

## European traditions in accounting

# Accounting in Iceland

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*Iceland in the North Atlantic Ocean*

Iceland is one of the Nordic countries, and it is the smallest. The size of the country is around 103.000 km<sup>2</sup> and the population is about 320.000. That makes Iceland the most rural location in the world, about three inhabits pr. m<sup>2</sup>. Iceland was a part of Denmark until June 1944. Danish influence in administration and law making have always been great. As the time passed, the independence began to manifest in Icelandic regulation and law making environment, but the recent years EU have impact the law making, specially in accounting via IFRS.

### The Accounting Act Development 1938-2013

#### *The early years*

In 1938 was for the first law passed by Parliament which specifically dealt with accounting, Act No. 62/1938 on bookkeeping. The Act focused mostly on two things, firstly, classifying firms regarding mandatory to keep accounting records, secondly, how to do the bookkeeping. In articles 10 to 12 it is mentioned who to prepare the balance sheet and all assets which have been pledged or any warranties to third person shall be disclosed. This law was enacted by The King Christian X of Denmark.

In the next thirty years there were no major changes in the accounting legislation. It was not until 1968 that a new accounting law was adopted by the Parliament (Alþingi), Act No. 51/1968. In the Act, it was stated for the first time, in details, how accounts should be prepared and the structure of the annual accounts and which issues should be accounted for in the balance sheet and the profit and loss account. The Cash flow statement was not mentioned in the Act.

Many new issues were observed but the eight main issues in the Act were as following: 1. Requirement to keep accounts. 2. Exemptions from the use of double-entry accounting listed. 3. The term generally accepted accounting principles applied. 4. Process for doing accounting defined. 5. Documentation in bookkeeping applied. 6. Valuation of inventories. 7. New provisions for the preparation of annual accounts (financial statements) and valuation. 8. The Minister may, by a government regulation, establish further provisions regarding the enforcement of this Act, and decide that industries should have a standardized accounting system.

The concept "generally accepted accounting principle" was introduced in the law for the first time in the Accounting Act No. 51/1968. In comments under Article 4., in the law bill, it is stated that the concept implies in particular that "... accounts are kept and annual accounts are prepared in accordance with the views, that are at any given time generally dominated by skilled and conscientious people, working with bookkeeping and accounting." The term "conscientious people" is noteworthy as it refers to the people that shape the generally accepted accounting principles.

During the high inflation period of the 1970s and 1980s, the using of the cost method of accounting, to value properties in the annual accounts, became

subject to criticism. Unlike the assets, the debt became more inflation-indexed and therefore revalued at every balance sheet date. As a result of that, shareholders equity dropped. Therefore, it was considered necessary to reevaluate assets for inflation. This was the first step toward inflation-adjusted accounting.

### *New Annual Accounts Act, No. 144/1994*

In 1994 a new law on Annual Accounts was passed, Act No. 144/1994. This new Act had a huge impact on the accounting environment. This was the first time that provisions on preparation and presentation of annual accounts was placed in one single act. Before it was to be found in several different laws. The provisions of the Act No. 144/1994 were largely based on the "Nordic model". The agreement with the European Union regarding European Economic Area (EEA) was signed by Iceland in 1994. Many new provisions were introduced in this Act which had a huge impact on the accounting environment in Iceland:

1. In chapter IX the Accounting Standards Board is mentioned for the first time. The main task of the Accounting Standards Board is to promote and develop the generally accepted accounting principles. This is a change from the provisions in Act No. 51/1968, when individual professionals did develop the generally accepted accounting principle.

2. In chapter VI the concept "consolidated accounts" is mentioned for the first time. It mainly deals with internal transactions and how shares in associated companies should be accounted for.

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3. Chapter VIII deals with the obligation of companies to elect an external auditor at the annual general meeting. The chapter also contains general requirements concerning size limits, sales, assets and equity, which have impact on the duty to elect an auditor.

4. In Chapter V, the content of the director's report is discussed. The Act specifies what information should be included in the director's report, e.g. it must be disclosed who owns more than 10% share in the company.

5. Emphasis was placed on the high relevance of the disclosures of the annual accounts.

6. The valuation rules were detailed and many accounting terms were adjusted to international standards, i.e. revenue recognition, the matching principle and inventories valuation methods.

7. The impact of inflation is taken into account as "inflation-adjusted accounts", i.e. the assets, liabilities and operations were adjusted to inflation. Under Article 25, it was permitted to adjust the annual accounts by taking into account the impact of general price level changes on operations and financial position of the companies. By using the permission, the company was required to establish a revaluation reserve within the equity accounts, that were used to offset the inflation adjustments. Almost all loans were inflation-indexed which had a negative impact on the principal balance of the loans. These circumstances led to discrepancies between non-indexed assets and indexed liabilities. The Inflation rate was calculated on a monthly basis. Inflation-adjusted accounting was intended to correct the difference in valuation of assets and liabilities arising from the inflation.

