



Icelandic National Audit Office – Annual Report 2017



RÍKISENDURSKOÐUN

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Contents

Contents	2
Preamble by	3
the Auditor General	3
Legal status, Role and Strategy	6
General information on Activities and Operations in 2017	9
Organisation of operations.....	9
Division of work contribution between divisions.....	10
Division of work contribution between ministries.....	10
Revenue and expenditure	11
Human resources.....	12
Communications with committees of Althingi.....	14
Communications and public relations	14
International relations.....	15
Financial audit	17
Diverse tasks.....	17
Items and bodies audited in 2017	18
Outsourcing of audit projects.....	19
Publication of financial audit reports	20
Impact of new Public Finance Act	20
Assessments of internal controls	20
IT audits	21
Performance audit	22
Strategic planning.....	22
Completed primary audits in 2017	24
Follow-up reports	24
Other monitoring tasks	25
Monitoring the implementation of the Government Budget	25
Monitoring the finances of political parties and political candidates.....	26
Monitoring registered charities.....	27
Monitoring the annual financial statements of cemeteries and parishes	27
Financial Statements 2017	28



Preamble by the Auditor General

For the National Audit Office, 2017 has been a year of change.

On the one hand, the new Act on the Auditor General and the auditing of government Accounts, no. 46/2016 has entered into force. The main changes that resulted from this new legislation were explained in the preamble of the Agency's report for 2016. During the year, the Auditor General and the Agency worked to implement the innovations and changes that the new law entails.

On the other hand, the Public Finance Act (LOF), no. 123/2015, entered in full force at the beginning of 2017 with new provisions for financial statements of entities of Group A of the Central Government Accounts and preparation of state accounts, cf. provisional provision I. The adoption of the Act at the time was a major step in introducing new rules for the preparation and implementation of public finances in the long term. By drawing up and approving the fiscal policy, the financial plan and the fiscal budget for the state finances, as for individual state parties, it was possible to formulate the appropriate framework for plans and authorizations in the long term. The aim was to create greater

stability and permanency to increase predictability and consequently lower risk of fluctuations in the state's operations, that have hitherto been characteristic of the state finances. Frequent exchange of power between governments and following parliamentary elections had not been envisaged to delay the functioning of the Act, as the case has been. The foundation laid at the outset, however, has been a source of security in the turmoil that has characterized politics during this period from the passing of the law.

The introduction of new financial statements for Group A entities and state accounts has taken more time than expected. The Financial Management Authority has worked hard to review, analyze and classify the international standards, IPSAS, which are to be followed in the preparation of the state accounts and has also worked on a draft implementation plan.

Inconsistencies have been found between the provisions of the Financial Statements Act and the accompanying accounting standards, and the provisions of the Public Finance Act which allows for up to three years to prepare for full compliance with IPSAS. IPSAS, which is intended to apply to the accounting of public entities, is not part of the *acquis* in the Financial Statements Act and attempts to authorize such a criterion against public entities has not been successful. Furthermore, the statutory provisions in the Public Finance Act to validate the decisions already followed have not been changed. Thus, the Ministry of Finance and Economic Affairs has formulated certain accounting principles which, in the opinion of the Auditor General, need to have a stronger legal basis. The State Accounting Standards Board has assigned a working group to draft legislative amendments that address various issues that have arisen during the implementation process.

The National Audit Office continues to emphasize good relations and cooperation with its foreign counterparts with regard to various common interests and professional development of its activities. The greatest emphasis is placed on Nordic co-operation, which is planned at the annual meetings of the Nordic Auditors and considers the focus of their work and their offices. Meeting of the West Nordic Auditors was held for the second time and now in Nuuk, Greenland. Meetings in the EFTA / EEA Board of Auditors, as well as auditing work related to the EFTA Development Fund (FMO), are also regular tasks of the National Audit Office. Other projects include participation in conferences and workshops that deal with specific projects related to the tasks that the Office carries out.

The Office's tasks have also been at a similar pace to previous years. As before, the Financial Audit Division had the largest share of active working hours, 55%. The division completed 138 auditing projects during the year, including the audit assignments outsourced to audit firms. These are mainly auditing of public limited companies, corporations and funds which the state has a majority and falls under Group B-E of the central government account. However, the audit of Group A agencies is mostly performed by the Office's staff. The Performance Audit Division, which is the second-largest division with 21% working hours, completed 30 projects during the year. Of these, ten were primary audits, 19 followed up on previous audits and one report on the results of a preliminary survey. Other projects carried out by the Office include the supervision of the finances of political organizations, the supervision of established funds, the supervision of

the annual accounts of cemeteries and parishes of the National Church. Statements concerning these projects were published, as well as the results of the annual accounts of political organizations and political candidates. A summary of budget implementation was also issued. As a rule, comments were made on specific parliamentary matters on the Budget Committee's agenda.

In 2017, the National Audit Office had a net income of ISK 31.9 million, compared to 12.5 m.kr. surplus the year before. The changes that occurred in the Office's operations from the previous year were; Investments in assets were capitalized in 2017 but had been expensed in the previous year. On the other hand, depreciation was expensed during the year, but an equal contribution from the Treasury was recognized as income. Furthermore, the change in accrued vacation pay was recognized.

In the balance sheet, assets were capitalized at the beginning of the year by offsetting deferred income from investments. The year's investment was entered as an asset, but investment contribution was, however, credited to deferred investment income. Accrued vacation pay at the beginning of the year was recognized in debt and changes in them recognized at the end of the year.

The annual financial statements make a reservation as to the correctness of the offset of assets at the beginning of the year. There is also a reservation concerning the Financial Management Authority's reversal of the effect of updating accrued vacation pay in the Office's equity as it is not based on budgetary appropriations or accounting standards. This entry was therefore not included in the Office's annual account.

The annual Accounts of the National Audit Office can be found on p. 29-36 of this report, with a detailed breakdown of operations and balance sheet and notes to individual items, together with notes on specified accounting policies and appropriations.

The success of the Office's activities is based on the human resources it employs. Its employees make every effort to be effective with the aim of enabling decision-makers to make decisions based on the Office's reports for the benefit of the state. Thank you for these efforts.

I have previously pointed out that the age composition of the Office's staff has been such that significant changes have taken place in a relatively few years. Six employees have retired in the past two years and an additional five will retire in 2018. I want to take this opportunity to thank them for their long and loyal service and wish them well in the future.

Finally, as I am resigning as Auditor General, I would like to thank everyone with whom I have worked. And to the Office, I wish all the best in its future endeavours.





The President of Iceland, Auditor General and Audit Office staff at Bessastadir, in March 2018.

Legal status, Role and Strategy

The INAO is an independent body operating under the auspices of the Althingi and is part of the legislature's monitoring of the executive branch. The Office is responsible for auditing the Annual Accounts of the Central Government and other bodies charged with government operations and financial guardianship. Moreover, the Office promotes improvements to the financial management of such bodies as well as their improved economy, efficiency and effectiveness.

The INAO operates in accordance with the National Audit Act No. 86/1997 (now [Act on the Auditor General and the auditing of government accounts No. 46/2016](#)) as well as other legislation pertaining to its operations. These include the Public Finance Act (No. 123/2015) and the Act on the Rights and Obligations of Government Employees (No. 70/1996). Furthermore, the Office is entrusted tasks according to the Act on Funds and Institutions Operating According to Approved Charters (No. 19/1988), the Act on Cemeteries, Burials and Cremations (No. 36/1993) and the Act on the Finances of Political Parties and Candidates and Their Duty to Provide Information (No. 162/2006). Standards and guidelines of the International Organisation of Supreme Audit Institutions (INTOSAI) and, as applicable, the standards of the International Federation of Accountants (IFAC) are taken into account the Office's work. Moreover, the Office's Code of Professional Conduct is adhered to. As the National Audit Office operates under the auspices of the

Althingi, the Administrative Procedures Act and the Information Act do not apply to the activities of the Office. Nevertheless, many unwritten principles of administrative justice apply to the Office, such as rules on competence.

