

Q&A CNC 22/027	<u>QUESTIONS / ANSWERS:</u> ACCOUNTING TREATMENT OF TRANSACTIONS AND BALANCES DENOMINATED IN FOREIGN CURRENCIES UNDER THE LUX GAAP AND LUX GAAP – FV REGIMES
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Context:

As an international financial center and an open economy, it is hardly surprising that many transactions carried out in Luxembourg by undertakings are concluded in foreign currencies instead of the national currency, the euro. Luxembourg undertakings also have the option of keeping their day-to-day books and of drawing up their annual accounts in a foreign currency other than the euro (see: Q&A CNC 22/026 "*Currency of bookkeeping and of presentation of the annual accounts under LUX GAAP and LUX GAAP-FV*").

Since transactions and balances denominated in different currencies must necessarily be translated into one and the same currency for the purposes of preparing the annual accounts, it is important to establish accounting policies that allow to translate foreign currency transactions and that allow, where appropriate, to revalue balances denominated in foreign currencies at the end of the financial year.

In this respect, it should be noted that, in line with the accounting directive 2013/34/EU¹, Luxembourg accounting law for undertakings is silent on the accounting treatment of transactions and balances denominated in foreign currencies. In contrast, the international accounting standards IFRS as adopted by the European Union (IFRS – EU regime) include the standard IAS 21 "*The Effects of Changes in Foreign Exchange Rates*", which deals with these issues by providing guidelines.

The silence of the European and Luxembourg texts has led to the development of fairly heterogeneous accounting practices in Luxembourg with regard to the accounting treatment of transactions and balances denominated in foreign currencies. These practices include in particular the "classic approach", the "monetary vs. non-monetary approach" and the "short-term vs. long-term approach".

In this context, the objective of this Q&A is to formalise – by way of doctrinal interpretation – the main approaches adopted by Luxembourg undertakings with regard to the treatment of transactions and balances denominated in foreign currencies under LUX GAAP and LUX GAAP – FV.

Questions:

This Q&A proposes to provide answers to the following questions:

- 1. How should transactions denominated in currencies other than the currency of day-to-day bookkeeping and of presentation of the annual accounts be accounted for?**
- 2. How should balances denominated in currencies other than the currency of day-to-day bookkeeping and of presentation of the annual accounts be (re)valued at the end of the financial year?**
- 3. Concept of hedge accounting: what are the implications for the measurement of assets and liabilities?**
- 4. What information should be disclosed in the notes to the accounts?**

¹ See: 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.

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Definitions:

For the purposes of this Q&A, it is proposed to define the following concepts:

Foreign currency: any currency other than the currency in which the day-to-day books are kept and the annual accounts are presented.

Exchange rate: the price at which two currencies are exchanged at a given time on the market.

Bid/ask rate: the published exchange rate applicable to the sale (bid rate) or purchase (ask rate) of foreign currencies to a credit institution or its intermediary.

Average rate: the average of the bid and ask rates at a given time.

Average exchange rate: the average exchange rate determined by calculating the average between two points in time (e.g. week, month).

Historical exchange rate: the exchange rate at which the currency in which the day-to-day books are kept and the annual accounts are presented could be exchanged for a foreign currency on the date on which a transaction or a particular event occurred.

Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency² (e.g. receivables and payables).

Non-monetary items are items that do not confer a right to receive or an obligation to pay a fixed or determinable number of units of currency (e.g. intangible and tangible fixed assets, shares in affiliated undertakings and participating interests, inventories, etc.).

Long-term items are mainly formation expenses, fixed assets and current assets with a residual term of more than one year, as well as liabilities with a residual term of more than one year.

Short-term items are mainly current assets with a residual term of less than or equal to one year and liabilities with a residual term of less than or equal to one year.

² Definition taken from IAS 21 "The Effects of Changes in Foreign Exchange Rates", paragraph 8.

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Answers:

1. How should transactions denominated in currencies other than the currency of day-to-day bookkeeping and of presentation of annual accounts be accounted for?

