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| Q&A CNC 22/028 | **QUESTIONS / ANSWERS:**<br><br>**IMPLEMENTATION OF THE SMALL GROUP CONSOLIDATION EXEMPTION (ARTICLE 1711-4 LSC): PRACTICALITIES** |
|---|---|

**Context:**

Article 1711-4, paragraph 1 of the law of 10 August 1915 on commercial companies (LSC) provides that:

"*(1) By way of derogation from Article 1711-1, paragraph 1, a parent company shall be exempted from the obligation to draw up consolidated accounts and a consolidated management report if at the balance sheet date of the parent company, the undertakings which would have to be consolidated do not together, on the basis of their latest annual accounts, exceed the limits of at least two of the three criteria set out below:*

- *balance sheet total: 20 million euros*
- *net turnover: 40 million euros*
- *average number of full-time staff employed during the financial year: 250*."

The practical implementation of this consolidation exemption – usually referred to as the "small group exemption" – raises a number of questions. One of the recurring questions is whether the parent company must carry out a consolidation in order to determine whether it can validly claim the "small group exemption", or whether there are practical ways of avoiding a formal consolidation exercise.

The purpose of this Q&A is to set out the practical arrangements facilitating the implementation of the small group exemption (article 1711-4 LSC).

**Content:**

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|---|---|

**Content (continued):**



**Questions / Answers:**

**1. Do the balance sheet total and net turnover thresholds apply to the consolidated balance sheet and the consolidated profit and loss account?**

Yes, the thresholds of €20 million for the balance sheet total and of €40 million for the net turnover[1] apply to the consolidated balance sheet and the consolidated profit and loss account. "*The consequence of this is that a company, in order to determine whether it is eligible for the exemption, may first have to carry out a consolidation test, which is contrary to the intended objective, which is precisely to spare it this work*"[2].

**2. Are there any practical arrangements facilitating the implementation of the "small group exemption" (article 1711-4 LSC)?**

***2.1. What are the practical arrangements provided for by the legislator?***

In paragraph 2 of Article 1711-4 LSC, the legislator has provided for practical arrangements facilitating the implementation of the "small group exemption" by providing that "*the figures of the criteria relating to the balance sheet total and the net turnover may be increased by 20 percent, if the set-off referred to in Article 1712-4, paragraph 1 and the elimination referred to in Article 1712-11, paragraph 1, points 1° and 2° are not effected*".

[1] With regard to the net turnover criterion, it should be noted that under the terms of article 48 LRCS: "*The net turnover shall comprise the amounts derived from the sale of products and the provision of services after deducting sales rebates and value added tax and other taxes directly linked to the turnover*". In practice, this means that all financial income is excluded from the definition of net turnover, including dividends, interest income and capital gains on the disposal of participations. On the other hand, income from leasing of movable and immovable property as well as royalties generated by intellectual property rights (e.g. concessions, patents, licenses, trademarks) are included provided they do not relate to activities carried out on an ancillary basis.

[2] Bill 3154 on the preparation of consolidated accounts, comments on article 313, page 26.

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*"Therefore, in order to remedy this disadvantage* [cf. point 1 above], *the draft bill of law (...) authorises that the criteria expressed in monetary units also apply to the non-consolidated accounts, i.e. the balance sheets and profit and loss accounts simply aggregated of the parent company and of its subsidiaries, and that in this event they may be increased by 20%. This increase is necessary if companies opting for the second method of calculation are not to be placed in a more unfavourable situation, given that the balance sheet total and the amount of turnover of accounts not corrected for internal transactions are necessarily higher than those of the same accounts for which these eliminations have been made"*[3].

***2.2. What should be done in the case of subsidiaries with a different closing date?***

Considering the wording of Article 1711-4, paragraph 1 LSC, which provides that the latest annual accounts of subsidiary undertakings are to be taken into account *("(...) the undertakings which would have to be consolidated (...)* ***on the basis of their latest annual accounts*** (...)"), CNC is of the opinion that, for the sole purpose of determining the "small group exemption", it would not be reasonable to require subsidiary undertakings to prepare interim accounts. Consequently, in the case of subsidiary undertakings with different closing dates, CNC considers that the figures to be used are those in the latest annual accounts, regardless of the difference between the closing date of the parent undertaking and that of its subsidiaries.

***2.3 Case of an undertaking with a financial year of less than 12 months***

For the purposes of determining the "small group exemption", CNC is of the opinion that if a financial year of an undertaking that should be consolidated lasts less than 12 months – for example, following a change in the closing date – there is no need to adjust net turnover (annualised) or other accounting items (e.g. balance sheet total).

