



# **ICELANDIC NATIONAL AUDIT OFFICE (INAO) ANNUAL REPORT 2011**

**JULY 2012**



**RÍKISENDURSKOÐUN**

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THE PHOTOGRAPH ON THE FRONT PAGE IS OF LAKAGÍGAR AND WAS TAKEN BY GEIR GUNNLAUGSSON,  
EMPLOYEE OF THE INAO.



# INTRODUCTION BY THE AUDITOR GENERAL, MR SVEINN ARASON



At the beginning of the economic recovery programme agreed upon by the Icelandic government and the International Monetary Fund (IMF) in 2009, the plan was to ensure that the overall balance of the central government's finances, i.e. results including interest balance, would be positive by 2013. This goal was to be achieved with a mixture of cutbacks and tax increases. When passing the Budget for 2012, Althingi decided to slow the process. At present, the overall balance is expected to become positive in 2014. Nevertheless, it is clear that cutbacks and cost-restraint measures will continue to make things difficult for many public bodies. Some of them have resorted to using budget surpluses from earlier years in order to make ends meet. However, when this is done, the annual statements show a deficit. Once such surpluses have been fully utilised, it is clear that the bodies in question will have to cut back operations and curtail services. This is simply inevitable. In my opinion, the public bodies and their employees have generally pulled together to try to get through these difficult times without irreparably damaging their operations.

Last year, the Althingi approved amendments to the Althingi Procedures Act, including amendments to provisions on the parliament's powers to appoint committees. A Constitutional and Supervisory Committee was established for the purpose of discussing constitutional issues and issues relating to the highest authority of the state, as well as being responsible for monitoring the executive branch. The Committee, moreover, is responsible for processing the reports from the INAO and

the Althingi ombudsman. This is a change from what has been the norm, as hitherto different committees, depending on the issue under consideration, have processed the INAO reports. The Parliamentary Budget Committee is expected to continue to process the INAO's reports on the implementation of the Government Budget and audit of the Central Government Accounts. I would like to take this opportunity to express my pleasure with these changes, which I believe will strengthen the Althingi's monitoring role and promote its organised processing of the INAO's reports. At the same time, I would like to thank the Constitutional and Supervisory Committee and the Budget Committee for their excellent co-operation over the past year. At the beginning of this year, the Presidential Committee established new rules on the Althingi's treatment of the reports, which take account of the said changes.

Over the past few years, the INAO has repeatedly proposed a revision of the legislation pertaining to state finances. Following the report of the International Monetary Fund (IMF) last autumn, the Minister of Finance decided to initiate a formal revision of the Government Financial Reporting Act (fjárreiðulögin). For this purpose, the Minister appointed a 12 member steering committee (myself being one of the members), to organise and manage the work. Four working groups work under the committee, each being responsible for examining a specific portion of the Act. The INAO has a representative in three of these groups. This work is expected to result in a legislative Bill to be presented to the Althingi next autumn. I would like to take this opportunity to express my satisfaction with this work and the collaboration within the aforesaid groups.

The Presidential Committee of the Althingi asked the INAO to prepare a report on guarantees and other state obligations that are not included in the Budget and the Central Government Accounts. The report, published in January 2012, reveals the INAO's opinion that some obligations and liabilities not included in the Central Government Accounts should be included and that there should be more discussion of them in the Budget than is the case at present. In this context, mention should be made of the financing lease agreements that are not included in the Central Government Accounts. According to special provisions applicable to the Central Government Accounts, property, plant and equipment, for example real estate, must be fully recorded in the year during which binding contracts are made for their purchase. In the opinion of the INAO, based on these special provisions, financing lease agreements should also be fully recorded in the Central Government Accounts. As a matter of fact, the INAO would prefer if this special provision were repealed and that the Central Government Accounts were recorded in the same manner as undertakings in the private sector as regards the recording of property, plant and equipment, i.e. that they be recorded in the balance sheet and subsequently depreciated annually. This is one of the issues that the steering committee on the review of Government Financial Reporting Act has under examination.

In 2010, the INAO began an investigation into the State's procurement practices. The investigation focuses on examining whether purchases made by public bodies are in accordance with laws and regulations that apply to such bodies. This investigation was continued in 2011. Public bodies have, in general, welcomed the INAO

recommendations as regards procurement, although there have been some exceptions. In this context, I would like to reiterate that the INAO is, according to law, responsible for examining whether public agencies and enterprises comply with laws, and to call attention to those that do not. This is a task that the INAO has sought to carry out with dedication and will continue to do so.

Over the past two years, the INAO has focused on defining its performance audits rather narrowly and completing them quickly with the issue of concise reports. With these changes, the INAO's communication with the ministries has increased somewhat. Some ministry's may find this all a bit much. However, in this context, mention must be made of the Office's statutory roles and its investigative authorisations. I would also like to make it absolutely clear that the Office makes every effort to cause as little disruption as possible to the activities of the ministries and public bodies to which its auditing and monitoring activities apply. The INAO has established rules of procedure on the manner in which the Office communicates with ministries and public bodies. These parties are, for example, always given the opportunity to lodge formal complaints and submit comments on draft reports. Such objections and comments are published in all the Office's performance audit reports.

The INAO seeks to complete the financial performance audits of bodies responsible for at least 80% of public spending by the middle of the year. This goal was not fully achieved in 2011, i.e. for the audit of 2010. The Office plans, however, to achieve this goal for the present year, i.e. for the audit of 2011. An account is given of the main results of the State's financial auditing in the annual report on the audit of the Central Government Accounts. The report on the audit of the 2010 Central Government Accounts was published in November 2011. The INAO is fully aware that when the report is issued so late, it is not as much use to the Budget Committee and Althingi as it should be. Measures have been taken to ensure that the report on the audit of the 2011 Central Government Accounts will be published no later than October 2012.

One of the statutory responsibilities of the National Audit Office is monitoring the finances of political parties and candidates. These entities are under obligation, pursuant to law, to submit financial information to the Office within set deadlines. The time limit that political parties have to submit their annual financial statements is bound by law and is 1 October each year. INAO, however, is responsible for establishing time limits as regards information on candidates' campaign expenses. Political parties and candidates, however, repeatedly fail to provide the Office with this information within set deadlines. Four parties, for example, did not submit their 2010 accounts before 1 October 2011 (see page 27) I find it reprehensible that parties who have representatives in the Althingi do not comply with the time limits that the Althingi itself has established by law.

Last year, the INAO completed its strategy formulation process, which is based on the balanced scorecard methodology. The Office's strategy map for 2011–15 takes account of the four basic dimensions of the operation: finances, human resources, procedure and services. Specific key objectives in each dimension are defined. The objectives are then further demarcated in the Office's scorecard, which also

establishes criteria to measure how well objectives are achieved each time. Some of the performance measurements according to the scorecard are described on pages 12–17. One of the INAO's key objectives is to enjoy the confidence of the members of parliament, the state administration and the Icelandic public. According to recent attitude surveys, the Office generally enjoys the confidence of members of parliament, permanent secretaries and agency heads, while public confidence in the Office has subsided significantly in recent years, i.e. since the collapse of the banks. This development is a matter of considerable concern to us and we have taken steps to try to reverse this trend.

The Presidential Committee of the Althingi decided in late 2012 to appoint a committee to review the National Audit Act. Member of parliament Thurídur Backman chairs the committee. Other members of the committee are Stefán Svavarsson, Chartered Accountant and the undersigned. The committee began work immediately and plans to submit proposals to the 2012 autumn session of the Althingi for processing.

The Office's operations were generally as normal in 2011. The number of employees at the end of the year was 47, unchanged from the previous year. Man-years worked by permanent employees were 44, down by approximately one from the previous year.

In 2011, there was an ISK 33.9m deficit in the operation of the Office. This was met by utilising surpluses from earlier years. These amounted to ISK 69.9m at the beginning of the year and stood at ISK 36.1 at its close. Costs increased by ISK 6.1m between years while user fees decreased by ISK 25.6m and state contributions by ISK 19m. The reversal between years, therefore, is approximately ISK 50.6m. There is every indication that unused surpluses from earlier years will be fully utilised in 2012.

Finally, I would like to thank the INAO's employees for all their good work in the past year. Significant and growing demands are being made to the Office and, with the addition of cutbacks and strict cost restraints on operations, it is clear that pressures on staff are considerable. In spite of all this, employees have made every effort and have performed their work diligently and conscientiously, as is shown by this report.



