

Private equity and consolidation dated December 23, 2009

Interpretative guideline from the Luxembourg
Accounting Standards Board (“CNC”)¹

The Luxembourg Accounting Standards Board (“*Commission des normes comptables*” or “CNC”) has recently issued an interpretative guideline that aims at clarifying the circumstances under which a Luxembourg company active in the private equity or venture capital industries may not be required to prepare and file consolidated accounts.

More specifically, the purpose of this interpretation is to specify the conditions that are deemed appropriate for companies active in the private equity or venture capital industries to meet in order for them to be able to apply the consolidation scope exclusion set out in article 317 (3) c) of the amended law of August 10, 1915 on commercial companies (“the Company Law”) which tackles the concept of “*investment held exclusively for subsequent resale*” (“*held for resale investment*”).

The use of this interpretative guideline will imply a strict compliance with the conditions set out by the CNC. This will necessitate a thorough analysis to be performed on a case-by-case basis.

The consolidation scope exclusion of article 317 (3) c) of the Company Law

The concept of “held for resale investment”

Under Luxembourg GAAP, companies that control one or more subsidiaries are generally required to prepare consolidated accounts, to have them audited by a Luxembourg *réviseur d'entreprises* and to have them filed at the *Registre de Commerce et des Sociétés* (“RCS”).

However, the Company Law provides for a number of exemptions or scope exclusions that cause a parent company either to be exempt from preparing consolidated accounts or to exclude one or more subsidiaries from consolidation.

In this context, article 317 (3) c) of the Company Law provides for a general scope exclusion that allows a parent company to exclude a controlled entity from its consolidation scope in circumstances where “*the shares of that undertaking are held exclusively with a view to their subsequent resale*”.

The underlying argument for such scope exclusion is the fact that consolidated accounts are supposed to convey a true and fair view of a group, understood as a consistent and reasonably stable structure of separate legal entities. Under that theory, such controlled entities could distort that image of the group and hinder comparison through time thus providing ground for their exclusion from the scope of consolidation.

¹ Interpretative guideline posted on the website of the Ministry of Justice on December 23, 2009 (www.mj.public.lu).

This concept of “held for resale investment” is generally used by private equity and venture capital market players to justify the absence of consolidation considering that their investments are all acquired with a view to their subsequent resale.

The purpose of the interpretative guideline

The scope exclusion set out in article 317 (3) c) of the Company Law is relatively vague and therefore subject to a variety of interpretations and of potential abuse leading to inconsistent practices in the market. So far, the main source of authoritative interpretation came from the commentaries included in the preparatory acts² that led to the law of July 11, 1988 on consolidated accounts.

This is the reason why the CNC was requested by the Minister of Justice to develop an interpretative guideline that is sufficiently clear to provide guidance for companies active in the private equity and venture capital industries.

The interpretative guideline in practice

The interpretation issued by the CNC defines 6 conditions that need to be met in order for a non-regulated company acting in the private equity or venture capital industries to apply the scope exclusion set out in article 317 (3) c).

- The non-regulated company acting in the private equity or venture capital industries must be held by well-informed investors;
- Its activities must be restricted to investments in securities representing risk capital meaning the direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange;
- Its object is to ensure for their investors the benefit of the result of the management of their assets in consideration for the risk which they incur;
- The assets of the company shall be disclosed at fair value (either on the face of the balance sheet or in the notes to the accounts);
- An exit strategy should be defined ex-ante in a document addressed to the investors which should stipulate an intent to dispose of the asset within a 3 to 8 year timeframe;
- Any event or commitment which may have a significant impact on the financial situation (e.g. guarantees, pledges, debt covenants...) should be appropriately disclosed in the notes to the accounts.

These conditions and their meaning are further explained in the interpretative guideline.

A key point to note is that this interpretative guideline does not hinder the ability of supervisory authorities or of minority shareholders to request the preparation of consolidated accounts by management.

Eventually, the responsibility for not preparing consolidated accounts rests with the directors. Hence it is advisable for management to assess carefully – on a case-by-case basis – that the conditions are fully complied with and that the absence of

² Draft bill of law N°3154 « *Projet de loi relatif à l'établissement des comptes consolidés* » filed on December 1, 1987.

consolidation is indeed in the best interest of the company and of its internal and external stakeholders.

Date of enforcement

This interpretative guideline from the CNC shall apply to Luxembourg companies active in the private equity or venture capital industries that meet all of the 6 conditions without exceptions for financial years beginning on or after January 1st, 2009.

In times like these where transparency is key to restore public confidence and where substance requirements are increasing, caution is needed to ensure that the risks associated with the absence of consolidation are properly assessed and adequately mitigated. PricewaterhouseCoopers intends to provide its clients with its support and expertise in this respect.

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