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Brussels, 13 October 2021  
Case No: 87332  
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Ministry of Transport and Local Government  
Sölvhólgötu 7  
101 Reykjavík  
Iceland

Dear Sir/Madam,

**Subject: Complaint against Iceland concerning the interpretation and application of International Accounting Standards**

On 23 August 2021, the EFTA Surveillance Authority (“the Authority”) received a complaint against Iceland concerning the alleged breach of its obligations under the EEA Agreement due to interpretation and application of International Accounting Standards (“IAS”) as set out by Regulation (EC) No 1606/2002 on the application of international accounting standards (“the Application Regulation”) and Regulation (EC) No 1126/2008 on adoption of international accounting standards into EU law (“the Adoption Regulation”).<sup>1</sup>

According to the complaint, the alleged breach is evidenced by administrative practice of the municipalities when submitting their annual accounts and financial statements. This relates both to municipalities and companies owned by the municipalities, which run affairs on their behalf. The complainant considers that the alleged breach, or said misapplication of the standards, has recently been upheld by the Municipal Accounting and Information Committee (“MAIC” or *Reikningsskila- og upplýsinganefnd sveitarfélaga*).

MAIC is a supervisory committee under the Icelandic Ministry of Transport and Local Government (*Samgöngu- og sveitarstjórnarráðuneytið* or “SSR”). The complainant submits that this breach is evident by MAIC’s ruling in case no. 1/2020 of October 2020, where it ruled on the submission of consolidated financial statements by Reykjavík City and its company Social Housing Inc. (*Félagsbústaðir hf.*), a public corporation that manages social housing on behalf of the municipality.

More specifically, the complainant considers that interpretation and application of the term “*investment property*” in Reykjavík City’s and Social Housing Inc.’s consolidated financial statements is contrary to said EEA Acts and IAS. The complainant holds that the interpretation and application of the term “*investment property*” by both the municipality and Social Housing Inc. is in stark contrast to practice by other municipalities within the EEA, which do not classify publicly owned real estate, used for *social housing purposes*, as investment property.

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<sup>1</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p. 1–4) was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 37/2004 of 14 March 2003, which inserted it as point 10a Annex XXII (Company law) to the EEA Agreement. Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council (OJ L 320, 29.11.2008, p. 1–481) was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 74/2009 of 29 May 2009, which inserted it as point 10ba of Annex XXII (Company Law) to the EEA Agreement.

The complainant holds that this classification and interpretation of the IAS by Reykjavík City and its company entails an incorrect use of the term “*investment property*” under the standards. The Authority notes that as per an audit report by Grant Thornton, dated 29 April 2021, for Reykjavík City, Social Housing Inc. owned investment property of a considerable amount, which was accounted for in accordance with IAS40.<sup>2</sup>

With regard to the ruling of the MAIC, allegedly upholding the incorrect interpretation and application of the term *investment property*, the Authority notes that MAIC stated that Social Housing Inc. *had an obligation to apply IAS* when preparing its annual accounts, by reference to a previous ruling by the Ministry of Industries and Innovation (“ANR”) from 11 July 2013.

Having considered this, MAIC concluded that Reykjavík City was authorised to use financial statements or annual accounts by Social Housing Inc. *unchanged or as is* into their consolidated accounts, *if* the same method of assessment was used for both statements, and *if* the municipality did consider that the operations of the publicly owned company was in the area of investments in investment property, which would authorise the use of fair value assessment – contrary to cost value – as per Article 39 of the Icelandic Act on Annual Accounts No 3/2006. The Authority furthermore notes that MAIC neither made reference to the provisions of Annex I of the Adoption Regulation nor the corresponding IAS 40 in its ruling.

Lastly, the complainant states that both Reykjavík municipality and its company, Social Housing Inc., issue bonds, which are publicly traded on the regulated market. Therefore, in the complainant’s view, it is of utmost importance that the financial statements of municipalities and their entities are prepared on the basis of correct use of accounting standards, which in turn can be relied upon by the financial markets.