# ROLE AND LEGAL STATUS OF THE ICELANDIC NATIONAL AUDIT OFFICE

The INAO is an independent body operating under the auspices of the Althingi (Iceland's parliament). The Office is a part of the legislature and is involved in monitoring the executive branch. Its main role is to monitor and promote improvements in the financial management of the state and in the performance of public bodies. The Office's vision is to be a leader in professional government auditing.

**PART OF ALTHINGI'S  
MONITORING OF THE  
EXECUTIVE BRANCH**

The INAO operates in accordance with legislation applicable to it (No. 86/1997) and, as applicable, the Act on Auditors (No. 79/2008), as well as with various other acts of law applicable to its operation. Furthermore, the Office takes account of the standards and guidelines of the International Organisation of Supreme Audit Institutions (INTOSAI) and the standards of the International Federation of Accountants (IFAC). Moreover, employees take account of the Office's Code of Professional Conduct.

As the INAO 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, a number of unwritten principles of administrative justice apply to the Office, such as rules on competence.

**MAIN TASKS OF THE  
INAO**

Taking into account acts of law, rules, standards and guidelines, the INAO 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. Examination of the internal controls and security of IT systems. Suggestions on what improvements may be made to accounting, the preparation of financial statements, internal controls and the operation of IT systems.

## PERFORMANCE AUDITING

Evaluations of the performance of public bodies, state-owned enterprises and parties that accept contributions from the State. Assessments of economy,



efficiency and effectiveness in operations. Suggestions on how performance may be improved.

#### MONITORING THE IMPLEMENTATION OF THE GOVERNMENT BUDGET

Monitoring whether public bodies operate in accordance with the Budget, the Government Financial Reporting Act and the Regulation on the Implementation of the Government Budget.

#### MONITORING THE FINANCES OF SELF-OWNED ORGANISATIONS (FOUNDATIONS)

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

#### MONITORING THE FINANCES OF POLITICAL PARTIES AND POLITICAL CANDIDATES

Receipt, processing and publication of information on the income and expenses of political parties and candidates in pre-elections.

It must be noted that the above tasks often overlap and are linked in various ways. Moreover, the definition of a task may change in accordance with the Office's change of focus from time to time.

### BROAD AUDITING MANDATE

By law, the INAO has a very broad mandate for auditing. 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 in relation to invoices issued to the Government, in order 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 and assess whether such payments have achieved the intended results.

### INAO's INDEPENDENCE

The INAO selects and organises its own projects, even though it is constitutionally under the auspices of the Althingi. The Presidential Committee of the Althingi, however, may require the Office to submit reports on matters that fall within its mandate. In such cases, however, the Office determines the approach to the subject matter, the methods used, when the report is completed and the manner in which the conclusions are presented. The staff of the INAO shall be completely independent of those Ministries and organisations where the audit is being carried out.

The INAO notifies the appropriate public bodies, the Althingi, the media and the public of the results of its investigations through printed reports, press releases and its website, [www.rikisend.is](http://www.rikisend.is). Results that touch on sensitive internal issues of public bodies, however, are not made public. The Althingi discusses the reports of the INAO in accordance with the Althingi Procedures Act and rules on the parliamentary treatment of reports from the Office.



# GENERAL INFORMATION ON THE ACTIVITIES AND OPERATION OF THE INAO IN 2011

## DIVISION OF WORK CONTRIBUTION BETWEEN TASKS

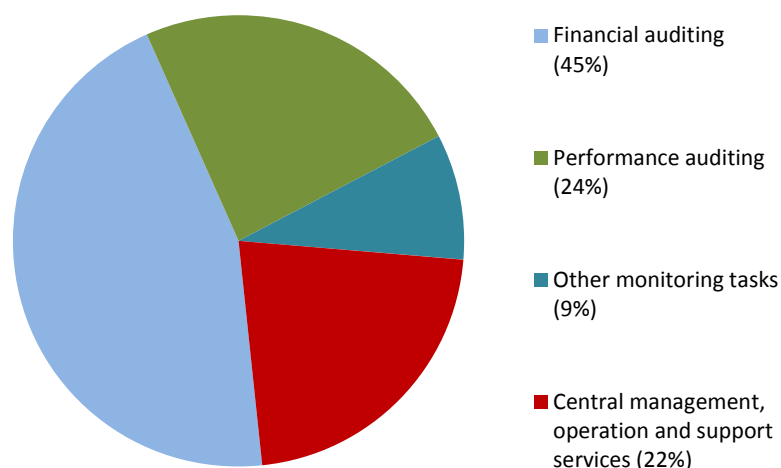
In 2011, the active working hours of the INAO's employees came to a total of just under 82,000, increasing slightly from the previous year, or by 2%. Active man-hours refer to the hours employees are at work, with absences, due to illness or vacation for example, excluded. In addition to the work contribution of employees, the Office purchases services from auditing firms corresponding to approximately 3,500 working hours.

Active man-hours  
increased slightly

As in recent years, the largest proportion of active man-hours by far was spent on financial auditing. The proportion, however, was slightly less in 2011 than the previous year, 45% instead of 50%. Approximately 24% was spent on performance auditing, which is a similar proportion as in 2010. The proportion of performance auditing has in fact increased in recent years, was e.g. only 16% in 2008. Approximately 9% of active man-hours were spent on other monitoring activities, a slightly higher proportion than in 2010, and around 22% were spent on central management, operation and support services, which is 3% more than in 2010. The principal reason is that several large projects were carried out in 2011, which relate to the Office as a whole, such as the adoption of a new filing system.

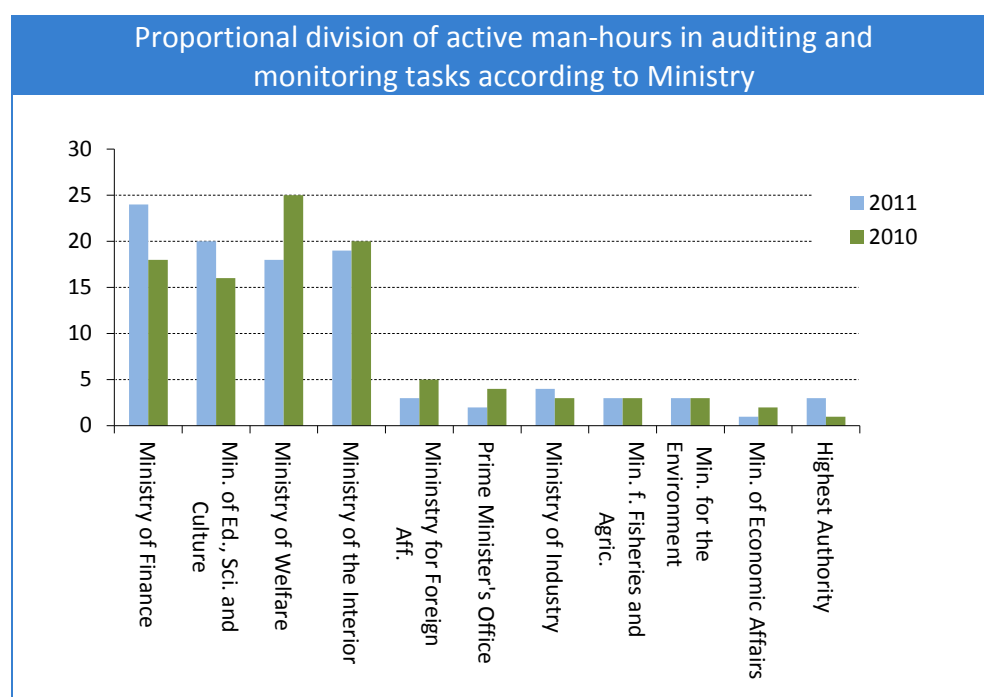
DIVISION DID NOT  
CHANGE MUCH  
BETWEEN YEARS

Division of active man-hours according to tasks in 2011



#### **GREATEST AMOUNT OF TIME USED TO EXAMINE MINISTRY OF FINANCE BUDGET ITEMS**

In total, active man-hours in auditing and monitoring tasks were approximately 63,400 in 2011, which is a similar number as in the year before. The greatest amount of time was spent on auditing and monitoring the budgetary items of the Ministry of Finance, or approximately a quarter of the working hours. This is a higher proportion than in 2010 when 18% of working hours were spent on the Ministry's budgetary items. Approximately one fifth of working hours was spent on the budgetary items of the Ministry of Education, Science and Culture, which is also a higher proportion than in 2010. The increase is 4%. In contrast, proportionately less time was spent on auditing and monitoring the budgetary items of the Ministry of Welfare in 2011 than the comparative items of the Ministry of Health, Social Affairs and Social Security the year before, or 18% instead of 25%. A similar amount of time was spent on the budgetary items of the Ministry of the Interior in 2011 as was spent on the items of the Ministries of Communications, Justice and Human Rights in 2010, or approximately 20%.



