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**The role and current status of IFRS in the completion of national  
accounting rules - Evidence from Finland**

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# **The role and current status of IFRS in the completion of national accounting rules - Evidence from Finland**

## **Abstract**

We investigate how Finland has applied Directive 2013/34/EU of the European Parliament and of the Council to the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. In addition to the implementation process and general implications of the Finnish Accounting Act, we emphasize its implications and interplay with IFRS. We conclude that the national implementation of Directive 2013/34/EU successfully diminished the administrative burden experienced by small companies.

Keywords: IFRS, Finland, EU Accounting Directive 2013/34/EU, SMEs

## **Implementation Process**

Directive 2013/34/EU (henceforth, the “2013 Directive”) was published in June 2013 before the summer holidays. The implementation process of the 2013 Directive began on the national level in Finland in August 2013 when the Ministry of Economic Affairs and Employment set up a task force of nine persons. Their task was to analyse and identify the required changes in national legislation to fulfil the requirements of the 2013 Directive.

The task force argued that there was a clear need to develop the Finnish Accounting Act to fulfil the new EU requirements as the former financial statement directive (78/660/ETY) was from 1978 and the consolidated financial statement directive (83/349/ETY) was from 1983. An updated Accounting Act was indeed needed to replace old acts. The targets of the task force also included the critical evaluation of the current administrative practices related to bookkeeping, financial statement reporting requirements and cooperation practices with the national legislators and the tax authorities.

In the beginning, the task force organized a few public discussion events that were open for everyone to participate in. The initial target was to develop a new national law very openly so that all opinions would be listened to as long as they were in line with the directive. As an outcome of the work done by the task force, they delivered a 298 page report on their observations and recommendations to the Ministry of Economic Affairs and Employment in October 2014. The word “IFRS” was mentioned in the report 67 times. The report included two new issues that were not included in the previous laws.

First, the 2013 Directive offers an option for the member states to relieve the financial statement requirement for the smallest companies. In the very beginning, with the support of the Ministry, the task force made a decision in principle that Finland will use this option to the maximum scale when implementing the 2013 Directive. Second, the 2013 Directive includes a requirement for entities that are active in the extractive industry or logging of primary forests to provide for the enhanced transparency of payments made to governments and large undertakings and for the public interest. The task force felt unprepared to include the content of this requirement in the National Accounting Act.

At the end of October, the Ministry of Economic Affairs and Employment sent the draft of the new law to 48 stakeholders, including many kinds of organizations and associations, to ask for their written statements on their comments and feedback on the proposed national law. By the end of January 2015, they had received a written response from nine organizations including the Ministry of Finance, three auditing companies, some business and professional associations, and one publicly listed company. The feedback and comments were more or less on details of the proposed national law but did not include debate about fundamental views or changes. The role of IFRS did not factor extensively in the comments, and it was rarely mentioned in the statements made by the stakeholders.

Based on the written statements given by the stakeholders, the task force modified the law proposal. Once they completed their work, they sent it to the national Parliament for agreement in November 2015. First, the standing committee of the Parliament heard views from several experts, of which many were the task force members. Finally, the Parliament agreed on the proposed national law to implement the 2013 Directive at the end of December 2015.

### ***Accounting Requirements and Company Size Categories***

The new national law changed the size limits for small companies. Table 1 reports the new company size limits (the old size limit for small companies is in brackets).

[Insert Table 1 about here]

The distinction between micro and small companies is a remarkable change as micro companies received many simplifications regarding their bookkeeping principles and financial reporting requirements. They are (as private entrepreneurs, sole traders) required to have a bookkeeping system but not a double-entry bookkeeping system, and they are only required to create a financial statement if one of the following requirements is exceeded in two consecutive years:

- (1) balance sheet is larger than 100,000 euros,
- (2) net sales are larger than 200,000 euros or
- (3) the company employs, on average, more than three persons.

Many small companies according to the old Accounting Act are now defined as micro companies, and they were freed from some bookkeeping requirements when the law was updated. Therefore, the initial decision in principle to help small companies was conducted in practice in the national implementation of the 2013 Directive, which successfully diminished the administrative burden on these companies.