*Effects on the profit and loss*

In manufacturing companies where the debts/loans were inflation-indexed, a gain was generated in order to reduce the financial expenses impact of indexation due to inflation. In financial institutions where the loans/advances were mostly inflation-indexed, expenses were generated to offset the (inflation) gain. The price adjustments transaction is recognized as financial income or expenses. The accounts were adjusted to the price level. Profit or loss was shown at real value, i.e. after inflation had been taken into account.

### **From 1995 and on**

An amendment was made to the Annual Accounts Act, no. 144/1994, in 1995, which imposed new sanctions and procedures for reporting of financial fraud and for those parties who neglect to take measures to prevent that wrong information, financial or non-financial, enter the market.

In context with the EEA Agreement, new amendments to the annual accounts were adopted in 2001 and a new surveillance authority was established, The Register of Annual Accounts, to keep a register of all companies that have to prepare annual accounts according to law. The new amendments make it mandatory for all companies to submit their annual accounts (financial statements) to the Register of Annual Accounts.

In Iceland, the Icelandic krona is used as the functional currency, but with changes to the law on the annual accounts, the accounting law and the law on income tax it was permitted to present annual accounts in other currency than the Icelandic krona, i.e. the real functional currency. The presentation currency can be other than the Icelandic krona. This required a special authorization from the Register of Annual Accounts. It is a possible to choose

between three languages, regardless of currency, i.e. Icelandic, Danish or English. Nonetheless, companies that wish to register their accounts in foreign currency are required to register their accounts in Icelandic currency for tax purposes. Assessment of public expenditure shall be in Icelandic currency as well as the payment of fees and taxes.

Inflation-adjusted accounting was abolished by an amendment to the Annual Accounts Act in 2001. Companies were given a two-year transition period from beginning of 2002 to the end of 2003 to amend their accounts in accordance with the new rules. They were also allowed to take into account price changes in preparation of the accounts, without justifying the continued use of the method. During the transition period "three sets of" annual accounts were prepared, first, with price adjustments and second, without price adjustments and thirdly, big international companies used IASB/IAS standards.

Many major accounting topics were added to the Act, in 2003, such as, a true and fair view, consolidated accounting, explanations on impairment test. Companies were now required to prepare consolidated financial statements. Two methods were allowed for the preparation of consolidated accounts; the purchase method of accounting or the pooling-of-interests method of accounting. It may be noted that FASB agreed two years earlier, in July 2001, to prohibit the use of the pooling-of-interests method of accounting for preparation of consolidated accounts.

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On 1st of January 2005 a law was passed by the EU that all companies with listed securities, shares or bonds on the open market should use the IASB/IFRS accounting standards in the preparation and presentation of their annual accounts. In 2004, all international accounting standards were translated into Icelandic. This had a huge impact on the accounting environment, as many Icelandic companies changed their accounting policies with the adoption and implementation of IAS/IFRS.

At the beginning of 2006, a new comprehensive law on Annual Accounts was introduced in Iceland, Act No. 3/2006. The new law contain the additions to the former Act that occurred between 1994 - 2005. Various changes have taken place since then, as described before.

In 2008, special provisions on audit committees were adopted in Icelandic law. Companies, defined as a public interest entities shall (are obligated to) have an audit committee. The Audit Committee's role is discussed in this new law. Among other things, the audit committee shall assess the independence of the auditor or auditing firm and recommend to the board of directors on the choice of auditor or auditing firm.

### Accounting and education

The International Financial Reporting Standards (IFRS) was adopted in Iceland on 1 January 2005 and the largest companies in the country and international companies have prepared their annual accounts according to IFRS. The Register of Annual Accounts grants permission and keep record of companies that prepare their accounts under IFRS. It also monitors the preparation and presentation of the annual accounts and compliance with IFRS. Some industries do not use IFRS, among them are municipalities and pension funds.

The Accounting Standards Board was established in 1992. Until then, a special committee on accounting procedure operated within the national Association of Certified Accountants. The role of the Accounting Standards Board includes promoting the formulation of accounting principles, cf. the Annual Accounts Act.

The Public Auditors Oversight Board was established in 2008. It's role is to monitor compliance in the work by auditors and audit firms with the provisions of Act No. 79/2008 on Auditors, the Code of Ethics of the Institute of State Authorised Public Accountants and other rules that apply to the work of auditors. In Article 15, of the Act, a special emphasis is put on the following five issues:

1. Auditors meet the conditions for certification.
2. Auditors meet the requirements relating to continuous education.
3. The professional activities of auditors and audit firms are subjected to regular quality control.
4. A Code of Ethics and auditing standards are in place.
5. Auditors take in account provisions of law on money laundering and financing of terrorists.

Until 2006 it was not required for an individual to hold a master's degree in order to become state authorized public accountant in Iceland. It was sufficient to hold a bachelor's degree, with specialising in accounting, or equivalent undergraduate degree. In 2006 a change occurred, in order to become a student and an employee of an audit firm, a master degree in accounting and auditing from a university is required. According to the law, the Audit Oversight Board has to approve the content of the master's program.

To be licensed as a State Authorized Public Accountant an individual must have three years relevant work experience and have passed a comprehensive examination conducted by the Audit Oversight Board. The examinations are held once every year. So far only 25% of the participants have passed the exam (met the minimum requirements).

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