A transaction denominated in a foreign currency must be recorded and measured on initial recognition in the currency in which the day-to-day books are kept and the annual accounts are presented, by applying the exchange rate on the date of the transaction to the foreign currency amount³.

Contrary to certain tax provisions^{4/5}, Luxembourg accounting law applicable to undertakings does not impose a specific source concerning the exchange rates to be applied to measure amounts denominated in currencies other than the currency in which the day-to-day books are kept and the annual accounts are presented. While there is nothing to prevent a Luxembourg undertaking from applying published exchange rates from a source other than the European Central Bank (ECB), it is important that these exchange rates are consistent with those published by the ECB.

In principle, the bid rate applies to transactions giving rise to a receivable in a foreign currency, while the ask rate applies to transactions giving rise to a liability in a foreign currency. However, there is no prohibition against using the average rate on the transaction date for both.

In cases where the volume of transactions is too significant or where it is not possible to determine the precise transaction date, the undertaking is free to use – essentially for practical purposes – an average exchange rate (e.g. weekly, monthly). However, if exchange rates fluctuate significantly during the period, the use of an average exchange rate would no longer be appropriate, and it would then be necessary to revert to an approach based on the daily rate. It is essential that the most appropriate exchange rate is used so that the true and fair view objective is not compromised.

In accordance with general accounting principles, it is important to emphasise that undertakings are durably committed by their choice of accounting policy with regard to the treatment of transactions denominated in foreign currencies, in order to comply with Article 51 para. 1 point b) LRCS, which states that "*accounting policies and measurement bases may not be changed from one financial year to another*⁶".

³ The transaction date generally corresponds to the time at which the risks and rewards inherent in the transaction are transferred between the parties.

⁴ The circular of the Director of the Direct Tax Administration L.G. - A no.60 of 6 July 2018, which recommends the use of European Central Bank ("ECB") rates.

⁵ It should also be noted that Article 37 of the amended law of 12 February 1979 concerning value added tax provides that:

" 1. When the items used to determine the taxable amount on imports are denominated in a foreign currency, the exchange rate is determined in accordance with the provisions of the Community law in force for calculating customs value.

2. When the elements used to determine the taxable amount of a transaction other than an import of goods are denominated in a currency other than the euro, the applicable exchange rate is that of the last selling rate determined by reference to the rate published by the Luxembourg Central Bank or by an approved banking institution from the rate set by the European Central Bank, or published by the European Central Bank, at the time when the tax becomes payable".

⁶ See: Q&A CNC 21/024 "*Changes in accounting policies, measurement bases and accounting estimates under LUX GAAP and LUX GAAP-FV*".

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2. How should balances denominated in currencies other than the currency of day-to-day bookkeeping and of presentation of the annual accounts be (re)valued at the end of the financial year?

The main approaches used by Luxembourg undertakings to (re)-value balances denominated in currencies other than the currency in which the day-to-day books are kept and the annual accounts are presented are set out below:

- (i) the "classic approach" ([point 2.1.](#));
- (ii) the "monetary vs. non-monetary approach" ([point 2.2.](#)) and
- (iii) the "short-term vs. long-term approach" ([point 2.3.](#)).

It should be noted that when an undertaking chooses to follow one of these three approaches, it is important that such approach be applied in a complete and consistent manner to the full set of annual accounts.

2.1 The "classic" approach

Under the "classic approach", balances denominated in foreign currencies are (re)valued at year-end in the currency in which the day-to-day books are kept and the annual accounts are presented, as explained below:

2.1.1 Formation expenses and fixed assets denominated in foreign currencies

Formation expenses and fixed assets denominated in foreign currencies remain valued / measured at the historical exchange rate prevailing at the time of the transaction.

In principle, no exchange gains or losses are generated on these items⁷.

2.1.2 Cash at bank and in hand denominated in foreign currencies

Cash at banks and in hand denominated in foreign currencies is (re)valued at the exchange rate prevailing on the balance sheet date.

The resulting exchange gains and losses are considered as "realised" and are recorded in the profit and loss account for the financial year.