### ***Digitalization of Accounting***

The major change, which is advanced in the Nordic context, is related to the digitalization of accounting. One goal of the task force was to think about the current administrative practices related to bookkeeping and financial statement reporting requirements. The task force decided to boost digitalization so that the administrative processes with legislators and authorities should not prevent the digitalization of accounting. The new Accounting Act allows the saving of bookkeeping data in a digital database and paper copies of receipts are no longer required. The data, however, have to be easily produced in an understandable format independent of the geographical location of the original data. The digital data needs to be delivered to Finnish authorities and auditors without a time lag.

### ***Enforcement of Financial Reporting***

In practice, the enforcement of financial reporting is implemented by the requirements of the Tax Office and the Trade Register. First, and most importantly, all companies are required to file their financial statements with the Tax Office. Second, all limited liability companies are required to file their financial statements with the Trade Register (the requirement varies by type of business, see <https://www.prh.fi/en/>). Unlike the Tax Office, the Trade Register does not actively monitor whether each reporting entity files their financial statement. However, there is a procedure in place that can lead to fines, liquidation or deregistration of a company if it fails to deliver its financial statement. Finally, auditing is mandatory for limited liability companies if two of the following requirements are met: (1) total assets exceed 100,000 euros; (2) annual turnover exceeds 200,000 euros; or (3) average number of employees exceeds three. It is likely that the monitoring and enforcement process will be strengthened in the future as the digitalization process continues.

## **The Use of IFRS in Finland**

### *Academic Evidence*

The Finnish Accounting Act (30.12.1997/1336) has gone through several changes over the years. The adoption of IFRS was one of the greatest changes for the listed companies.

Academics have examined how the 2005 switch to IFRS impacted the financial reporting environment of the Finnish listed companies. The empirical setting in Finland provides a critical case to investigate the adoption of IFRS because under this institutional environment, regulation has changed dramatically. Carmona and Trombetta (2008, p. 457) argue that the adoption of principles-based IFRS imposes different requirements on practitioners, i.e., educational background and professional skills, because principle-based standards entail a comprehensive understanding of the business and economic fundamentals of transactions and events before deciding on accounting treatment under IFRS. In the beginning, Finnish firms had limited knowledge of and experience with many standards, especially annual impairments, and there was also a national lack of experts (FIVA, 2009). Finland is a relatively small country that has only a small, if any, role in setting the standard. Publicly listed firms follow the original English version of the IFRS standard book (Kettunen, 2016).

There are few studies that have directly examined the effects of IFRS in Finland. Jarva and Lantto (2012) examined the value relevance effects of mandatory IFRS adoption for 94 listed companies. Based on the reconciliation adjustments for the year 2004, Jarva and Lantto (2012) found that IFRS, on average, increased assets and liabilities (net effect being negative for equity), but increased earnings. The largest income-increasing adjustments were because of abolishment of goodwill amortization and changes in accounting for employee benefits. However, accounting amounts based on FAS and those based on IFRS do not differ in timeliness and value relevance. Only the earnings' ability to predict future cash flows is marginally higher under IFRS than under FAS.

Huikku, Mouritsen and Silvola (2016) examined how IFRS adoption changed goodwill accounting (IAS 36) in 2005. To illustrate, transaction-based FAS requires straight-line depreciation of goodwill over 5-20 years, while IFRS requires annual impairment tests. Their study showed that in the case of goodwill impairment tests, financial accounting is a process of finding, qualifying, stabilizing and calculating traces that often have to be found beyond the company infrastructure of sheets of accounts and the financial ledger. These traces increase reliability when they are recognizable and impersonal. This means that no single person is responsible for the financial calculation and the traces used assume that a firm cannot systematically outperform the broader economy or the history of the firm. They argue that it also helps to increase reliability if institutional roles such as auditors and valuation experts tolerate the calculation. These findings indicate that the adoption of IFRS dramatically changed the process and content of goodwill calculation when national straight-line depreciations of goodwill were replaced with annual impairment tests.

### ***FAS References to IFRS***

The most recent change to the Finnish Accounting Act took effect on January 1, 2016 and included the requirements of the 2013 Directive. While the most significant changes concerned reporting requirements for small and medium-sized companies, there are also references to IFRS. Although the application of the IFRS rules is on a voluntary basis, it can be argued that the Finnish Accounting Act has further converged with IFRS. Next, we discuss how IFRS is used as a reference point in FAS.