Considering acts of law, rules, standards and guidelines, the National Audit Office has defined its principal tasks in the following manner:

Financial auditing

Auditing the Central Government Accounts and the accounts of public bodies and enterprises in which the state owns at least half or more of the shares. Auditing the accounts of entities that operate under the auspices of the state or provide statutory services or who undertake other projects in exchange for payment or contributions from the state. Examining the management controls and security of IT systems. Suggesting what improvements, if applicable, may be made to accounting, the preparation of financial statements, internal controls and the operation and security of IT systems.

Performance auditing

Evaluating the performance of public bodies, state-owned enterprises and parties that accept contributions from the State. Assessing the economy, efficiency and effectiveness of public bodies and suggesting ways to improve these aspects.

Monitoring the implementation of the Government Budget

Monitoring the finances and financial decisions of public bodies and whether they are in accordance with the Budget, the Government Financial Reporting Act and the Regulation on the Implementation of the Government Budget.

Monitoring the finances of registered charities

Monitoring the annual financial statements of funds and public bodies and whether they operate in accordance with approved charters.

Monitoring the finances of political parties and political candidates

Collecting, processing and publishing information on the revenues and costs of political parties and candidates in pre-elections.

Monitoring the annual financial statements of cemeteries and parishes

Collecting, processing and publishing information from the annual financial statements of cemeteries and parishes.

By law, the INAO has a rather broad mandate. The Office may call for financial statements from public bodies, associations, funds and any other bodies that receive government funds or guarantees. Furthermore, the Office is permitted access to original documents and reports prepared concerning invoices issued to the Government, to verify the content of the invoices and the Treasury's payment obligations. Finally, the Office may request reports on the disbursement of grants and other contributions from public funds to assess whether such payments have achieved the intended results.

The INAO selects and organises its projects and is wholly independent in its work, even though it is constitutionally under the auspices of the Althingi. The Constitutional and Supervisory Committee of the Althingi, however, may request reports, from the Office, on matters that fall within its mandate. The same applies if nine MPs formally request a report at a plenary meeting of the Althingi and such a request is tabled. In such cases the Office determines the approach to the subject matter, the methods used, when the report is completed and the way the conclusions are presented. According to the National Audit Act, the personnel of the Office shall be completely independent of the Ministries and organisations they are auditing.

The INAO notifies the appropriate public bodies, the Althingi and the public of the results of its investigations with reports and press releases published on its website, www.rikisendurskodun.is. Results that touch on sensitive internal issues of public bodies are however not made public. The Althingi discusses the reports of the National Audit Office in accordance with the Althingi Procedures Act and rules on the parliamentary treatment of reports from the Office.



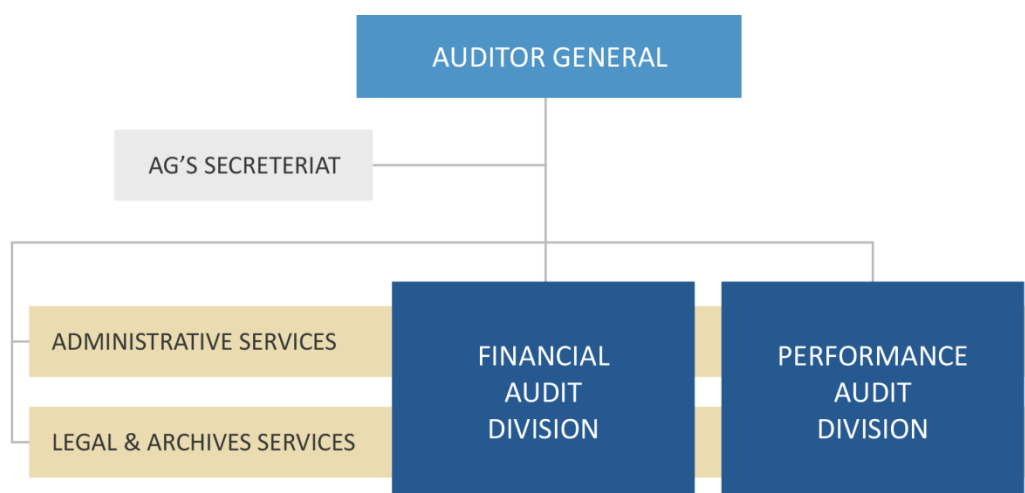
General information on Activities and Operations in 2017

Organisation of operations

There are two core divisions within the INAO: The Financial Audit Division and the Performance Audit Division. The former is responsible for financial auditing according to Article 5 of the Act on the Auditor General and the auditing of government accounts No. 46/2016 and consisted of 26 employees at year-end 2017. The latter is responsible for performance auditing according to Article 6 of the Act and had ten employees at year-end. Each core division is managed by a Director, assisted by Division Managers, who guide the work of auditors.

There are two support units responsible for diverse centralised tasks and for providing services to the core divisions: Administrative Services and Legal and Archives Services. Administrative Services consisted of four employees at year-end 2016 and Legal and Archives Services of five. The Auditor General's Secretariat is responsible for various monitoring tasks regarding the state's finances and operations, public relations, international communications and assistance to the Auditor General. The Office had three employees at year-end, i.e. in addition to the Auditor General. The total number of employees at the INAO at year-end 2017 was 47.

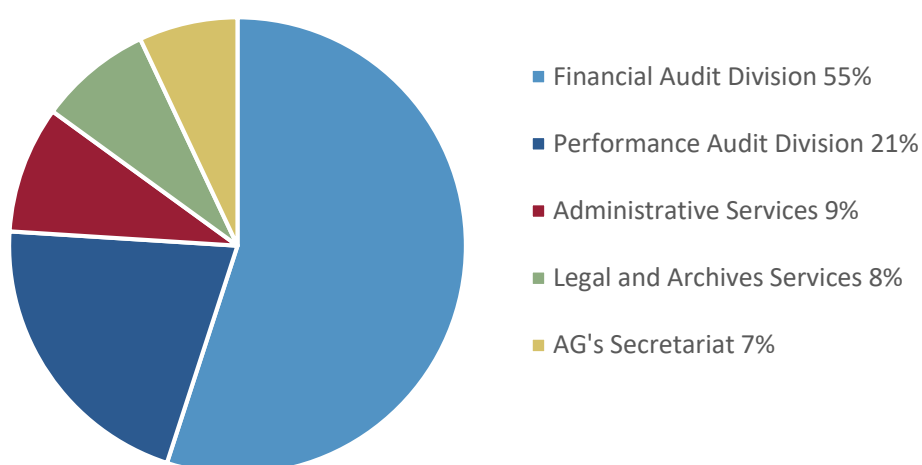
INAO's Organisational Chart



Division of work contribution between divisions

INAO's active man-hours in 2017 were in total about 74 thousand, an increase of about four thousand since 2016. Active man-hours refer to all working hours with absences, e.g. due to illness or vacation, excluded. For reference, a full-time position with an eight-hour working day results in about 1.700 active man-hours per year. Active man-hours in 2017 are equal to the full-time position of about 46 employees.