The proportional division of active man-hours spent on auditing and monitoring activities depends on risk assessments and the choice of projects at any particular time. Thus performance audits generally focus on different ministries between years, and this can have an effect on the division.

## **INCOME AND EXPENSES**

#### **STATE CONTRIBUTION DECREASED BY ISK 19M.**

The total expenditures of the INAO amounted to ISK 481.3m in 2011, increasing slightly between years or by 1%. Revenues amounted to ISK 41.6m and the state contribution amounted to ISK 405.8m. As a result, there was an ISK 33.9m deficit in the operation, which is a much poorer result than in 2010 when there was an ISK 16.8m surplus. A significant reason for this is the fact that the state contribution was reduced by ISK 19m and user fees fell by ISK 25.6 between years. The Office had budget surpluses from earlier years which were in part used to cover the deficit. It

should be noted that measures to ensure a deficit-free operation in 2012 have been taken. Further information on the Office's operations and financial position may be found in the financial statements and accompanying notes on pages 32-38

Summary of 2010 and 2011 profit and loss account (ISK millions)				
	2011	2010	CHANGE	%
SALARIES AND RELATED EXPENSES	367.0	349.0	18.0	5%
OTHER OPERATING EXPENSES	112.3	123.0	-10.7	-9%
PURCHASED ASSETS	2.0	3.2	-1.2	-38%
<b>TOTAL COST</b>	<b>481.3</b>	<b>475.2</b>	<b>6.1</b>	<b>1%</b>
REVENUES	41.6	67.2	-25.6	-38%
COSTS NET OF REVENUES	439.7	408.0	31.7	8%
<b>STATE CONTRIBUTION</b>	<b>405.8</b>	<b>424.8</b>	<b>-19.0</b>	<b>-4%</b>
<b>SURPLUS (DEFICIT)</b>	<b>-33.9</b>	<b>16.8</b>	<b>-50.7</b>	<b>-302%</b>

## HUMAN RESOURCES

At year-end 2011, the INAO had a total of 47 employees, 23 women and 24 men. The number of employees and gender ratio has not changed since 2001. The average age of employees was around 52 years. In comparison, the average age of employees of the Government Offices of Iceland was 47.5 in 2011.

Employee turnover is defined as the proportion of employees who resign during the year out of the total number of employees at year-end. The ratio was 4% in 2011, i.e. two employees left during the year. Over the past three years, employee turnover has fallen considerably when compared to the preceding years, as conditions in the labour market have altered drastically in the wake of the collapse of the banks. For example, employee turnover was 17% in 2007 but has been 2–4% over the past three years. The ratio of employees with at least three years' experience at the Office was 94% in 2011, and this figure has risen in recent years. The average length of service was around 13 years and has also been rising.

**STAFF TURNOVER 2–4%  
IN RECENT YEARS**

At year-end 2011, over 80% of the INAO employees had a university degree, many holding a master's degree. The majority had degrees in business administration, five had degrees in political or administrative sciences, three were lawyers, two in computer or systems analysis and two had degrees in humanities. Furthermore, there were five chartered accountants and three with certification in internal auditing (CIA). One of them is also a Certified Government Auditing Professional (CGAP), and another has certification in IT auditing (Certified Information Systems Auditor – CISA).

**OVER 80% OF STAFF  
HOLD A UNIVERSITY  
DEGREE**

The INAO endeavours to ensure that the staff maintain and strengthen their professional abilities through continuing education. To this end, employees are able to attend a range of courses in conjunction with their work. They may also undertake university studies in conjunction with their work in accordance with a special agreement between the Office and the employee. The employees who enter into such an agreement may spend up to 4 hours of their working hours in study programmes

for every course they complete. In 2011, one such agreement was in effect. Budget allocations to the INAO have been substantially reduced in the past few years. Economisation has been achieved by, among other things, reducing expenditures towards continuing education and educational courses. Plans have been made to strengthen this aspect of the operation as soon as the Office's financial position improves again.

Key figures in human resources			
	2011	2010	2009
STAFF TURNOVER	4%	4%	2%
AVERAGE AGE OF EMPLOYEES	52	52	50
AVERAGE LENGTH OF SERVICE INAO	13 YEARS	12 YEARS	11 YEARS
3 YEARS' WORK EXPERIENCE AT INAO	94%	90%	71%

## STRATEGIC PLANNING AND PERFORMANCE MEASUREMENTS

In 2009, the Auditor General appointed a working group to prepare proposals for a strategy for the Office based on the balanced scorecard methodology. The group submitted their proposals in August that same year. A new group was quickly formed to expand the proposals and finish the work. This group prepared a draft strategy map for the Office in which its key objectives were stated. The group, moreover, prepared draft descriptions of the substance of the objectives. During the INAO's Team Building Day, held in February 2011, the strategy map was completed with the participation of all employees. Subsequently, in August 2011, work began on scorecards. These define measurement criteria intended to illustrate if or how well objectives are achieved. This work was completed in December and the Office's strategy map and scorecards came into effect at the beginning of 2012.

The INAO's strategy map contains a total of 13 key objectives: three in the "services" dimension, four in the "procedures" dimension, four in the "human resources" dimension and two in the "finances" dimension. There are a total of 36 performance indicators in the scorecard, differing in number for each objective, ranging from between one and five and different in nature. Some are relatively easy to use, e.g. criteria that involve counting some form of units that the operation puts forward. Others require a bit more effort, e.g. a number of performance indicators are based on examining the attitudes of the employees or "clients" of the Office – i.e. target groups.

The following are a few examples of the INAO's performance measurements. In autumn 2011, the company Capacent Gallup was requested to survey public opinion of the Office. The survey polled a 1,400 person random sample from the National Registry and the response proportion was around 60%. The INAO subsequently surveyed the attitudes of the members of the Althingi toward the Office in March 2012. The survey polled the principal members of the four parliamentary committees that were most involved in discussing the Office's reports in 2011, a total of 33 persons. The response percentage was 52%. The attitudes of agency heads toward the Office were surveyed at a similar time. The survey included all permanent

BASED ON *BALANCED*  
*SCORECARD*

36 PERFORMANCE  
INDICATORS

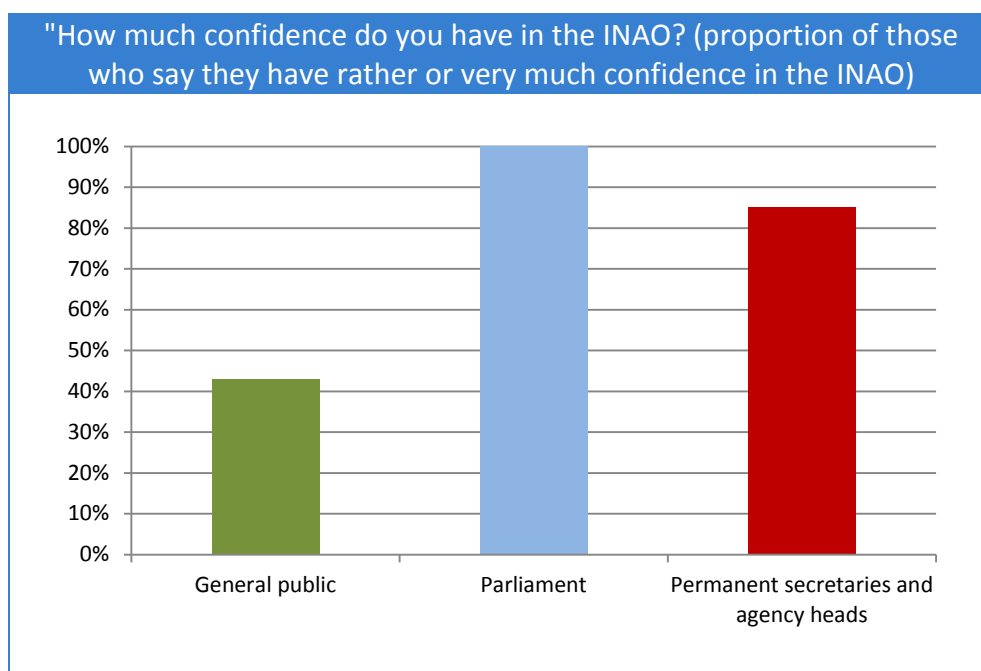
MEASURING THE  
ATTITUDES OF  
TARGET GROUPS



secretaries and the agency heads that had received recommendations in reports issued by the INAO in 2011, a total of 24 persons. The response rate in this survey was approximately 83%.

