

**Rules**  
**on the auditing of financial undertakings**  
**No. 532 of 30 June 2003**

**Chapter I**  
**Scope**

Article 1

These Rules apply to the auditing of financial undertakings, the term financial undertakings refers to commercial banks, savings banks, credit undertakings, electronic money undertakings, securities companies, securities brokerages and management companies of UCITS, cf. furthermore Article 4 of Act No. 161/2002 on Financial Undertakings.

These rules are a definition of the principles of good auditing practices for financial undertakings, cf. Article 93 of Act 161/2002 on Financial Undertakings These Rules are also guidelines as to the organisation, execution and auditor's report on the review of the interim financial statements of the said undertakings.

**Chapter II**  
**Audit objectives for annual accounts**

Article 2

The auditing of the annual accounts of a financial undertaking shall be completed in accordance with generally accepted auditing standards and the provisions of these Rules. The objective of the audit is to ascertain whether the annual accounts present fairly the performance and financial standing of a financial undertaking and that the annual accounts have been compiled in accordance with the legislation and rules applying to the undertaking, articles of association and generally accepted accounting principles and that the provisions of laws and regulations regarding the obligation of the undertaking concerned to publicize information.

This includes, *inter alia*:

1. Whether the information in the profit and loss account and the explanatory notes present fairly the operations of an undertaking in accordance with law, rules and generally accepted accounting principles.
2. Whether loans, claims and other assets in the balance sheet are at hand, owned by the undertaking and entered and evaluated in accordance with current law, rules and generally accepted accounting principles. Also that mortgages and other commitments on assets are presented in the annual accounts.
3. Whether obligations and liabilities, including guarantees and contingent liabilities are specified and evaluated in the balance sheet or off-balance sheet in accordance with law, rules and generally accepted accounting principles.
4. Whether the profit and loss account and balance sheet are in accordance with the accounting records of the undertaking concerned.
5. Whether individual entries in the profit and loss account and balance sheet are itemized and classified in accordance with law, rules and generally accepted accounting principles and that all necessary information is included in the annual accounts.

6. Whether the customers' assets, according to asset management contracts, exist or the information on them appear in the financial statements.

### **Chapter III**

#### **Role and position of the auditor**

##### Article 3

The auditor may not be dependent on the board of directors or the managing director of an undertaking, be a member of the board or be an employee. Furthermore, the auditor may not work on behalf of the undertaking on matters that may impair his independence towards the undertaking. At the same time, the auditor shall avoid direct participation in important lending and management decisions of a financial undertaking or acting as the instigator of proposals regarding the value assessment of the assets or commitments of a financial undertaking, particularly if such an assessment entails other work than assistance in technical calculations based on existing assumptions.

The auditor of a financial undertaking may not be in debt to the undertaking for which he carries out auditing, either as a principal debtor or a guarantor. The same shall apply to his or her spouse.

##### Article 4

The auditor may not accept the recommendations or interference of the board or the managing director of a financial undertaking or a third party on the completion of the auditing. Thus he may not enter into any agreement stipulating limitations to the auditing.

##### Article 5

The auditor of a financial undertaking may employ assistants or specialists for the completion of individual parts of the auditing on the condition that they are professionally qualified for the work. Furthermore, the auditor shall, in further agreement with the board of directors of the financial undertaking and to the extent he deems fit, base his work on the observations and reviews carried out by the internal auditing department of the financial undertaking provided he has ascertained that the independence, impartiality and professional skills of the employees of the department is a sufficient basis for such trust. The auditor shall always review and conduct the necessary surveys of the quality and scope of such aspects of the work of the internal auditing department that he intends to use as a basis for his results.

If an agreement has been reached with an independent supervisor on a yearly survey on the internal control of a financial undertaking in relation to the exception from the operation of an internal auditing department, the provisions of the first paragraph apply as appropriate.