Proportional division of active man-hours between divisions in 2017



Active man-hours in the Financial Audit Division were 55% of the total number. Active man-hours in the Performance Audit Division were 21% of the total number. Administrative Services accounted for 9%, Legal and Archives Services 8% and the AG's Secretariat 7%.

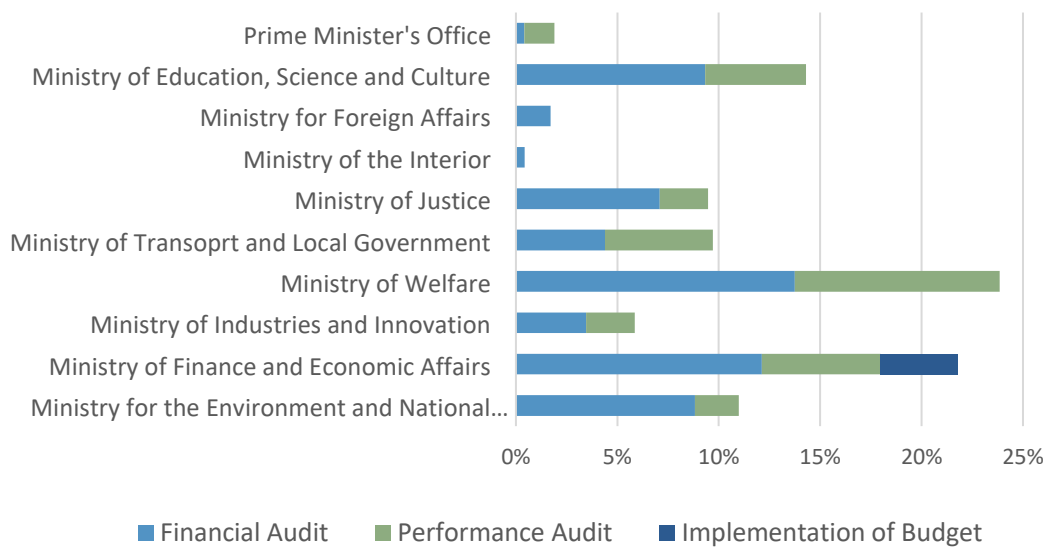
Division of work contribution between ministries

Approximately 60% of the active man-hours were allocated to auditing and monitoring tasks directly involving ministries and their agencies. About 40% was allocated to other tasks, such as other monitoring tasks, professional development, internal operations, central management and support services.

In 2017, the Office focused primarily on three ministries and their agencies, i.e. the Ministry of Welfare, The Ministry of Finances and Economic Affairs and The Ministry of Education, Science and Culture (see figure below). More than 60% of the total time was allocated to auditing and monitoring those three ministries and their agencies. About 30% of the time was allocated to auditing and monitoring the Ministry for the Environment

and Natural Resources, the Ministry of Transportation and Local Government and the Ministry of Justice and their agencies. Less than 10% was allocated to other ministries and their agencies.

Proportional division of active man-hours allocated to auditing and monitoring tasks according to ministries and their agencies 2017



The time allocated to each ministry and their agencies depends, among other things, on risk assessments and the choice of projects at any particular time. As a result, there may be considerable fluctuations between years. It should be noted that in the case of the Ministry of Finance and Economic Affairs, the hours include the auditing of the Treasury's balance sheet, taxes and other state revenues, monitoring the implementation of the Government Budget and the auditing of the Central Government Account.

Revenue and expenditure

The total expenditures of the INAO amounted to ISK 714m in 2017, up ISK 88m on the previous year, or by 14%. The increase can, for the most part, be attributed to increased payroll costs with an increase in the number of employees. Special revenue amounted to ISK 100m, and the government contribution amounted to ISK 646m. The surplus in the operation amounted to ISK 32m, which was an ISK 19m increase from the surplus in 2015.

Summary of 2016 and 2017 profit and loss statement (ISK millions)

	2017	2016	Change	%
Salary and salary related cost	622,1	539,7	82,5	15%
Other operating expenses	91,6	71,0	20,6	29%
Formation expenses	0,0	15,1	-15,1	-100%
Cost and expenses total	713,8	625,8	88,0	14%
Special revenue	100,0	60,1	39,9	66%
Expenses minus income	613,8	565,7	48,1	9%
Government contribution	645,6	578,2	67,4	12%
Revenue surplus	31,9	12,5	19,3	154%

Human resources

The INAO's human resources policy is shaped by the principle that a well-educated, interested and satisfied workforce is the key to success. The policy's main goals are to provide excellent working conditions, enhance capabilities and foster morale and team spirit in the workplace. In so doing, the Office is best positioned to fulfil its role.

Four employees left the INAO in 2017, and seven were recruited. At the end of 2017, employees were a total of 47, of which 24 were women and 23 men. The equal gender ratio at the office is not reflected in its management, which is 75% male and 25% female.

47 Employees

24 Women

23 Men

Employee turnover is defined as the proportion of employees who resign during the year out of the total number of employees at year-end. Employee turnover at INAO was approximately 9% in 2017.

The average age of employees at year-end 2017 was approximately 54 years. The ratio

of employees with at least three years experience at the Office was 83% and the average length of service was approximately 14 years.

Just over 40% of all the Office's employees were in the age group 61-70 years old. Therefore, the Office will remain on the track of considerable employee turnover when many of the current employees will retire. It is important to ensure that this transition will not cause unnecessary disruption and to protect the institutional knowledge of the



Administrative Services in March 2018. From left: Steinunn Gísladóttir, Eyþór Borgþórsson and Ásdís Hauksdóttir. Missing: Sigurður Þorvaldsson.

older employees. It has been the policy of the Office to offer those who have reached the age of 60 to reduce their working hours, as they begin to start their pension. Those employees to choose this option might be tasked in turn to train new employees.

The INAO endeavours to ensure that its personnel maintain and strengthens their professional abilities through continuing education. To this end, employees can pursue their continued education with their work. These usually involve short courses on issues relevant to the activities of the Office, both in Iceland and abroad. The INAO offers employees support, in the form of leave on pay, to further their education, e.g. for becoming chartered accountants, for certification in auditing or to attend university courses. Four employees received such paid leave in 2017.

Approximately 80% of employees have a university degree; many held more than one degree. There were five chartered accountants and three with certification in internal auditing (CIA). Two were certified government auditing professionals (CGAP) and one certified information system auditor (CISA).

Key Figures in Human Resources

	2017	2016	2015	2014
Employee turnover	9%	6%	10%	5%
Average age of employees	54 yrs.	55 yrs.	56 yrs.	55 yrs.
Average age of service at INAO	14 yrs.	17 yrs.	17 yrs.	16 yrs.
3-year working experience at INAO	83%	81%	88%	88%

Communications with committees of Althingi

According to Article 13 of the Althingi Procedures Act, the Constitutional and Surveillance Committee (CSC) is responsible for addressing the INAO's reports and returning an opinion on them. The Committee may, however, as appropriate, refer a report to another parliamentary committee, in which case that committee will return an opinion. These provisions of the Althingi Procedures Act entered into force in September 2012, while the applicable rules of the Speaker's Committee on the treatment of reports from the INAO are from January of the same year. According to Article 1 of the rules, the Office is to send its reports by letter to the Speaker of the Althingi. Article 2 states that the Speaker shall send reports on the implementation of the Government Budget and audits of the Central Government Accounts for discussion to the Parliamentary Budget Committee, while other reports are to be sent to CSC. The provisions of Article 2 are not in full accordance with the provisions of Article 13 of the Althingi Procedures Act, which states that CSC is to discuss all the reports of the Office except those that the CSC send to other parliamentary committees.