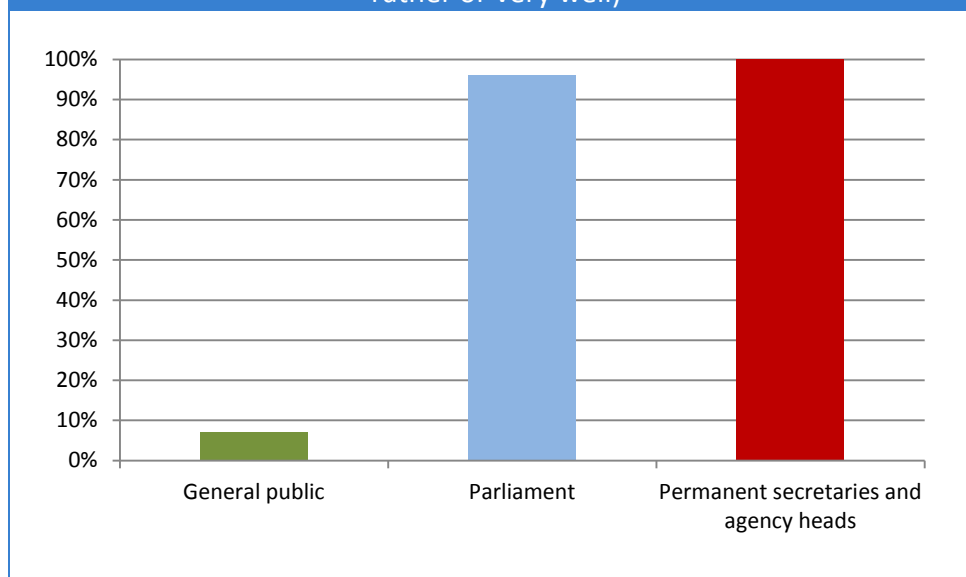
The groups were asked, for instance, how much confidence they had in the INAO. The result was that only 43% of respondents among the public considered the Office to be rather or very trustworthy, while all respondents in the survey among members of the Althingi and 85% of respondents among permanent secretaries and agency heads held this opinion. According to the scorecard, the INAO aims to enjoy the confidence of at least 60% of the nation. It is clear that there is some way to go to achieve this objective. Conversely, the Office has achieved its objectives as regards enjoying the trust of the members of the Althingi, permanent secretaries and agency heads. According to the scorecard, the Office wishes to be seen as trustworthy by at least 70% of the members of these groups.

**INAO WANTS TO  
ENJOY THE  
CONFIDENCE OF AT  
LEAST 60% OF THE  
NATION**



When interpreting the above results, account should be taken of how well the groups understand the role and tasks of the INAO. The survey among the public revealed that its members generally know very little about the Office. Only 7% of respondents were of the opinion that they understood the Office's role and tasks rather or very well. The corresponding ratio in the survey among the members of the Althingi, permanent secretaries and agency heads was between 96 and 100%.

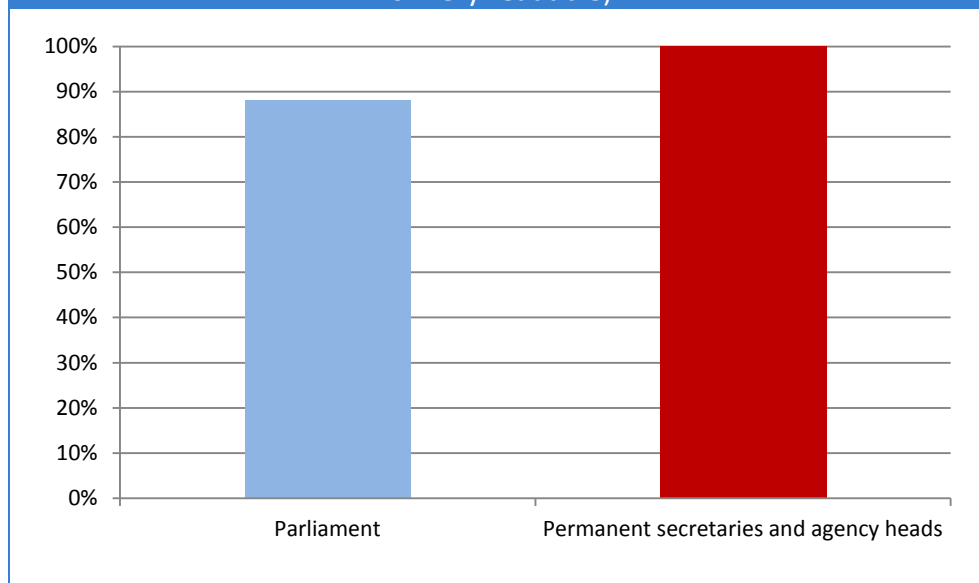
"How well do you understand the role and tasks of INAO?" (proportion of those that understand the role and tasks rather or very well)



**REPORTS ARE  
CONSIDERED  
READABLE**

In the survey among the members of the Althingi, permanent secretaries and agency heads, they were asked how readable the respondents thought the reports of the Office were. The survey revealed that 88% of the members of the Althingi and 100% of the agency heads of ministries and public bodies were of the opinion that the reports were rather or very readable. This is a considerably better result than the Office has aimed for as, according to the scorecard, the objective is that at least 70% of the members of these groups consider the reports to be quite or very readable.

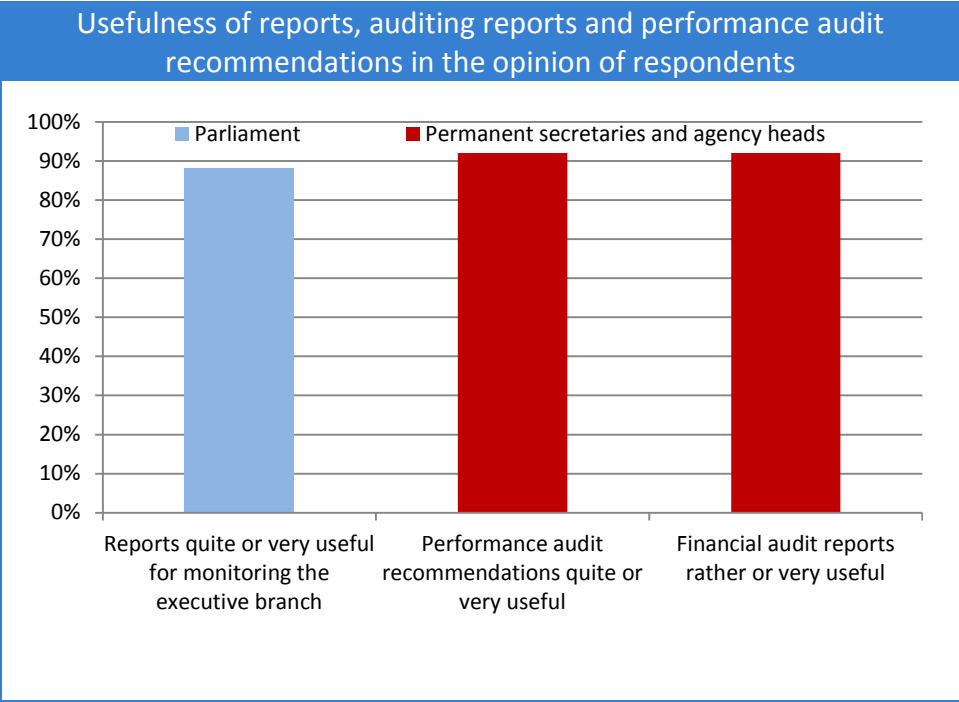
"How readable do you consider INAO's reports?" (proportion of those who say the reports are quite or very readable)



Members of the Althingi, permanent secretaries and agency heads were also asked about the usefulness of the reports and performance audit recommendations issued

by the Office. The survey revealed that 88% of respondents among members of the Althingi were of the opinion that the reports were rather or very useful for monitoring the executive branch. Approximately 92% of permanent secretaries and agency heads were of the opinion that recommendations contained in performance audits and financial audit reports were rather or very useful. This is a considerably better result than the Office has aimed for as, according to the scorecard, the objective is that at least 70% of respondents consider the reports quite or very useful.