The Authority notes that the EEA Acts have been fully incorporated into national law according to notifications of the Icelandic Government by Form 1s. The Icelandic Government notified of full implementation of Adoption Regulation on 21 July 2010, by way of Regulation No 596/2010.<sup>3</sup> The Icelandic Government had prior to that notified of full implementation of Application Regulation on 2 June 2005, with a Form 1, by way of Act on Annual Accounts No 144/1994<sup>4</sup>, which was later replaced by current Act No 3/2006 on Annual Accounts. More recently, on 26 October 2015, Iceland sent a Form 1, notifying of full implementation of IAS 40, by way of administrative Regulation No 937/2015, cf. also Article 127 of the Act on Annual Accounts, on adoption of Commission Regulation (EU) No 1361/2014 as regards *inter alia* IAS 40.<sup>56</sup>

The Authority notes that Article 45 of Act No 40/1991 on social services by municipalities (“*lög um félagsþjónustu sveitarfélaga*”) states that municipalities have duties to offer social housing. Moreover, as outlined by Article 61 of the Local Authorities Act No 138/2011, municipalities shall prepare and submit their annual financial statements in accordance with Act No 3/2006 on Annual Accounts. The same rule applies for their

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<sup>2</sup>Slide 9 of the presentation by the auditor, available at [https://reykjavik.is/sites/default/files/skjol\\_borgarstjornarfundur/2\\_12\\_reykjavikurborg\\_endurskodun\\_arskyrsla\\_2020.pdf](https://reykjavik.is/sites/default/files/skjol_borgarstjornarfundur/2_12_reykjavikurborg_endurskodun_arskyrsla_2020.pdf).

<sup>3</sup> Doc No 565649.

<sup>4</sup> Doc No 321903.

<sup>5</sup> Doc No 78395.

<sup>6</sup> *Commission Regulation (EU) No 1361/2014 as regards International Financial Reporting Standards 3 and 13 and International Accounting Standard 40* (OJ L 365, 19.12.2014, p. 120–123) was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 171/2015 of 11 June 2015, which inserted it as point 10ba Annex XXII (Company law) to the EEA Agreement.

companies or agencies, thus also applying to the entity of *Social Housing Inc.*, owned by Reykjavík municipality, according to the complaint.<sup>7</sup>

Today, the concept “*international public accounting standards*” is defined in of the Act No 3/2006 on Annual Accounts, namely Article 2(1), by an explicit reference to the IAS as per Article 2 of Regulation (EC) No 1606/2002. According to Article 3(1) of Act No 3/2006 on Annual Accounts, the preparation of annual accounts shall be in accordance with the law and accounting rules, i.e. the IASs. In the absence of instructions by Icelandic law, reference is made to rules set out by the IASs, which shall then take precedence.

Chapter VIII of the Act bears the title “*International Accounting Standards*”, whereas Article 88 of the Act states that the Act incorporates Regulation No. 1606/2002 into national law and that the Regulation is annexed to it. As per Article 89, the Chapter shall be applied to companies that fall under the Act. Article 90 states that Companies falling within the scope of point 2 of the first paragraph of Article 1 shall prepare their consolidated financial statement in conformity with IAS, as required in Article 4 of Regulation (EC) No 1606/2002. According to information available online at the website of the Icelandic Tax Authorities, Social Housing Inc. offers securities registered on the market and shall apply IAS when preparing their financial statements.<sup>8</sup>

According to Article 127 of the Act, the Ministry can issue a regulation on the enforcement of this Act, including the implementation of IASs approved in accordance with Article 3 of the Application Regulation. In this regard, Regulation No 937/2015 by the Ministry of Industries and Innovation, cited above, incorporates IAS 40 into the national legal order.

The Authority notes that investment property is the subject of IAS 40, cf. Annex I of the Adoption Regulation, cf. also the Ministry’s Regulation No 937/2015. According to Article 2 of IAS 40, the standard should be applied in the recognition, measurement and disclosure of investment property.

Article 5 of IAS 40 defines investment property as:

*“property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:*

- (a) *use in the production or supply of goods or services or for administrative purposes;*
- or*
- (b) *sale in the ordinary course of business”.*

A distinction between “*investment property*” and “*owner-occupied property*” is set out in Article 7 of IAS 40, whereas:

*“Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not only to property, but also to other assets used in the*

<sup>7</sup> The Authority notes that Article 5 of the Articles of Association (“*stofnsamþykktir*”) of Félagsbústaðir hf. states that the company is owned by Reykjavík City, cf. <https://www.felagsbustadir.is/media/wklnlr/stofnsam%C3%BEykkir-f%C3%A9lagsb%C3%BAsta%C3%B0a-hf.pdf>.