2.1.3. Other current assets denominated in foreign currencies

Other current assets denominated in foreign currencies are (re)valued at the lower of their value determined on the basis of the historical exchange rate or their value determined on the basis of the exchange rate prevailing at the balance sheet date.

Unrealised foreign exchange losses are recorded in the profit and loss account. Unrealised foreign exchange gains are not recognised in application of the principle of prudence as regards the realisation of profits (art. 51 para. 1 point c) aa) LRCS).

2.1.4. Equity contributed or generated in foreign currencies

Equity (e.g. share capital, share premium) contributed in foreign currencies remains valued / measured at the historical exchange rates in force at the time of the contributions.

⁷ Assets denominated in, or significantly correlated to, a foreign currency (e.g. land held in a country where the foreign currency is used) must be subject to a value adjustment in order to give them the lower value in force at the balance sheet date if it is estimated that the foreign currency has suffered a **durable** depreciation in relation to the currency of day-to-day bookkeeping and of presentation of the annual accounts. This unrealised foreign exchange loss may, where appropriate, be offset against an unrealised gain on the intrinsic value of the asset concerned.

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Equity generated in foreign currencies by the undertaking (e.g. reserves, retained earnings, profit or loss for the financial year) remains valued / measured at its historical exchange rates, which generally reflect the various exchange rates used to value / measure foreign currency-denominated income and expenses recorded in the profit and loss account for the financial year in question⁸.

2.1.5. Liability items denominated in foreign currencies

At the end of the financial year, liabilities denominated in foreign currencies are valued / measured at the higher of their value determined on the basis of the historical exchange rate or their value determined on the basis of the exchange rate prevailing on the balance sheet date.

Unrealised foreign exchange losses are recognised in the profit and loss account. In accordance with the principle of prudence with regard to the realisation of profits (art. 51 para. 1 point c) aa) LRCS), unrealised foreign exchange gains are not recorded.

2.1.6 Assets and liabilities denominated in foreign currencies and measured at fair value (LUX GAAP – FV regime)

Assets and liabilities denominated in foreign currencies and measured at fair value are valued / measured at the exchange rate prevailing at the balance sheet date⁹.

Changes in fair value, including unrealised foreign exchange gains and losses, are recognised in accordance with Section 7bis of Chapter II of Title II LRCS and, where applicable, in compliance with Article 72ter of the LRCS.

Classic approach		
Items denominated in foreign currencies	Exchange rate applied	Profit and loss account
Formation expenses and fixed assets	Historical rate	n/a ^(a)
Cash at bank and in hand	Closing rate	unrealised foreign exchange gains and losses
Current assets (other than cash at bank and in hand)	Closing rate (if exchange losses) / historical rate (if exchange gain)	only unrealised foreign exchange losses
Equity	Historical rate	n/a
Liabilities	Closing rate (if exchange losses) / historical rate (if exchange gain)	only unrealised foreign exchange losses
Items measured at fair value (LUX GAAP - FV)	Closing rate	in accordance with section 7bis chap. II title II LRCS and Art.72ter LRCS

(a) Except in the event of a durable depreciation of the currency in which the asset is denominated or with which the value of the asset is significantly correlated.

⁸ Where dividends are paid in a foreign currency, the amount of the dividend is generally valued / measured in the currency of day-to-day bookkeeping and of presentation of the annual accounts at the date on which the decision to pay the dividend was taken by the decision-making body.

⁹ If the fair value has been determined at a date other than the balance sheet date, the exchange rate to be used is that prevailing on the date on which the fair value was measured.

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2.2. The "monetary vs non-monetary" approach

Under the "monetary vs. non-monetary" approach, balances denominated in foreign currencies are (re)valued at the end of the financial year in the currency in which the day-to-day books are kept and the annual accounts are presented, as explained below:

2.2.1. Monetary items denominated in foreign currencies

At the end of the financial year, monetary items (e.g. short and long-term receivables and payables, cash and cash equivalents) are revalued at the exchange rate prevailing on the balance sheet date.

Unrealised foreign exchange gains and losses are recognised in the profit and loss account. Unrealised foreign exchange gains cannot be distributed in accordance with the principle of prudence.