CSC regularly calls meetings with the INAO to present the Office's reports and to discuss their substance. The entities to which recommendations are made are given the opportunity to present their views in the meetings of the Committee. The INAO attended six CSC meetings in 2017 and presented eight reports from the Office. The committee did not issue any opinions on performance audit reports in 2017. The Auditor General and other managers also attended five meetings of the Parliamentary Budget Committee and the annual summer meeting of the Speaker's Committee.

Communications and public relations

The INAO's communication policy follows INTOSAI's *Principles of Transparency and Accountability* (ISSAI 20) and *The Value and Benefits of Supreme Audit Institutions* (ISSAI 12).

The Office published its social media policy in 2017 and participates in social media via facebook.com/rikisendurskodun and twitter.com/rikisend. Participation in social media aims to:

- ✓ Disseminate information about the results of INAO's published reports.
- ✓ Inform the media and public about the Office's role and work.
- ✓ Promote increased transparency in government operations.
- ✓ Promote public discourse on public finance and increased economics, efficiency and/or success in government operations.
- ✓ Encourage the public to make suggestions on how to better manage public funds.

As the INAO operates under the auspices of the Althingi and is part of its monitoring of the executive branch, its reports are for the most tailored to the needs of the parliament



or individual parliamentary committees. At the same time, the Office endeavours to tailor its dissemination of information to the needs of the ministries and public bodies, as the recommendations issued by the Office for improvements are usually directed toward these entities. However, the information dissemination of these agencies is not directed exclusively to national assemblies and public administrations. There is a consensus that Supreme Audit Institutions should endeavour to inform the media, and thereby the public, about their role and work. This encourages increased transparency in the disposal of public funds and clearer accountability in the executive branch.

The INAO maintains a website, rikisendurskodun.is, where all its public reports may be accessed. Visits to the site in 2017 numbered more than 18 thousand and the number of users just more than 10 thousand. In 2017 The INAO started publishing financial audit reports of most public agencies on its website.

International relations

To ensure that the operations of the National Audit Office develop in tune with international trends, the Office focuses on good relations with its overseas counterparts. There is a long history of co-operation with the Supreme Audit Institutions of the other Nordic countries, as well as participation in the work of the European and international associations in this field, i.e. EUROSAI and INTOSAI. Moreover, the INAO participates in the auditing of multinational bodies, associations, funds and programmes of which Iceland is a member. Employees of the Office attended a total of eleven meetings, seminars and conferences overseas in 2017.



The Nordic Auditors General have co-operated closely for many years with annual meetings. In 2016 the meeting was held in Copenhagen. Following that meeting, the Nordic SAIs decided to cooperate on projects related to digital auditing and the efficiency of higher education institutions.

West-Nordic SAI cooperation, which started two years ago, comprises of the Auditors General of Iceland and Faroe Islands in addition to the representative which audits the state accounts of Greenland. The first meeting was held in Reykjavik in 2016 and the cooperation continued in 2017 with a meeting in Nuuk, Greenland.

Ingi K. Magnússon, Director of the Financial Audit Division, is INAO's representative on the EFTA Board of Auditors (EBOA) and attended two meetings in Brussels in 2017. Additionally, he organized an EBOA meeting in Reykjavik.



Several working groups operate under the auspices of EUROSAI and address various issues that relate to public auditing. The INOA has participated in a working group in IT-auditing and developing a handbook for such auditing.

Representatives of the INOA participated in YES, Young EUROSAI conference, which took place in Tallinn, Estonia in 2017.



A representative of the INOA participated in an IDI course on SAI Performance Measurement Framework in Lissabon, Portugal.



Financial audit

The regular financial audit of public bodies and enterprises is the most extensive task undertaken by the INAO. By the end of 2017, the Financial Audit Division had a total of 26 employees, an increase from year-end 2016. The employees of the division were responsible for 55% of the Office's active man-hours.

The Icelandic National Audit Office annually audits the Central Government Accounts and the accounts of ministries, agencies, funds and other public parties.

An account is taken of the National Audit Act, the Auditors' Act, INTOSAI standards and IFAC standards where applicable.

The INAO annually sends to the Althingi and publishes an official report on the audit of the Central Government Accounts. The report also contains the main results of the financial audits of public entities as appropriate. Audit reports sent to individual public bodies are published on the office's website.

Financial audit shall take account of the following:

- ✓ That financial accounts give a true and fair view of the operation, financial position and changes thereto in conformity with the statutory financial reporting framework for public entities.
- ✓ The examination of internal controls and whether such controls ensure appropriate results.
- ✓ Whether the accounts and scope of activities comply with the fiscal budget, the supplementary fiscal budget and other acts of law, lawful instructions, contracts and procedures, as appropriate.

Diverse tasks

The Central Government Accounts consist of around 450 budgetary items in Group A of the Treasury. Additionally, there are financial statements of public bodies in Groups B-E. The INAO can not annually audit all items and entities in Groups A-E. As a result, the Office must carefully select which items are to be audited. The selection is based on a special risk assessment that takes account of several different risk aspects.

In the selection, an emphasis is put on auditing larger agencies and limited liability companies. Such items have a greater impact on whether the Central Government Accounts give a true and fair view of the operation and balance sheet of the state. It must also be considered that in general, smaller agencies are more at risk at not presenting a true and fair view of operations and their financial position, as they do not have the same opportunities to enforce internal controls. Therefore, it is important to integrate smaller agencies to the annual selection of auditing tasks. Once an agency or a budget item has



Financial Audit Division in March 2018. From left: Telma Steingrímsdóttir, Óskar Sverrisson, Álfheiður Dögg Gunnarsdóttir, Albert Ólafsson, Thelma Hillers, Svafa Þ. Hinriksdóttir, Guðbrandur R. Leósson, Kristín Þorbjörg Jónsdóttir, Sigurgeir Bóasson, María Bjargmundsdóttir, Helgi Guðmundsson, Guðrún Eggertsdóttir, Ingi K. Magnússon, Geir Gunnlaugsson, Sigríður H. Sigurðardóttir, Grétar Bjarni Guðjónsson, Kristín Inga Pétursdóttir and Guðjón Magnússon. Missing: Auður Guðjónsdóttir, Birgi Finnbogason, Brynja Pétursdóttir, Guðmundur Óli Magnússon, Viðar H. Jónsson and Þorbjörg Guðnadóttir.