**3. How to implement the simplifications referred to in article 1711-4 LSC?**

***3.1 What are the thresholds to be taken into consideration?***

| | Unadjusted thresholds<br>art. 1711-4 para. 1st LSC | | Adjusted thresholds<br>Art. 1711-4 para. 2 LSC |
|---|---|---|---|
| Balance sheet total: | EUR 20 million | → | EUR 24 million |
| Net turnover: | EUR 40 million | | EUR 48 million |

If the simplified method referred to in Article 1711-4, paragraph 2 LSC is used, thresholds of EUR 24 million for the balance sheet total and EUR 48 million for the net turnover must be taken into account in order to determine whether or not the parent company and its subsidiaries can benefit from the "small group exemption".

[3] Supra note 2.

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***3.2. Which undertakings should be taken into account for the aggregation of accounts?***

Article 1711-4, paragraph 1 LSC provides that "(...) *a parent company shall be exempted from the obligation to draw up consolidated accounts and a consolidated management report if at the balance sheet date of the parent company, the undertakings which would have to be consolidated do not together, on the basis of their latest annual accounts, exceed the limits of at least two of the three criteria set out below (…)".*

It must therefore be concluded that the undertakings to be taken into account for the aggregation of accounts are the parent company as well as each of its direct or indirect subsidiaries, i.e. undertakings over which the parent company has exclusive control and which would be fully consolidated.

In view of the above, undertakings over which joint control is exercised (article 1712-17 LSC) and undertakings over which significant influence is exercised (article 1712-18 LSC) are therefore excluded from the aggregation of accounts. Similarly, undertakings excluded from the scope of consolidation pursuant to article 1711-8 LSC[4] are excluded from the aggregation of accounts.

***3.3 How are accounts aggregated and how does this differ from consolidation?***

The aggregation of accounts provided for in Article 1711-4, paragraph 2 LSC consists of a simple aggregation of the balance sheet totals and of the net turnovers of the parent company and of its subsidiary undertakings that would be included in the consolidation without "(...) *the set-off referred to in Article 1712-4, paragraph 1 and the elimination referred to in Article 1712-11, paragraph 1, points 1° and 2°* "[5].

For the record:

- the set-off referred to in article 1712-4, paragraph 1 LSC consists of the elimination of shares or corporate units in exchange for the proportion of the capital and reserves of the subsidiary undertakings included in the consolidation;
- the elimination referred to in Article 1712-11, paragraph 1, points 1° and 2° LSC consists of the elimination of reciprocal receivables and payables between undertakings included in the consolidation (point 1°) as well as income and expenses relating to intra-group transactions carried out between undertakings included in the consolidation (point 2°).

***3.4. What about the criterion of average full-time employees?***

Unlike the criteria of balance sheet total and of net turnover, article 1711-4, paragraph 2 LSC does not provide for an increase relating to the criterion of the average number of full-time employees employed during the financial year.

In this context, it is necessary to aggregate the average number of full-time staff employed during the financial year by the parent company and by all the subsidiary undertakings that would be included in the consolidation, i.e. undertakings that are exclusively controlled and that would be fully consolidated. In this respect, CNC is of the opinion that the notion of "average number of full-time staff employed" implicitly refers to the notion of "full-time equivalent (FTE)". Thus, two members of staff employed half-time for the entire financial year would be equivalent to one full-time employee for the purposes of calculating the criterion.

[4] Infra. note 6.

[5] See: article 1711-4, paragraph 2 LSC.

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However, staff employed by jointly-controlled undertakings or by undertakings over which significant influence is exercised are excluded from this calculation. Similarly, staff employed by undertakings that would be excluded from the scope of consolidation in accordance with article 1711-8 LSC[6] are also excluded from the calculation.

***3.5. Does the criterion of two consecutive years apply?***

Yes, the "small group exemption" is subject to the criterion of repetition of two consecutive financial years pursuant to article 1711-4, paragraph 4 LSC, which refers to article 36 LRCS.

In this respect, reference is made to Q&A CNC 19/019 "Categorisation of undertakings: interpretation of the repetition criterion referred to in Article 36 LRCS" and in particular to the following cases:

- **Case 3**: pre-existing group C that has exceeded, or ceases to exceed, at least two of the three criteria (pp. 7-10), and
- **Case 5**: new group E exceeding at least two of the three criteria (pp. 12-13) at the end of its first financial year.

In the case of pre-existing groups which have exceeded at least two of the three criteria of article 1711-4 LSC for two consecutive financial years (N and N+1) and which are subject to the obligation to draw up consolidated accounts as from the following financial year (N+2), it is important that the first consolidated accounts that are drawn up include comparative figures relating to the previous financial year (N+1) for both the balance sheet and the profit and loss account.

**4. What are the impacts of changes in the scope of consolidation?**

CNC is of the opinion that, for the purposes of determining the "small group exemption", the scope of consolidation should be assessed at the balance sheet date.

