



Luxembourg - A new step towards the modernization of accounting

On 9 January 2009 the Luxembourg Ministry of Justice presented a bill (bill 5976) for the implementation in domestic law of the Modernization of Accounts Directives 2003/51/EC and 2006/46/EC, Fair Value Directive 2001/65/EC, as well as certain provisions of the Regulation (EC) 1606/2002 as regards International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). Except for Directive 2006/46/EC, the aforementioned directives and regulation had already been partially implemented into Luxembourg law as regards credit institutions and insurance undertakings by the laws of 16 March and 27 April 2006 and as regards commercial companies by the Grand-Ducal decrees of 24 July and 11 September 2006. The bill extends the application of the EC provisions to all commercial companies and, once enacted, may be supplemented by a Grand-Ducal decree implementing a standard chart of accounts.

The bill is twofold: it deals first with the modernization of accounting and secondly with the introduction of fair value accounting for financial instruments and IFRS.

Modernization of accounting

Bill 5976 confirms the implementation by the Grand-Ducal decrees of 24 July and 11 September 2006 of some provisions of the relevant European directives as regards commercial companies.

- As regards the preparation of annual accounts in accordance with the law of 19 December 2002 on the register of commerce and companies and the accounting and annual accounts of undertakings, the bill provides for the definition of a provision in line with that of the EC Directive. Whereas the law of 19 December 2002 initially required to provide for all foreseeable liabilities and potential losses, the bill requires to provide for all liabilities and grants the possibility, offered by the 4th Directive EC and used by the Luxembourg legislator, to take into account all foreseeable liabilities and potential losses.

The abolition of certain exemptions granted to small companies whose securities are admitted to trading on a regulated market of any Member State of the European Union is confirmed.

- As regards the preparation of consolidated accounts in accordance with Section XVI of the law of 10 August 1915 on commercial companies, as subsequently amended, the bill confirms the impossibility to exclude from the consolidation scope those undertakings to be consolidated whose activities are so different that their inclusion in the consolidated accounts would be incompatible with the obligation of true and fair view. This provision is in line with the International Accounting Standard 27.

It is upheld that the consolidation exemption formerly granted to a Luxembourg parent undertaking, whose securities are admitted to trading on a regulated market of any Member State and which is also a subsidiary undertaking of a parent undertaking governed by the law of another Member State, is removed.

- Some provisions pertaining to both annual and consolidated accounts are recaptured within bill 5976, namely:
 - Disclosures are required in the notes to the accounts regarding derivative financial instruments and certain financial instruments which are not fair valued;

- The bill expands the content of the management report. The management report shall include a description of the principal risks and uncertainties faced by the company, key performance indicators, references to the amounts reported in both the annual and the consolidated accounts. When relevant, the management report shall also give an indication of the company's objectives and policies as regards financial risk management as well as its exposure to financial risks.

The bill also implements into domestic law Directive 2006/46/EC and provisions that had not been implemented by the Grand-Ducal decrees of 24 July and 11 September 2006.

- The "substance over form" principle is enshrined, in application of which transactions and other events are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. Whilst the concept of substance is not explicitly defined, the bill makes reference to a potential future opinion of the "Commission des Normes Comptables".
- An additional layout for the consolidated balance sheet and consolidated profit and loss account is also provided. Since the consolidated accounts do not need to be lodged with the future "Central Balance Sheet Office", extensive flexibility is thus offered in the choice of layouts.
- The bill increases the thresholds provided for in the law of 19 December 2002 to determine the size of commercial companies or group of companies in accordance with EC Directive. In practice the main consequences will be as follows:
 - The company's size is indeed a criteria used to determine whether the company can benefit from certain exemptions relating to the preparation, presentation, audit and publication of annual accounts as well as to the preparation of the management report. A medium company could, for instance, become again a small company after two consecutive financial years and thus benefit from additional exemptions.
 - The size of a group of companies is indeed a criteria used to determine whether a parent company which controls one or more subsidiaries may be exempt from the preparation of consolidated accounts.
- The bill expands disclosure requirements in the notes to the accounts and requires additional information with respect to off balance sheet items and transactions with related parties if such transactions are material and have not been concluded under normal market conditions.
- The bill requires all companies whose securities are admitted to trading on a regulated market of any Member State to prepare a corporate governance statement which will be either included in a specific and clearly identified section of the management report or set out in a separate report published together with the management report, or made directly available to the public on the company's website. This statement shall describe, inter alia, the corporate governance practices actually applied by the company (like, for instance, the ten principles of corporate governance of the Luxembourg Stock Exchange), the main features of the company's internal control and risk management systems in relation to the financial reporting process, the operation of the general meeting of shareholders, the administrative, management and supervisory bodies of the company, etc.... A company which prepares a consolidated management report will not be required to publish a separate corporate governance statement but shall describe the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts in its annual statement. Information provided in this annual statement shall tie with information provided in the management report in accordance with the law of 19 May 2006 regarding takeover bids. This annual statement will be subject to certain verifications by the réviseur d'entreprises.