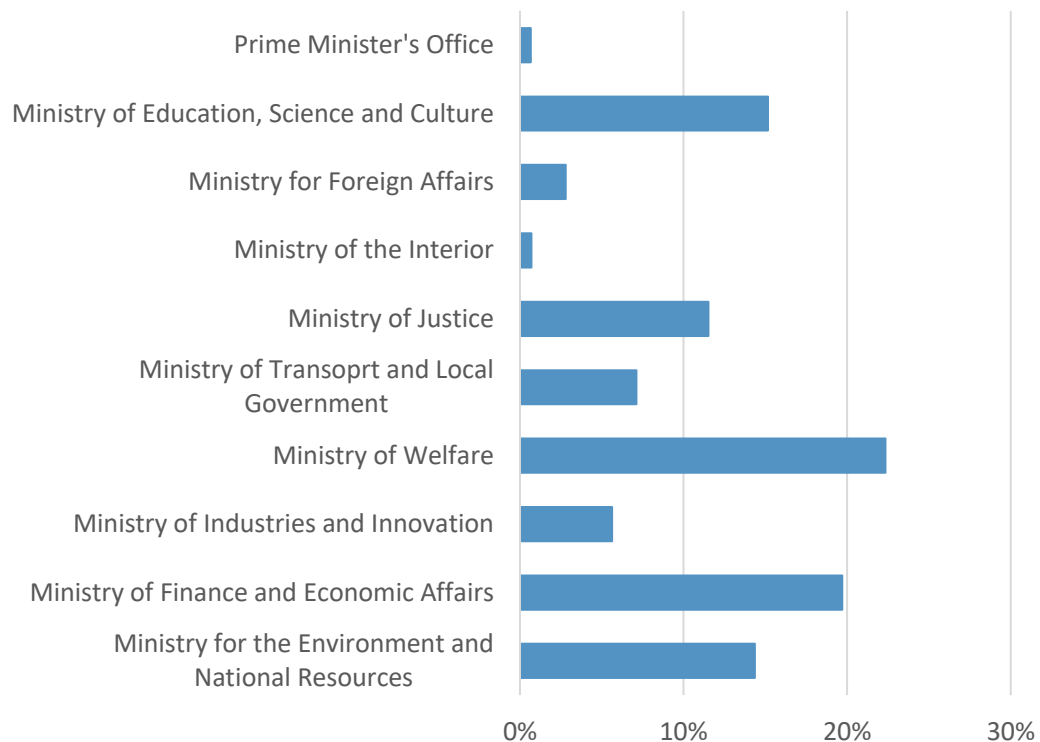
been selected for review, the potential risks associated with accounting, financial management and operations are assessed. At the same time, the audit and audit plan are prepared, and the internal controls assessed. Next, it is decided which auditing measures should be implemented following the risk assessment results. Upon completion of the actual audit, a report setting out the results is written.

Items and bodies audited in 2017

In 2017, the INAO audited a total of 93 items in Group A (i.e. for the 2016 accounting year) and 15 entities in Groups B-E. The Division also undertook various other auditing assignments, such as the auditing of multinational organisations and programmes. In total, there were 138 auditing tasks undertaken during the year.

As the following chart shows, the division spent about three-quarters of its working hours on auditing the Ministry of Welfare, the Ministry of Finance and Economic Affairs, the Ministry of Education, Science and Culture and their agencies.

Proportional breakdown of working-hours of financial auditing by ministry and their agencies in 2017



The division aims to review all budget items no less than every three years. This goal has not been fully achieved in recent years, but the Office's risk analysis will be reassessed to ensure its attainment.

Outsourcing of audit projects

According to Art. 7 of the Act on the Auditor General and the auditing of government accounts, the Agency may entrust auditors or other experts to work on specific tasks entrusted to it. The Office has utilized this authorization and for many years outsourced projects in the field of financial auditing, primarily projects of Group B-E of the state account. Invitation to tender is in accordance with Act no. 120/2016 on public procurement or contracts are made based on the State Procurement Framework Agreements on auditing, usually following a micro-tender. In 2017, contracts were signed with six audit firms, which audited a total of 21 state-owned companies and state-owned limited liability companies.

Publication of financial audit reports

In 2017, the National Audit Office began publishing financial audit reports of Group A agencies. A total of 49 reports for the year 2016 were published. Most of the reports are for agencies in the field of education, research and knowledge, a total of 12. Breakdown of the published audit reports, by category of agency, can be seen in the accompanying table.

Published financial audit reports 2017 by category of agency

Industry and Innovation	2
Social Affairs	5
Healthcare	5
Church	1
Law enforcement and judicial system	8
Culture	1
Education, research and knowledge	12
Energy	1
Transport and communication	2
Tax, assets and finance	3
Environment	6
Foreign affairs	3

Impact of new Public Finance Act

By Act no. 123/2015 on Public Finance, International Public Sector Accounting Standards (IPSAS) were adopted by the State for Group A of the consolidated state account. According to these amendments, which entered into force on 1 January 2017, the financial statements of agencies in Group A and companies and funds in Group B-C must comply with the Annual Accounts Act. This makes increased requirements for public sector accounting and the introduction of the Act has a significant impact on the conduct of financial auditing. It can be expected that, as a rule, auditing of individual agencies and the state accounts will be more timeconsuming. The adoption of the Act has also meant that internal auditing in ministries and agencies will be strengthened.

Assessments of internal controls

Public sector auditing includes examining the internal control of ministries, agencies and public companies. Internal controls refer to various measures and actions that are intended to promote successful and cost-effective operations, protect assets, value and sensitive data, provide reliable financial information and ensure compliance with laws and regulations. Internal controls are usually based on the analysis and assessment of potential operational risk and are published, i.e. in various procedures, e.g. on job segregation, approval of expenses and registration of transactions, ethical rules and personnel policy. In 2011, the National Audit Office issued guidance on the internalisation of internal controls for Group A agencies. The National Audit Office published the second edition of Guideline for Internal Controls in 2017.

IT audits

Part of the state's financial auditing involves examining whether the IT systems of public bodies and enterprises are secure and perform as expected. An account is taken of the Act on The Auditor General, the standards and guidelines of INTOSAI, as well as the guidelines of the Financial Supervisory Authority on the operation of the IT systems of parties subject to supervision in such work. 2017 saw continued audit on a payroll system, which is part of the state's accounting and human resources system (Orri). The Office also worked on a shared Nordic project on IT audit.

The results of IT audits are presented in reports that are sent only to the public bodies being audited and to the relevant ministry, as these reports regularly include information on sensitive security issues.

Performance audit

The Performance Audit Division had a total of nine employees at year-end 2017, which was a decrease by one since year-end 2016, and was responsible for approximately a fifth (21%) of the total active man-hours in the Office.

Performance auditing comprises of examination of the handling and utilisation of public funds, whether economy and efficiency are practised in the operation of public bodies and state-owned enterprises and whether applicable lawful instructions are being complied with, in this context. The Office reports the findings of such work, draws attention to any faulty procedures and point out possible areas of improvement.

When performing this work, the INAO takes account of the Act on the Auditor General and the ISSAIs, in particular, ISSAI 300 and ISSAI 3000. Also, account is taken of the legislation, rules, policies and schedules concerning the issues examined each time.

Strategic planning

The Performance Audit Division operates according to a three-year operating schedule that is reviewed annually. The schedule defines the sectors and issues to which the Office-initiated audits are to be directed during the period. The current schedule applies to the years 2016 to 2018. It is based on a risk assessment, i.e. where there is a risk that the operation is not as economical, efficient and effective as expected. Audits during the period will largely focus on issues that are under the auspices of the largest ministries with the largest budgets: the Ministry of Welfare; the Ministry of Education, Science and Culture; the Ministry of Finance and Economic Affairs; and the Ministry of Transport and Local Government and the Ministry of Justice. The affairs of other ministries, however, will also be under examination as deemed appropriate.

As the following chart shows, the division spent about three-quarters of its working hours on auditing those ministries and their agencies.

A majority of the Office's performance audits are carried out at its initiative, while some are at the request of Althingi or ministries. In all instances, however, the INAO is responsible for delimiting the material, deciding methods used, defining focus areas and presenting the results. Of ten primary performance audits published in 2017, eight were at the Office's initiative.