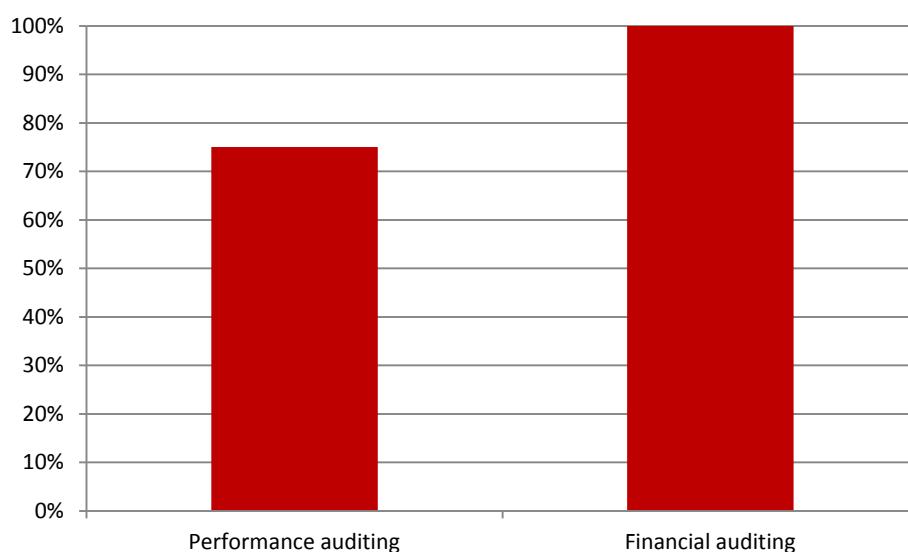
**SIGNIFICANTLY  
BETTER RESULTS  
THAN THE OFFICE HAS  
AIMED FOR**



Permanent secretaries and agency heads were requested to evaluate the work practices of the employees of the Office. Approximately 75% of respondents who had had interactions with the employees of the Office due to performance audits in 2011 were of the opinion that their work practices had been quite or very professional. All respondents who had had communication with the employees of the Office due to financial audits in 2011, however, were of the opinion that their work practices had been quite or very professional.

**INAO'S STAFF  
CONSIDERED  
PROFESSIONAL**

"In your opinion, how professional were INAO employees in performance/financial auditing?" (proportion of the permanent secretaries and agency heads who considered practices quite or very professional)



The results of one additional measurement criteria are on page 26 of this report, in the section on the Office's performance auditing activities in 2011.

**SELECTED  
PERFORMANCE  
MEASUREMENTS WILL  
BE PUBLISHED**

It should be noted that the INAO's scorecards are still being developed and that no "baseline" measurements have been made for all its indicators. In addition, the scorecard will always be an "organic" document and will probably alter over time. The Office will henceforth publish the results of selected performance indicators in its Annual Report.

## INTERNAL ORGANISATION

INAO's current organisational chart came into effect on 1 April 2010. The Office has two main departments: the Financial Audit Department and the Performance Audit Department. The Financial Auditing Department is responsible for carrying out financial audits and related tasks in accordance with Article 8 of the National Audit Act, while the Performance Audit Department is responsible for carrying out performance audits and related tasks in accordance with Article 9 of the same Act. In addition, there are three support departments responsible for diverse centralised tasks and for providing services to the main departments: Financial Administration and IT Services, Legal and Archive Services and Information and International Relations. The Auditor General's Office, moreover, is responsible for a range of tasks involving public administration monitoring, monitoring the implementation of the Government Budget, as well as providing assistance to the Auditor General. Five employees have been appointed to an Advisory Board which addresses various issues that relate to the professional development of the Office's activities.

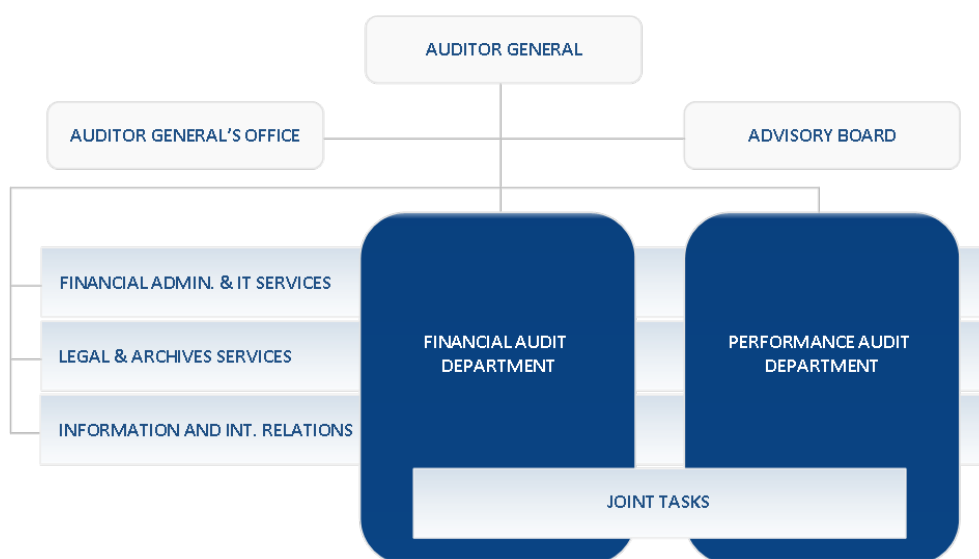
**TWO MAIN  
DEPARTMENTS,  
THREE SUPPORT  
DEPARTMENTS AND  
THE OFFICE OF THE  
AUDITOR GENERAL**



Each speciality department is managed by a Director, and under him are Department Managers, four in the Financial Audit Department and two in the Performance Audit Department, who guide the work of experts. The Director of the Financial Auditing Department is Ingi K. Magnússon, and the Director of the Performance Auditing Department is Kristín Kalmansdóttir. Senior Attorney at Law and substitute for the Auditor General is Lárus Ögmundsson, the Director of Operations is Eythór Borgthórsson and the Director of the Office of the Auditor General is Jón Loftur Björnsson.

Members of the Office's Advisory Board are Pétur Vilhjálmsson, Chairman, expert in the Office of the Auditor General; Albert Ólafsson, Office Manager in the Financial Audit Department; Ingunn Ólafsdóttir, expert in the Performance Audit Department; Kristín Jónsdóttir, expert in the Financial Audit Department; Sigurgeir Bóasson, Department Manager in the Financial Audit Department.

## INAO's ADVISORY BOARD



# FINANCIAL AUDITING

## **MOST EXTENSIVE TASK UNDERTAKEN BY THE OFFICE**

Financial auditing is the most extensive task undertaken by the INAO. In 2011, a total of over 35 thousand hours were spent on financial auditing, or the equivalent of approximately 45% of the total number of active man-hours spent by the Office. Employees of the Financial Audit Division at year-end 2010 were 24 in 21 full-time equivalent positions.

The INAO annually audits the Central Government Accounts and the accounts of ministries, agencies, funds and other parties. By law, the financial audits must determine the following in particular:

## **GOALS OF CENTRAL GOVERNMENT FINANCIAL AUDITING**

- That the financial statements present a fair view of operations and financial position in accordance with generally accepted accounting principles.
- That internal controls are examined to ascertain whether they ensure adequate results.
- That accounts are in accordance with Budget authorisations, the supplementary Budget or other appropriate laws, lawful instructions, business practices or service contracts.
- That the reliability of key indicators on the scope and results of the operation of public bodies are examined and certified, if such indicators are published with the annual accounts.



Account is taken of the National Audit Act, the Auditors' Act, INTOSAI standards and IFAC standards in the Office's auditing activities as applicable.

The INAO annually publishes an official report, *The Audit of the Central Government Accounts*, containing a summary of all the financial audits that it has performed during the year, the principal results of such audits, and comments. In 2011, this report was issued in November.