### ***Financial Instruments***

The Accounting Act Chapter 5 Article 2a permits the adoption of fair value accounting in the measurement of financial instruments, including derivative financial instruments. This is an important exception because the Accounting Act § 5:2 requires the use of the conservatism

principle in the measurement of assets and liabilities: i) receivables are valued to their nominal amount or their probable value, if lower; ii) financial assets are valued to their acquisition cost or their expected fair market value at fiscal year-end, if lower; iii) liabilities are valued to their nominal amount or their index-linked value, if higher. Generally, representation and measurement of financial instruments must agree with IFRS (specifically, there is a reference to the EC Article No 1606/2002). The associated change in the fair value of the financial instrument shall be included directly in a fair value reserve. Notwithstanding the disclosure requirements of IFRS, the annual report must show i) the purpose and nature of financial risk management (including main hedge against financial risk) and ii) consider all relevant risk factors (including price, credit, liquidity, and cash flow risks).

#### *Investment Property*

Finnish companies (except micro) are allowed to use fair value accounting for investment property. The Accounting Act Chapter 5 Article 2b states that recognition and disclosure shall follow IFRS. IAS 40 defines investment property, while IFRS 13 describes the fair value model.

#### *Finance Leases*

The Accounting Act Chapter 5 Article 5a states that if significant risks and rewards associated with leased assets through contractual agreement pass to the lessee, the lessee (lessor) can account this event as a purchase (sale). Such an accounting treatment must then be done uniformly to all similar rental contracts. The recognition and disclosure shall follow IFRS accounting for leases.

#### *Subordinated Loan*

The Accounting Act Chapter 5 Article 5c states that a company can use IFRS accounting for

subordinated loans (“pääomalaina” in Finnish) and consequently treat them as equity. This implies that the definition of a subordinated loan is the same as in IFRS. However, the Companies Act (21.7.2006/624) definition for a subordinated loan is somewhat more limited (being more like a capital loan). The Companies Act Chapter 12 Article 1 defines a subordinated loan as follows: 1) the principal and interest of the loan is subordinated to claims of other creditors in the case of liquidation or bankruptcy; 2) equity conditions (not detailed here) are met for the payment of principal or interest; 3) no collateral is set for the principal or interest. There must also be a written contract about the loan. These requirements by the Companies Act set the boundaries for the use of IFRS.

### **FAS Lacking Reference to IFRS**

Despite recent changes, there still exist two notable standards that do not have a reference to IFRS: goodwill and research and development costs. As we will see below, it seems that the accounting treatment of these items is intended to take into account the information needs of creditors. Specifically, creditors demand financial statements that supply information about the value of the firm’s assets in the event of liquidation.

#### *Goodwill*

The Accounting Act Chapter 5 Article 9 allows the capitalization of goodwill. However, there is no reference to IFRS with how the purchase price is to be allocated. Unlike IFRS, it requires goodwill to be amortized to expense over a period not to exceed ten years (a longer schedule is possible if the company can reliably estimate the benefits).

#### *Research and Development Costs*

FAS does not have a reference to IAS 38, but the accounting treatment shares common features with IFRS. Research expenditures are always expensed under FAS. Development

expenditures can be capitalized if expected benefits are likely to occur in subsequent periods. The capitalized amount must be amortized over a period not to exceed ten years (a longer schedule is possible if the company can reliably estimate the benefits). The unamortized amount of development expenditures restricts the amount a company can declare as dividends.

### ***Potential carve-outs***

It should be noted that the Council of State (i.e., government) can enact exceptions (for example, in the form of a decree) on the application and disclosure requirements of IFRS standards. However, this option is rarely used. The Accounting Board (“KILA”), which operates under the Ministry of Employment and the Economy, is a body that has historically taken a position on accounting issues. The Accounting Board’s general exceptions and statements can be found here (available only in Finnish and in Swedish):

<https://www.edilex.fi/kilaohje> and <https://www.edilex.fi/kila>, respectively. None of the general exceptions concern the implementation of the above-discussed accounting rules. However, the Accounting Board’s statement 1949/1.3.2016 concerns the use of fair value accounting for investment property. The statement clarifies that 1) the use of fair value accounting is possible regardless of the ownership structure of the investment property (whether a direct holding of shares or through an investment company) and 2) the reporting entity may use a more detailed disclosure than specified in accounting standards. Taken together, it seems that Finland avoids creating domestic carve-outs for IFRS and continues the convergence process to IFRS.

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