***4.1. Case of a subsidiary acquired during the financial year and held at the balance sheet date***

Where the parent company has exclusive control at the end of the financial year over a subsidiary acquired during the course of financial year N, this subsidiary should be taken into account in determining the "small group exemption" for financial year N without prorating the net turnover or other accounting items from the date on which control is acquired.

***4.2 Case of a subsidiary sold during the financial year and not held at year-end***

Where a subsidiary is disposed of prior to the end of the financial year N, such subsidiary should be disregarded for the financial year N and not considered for the purpose of determining the "small group exemption".

[6] In summary, the following undertakings may be excluded from the scope of consolidation if:
- they are not material in relation to the true and fair view objective, or
- where severe long-term restrictions substantially hinder the exercise of control by the parent company, or
- for which the information necessary for the preparation of consolidated accounts cannot be obtained without disproportionate expense or undue delay, or
- whose shares are held exclusively with a view to their subsequent sale.

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***4.3. Case where a parent company has disposed of all its subsidiaries before the end of the year***

If a parent company disposes of its entire group before the end of the financial year (N) and no longer exercises control over any of its subsidiaries, it no longer meets the definition of a parent company within the meaning of article 1711-1 LSC and is therefore excluded from the scope of the obligation to prepare consolidated accounts. It is important to note that this exclusion is immediate and that the undertaking – which is no longer a parent company – does not need then to meet the criterion of repetition for two consecutive financial years (N+1 and N+2) before being able to benefit from the exemption from consolidation.

***4.4 Case where a parent company has disposed of all its operational subsidiaries***

In the event that the parent company has disposed of its operational group prior to year-end (N) but continues – pending their liquidation – to control intermediate subsidiaries with no operational activities, the parent company must then determine whether or not all the subsidiaries it continues to hold at year-end are material or not.

In the case where the administrative or management body concludes that all the subsidiaries held at the end of the financial year are not material, the parent company is no longer – in substance – a parent company and is therefore immediately exempt from the obligation to prepare consolidated accounts, pursuant to article 1711-9 LSC.

In the opposite case, where the administrative or management body concludes that some or all of the subsidiaries held at the end of the financial year (N) remain material, then the parent company remains subject – even if at least two of the three criteria of article 1711-4 LSC are no longer exceeded – to the preparation of consolidated accounts for two consecutive financial years (N+1 and N+2).

**5. Which undertakings are excluded from the "small group exemption"?**

***5.1. Is the "small group exemption" available where there is a listed undertaking?***

No. Pursuant to paragraph 3 of Article 1711-4 LSC, the "small group exemption" does not apply to parent companies where one of the undertakings to be consolidated – i.e. the parent company itself or one of its direct or indirect subsidiary undertakings (see: point 3.2.) – is a company whose transferable securities (shares or bonds) are admitted to trading on a regulated market of a Member State within the meaning of Article 1er, point 31° of the law of 30 May 2018 on markets in financial instruments.

Note that if the undertaking whose transferable securities are traded on a regulated market is not a subsidiary but – for example – a jointly controlled company (joint venture) or a company over which significant influence is exercised (associate undertaking), then the "small group exemption" remains available to the parent company.

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***5.2. Is the "small group exemption" available for banking or insurance holding companies?***

No. Article 1711-3, paragraph 3 LSC provides that "*each parent company within the meaning of Article 1711-1 which principally holds one or more subsidiary companies required to be consolidated which are credit institutions or insurance undertakings (...)*" may prepare its consolidated accounts either in accordance with general accounting law, i.e. Title XVII LSC, or in accordance with sector-specific accounting law, i.e. the Banking Accounting Law of 17 June 1992[7] and the Insurance Accounting Law of 8 December 1994[8].

For holding companies of banking or insurance groups that are subject to prudential supervision on a consolidated basis and that choose to draw up their consolidated accounts in accordance with Title XVII LSC (art. 1711-3, para. 3 LSC), CNC is of the opinion that the "small group exemption" is not available by analogy with a holding company of a banking or insurance group that chooses to prepare its consolidated accounts in accordance with sector-specific accounting law (banking accounting law of 17 June 1992 or insurance accounting law of 8 December 1994).

*



[7] Law of 17 June 1992 on:
- the annual and consolidated accounts of credit institutions governed by the laws of Luxembourg;
- the obligations regarding publication of the accounting documents of branches of credit institutions and financial institutions governed by foreign laws.

[8] Law of 8 December 1994 on:
- the annual accounts and consolidated accounts of insurance and reinsurance undertakings governed by Luxembourg law,
- the obligations relating to the preparation and publication of accounting documents of branches of insurance undertakings governed by foreign law.