## FINANCIAL STATEMENTS OF GROUP A PUBLIC BODIES

The financial statements of public bodies belonging to Group A of the Central Government Accounts are generally simpler than the financial statements of undertakings in the private sector. The difference is, among other things, that in public bodies, investments and asset purchases are charged to the year in which they take place and are not capitalised and depreciated as is the case in financial statements in the private sector. Conversely, the public bodies are instructed to keep a detailed record of their assets. Financing is also usually much simpler than in the private sector, i.e. involves for the most part an allocation from the Treasury. The presentation of the Budget and the Central Government Accounts, therefore, is relatively simple and there are very few accounting complications. This may, however, change in the near future. The Government Financial Reporting Act, the majority of which is since 1997, is currently under revision.

**FINANCIAL  
STATEMENTS LESS  
COMPLICATED THAN  
IN THE PRIVATE  
SECTOR**

## ASSESSMENT OF INTERNAL CONTROLS

As stated earlier, Government financial auditing includes examining the internal controls of ministries, public bodies and state-owned enterprises. Internal control means diverse measures and actions intended to encourage successful and efficient operations; safeguard assets, valuables and sensitive data; provide trustworthy financial information; and ensure that operations comply with laws and regulations. Internal controls are generally based on analyses and assessments made by public bodies and enterprises of possible operational risks, and can be seen in work procedures of various types, e.g. regarding the division of tasks, the approval of expenses and recording of business transactions, and also in codes of conduct and human resources policies.

The status of internal control in public bodies is generally quite good in INAO's opinion. However, not all public bodies have documented their internal controls so there is no overall view of all the supervisory actions that are used to monitor operations. The INAO decided, therefore, to prepare instructions on internal controls for public bodies in Group A. The instructions were issued in May 2011.

**INTERNAL CONTROLS  
GENERALLY GOOD IN  
MOST PUBLIC BODIES**

It should be noted that the INAO does not create rules of procedure and processes for public bodies as these are the responsibility of their agency heads. The INAO, however, investigates whether the effectiveness of internal controls is in accordance with such rules and, as appropriate, issues recommendations and suggestions for improvement.

## FOCUS POINTS IN THE 2010 AUDIT

As has previously been stated, Government financial auditing involves examining whether accounts are in accordance with Budget authorisations, the supplementary Budget and other laws, lawful instructions, business practices and/or service contracts, as appropriate. This aspect in the auditing is extremely important and its importance has increased in recent years.

Specific aspects in the operation of the State are selected each year and examined in a co-ordinated manner in all bodies. Three such points of focus were examined in all the public bodies audited in 2010. First, the development of government employee salaries from 2008 to 2010 was examined and an assessment made of whether actions taken by public bodies as regards salary issues were in accordance with guidelines in the Minister of Finance's report on the schedule for balance in central government finances. Second, an assessment was made of the implementation of the Government's decision to terminate all fixed transport agreements with government employees and pay only for transport in accordance with driving logs. Third, an examination was made of the effect of a new regulation on the payment of travel expenses when travelling on state business that entered into effect on 6 March 2009. The results may be read in the INAO's 2010 report on the Audit of the Central Government Accounts.

## SELECTION OF AUDITING SUBJECTS – RISK ASSESSMENT

The Central Government Accounts consist of over 450 budgetary items in Group A of the Treasury in addition to information on the financial statements of public bodies in Groups B to E. Due to the scope, the INAO, and the auditors operating on its behalf, are not able to audit all these parties before the issue of the Central Government Accounts, which, in recent years, has been in June. Therefore, the Office must select specific bodies for auditing. This selection is for the most part based on risk assessments, i.e. risk of the accounts not giving a clear picture of the operation and financial position, that laws have not been complied with or other lawful instructions, etc. The selection is also based on ensuring that all Budget items are regularly audited. When assessing risk, the scope of the Budget item is important. Over 70 Budget items have expenditures over one billion ISK and together they form approximately 80% of the total state expenditures. These consist of public bodies, collective items and transfer items. The financial statements of these items can make a big difference to whether or not the Central Government Accounts as a whole provide a clear image of the operation and financial position of the Treasury. As a result, the Auditor General normally does not endorse the Central Government Accounts until after these items have been audited. As the Central Government Accounts are issued in July, their audit must be completed before the middle of the year. This goal was not fully achieved in 2011 and every effort will be made to ensure it achieved this year.

The INAO has, to date, audited the annual financial statements of the majority of Budget items. The scope of some of the items is relatively small and they have negligible effects on the results of the Central Government Accounts. The plan is to

### FOCUS POINTS IN 2010 AUDIT

### GOAL IS TO AUDIT 80% OF EXPENDITURES BEFORE THE MIDDLE OF THE YEAR



reduce the auditing of these items and instead direct efforts to other aspects of State finances, which are of greater importance.

## AUDITING BALANCE SHEET ITEMS AND REVENUES

Following the collapse of the banks in 2008, the State's balance sheet has become much more complicated than was previously the case. Both borrowing and lending have increased substantially. In addition, the Treasury has been engaged in complicated financial transactions due to the resurrection of the banking system. In response, the INAO has sought to spend more time than previously auditing the balance sheet. The collapse has also had extensive effects on the Treasury's revenue generation. The Althingi, for instance, has approved numerous actions to increase the income. In many cases this involves multiple and complicated changes to legislation. The Office has tried to respond to this by spending more time analysing and auditing the State's income sources.

STATE BALANCE  
SHEET HAS BECOME  
MORE COMPLICATED

## AUDITING PROCEDURES – ADOPTION OF INTERNATIONAL STANDARDS

The International Organisation of Supreme Audit Institutions (INTOSAI) publishes standards on auditing public bodies (International Standards of Supreme Audit Institutions – ISSAI). Member institutions are not under obligation to follow these standards unless so ordered by law. However, they all endeavour to fulfil the requirements of the standards, given that they are based on the best knowledge and experience in the field of central government auditing. In 2010, INTOSAI published new and much more detailed standards on financial auditing than the Organisation had previously published. The new standards involve the adaptation of the standards of the International Federation of Auditors to the public sector. With the enactment of new legislation applicable to auditors in 2008, auditors were compelled to follow the latter standards in their work.



**ADOPTION TO BE  
COMPLETED IN THE  
PRESENT YEAR**

The INAO focuses on following in every respect the international standards that apply to the Office's activities. In 2011, the adoption of the ISSAI began in the Office, involving, for example training employees to use them. Specific standards have been focused on each month in the Financial Auditing Department; they have been thoroughly examined and there have been discussions on how they should be used. This work will probably be completed in the latter part of 2012. It should be noted that substantial account has been taken of the manner in which the Nordic sister offices of the INAO have carried out the adoption of the standards. Most of these offices plan to complete the adoption during the present year.

## **IT AUDITING**

**GOAL OF IT AUDITING**

Part of the state's financial auditing involves examining whether the IT systems of public bodies and enterprises are secure and perform as expected. Account is taken of the National Audit Act, 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.

The results of IT audits are presented in reports that are usually sent only to the public bodies being audited and to the relevant ministry, as these reports regularly include information on sensitive security issues. It would be irresponsible to publish such reports and allow information on the possible weaknesses of an IT system to become common knowledge before any such weaknesses could be remedied.

Three of the 24 employees of the Financial Audit Division were responsible for IT systems auditing in 2011. In addition, these employees were responsible for various tasks relating to the adoption and operation of software used by the INAO.

# PERFORMANCE AUDITING

According to Article 9 of the National Audit Act, the INAO may examine the handling and utilisation of public funds and submit proposals on ways for improvement. The task is called performance auditing and is one of the principal tasks of supreme audit institutions (SAIs) around the world. Performance audits are, in reality, examinations of how successful ministries, public bodies and state enterprises are in the tasks entrusted to them. When performing this work, the Office takes account of the National Audit Act, documents relevant to the interpretation of applicable acts and the standards and guidelines issued by INTOSAI (ISSAI 3000).

**IN ACCORDANCE WITH  
ISSAI 3000**

In 2011, a total of just under 20,000 hours were spent on performance auditing, or the equivalent of a quarter of the total number of active man-hours spent by the Office. This is a similar proportion as in 2010 and much higher than it had been in the years prior to 2010. The reason is that the number of employees in the Performance Audit Division has increased in conjunction with the focus and organisational changes within the Office. They were 8 at year-end 2009, 12 at year-end 2010, and then actually 2 fewer in 2011, when they numbered 10 at the end of that year.



Performance audits endeavour to assess whether the operation in question is economic, efficient and effective and whether applicable laws and regulations are complied with.