- Last but not least, the bill introduces a mechanism of collective duty and liability of the members of the administrative, management and supervisory bodies who fail to comply with the legal and regulatory provisions as well as with the accounting standards pertaining to annual accounts, consolidated accounts, management report and, when relevant, to the corporate governance statement.

Other bills also propose to modify certain current provisions regarding the preparation and the presentation of the accounts as well as their audit by a réviseur d'entreprises:

- The bill which transposes into Luxembourg law the European Directive regarding the statutory audit of the accounts provides that the total fees for the financial year charged by the authorized réviseur d'entreprises or audit firm and broken down by category of services shall be disclosed in the notes to the annual accounts and, when relevant, the consolidated accounts.
- The bill which modernizes the law of 10 August 1915 on commercial companies, as subsequently amended, provides the possibility for small companies not to appoint a commissaire and to have their annual accounts audited by an authorized réviseur d'entreprises.

Introduction of fair value accounting for financial instruments and IFRS

Before the adoption of the bill, the financial reporting frameworks that are applicable in the Grand-Duchy of Luxembourg are summarized as follows:

		IFRS	Lux GAAP + Fair Value	Lux GAAP
Listed companies	Annual accounts			Obligation
	Consolidated accounts	Obligation		
Credit institutions, insurance and reinsurance undertakings	Annual accounts	Optional	Optional	Common regime
	Consolidated accounts	Optional	Optional	Common regime
Other companies	Annual accounts			Obligation
	Consolidated accounts		Optional	Common regime

The commercial companies whose securities are not admitted to trading on a regulated market of any Member State and who wish to draw up their annual and/or consolidated accounts in accordance with international financial reporting standards, although this financial reporting framework is currently not recognized by the Luxembourg law, have to request an individual exemption from the Ministry of Justice.

The adoption of the bill would lead to the following situation:

		IFRS	Lux GAAP + Fair Value	Lux GAAP
Listed companies	Annual accounts	Optional	Optional	Common regime
	Consolidated accounts	Obligation		
Other companies	Annual accounts	Optional	Optional	Common regime
	Consolidated accounts	Optional	Optional	Common regime

The companies opting either for the use of fair value accounting for financial instruments or for international financial reporting standards, should nonetheless comply with certain additional provisions with regards to the content of the notes to the accounts:

- When fair value accounting is used for financial instruments, additional information should be disclosed in the notes to the accounts.
- When the accounts are drawn up in accordance with international financial reporting standards, the additional information specifically requested by the Luxembourg law, in addition to those normally requested by international financial reporting standards, should be disclosed in the notes to the accounts.

Furthermore, the companies opting either for the use of fair value accounting for financial instruments or for international financial reporting standards should comply with the legal provisions with regards to the contents of the management report and of the annual corporate governance statement, the audit of the accounts and the collective duty and liability of the members of the administrative, management and supervisory bodies of the company. The companies opting for international financial reporting standards will only be exempt from lodging the balance of accounts in accordance with the standard chart of accounts with the register of commerce and companies.

The bill 5976 therefore offers new possibilities for the preparation and presentation of the financial information of companies in accordance with EU directives and regulation currently in force. It responds to a real need of companies as proven by the increase of demands for individual exemption from the Ministry of Justice over the past few months. The bill also occurs at the same time as other draft bills are being examined and the project of international financial reporting standards for non-publicly accountable entities is in progress. The bill therefore constitutes a real step towards the modernization of accounting in the Grand-Duchy of Luxembourg and will probably be followed by other steps in the coming months and years.

Should you require further assistance in this matter, *please contact your usual KPMG adviser.*

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