### **Chapter IV**

#### **Execution and scope of the auditing**

##### Article 6

The audit shall be carried out in accordance with generally accepted auditing standards. This means auditing by approved methods as used by competent and conscientious auditors. The main features of auditing are as follows:

1. Review of accounting systems, including linked computer systems, accounting organisation and the organisation of other functions with a view to the reliability of the accounting systems in use and with a view to internal control.
2. Observations and collection of data to confirm the correctness of individual items in the annual accounts. This entails a survey by the auditor of the kind of account statements and confirmations sent from the undertaking and an assessment based on generally accepted auditing standards of the need for further surveys. This also entails that the auditor shall, while auditing the annual accounts, conduct special surveys of the standing of major borrowers with respect to collateral and the need to provide for losses on loans. The auditor shall also obtain a declaration from the board of directors and the managing director to the effect that all assets, liabilities, guarantees, obligations and commitments are stated in the annual accounts and that the same bodies know of no risk or incident, before or after the end of the fiscal year, related to the financial position of the financial undertaking and which might at a later date give rise to a considerable reduction in the financial position shown in the annual accounts.
3. A review of the operations of an undertaking, its development and prospects, primarily to assess whether there is any danger that the capital of the undertaking might drop in the following year below the minimum legal requirement.

#### Article 7

The auditor shall ensure that the description of accounting systems, including linked computer systems, and internal control, on which he bases his assessment for decisions regarding the scope and methods for auditing the annual accounts, is reliable. This includes test checks of entries in different fields of the accounting system and regular surveys of individual features of internal control.

If the results of surveys reveal that accounting systems and internal control provide sufficient assurance that accounting is in order, extensive surveys of individual accounting items might be deemed unnecessary.

### **Chapter V** **Importance and risk**

#### Article 8

In deciding on the execution and scope of surveys in relation to the auditing and endorsement of annual accounts, the auditor shall consider the importance of individual elements and risk. While conducting his survey, the auditor shall focus primarily on the most important items in the annual accounts and the elements of internal control where there is greatest danger of deviation.

The danger of deviation varies between the different items in the annual accounts. The strength of internal control affects the danger and hence all decisions regarding the execution and scope of the audit.

Efficient internal control can, however, never fully replace the independent reviews and data collection of the auditor to confirm the correctness of individual important items in the annual accounts. Thus the auditor shall always conduct special observations of the real value of the assets of an undertaking and survey in particular the possible risk involved in obligations or contracts entered into by the

undertaking. The distribution of lending and loans to major borrowers, collaterals and provisions for possible losses on loans shall also be specially examined.

#### Article 9

If an auditor becomes aware of substantial flaws in operations or matters concerning internal control, collateral of loans, or other matters which could weaken the financial position of the undertaking in question, or aspects which could result in his refusal to endorse the accounts or in endorsement with reservations, or if an auditor has reason to expect that there has been any violation of laws, regulations or rules which apply to the undertaking, the auditor must notify its board of directors and the Financial Supervisory Authority thereof. This shall also apply to similar matters which an auditor may learn of concerning undertakings with close links to the financial undertaking concerned.

### **Chapter VI**

#### **Organisation and documentation of the auditing work**

##### Article 10

The main aspects of the annual auditing work shall be organised in advance in an audit plan, which is a written description of the intended scope and execution of the audit and also an orderly summary of those elements in the internal and external environment of the undertaking that might affect the auditing work.

The audit shall then be conducted in accordance with the audit programme, which is a written description of the steps necessary in order to carry out the audit plan.

The scope and result of individual audit steps and the total results for individual items in the annual accounts shall be documented in working papers. Audit working papers shall be collected and systematically stored.

##### Article 11

Suggestions and comments which the auditor wishes to express to the board and/or to the managing director shall be communicated in writing and these parties shall be given a reasonable period in which to reply. If the auditor sees fit, he may submit proposals to the board of directors of a financial undertaking regarding improvements in the handling of financial resources, modifications of internal control and internal auditing, and other matters that he considers might be beneficial to the operations of the undertaking.