Performance audit involves assessing the performance and public bodies. The goal is to promote improvements that focus in particular on:

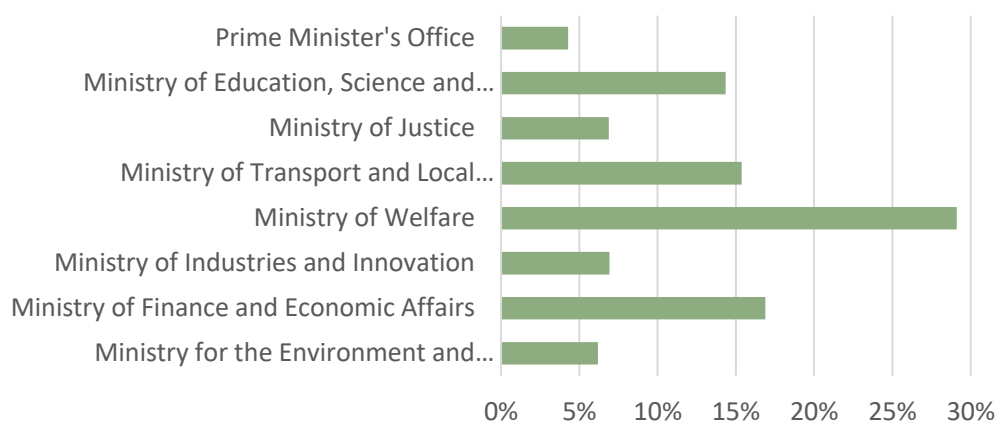
- ✓ The disposal and use of State funds
- ✓ The observance of principles of effectiveness and efficiency in the operation of government agencies and State-owned companies
- ✓ Whether State allocations are achieving their intended results.



Performance Audit Division in March 2018. From left: Berglind Eygló Jónsdóttir, Markús Ingólfur Eiríksson, Magnús Lyngdal Magnússon, Gestur Páll Reynisson, Sigríður Kristjánsdóttir, Jakob Guðmundur Rúnarsson, Steingerður Ólafsdóttir, Þórir Óskarsson and Haraldur Guðmundsson. Missing: Hrafnhildur Ragnarsdóttir and Elísabet Stefánsdóttir.

The Performance Audit Division's three-year schedule is further demarcated in a schedule that applies to each year (single-year plan). These further define what subjects within ministries and public bodies will be examined during the year.

Proportional breakdown of working-hours of financial auditing by ministry and their agencies in 2017



Completed primary audits in 2017

In 2017 a total of 29 reports were published. Of these, ten were primary audit and 19 follow-up reports. Additionally, the results of one preliminary survey on ecological procurement and a green government was published, as it was decided not to conduct a primary audit on the subject at this time.

Three of the primary audits covered education and culture: *Continuing education for ministerial employees; Vocational training at secondary education: Organization and administration; and Cost and efficiency of educating teachers: the University of Iceland and University of Akureyri*. Three audits covered industry, transport and communication: *Post and Telecom Administration in Iceland: Procedure and administration; Tourism administration; and Icelandic Transport Authority: Charging Costs*. Two audits covered finance administration: *Ministries' procurement of expertise; and Public innovations: Environment, incentives and barriers*. Two audits covered healthcare: *Rural healthcare and Nurses; staffing, education and work environment*.

Published performance audits 2017 by category

Finance administration	2
Healthcare	2
Education and culture	3
Industry, transport and communication	3

Follow-up reports

Approximately three years after the issue of a report, an examination is made of whether and if so, in what manner, the Office's recommendations have been responded to, i.e. whether attention has been paid to the deficiencies or weaknesses described and whether anything has been done to improve the situation. If recommendations are not responded to adequately, such recommendations are reiterated in a follow-up report to the Althingi and published.

Published follow-ups 2017 by category

Social affairs	1
Financial administration	3
Healthcare	2
Education and culture	5
Tax and customs	1
General administration	4
Environment	2
Industry and transport	1

In 2017 there were 19 such follow-ups on performance audits from 2014, examining 62 recommendations. In one instance it was decided to start a new audit, based on the results.

it should be kept in mind that the Office does not have executive powers and can only encourage the acceptance of its recommendations by careful reasoning and presenting them to the Althingi and other stakeholders. It should also be noted that recommendations are not reiterated in some cases even when such recommendation has not

been responded to in full.



Legal and Archive Services in March 2018. From left: Linda Sigurðardóttir, Lárus Ögmundsson and Laufey Ásgrímsdóttir. Missing Elín Ingadóttir.

Other monitoring tasks

The INAO's two support units, Administrative Services and Legal and Archives Services, are responsible for providing various services to the other divisions. The Legal and Archives Services unit is responsible for special monitoring tasks that relate to entities outside the public sector. This involves monitoring the finances of political parties and political candidates, chartered institutions (foundations) and that of cemeteries and parishes. The AG's Secretariat is responsible for monitoring the implementation of the Government Budget and carries out various audits on the finances and operation of public bodies.

Monitoring the implementation of the Government Budget

In addition to financial auditing, the INAO is responsible for monitoring the implementation of the Government Budget in accordance with the legislation applicable to the Office. This means examining whether public bodies comply with the provisions of the Budget, the Government Financial Reporting Act and the Regulation on the Implementation of the Government Budget. In 2017, the INAO published one report containing the results of these monitoring duties.

Monitoring the finances of political parties and political candidates

The INAO is responsible for monitoring the finances of political parties and candidates in accordance with Act No. 162/2006. The Act requires political parties to submit their consolidated accounts, i.e. annual financial statements for all units under their responsibility, to the INAO, which subsequently publishes a summary thereof. Moreover, the Act obligates candidates standing for personal election to submit a statement of income and costs relating to the election campaign no later than three months after the election. The INAO subsequently publishes a summary of such statements. If, however, the total costs of the candidate do not exceed ISK 400,000, it is sufficient for the candidate to submit a written statement thereto.

According to the Act, the political parties have until 1 October each year to submit the statement of the previous year to the INAO. A total of nine political parties submitted their 2016 statement before 1 October 2017, and four parties submitted their statement later. Two parties submitted their 2015 statements. No individual candidate submitted a statement or a declaration in 2017.



AG's Secretariat in March. From left: Jón Loftur Björnsson, Sveinn Arason og Svanborg Sigmarsdóttir. Missing Ingibjörg Hallbjörnsdóttir.

Monitoring registered charities

The INAO is responsible for monitoring the finances of entities operating in accordance with Act No. 19/1998 on Funds and Institutions Operating According to Approved Charters. These are non-profit organisations (foundations), such as various charities and memorial funds. They are obliged to send their annual financial statements to the INAO, no later than 30 June each year. The Office maintains a register of the revenues and expenditures of these entities, including the notes to the submitted statements.

In December 2017, the INAO published a Summary of self-owned organisations and funds that operate under an approved charter for the 2016 operating year. This revealed that only 364 statements, out of a total of 731 listed in the registry, had been submitted for the 2016 operating year. 364 statements had not been received, out of which 22 entities had not returned their statements in more than a decade, 96 entities had not returned a statement in 5-10 years. About 50 entities have never returned their statements. The INAO sends a letter and, as the case may be, an e-mail to the legal guardians of the funds and organisations that have not submitted the annual financial statements on time, strongly encouraging them to submit their statements. This, however, does not always prove sufficient, in which case the INAO refers the issue to the relevant authority.

Monitoring the annual financial statements of cemeteries and parishes

According to Act No. 36/1993 on Cemeteries, Burial and Cremation, the boards of cemeteries are under obligation to submit their annual financial statements to the INAO by 1 June each year. The Office reviews the statements, checks if audit opinions are in order and balances the totals. The Office maintains a register containing information from the annual statements of cemeteries on their operation and financial standing.

At the beginning of October 2017, the Office had received statements of 196 cemeteries out of a total 242. In light of the poor return during recent years, the INAO has repeatedly urged that the option of further mergers of cemetery boards be examined. In November the Office published a Summary of Annual Financial Statements of Cemeteries for the 2016 operating year.