2.2.2. Monetary items denominated in foreign currencies and measured at fair value (LUX GAAP - FV)

Monetary items denominated in foreign currencies and which may be valued / measured by reference to the fair value method in accordance with section 7bis of Chapter II of Title II LRCS are revalued at the exchange rate prevailing on the balance sheet date.

Foreign exchange gains and losses are accounted for in the same way as changes in fair value in accordance with section 7bis of Chapter II of Title II LRCS and, where applicable, in compliance with article 72ter LRCS.

2.2.3. Non-monetary items denominated in foreign currencies

At the end of the financial year, non-monetary items (e.g. intangible assets, tangible assets, inventories) remain – with some exceptions¹⁰ – valued / measured at the historical exchange rate prevailing at the time of the transaction.

In principle, no exchange gains or losses are generated on these items.

2.2.4. Non-monetary items denominated in foreign currencies and measured at fair value (LUX GAAP – FV regime)

Non-monetary items denominated in foreign currencies and which may be valued / measured by reference to the fair value method pursuant to section 7bis of Chapter II of Title II LRCS are revalued at the exchange rate prevailing on the balance sheet date¹¹.

Changes in fair value, including foreign exchange gains and losses, are recognised in accordance with section 7bis of Chapter II of Title II LRCS and, where applicable, in compliance with Article 72ter LRCS.

Monetary vs. non-monetary approach		
Items denominated in foreign currencies	Exchange rate applied	Profit and loss account
Monetary items	Closing rate	unrealised foreign exchange gains and losses ^(b)
Monetary items measured at fair value (LUX GAAP - FV)	Closing rate	in accordance with Section 7bis Chapter II Title II LRCS and Art.72ter LRCS
Non-monetary items	Historical rate	n/a ^(c)
Non-monetary items measured at fair value (LUX GAAP - FV)	Closing rate	in accordance with Section 7bis Chapter II Title II LRCS and Art.72ter LRCS

(b) Unrealised foreign exchange gains are not available for distribution in accordance with the principle of prudence.

(c) Except in the event of a durable decline in the currency in which the asset is denominated or with which the value of the asset is significantly correlated.

¹⁰ See footnote 7, p.4.

¹¹ See footnote 9, p.5.

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2.3. The "short-term vs. long-term" approach

Under the "short-term vs. long-term" approach, balances denominated in foreign currencies are (re)valued at the end of the financial year in the currency in which the day-to-day books are kept and the annual accounts are presented, as explained below:

2.3.1. Short-term assets and liabilities denominated in foreign currencies

Short-term assets and liabilities denominated in foreign currencies are revalued at the year-end exchange rate.

Unrealised foreign exchange gains and losses are recognised in the profit and loss account. Unrealised foreign exchange gains cannot be distributed in accordance with the principle of prudence.

2.3.2. Short-term assets and liabilities denominated in foreign currencies and measured at fair value (LUX GAAP - FV regime)

Short-term assets and liabilities denominated in foreign currencies and which may be measured by reference to fair value in accordance with section 7bis of Chapter II of Title II LRCS are revalued at the exchange rate prevailing on the balance sheet date¹².

Exchange gains and losses are accounted for in the same way as changes in fair value in application of section 7bis of Chapter II of Title II LRCS and, where applicable, in compliance with Article 72ter LRCS.

2.3.3. Long-term assets and liabilities denominated in foreign currencies

Long-term assets and liabilities denominated in foreign currencies remain – with some exceptions¹³ – valued / measured at the historical exchange rate in force at the time of the transaction.

In principle, no exchange gains or losses are generated on these items.

2.3.4. Long-term assets and liabilities denominated in foreign currencies and measured at fair value (LUX GAAP - FV regime)

Long-term assets and liabilities denominated in foreign currencies that may be measured by reference to fair value in accordance with section 7bis of Chapter II of Title II LRCS are revalued at the exchange rate prevailing on the balance sheet date¹⁴.

Changes in fair value, including foreign exchange gains and losses, are recognised in accordance with Section 7bis of Chapter II of Title II LRCS and, where applicable, in compliance with Article 72ter LRCS.