### **Chapter VII**

#### **Endorsement of the annual accounts and the auditor's report to the board of directors**

##### Article 12

The auditor shall endorse the annual accounts and state the conclusion of his audit. The endorsement shall contain information to the effect that the annual accounts have been audited in accordance with generally accepted auditing standards and in accordance with current legislation and rules, and that in this respect all necessary audit steps have been taken. If the auditor considers that the directors' report does not contain the information which should be given, or that it is not in conformity with the annual accounts, he shall draw attention to this in his audit report, and, if possible, present additional information. In other respects, the

auditor may mention in his audit report other matters which he considers appropriate to include in the annual accounts.

The auditor shall sign and date his endorsement on the date of completion of the auditing work, including special audit steps on account of events taking place after the accounting date and special audit steps on account of events taking place after the completion of normal auditing work and until the endorsement date. The auditor shall not endorse the annual accounts until the board of directors and the managing director have confirmed it by their signatures.

#### Article 13

In addition to endorsing the annual accounts of an undertaking, the auditor shall, upon completion of traditional auditing work, submit to the board of directors of the financial undertaking concerned a special auditor's report for the annual financial statements. In this report, the auditor shall, as applicable, explain the following:

1. Main aspects of the auditing work carried out in relation to the audit of the annual accounts, including surveys of lending by the undertaking.
2. The auditor's comments on provisions to the allowance account for possible credit losses, including comments on special contributions on account of major borrowers.
3. Main results of auditing reviews on the internal control of the undertaking and the auditor's opinion regarding the quality of the internal control system of the undertaking and the operations of the internal auditing department. In this respect it is appropriate to refer to the written suggestions and comments previously submitted to the board and the managing director by the auditor during the year.
4. Other comments and suggestions which the auditor believes should be communicated to the board of directors of the undertaking, such as comments regarding the operations of the financial undertaking and the safeguarding of assets and the risk management of the undertaking as regards, for example, credit risk, exchange rate risk, or interest risk.

### Chapter VIII

#### **Review of the interim financial statements of financial undertakings**

##### Article 14

The auditor may only endorse the interim financial statements as having been reviewed provided that he is fully familiar with the activities of the undertaking and its operational environment.

Review of interim financial statements is based on an assessment of importance and of risk similar to that of auditing, whereas the auditor's task is less extensive than when auditing.

In conducting a review of interim financial statements, the auditor shall make use of analytical procedures to assess the internal conformity of the financial statements and whether performance and changes in the assets and liabilities and of the undertaking are normal and consistent with the auditor's knowledge of the activities of the undertaking. This entails that the auditor shall assess the development of major loans, collaterals and contributions to the allowance account for possible credit losses, and that the auditor shall, through inquiries, collect information on such incidents after the end of the accounting period and until the

date of the auditor's endorsement which could have a substantial effect on the financial statements.

The review comprises analytical procedures and inquiries made in order to verify the conclusion of the financial statements, and the making of further observations should these procedures prove insufficient. The scope and nature of the procedures considered necessary by the auditor in each particular instance are based on his professional knowledge and his knowledge of individual risk factors in the financial statements of the undertaking.

If the auditor finds the financial statements to be materially wanting, he shall conduct further observations in order to reach a decision on an unqualified statement in his opinion, or whether special qualifications are necessary.

The audit working papers on the review of interim financial statements shall contain a description of the work carried out together with conclusions.

Following the review, the auditor shall issue a declaration on the financial statements by endorsing them. The declaration shall be unambiguous, clear and comprehensible, and contain a report on the review and its scope. If the auditor has detected substantial deviation, considerable uncertainty, the lack of important information in the interim financial statements, or that the capital of the undertaking concerned is below the minimum legal requirement, the auditor shall state his qualification together with an explanation of its nature. If the financial statements are in any way imperfect with respect to laws and rules on the accounting and financial statements of financial undertakings, the auditor shall not issue a declaration on the performance or financial position of the undertaking.

**Chapter IX**  
**Entry into effect**  
Article 15

These Rules are adopted with reference to the first paragraph of Article 93 of Act No.161/2002 on Financial Undertakings, and take effect forthwith. At the same time, Rules on auditing of credit institutions No. 694 of 10 september 2001, cease to apply.

Reykjavik, 30 June 2003

FJÁRMÁLAEFTIRLITIÐ  
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