According to an agreement with the National Church, the Bishop's Office sends annual statements of parishes to the INAO, which reviews the statements, checks if audit opinions are in order and balances the totals. It also maintains a record where information from the annual accounts of operations and balance sheets can be found. In October 2017, the Office had received statements from 234 parishes out of a total of 267. In November, the agency published a Summary of Annual Financial Statements of Parishes for the 2016 operating year.

Financial Statements 2017

Report of the Management and Endorsement of the Financial Statements

On May 25, 2016, Parliament passed a new law, no. 46/2016, on the Auditor General and the Auditing of Government Accounts. The Act was ratified on 7 June 2016 and entered into force on 1 January 2017. The main change from the previous law is that they now concern the office of the Auditor General, acting on behalf of Parliament. He is its confidant and responsible for auditing and supervising the state's operations and finances. The Office of the Auditor General is called the National Audit Office.

The role of the Auditor General is to supervise the finances of the State, its institutions and state-owned enterprises under the authority of the Althingi in a manner specified in the Act. He shall oversee the revenue of the State and that the budgetary resources and any kind of value are used and disposed of in a cost-effective and justified manner and following the premises and decisions of the Althingi.

The Auditor General shall inform the Althingi and the Government on matters relating to the operation and finances of the State, reveal deviations from laws and regulations in this area and make proposals for improvements, improved administration, clearer responsibilities and better utilization of fiscal resources.

As of the beginning of 2017, new accounting principles for Group A entities of the state entered into force. Henceforth, accounting shall be fully accrual. This entails capitalization of assets and rights, as well as the upgrading of obligations that accompany state operations in Group A, including those of the National Audit Office. The Auditor General has a qualification concerning the accounting method used for the initial balance sheet as of 1 January 2017.

The Auditor General refers to note no. 17 on the decision of the Ministry of Finance and Economic Affairs to compensate for the negative impact of the transfer of accrued vacation pay on the capital of state agencies. The Auditor General has not taken this entry into account as it does not support the accounting principles and is without a financial authorization. Reference is also made to note 18 on deferred investment income, where the Auditor General makes a note on the use of the relevant accounting principle.

In 2017, the Office generated a surplus of ISK 31.9 million. According to the Balance Sheet, the assets of the Office amounted to ISK 110.2 million, and equity amounted to ISK 14.9 million at year-end 2017.

The Financial Statements are prepared in accordance with the Annual Accounts Act and government regulations, subject to the comments outlined in Notes 17 and 18, which deal with improper accounting principles and a lack of budgetary authority. The Auditor General and the Chief Operating Officer confirm the National Audit Office's annual accounts for 2017.

Reykjavík, 30. apríl 2018.



Sveinn Arason
ríkisendurskoðandi



Eyþór Borgþórsson
rekstrarstjóri

Auditor's Report

To the Presidential Committee of the Icelandic Parliament

Audit Opinion

I have concluded an audit of the Financial Statements of the National Audit Office for the year 2017. The Financial Statements contain the management's statement, a Profit and Loss Account, a Balance Sheet, a Statement of Cash Flows, Accounting Policy and Notes.

In my opinion, the Financial Statements give a true and fair view of the operation of the National Audit Office in 2017, its Balance Sheet as of 31 December 2017 and change in cash during the year 2017, in accordance with laws and regulations.

Grounds for opinion

The audit was completed in accordance with IPSAS. My responsibilities under those standards are described in more detail in the section on Auditor's Responsibility below. I am independent of the National Audit Office and in accordance with established ethics rules for auditors in Iceland, I have complied with their provisions. I believe that the audit provided sufficient and relevant evidence to support my opinion.

Audit recommendations

With the entry into force of Act no. 123/2015 on Public Finance (LOF), on 1 January 2016, with the exception that the annual accounts of state entities shall for the first time be implemented in accordance with the Act for the accountant year 2017. To comply with the provisions of the Act, the annual accounts of the National Audit Office must be fully complied with in accordance with the law on annual accounts. If the Annual Accounts Act and established accounting policies do not address specific issues, it may be based on International Accounting Standards (IPSAS), cf. a letter from the Ministry of Finance and the Ministry of Finance to the Financial Management Authority dated December 22, 2017.

It is the opinion of the auditor that the National Audit Office's annual accounts for 2017 deviate from the Annual Accounts Act and the accounting principles regarding the following:

- Capitalization of liabilities in the balance sheet is offset against capitalized assets in the amount of ISK 23.2 million, which was raised by a budget from the Treasury, cf. notes based on financial statements and assets, together with notes no. 13, 17 and 18 in the annual accounts of the National Audit Office.

The entries made in the comments above are based on instructions from the Ministry of Finance and Economic Affairs and are referred to in notes 17 and 18 to

the annual accounts, as well as information in the Auditor General's report and individual notes.

Auditor's responsibility for the annual accounts

The Auditor General is responsible for the preparation and presentation of the annual accounts in accordance with the Annual Accounts Act and the Public Finance Act. Accordingly, he is required to plan, implement and maintain internal controls relating to the preparation and presentation of annual accounts so that it is essentially free of significant deficiencies. The Auditor General's responsibility also includes applying appropriate accounting policies and assessments based on circumstances.

When preparing the annual accounts, the Auditor General is responsible for assessing the audits' operability and providing an explanation if necessary.

The auditor's responsibility for auditing the financial statements

My goal is to provide sufficient assurance that the financial statements are free of material deficiencies, whether due to fraud or error and to issue an audit report which expresses my opinion. Sufficient certainty is a great certainty, but not an assurance that an audit conducted in accordance with international public accounting standards will detect any significant errors if any. Mistakes can occur due to mistakes or fraud and are considered significant if they could affect the financial decision-making of users of the annual accounts, alone or in aggregate.

My audit is in line with international public accounting standards and is based on professional judgment and criticism. I also do the following:

- Identify and assess the risk of material misstatement of the financial statements, whether due to error or fraud, plan and perform audit procedures to address the risks and obtaining audit evidence that is sufficient and appropriate to support my opinion. The risk of not detecting a significant error due to fraud is greater than not detecting a mistake, as fraud may involve conspiracy, forgery, misleading presentation of annual financial statements, the intentional omission of information or omission of internal control measures.
- Provide an understanding of the internal controls related to the audit to organize appropriate audit actions and to ascertain whether it provides satisfactory results.
- Assess whether accounting procedures and the auditor's accounting, together with related notes, are appropriate.
- Conclude on the use of the Auditor General's assumption of interoperability, and based on the audit, assess whether there is significant doubt about the interoperability or whether circumstances exist that could cause significant doubts about the interoperability. If I consider that there is significant doubt about the suitability of the business, I should pay particular attention to the relevant notes of the financial statements in my endorsement. If such explanations are incomplete, I must deviate from the unqualified opinion. My conclusion is based on audit data

collected up to the date of my signature. Nevertheless, events or circumstances in the future may cause uncertainty about the serviceability of the office.

- Overall, assess whether the financial statements give a true and fair presentation of underlying transactions and events, assess presentation, structure and content, including explanations concerning a fair presentation.

I inform the Auditor General of the estimated scope of the audit and important issues that may arise during my audit, including significant deficiencies in internal control.

Reykjavík, 30. apríl 2018.

A handwritten signature in blue ink, reading "Gunnar Sigurðsson".