<sup>8</sup> Information available at <https://www.skatturinn.is/fyrirtaekjaskra/arsreikningaskra/felog-med-althjodlega-reikningsskilastadla/2017>.

*production or supply process. IAS 16 applies to owned owner-occupied property and IFRS 16 applies to owner-occupied property held by a lessee as a right-of-use asset.”*

Article 8(c) of IAS 40 gives examples of investment property being inter alia “a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases”. Finally, Article 9 sets out examples of items that are not investment property and therefore fall outside of the scope of the standard, e.g. owner-occupied property.

On the basis of the above and in order for the Authority to examine and assess the complaint, the Icelandic Government is invited to provide the following information:

1. The Icelandic Government is invited to state whether it agrees with the Directorate’s assessment that IASs have been fully incorporated into Icelandic law and notified by way of submitting the Form 1s cited above.
  - a. Do Article 88 and 127 of the Act on Annual Accounts No 3/2006, as well as Regulation No 937/2015, incorporate the Application Regulation and the Adoption Regulation, more specifically IAS 40?
2. Can the Icelandic Government please clarify whether measures by virtue of Art. 5 of the Application Regulation No 1606/2002 were applied by the Icelandic Government?
  - a. If so, did the Icelandic Government notify of such an application in line with Article 8 of the Application Regulation?
3. Has the Ministry issued regulations on the enforcements and interpretation of the IASs that is relevant to application of standards related to investment property, besides Regulation No 937/2015?
4. In the Government’s view, what is the legal basis for the municipalities’ obligation to apply the IASs? Please state the said legal basis both under national and EEA law.
  - a. In that regard, what legal basis did ANR cite in its ruling of 11 July 2013 regarding the municipalities’ or Social Housing Inc.’s obligations to apply IAS? Was the reference made on the basis of national law or EEA law?
5. Can the Icelandic Government confirm whether *Social Housing Inc.* falls under the definition of companies as per Article 4 of Application Regulation No 1606/2002, i.e. that it issues securities in a regulated market, as per definition set out in Article 4 of the Regulation, cf. also definition set out in Article 24, sub-paragraph (21) of MiFID II<sup>9</sup>?
  - a. If that definition does not apply, by virtue of what legal basis rests the obligation of *Social Housing Inc.* to apply IASs, in the view of the Icelandic Government?
6. More generally, is the Icelandic Government aware of any judgments or administrative practice, such as rulings by the relevant ministry or supervisory committees, setting out an obligation for municipalities or their companies/entities to apply the IASs? If so, the Directorate would welcome such examples.
  - a. Furthermore, is the Government aware of examples, in practice, demonstrating a departure from said obligation? If so, the Directorate would welcome such examples.
7. Does the Government consider the term investment property (“*fjárfestingareign*”) as defined by Article 2(15) of the Act No 3/2006 on Annual Accounts to apply to real estate used for social housing? Please elaborate on the reasons for it applying or not applying.

<sup>9</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349–496) was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 78/2019 of 29 March 2019, which inserted it as point 31ba Annex IX (Financial Services) to the EEA Agreement.

8. Furthermore, does the Government consider the definition set out in Article 2(15) of Act No 3/2006 to be in line with interpretation by the IASB, cf. the definition in Article 5 of IAS 40, cf. Article 7-8 of IAS 40, as annexed to Adoption Regulation? If examples of interpretation on this subject are demonstrated in e.g. administrative practice, please refer to such examples.
  - a. In that respect, please clarify whether social housing by Félagsbústaðir hf. would be considered as owner-occupied property as per Article 7 of IAS 40.
9. Are there other IASs relevant for the Directorate's assessment in this case, besides IAS 40?

The Icelandic Government is invited to submit the above information, as well as any other information it deems relevant to the case, so that it reaches the Authority by *15 November 2021*. Please enclose copies of any relevant national legislation, including English translations if available.

Yours faithfully,

Marco Uccelli  
Deputy Director  
Internal Market Affairs Directorate

*This document has been electronically authenticated by Marco Uccelli.*