## MOST AUDITS INITIATED BY THE INAO

According to law, the Office may carry out performance audits on all bodies that finance their activities with public money, bodies in which the State owns at least half of the shares and bodies that enjoy contributions from the State Treasury for the services they provide. Most audits are performed on the initiative of the Office based on analyses of either their financial or social importance or risks in their operation and operating environment. A proportion of audits, however, is always carried out at the request of Althingi or the ministries. When an audit is carried out as the result of an external request, the INAO is responsible for delimiting the material, making decisions on methods, defining focus areas and presenting the results.

## PRE-STUDY, MAIN AUDIT AND FOLLOW- UP

The INAO commonly divides its performance audits into three main parts: *pre-study*, *main audit* and *follow-up*. *Pre-studies* are carried out in an effort to assess the possibility and legitimacy of initiating a performance audit. If a *pre-study* reveals that a *main audit* is premature or that its expected benefits will be less than costs, the *main audit* is not carried out. If a *pre-study* reveals that there would be significant benefits from a *main audit*, an audit plan is prepared containing the questions that the *main audit* is intended to answer, the scope is delimited, methods are defined and the time and manpower necessary to carry out the audit are specified. In *main audits*, all available data is collected that is of importance to answer the audit questions. Such data is analysed, assessed and interpreted objectively and professionally. Thereafter the conclusions are formulated and, as appropriate, recommendations for improvements. After the draft report has been reviewed in-house it is sent to the public body and/or ministry for review. The final report is later published and sent to the parties involved. One to three years after the completion of the *main audit*, the results of the audit must be assessed in a *follow-up* audit, i.e. the response of the public body, ministry or Althingi to the recommendations of the INAO. The results of this examination are published and sent to the parties involved. Such examination may lead to a new audit.

## WORK SCHEDULE OF THE PERFORMANCE AUDIT DEPARTMENT

The Performance Audit Division operates according to a three-year operating schedule that is reviewed annually. The current operating schedule applies from autumn 2010 to autumn 2012. It states that audits during the period will specifically be directed at the problems that the authorities and public bodies face with falling government revenues, reductions in public operations and the reorganisation of public services. Consideration must be given to ways to promote better utilisation of public funds and economisation in state operations and its individual bodies. Also, the Division will monitor whether tasks or services paid by the state are performed in accordance with laws and regulations. Furthermore, the Division will monitor the daily operation of ministries, public bodies and public enterprises and the general schedules and actions of the state in individual fields.

The results of performance audits are presented in reports sent to the Speaker of the Althingi and the entities involved and are published on the INAO's website, [www.rikisend.is](http://www.rikisend.is). In recent years, the audits have generally become more delimited than previously and generally take less time. As a result, the number of reports completed by the department every year has multiplied. By carrying out targeted



audits, the INAO wishes to ensure that the Althingi and the authorities receive timely information that is useful in their decision making.

In 2011, the employees of the Performance Audit Division completed a total of 28 reports, as opposed to 22 the year before. Of this number, 4 (15%) were carried out at the request of the Althingi's committees or ministries while 24 (85%) were carried out on the initiative of the INAO.

**THE NUMBER OF  
REPORTS HAS  
MULTIPLIED IN  
RECENT YEARS**

## **FOLLOW-UP OF PERFORMANCE AUDITS**

The INAO seeks to evaluate the results or outcome of performance auditing by examining reactions from the authorities and public bodies to the recommendations stated in the reports. Such follow-ups generally take place approximately three years after a report has been issued. Follow-ups, however, may take place sooner or later from the date of issue of the report. Results are evaluated based on whether the recommendations can be seen to have been implemented fully or partly.



In 2011, the INAO followed up on 12 reports prepared 2006–9 in which 89 principal recommendations were made. Of these, the INAO considered that 68 (76%) had been implemented in full or in part. The Office reiterated 24 recommendations that had not been implemented or which had only been implemented in part. The INAO thereby wishes to urge the Government to act on its recommendations or at least adopt a reasoned view towards such recommendations. A summary of the results of the follow-up of performance audits from 2005–11 may be seen in the table below.

**76% SUCCESS RATE  
IN FOLLOW-UPS IN  
2011**

Follow-up of performance audits 2008–11						
Year	Report	Recommendations	Implemented wholly or in part	Result	With drawn	Reiterated
2008	4 FROM 2005	42	38	90%		
2009	3 FROM 2006	29	22	76%		
2010	5 FROM 2007	45	32	71%	1	21
2011	12 FROM 2006–9	89	68	76%		24
<b>SUM</b>	<b>24</b>	<b>205</b>	<b>160</b>	<b>78%</b>	<b>1</b>	<b>45</b>

The INAO aims to ensure that at least 80% of the aggregate recommendations in the performance audits of each year have been implemented within three years of their publication. According to the table above, this goal has not quite been achieved during the past three years. Nevertheless, the Office is of the opinion that the results are acceptable. In this context it should be kept in mind that the INAO has no control over the reaction of the Central Government to the recommendations stated in its reports. However, the general rule applies that the better the reasoning that supports the recommendation, the more it is likely to be implemented.

## OTHER TASKS

In 2011, the INAO spent approximately 7.200 of its active man-hours on monitoring tasks other than financial auditing or performance auditing. This is equivalent to approximately 9% of the total number of active man-hours during the year, a slightly higher proportion than the year before. These included monitoring the implementation of the Budget, monitoring the finances of political parties and political candidates and monitoring self-owned organisations.

Over 18,000 man-hours were spent on management and support services, which is equivalent to a fifth of the total number of man-hours during the year. This includes the work of the Auditor General, the general operation of the Office, canteen, reception and computer services to employees. This also includes legal consultancy services to the Auditor General and the Office's departments, internal and external communications, publications and international relations.

In total, the employees responsible for support services and monitoring tasks other than financial auditing or performance auditing numbered 14 at year-end 2011.

### MONITORING THE IMPLEMENTATION OF THE GOVERNMENT BUDGET

In addition to regular financial auditing, the INAO is responsible for monitoring the implementation of the Government Budget in accordance with 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 2011, the INAO did not issue a separate report with the results of this monitoring although in recent years the Office has issued 1–2 such reports annually. As of 2012, the Office plans to publish a quarterly report on its monitoring of the implementation of the Government Budget.

### 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. If, however, the total costs of the candidate do not exceed ISK 400,000, it is sufficient for the

**DIVERSITY IN  
MONITORING TASKS**

**THE PLAN IS TO  
PUBLISH A  
QUARTERLY REPORT**

**REPORTING  
OBLIGATION OF  
POLITICAL PARTIES  
AND CANDIDATES**

candidate to submit a written statement thereto. The INAO subsequently publishes a summary of such statements. The accounts of political parties must be audited and certified by an auditor, and the accounts of a candidate must be endorsed by an auditor or an examiner familiar with accounting practices. Both political parties and candidates are not permitted, with some exceptions, however, to accept contributions from legal entities or private persons that exceed ISK 400,000 per year. The financial statements submitted by political parties and the accounts submitted by candidates must specify the name of all legal entities that have made contributions, irrespective of the amount contributed. The names of private persons who have contributed more than ISK 200,000 must also be stated.

In the Act, the political parties are given until 1 October each year to submit the statements of the previous year to the INAO. Not all the parties were able to submit their accounts for 2010 before 1 October 2011. The Social Democratic Alliance (Samfylkingin), the Coalition for the Sovereignty of Iceland (Samtök fullveldissinna), the Best Party (Besti flokkurinn), the Independence Party (Sjálfstæðisflokkurinn), the Progressive Party (Framsóknarflokkurinn) and the Icelandic Movement (Íslands-hreyfingin) all submitted their accounts after the expiry of the deadline. The INAO published a summary of the parties' statements after the Office had reviewed them.

Candidates to the Constitutional Assembly, voted on 27 November 2010, were under obligation to submit information on the contributions and costs of their election campaign to the INAO. Following the Icelandic Supreme Court's decision to invalidate the election, Althingi reversed the Act on the Constitutional Assembly on 7 April 2011. Many candidates had already submitted either their accounts or statements to the effect that their campaign did not exceed ISK 400,000 to the INAO. Information on the submission of the candidates and summaries from the accounts were published on the INAO website. However, as the act had been invalidated, the Office decided not to require the just under 200 candidates who had not yet submitted their accounts to do so.