Gunnar Sigurðsson
endurskoðandi

Profit and loss Account 2017

	2017	2016
Operating revenues		
Sale of services	99.995.689	57.213.215
Sale of assets	<u>0</u>	<u>2.906.000</u>
	<u>99.995.689</u>	<u>60.122.396</u>
Operating expenses		
Salaries and related expenses	622.131.611	539.671.694
Administrative expenses	11.590.029	10.756.903
Meeting and travel cost	10.453.867	6.840.532
Expert services	23.637.673	13.782.389
Operations of equipments	1.788.075	967.834
Other operating expenses	6.523.451	6.606.020
Housing	31.509.402	31.289.052
Operation of vehicles	499.612	779.783
Depreciation	<u>5.557.157</u>	<u>0</u>
	<u>713.690.877</u>	<u>610.694.207</u>
Purchased assets.	<u>0</u>	<u>15.060.952</u>
	<u>713.690.877</u>	<u>625.755.159</u>
Operating profit (-loss) before financial income	(565.657.472)	(565.657.472)
Financial income (financial expece)	(59.593)	(21.528)
Operating profit (-loss) before Treasury contribution	(613.754.781)	(565.657.472)
Treasury Contribution	<u>645.610.575</u>	<u>578.200.000</u>
Profit for the year	<u><u>31.855.794</u></u>	<u><u>12.542.528</u></u>

Balance Sheet 31. December 2017 (ISK)

	2017	1. January 2017
Assets		
Fixed assets		
Operational assets	23.264.990	23.175.565
Current assets		
Treasury	61.183.038	48.201.871
Balance due to related parties	5.816.000	586.050
Accounts receivable	19.756.251	3.594.010
Prepayments	53.725	120.610
Cash and cash equivalents	138.611	103.836
	<u>86.947.625</u>	<u>52.606.377</u>
Total assets	<u><u>110.212.615</u></u>	<u><u>75.781.942</u></u>
Equity and Liabilities		
Equity		
<i>Equity:</i>		
Equity at the beginning of the year	(16.905.815)	47.007.258
Cancelled appropriations, in acc. with final budget 2016	0	(2.466.251)
Revaluated accrued vacation pay		(61.446.822)
Profit for the year	<u>31.855.794</u>	<u>0</u>
Equity	<u>14.949.979</u>	<u>(16.905.815)</u>
Eigið fé	<u>47.007.258</u>	<u>47.007.258</u>
Liabilities		
Current liabilities		
Deferred income because of investments	23.264.990	23.175.565
Accrued vacation pay	59.602.876	61.446.882
Balance due to related parties	370.548	219.375
Accounts payable	11.786.949	7.592.796
Other payables	<u>237.273</u>	<u>253.199</u>
Liabilities	<u>95.262.636</u>	<u>92.687.817</u>
Total equity and liabilities	<u><u>110.212.615</u></u>	<u><u>75.781.942</u></u>

Cash Flow Statement 2017

	2017	2016
Cash flow from operations		
<i>Cash flow from operating activities:</i>		
Profit	31.855.794	12.542.528
Depreciation	5.557.157	0
(
Accrued vacation pay, change	<u>1.843.946)</u>	<u>0</u>
Cash flow from operating activities	<u>35.569.005</u>	<u>12.542.528</u>
 <i>Changes in current assets and liabilities:</i>		
(
Accounts receivable, decrease / (increase)	21.325.306)	3.018.960)
Accounts payable, (decrease) / increase	<u>4.329.400</u>	<u>853.950</u>
(
	<u>16.995.906)</u>	<u>2.165.010)</u>
 Net cash provided by operating activities	<u>18.573.099</u>	<u>10.377.518</u>
 Investing activities		
(
Year's investment	<u>5.646.582)</u>	<u>0</u>
(
	<u>5.646.582)</u>	<u>0</u>
 Cash flow from financial activities		
 <i>Changes in balance with the Treasury:</i>		
(
Treasury contribution.	645.610.575)	578.200.000)
Received from the Treasury	<u>632.718.833</u>	<u>567.521.210</u>
(
Net cash from financing activity	<u>12.891.742)</u>	<u>10.678.790)</u>
 Net increase in cash and cash equivalents	34.775	(301.272)
 Cash and cash equivalents at the beginning of the year	<u>103.836</u>	<u>405.108</u>
 Cash and cash equivalents at the end of the year	<u><u>138.611</u></u>	<u><u>103.836</u></u>

Notes

Accounting Policy

Basis for the Financial Statements

The Financial Statements of the National Audit Office have been prepared in accordance with the Act on Public Finance No. 123/2015. The Act specifies that the Act on Annual Accounts applies to Group A entities. However, IPSAS apply for the central government accounts

The financial statements are from 2017 and are recognized at cost, which includes the capitalization of assets, including previously expensed assets, and various assets related to the operation of the Office. The upgrading of accrued vacation pay at the beginning of the year and changes that will occur during the year. Other obligations relating to the Agency's operations are also entered.

In the 2017 financial statements, the comparative figures for the previous year are disclosed for operating segments according to presentation in the 2016 financial statements.

The National Audit Office's Balance Sheet Statement on 1 January 2017 was approved on 16 March 2018. This accounting method is in accordance with the decision of the Ministry of Finance and Economic Affairs and the Financial Management Authority. The accounts contain a qualification by the Auditor General.

Fixed assets

Fixed assets are capitalized at cost and amortized over their estimated lifetime. The State's investment contribution is credited to deferred debt. Investment authorization, equal to amortization, is recognized annually as income with a deduction of deferred investment income. These accounting policies and transactions are per the decision of the Ministry of Finance and Economic Affairs and the Financial Management Authority. The Auditor General includes a qualification concerning this transaction method.

Tax

Central government bodies and enterprises generally do not pay income tax.

Recording of Revenue

The Office's revenue is generally entered the same month as invoices are issued.

Recording of Expenses

Expenses are generally entered the same month they are incurred.

Operating Divisions

The Office's operations are divided into areas of responsibility appropriate to its organisation.

Other receivables

Other receivables are entered at nominal value in addition to incurred interests where relevant.

Cash and Cash Equivalents

The Office keeps no funds but has a bank account.

Pension Liabilities

The Office has accrued pension liabilities for its present and past employees. In accordance with the decision of the Ministry of Finance and Economic Affairs, pension liabilities are not recorded in the annual accounts of individual Group A entities but are recorded at the Treasury.

Accrued Vacation Pay

Accrued and matured vacation pay is calculated based on the relevant salary information.

Accounts Payable

Accounts payable are entered at nominal value in addition to incurred interests where relevant.

Accounting and Payment Functions

The Financial Management Authority handles payroll matters, accounting and payment services for the Office.

Budget and Operations

The appropriation for the National Audit Office, according to the accompanying statement with the budget 2017, amounted to a total of ISK 645.7 million. Of that amount, ISK 5.6 million investment contribution was entered as prepaid contributions and ISK 5.5 million investment contribution was equal to the amortization of the year. In total, appropriations for the year totalled ISK 645,6 million.

Operating expenses less sale of service totalled ISK 613,8 million, 31,9 million within appropriations. Operating expenses are specified as follows:

In ISK thousands	Initial	Total budget	Financial statements	Differences
Sales of services	-43.300	-43.300	-99,996	56.696
Salary and salary- related expenses	598.100	598.100	622.132	-24.032
Other Operating expenses	85.300	85.249	91.619	-6.370
	640.100	640.049	613.755	26.294
Investment contribution	5.600	5.562	0	5.562
	645.700	645.611	613.755	31.856

Break-down in ISK thousand by type:

	2017	2016
Sale of services	-99.996	-60.119
101 Icelandic National Audit Office	713.750	610.716
601 Formation expenses	0	15.061
	<hr/>	<hr/>
	613.755	565,657
	<hr/>	<hr/>



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