more than one financial year, CNC is of the opinion that an **alternative solution** should be permitted. Under this alternative solution, the error may be corrected in the annual accounts of the financial year in which the error has been identified. Considering that such a correction hinders the principle of matching income and expenses for the financial year referred to in Article 51 para 1 point d) LRCS as well as the objective of true and fair view of the undertaking's profit or loss referred to in Article 26 para. 3 LRCS, CNC notes that adequate information must be provided in the notes (see: illustrative example).

In conclusion, it should be noted that the occurrence of errors in the annual accounts approved by the governing body and filed with the RCS can only be extraordinary. In this respect, it should be noted that the recurring identification of errors in the published annual accounts would be such as to call into question the responsibility of the administrative or management bodies of the undertaking concerned.

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¹¹ Pursuant to article 17bis of the Grand-Ducal Regulation of 23 January 2003, which provides that "any form or document that has been filed may only be amended or returned on the basis of a court order issued to the trade and companies register", an undertaking may request the withdrawal of the annual accounts containing errors from the list of filings in its own file.

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Disclaimer

This document – provided as a courtesy – is an unofficial translation of the French original document entitled “Correction d’erreurs en régimes LUX GAAP et LUX GAAP-JV”. 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;
- only represent the opinion of the GIE CNC on a number of doctrinal and interpretative issues;
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