Short-term vs. long-term approach		
Items denominated in foreign currencies	Exchange rate applied	Profit and loss account
Current assets and liabilities	Closing rate	unrealised foreign exchange gains and losses ^(d)
Short-term assets and liabilities measured at fair value (LUX GAAP - FV)	Closing rate	in accordance with Section 7bis Chapter II Title II LRCS and art.72ter LRCS
Long-term assets and liabilities	Historical rate	n/a ^(e)
Long-term assets and liabilities measured at fair value (LUX GAAP - FV)	Closing rate	pursuant to Section 7bis chap.II title II LRCS and art.72ter LRCS

(d) Unrealised foreign exchange gains are not available for distribution in accordance with the principle of prudence.

(e) Except in the event of a durable decline in the currency in which the asset is denominated or with which the value of the asset is significantly correlated.

¹² See footnote 9, p.5.

¹³ See footnote 7, p.4.

¹⁴ See footnote 9, p.5.

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3. Concept of hedge accounting: what are the implications for the measurement of assets and liabilities?

Despite the silence of the texts concerning the concept of hedge accounting, practices of "hedge accounting" are observed under the LUX GAAP and LUX GAAP – FV regimes.

These practices and their validity under LUX GAAP and LUX GAAP – FV will be examined in separate Q&A's dedicated to the concept of hedge accounting.

4. What information should be disclosed in the notes to the accounts?

In a context where Luxembourg accounting law applicable to undertakings is silent on the subject of foreign currencies and the related valuation and revaluation rules, CNC is of the opinion that it is appropriate to rely on general principles and in particular on the true and fair view objective referred to in article 26 para. 3¹⁵ LRCS as well as on the principle of clarity (transparency) referred to in article 26 para. 2¹⁶ LRCS.

In practice, CNC notes that the currency in which the day-to-day books are kept and the annual accounts are presented is always mentioned in the annual accounts¹⁷. In addition, a generic note within the accounting policies is generally dedicated to foreign currencies' transactions and balances. CNC believes that the notes to the annual accounts should include a description of the approach adopted by the undertaking (e.g. "classic approach", "monetary vs. non-monetary approach", "short-term vs. long-term approach") as well as all relevant information relating to the accounting treatment of the effects of changes in foreign exchange rates. Undertakings must also ensure that the information disclosed is relevant to the users of the annual accounts.

Conclusion:

In the silence of European and Luxembourg texts, the accounting treatment of transactions and balances denominated in foreign currencies under LUX GAAP and LUX GAAP – FV is essentially based on practices rather than on legal or regulatory provisions.

In this context, the purpose of this Q&A is to formalise – by way of doctrinal interpretation – the main approaches adopted by Luxembourg undertakings with regard to the treatment of transactions and balances denominated in foreign currencies under the LUX GAAP and LUX GAAP – FV regimes.

Whether undertakings adopt the above-mentioned practices or prefer another approach – based on a national, European Union or international framework and complying, where applicable, with the provisions of article 72^{ter} LRCS – the key element is the disclosure of clear (transparent) (art. 26 (2) LRCS) and true and fair (art. 26 (3) LRCS) information in the notes to the accounts, enabling users of the annual accounts to understand the approach adopted and to assess its impact on the annual accounts.

¹⁵ Article 26 para. 3 LRCS "The annual accounts must give a true and fair view of the undertaking's assets and liabilities, financial position and results".

¹⁶ Article 26 para. 2 "The annual accounts must be drawn up clearly and in accordance with the provisions of this chapter".

¹⁷ The currency in which the annual accounts are presented appears automatically in the standard eCDF forms relating to the abridged and unabridged balance sheet and profit and loss account (as well as in the standard chart of accounts eCDF form).

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Disclaimer

This document – provided as a courtesy – is an unofficial translation of the French original document entitled “Traitement comptable des transactions et soldes libellés en devises étrangères en régimes LUX GAAP et LUX GAAP - JV”. In case of discrepancy in interpretation, the French version shall prevail.

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