## MONITORING SELF-OWNED ORGANISATIONS THAT DO NOT ENGAGE IN BUSINESS OPERATIONS

According to Act No. 19/1988 on Funds and Institutions Operating According to Approved Charters, the INAO is responsible for monitoring the entities covered by the Act. These currently number just over 700. Specifically, these are self-owned organisations (foundations) that do not engage in business operations, such as various sponsorship and memorial funds. These entities are under obligation to send their annual financial statements to the INAO, which is responsible for monitoring that they do so. Moreover, the Office is responsible for maintaining a register of these entities. If no statements have been submitted for one calendar year, or if the statements prove to be inadequate in some manner, the INAO is authorised to refer the matter to the relevant district commissioner, who, as appropriate, can ask the police to investigate the finances of the entity in question. In June 2011, the INAO published a list of self-owned organisations and funds operating in accordance with approved charters for the 2009 operating year

ACCOUNTS OF  
CANDIDATES TO THE  
CONSTITUTIONAL  
ASSEMBLY

OVER 700 ENTITIES

## LEGAL OPINIONS

Every year, the INAO must discuss or provide its opinion on various legal questions relating to central government administration and finances. These are generally prepared in connection with the Office's auditing and monitoring tasks and published, in one way or another, in its reports. In 2011, for example, the Office addressed various legal questions in its report *The 2010 Audit of the Central Government Accounts*.

## PUBLICATIONS AND EXTERNAL COMMUNICATIONS

The INAO makes every effort to disseminate information to society in general about itself and its role and operations. This the Office does so by, among other things, publishing reports electronically and by maintaining a website ([www.rikisend.is](http://www.rikisend.is)). The Office makes a particular effort to tailor its reports to the needs of the Althingi, as such reports are intended to be of use to the Althingi in its monitoring of the executive branch.

The INAO's communication policy is in accordance with INTOSAI's standards (ISSAI 20) and takes account of the communication policies of Nordic sister offices. According to the policy, dynamic and high-quality external publication of information is one of the prerequisites of the INAO's ability to fulfil its role and achieve results. It also states that the Office intends to take the initiative in the dissemination of information on its role and activities. The Office has prepared a three-year schedule for external communication, with measureable goals on the basis of the communication policy.

The majority of reports published by the INAO are intended for members of parliament and the public. Thus they have to be accessible and readable to these parties. Readers are not expected to have extensive prior knowledge of the material, although they are expected to know the principal tasks of the Government and the manner in which the administration is arranged. A proportion of the public reports of the Office, however, are specialist reports that are not written for general readers. Nevertheless, an effort is made to have them as accessible and readable as possible.

## INTERNATIONAL RELATIONS

In order to ensure that the operation of the INAO develops in tune with international trends, the Office focuses on good relations and co-operation with its overseas counterparts. The Office has a long history of co-operation with the INAOs of the 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 and associations of which Iceland is a member, such as EFTA. In addition, the Office's staff has actively participated in the work relating to the discussions on Iceland's possible membership of the EU. A representative from the INAO is a member of the negotiation team on financial issues that operates under the auspices of Iceland's main negotiating committee. Finally, it should be noted that employees of the Office have participated in improvement and development projects in the field of government finances that the Icelandic

government has embarked on in collaboration with the International Monetary Fund – IMF.



#### 15 OVERSEAS MEETINGS AND CONFERENCES IN 2011

The employees of the INAO attended a total of 15 meetings and conferences abroad in 2011. Most of the meetings related to the Office's participation in the EFTA Board of Auditors– EBOA of which Ingi K Magnússon, Director of the Auditing Department, is a member. Other meetings and conferences related to Nordic co-operation, the Office's participation in EUROSAI and its participation in the negotiations involving Iceland's application for EU membership.

A number of representatives from overseas sister offices, international bodies and overseas authorities visited the INAO and learnt about its activities. In January, a 14-strong group from the Swedish INAO (Riksrevisionen) came on a visit and was given a tour of the Office's tasks and working practices. In May, the City Auditor of Shanghai in China, Ms. Song Yija, visited the Office.

#### AUDITOR GENERAL RETIRES FROM EUROSAI BOARD

In 2005, the then Auditor General, Sigurdur Thórdarson, was elected to the Board of EUROSAI for 6 years. The current Auditor General, Sveinn Arason, replaced Sigurður on the Board when he retired in 2008. Sveinn's term ended last year and he left the Board formally at the Organisation's conference held in Lisbon in June. In total, Sveinn attended three board meetings of the Organisation between 2008 and 2011.

The Auditor General and two employees of the Office attended the VIII EUROSAI Congress in June 2011 in Lisbon, Portugal. The INAO was one of 12 member offices invited to hold a keynote speech at the congress. Sveinn Arason, the Auditor General, discussed changes to the legal environment and working practices of the Icelandic Financial supervisory Authority (FME) following the report of the Althingi's Special



Investigation Committee and the report that Kaarlo Jännäri, former head of the Finnish Financial Supervisory Authority, prepared for the Icelandic government. After his speech, Sveinn answered questions on a panel and participated in general discussions. The picture shows Sveinn Arason, the Auditor General (on the far right) during the panel discussions.

# 2011 FINANCIAL STATEMENTS

## REPORT OF THE MANAGEMENT AND ENDORSEMENT OF THE FINANCIAL STATEMENTS

The Icelandic National Audit Office operates under the auspices of the Icelandic Parliament according to Act No. 86/1997. Its principal role is to audit central government bodies, state enterprises and other entities responsible for operations on behalf of the Icelandic Government. The Office is also responsible for auditing companies which operations are guaranteed by the Government and companies in which the Treasury holds a share of at least 50%. The National Audit Office monitors the execution of the Government Budget and may conduct performance audits of state entities as authorized by the Legislature.

In the year 2011, the Office's operations generated a deficit of ISK 33.9 million. According to the Balance Sheet, the assets of the Office amounted to ISK 47.1 million, liabilities amounted to ISK 11.0 million, and equity amounted to ISK 36.1 million at year-end 2011.

The Auditor General and the Financial Manager certify the Financial Statements of the National Audit Office for the year 2011 with their signatures.

The Icelandic National Audit Office, 28 February 2012



Sveinn Arason, CPA  
Auditor General



Eythor Borgthorsson  
Financial Manager

## AUDITOR'S REPORT

To the Presidential Committee of the Icelandic Parliament

I have audited the Financial Statements of the Icelandic National Audit Office for the year 2011. 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.

### **Management responsibility for the annual accounts**

The management is responsible for the preparation and presentation of the annual accounts in accordance with the legislation on annual accounts and government financial reporting. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and presentation of financial statements that are free from all material misstatements. Management responsibility also includes applying appropriate accounting principles and estimates that are reasonable under the circumstances.

### **Auditor's responsibility**

My responsibility is to express an opinion on this annual financial statement based on my audit. The audit was conducted according to accepted auditing practices and the provisions of the National Audit Act. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.

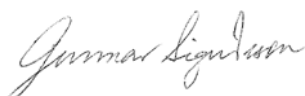
The audit involves performing procedures to obtain audit evidence about the amounts and other information in the financial statements. The selection of audit procedures is based on the professional opinion of the auditor, including whether there is a risk that there may be material misstatements in the financial statement. The audit also includes evaluating the accounting principles and valuation rules applicable to Group A entities and used by management to prepare the financial statements, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **Audit Opinion**

In my opinion, the Financial Statements give a true and fair view of the operation of the National Audit Office in the year 2011, its Balance Sheet as of 31 December 2011 and change in cash during the year 2011, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavik, 28 February 2012



Gunnar Sigurdsson  
Chartered Accountant

## PROFIT AND LOSS ACCOUNT 2011

	2011	2010
<b>Operating revenues</b>		
Sale of services .....	41.650.971	67.206.437
Other income .....	630	3.881
	<u>41.651.601</u>	<u>67.210.318</u>
<b>Operating expenses</b>		
Salaries and related expenses .....	366.978.442	349.014.391
Administrative expenses .....	9.269.648	10.935.183
Meeting and travel cost .....	10.012.709	8.891.913
Expert services .....	59.724.265	69.590.882
Operations of equipments .....	1.445.817	1.913.986
Other operating expenses .....	4.889.424	5.379.711
Housing .....	24.932.854	25.654.008
Operation of vehicles .....	566.126	637.766
Grants .....	1.475.000	11.225
	<u>479.294.285</u>	<u>472.029.065</u>
Purchased assets .....	2.013.781	3.187.132
	<u>481.308.066</u>	<u>475.216.197</u>
<b>Operating profit (-loss) before Treasury contribution</b>	( 439.656.465 )	( 408.005.879 )
Treasury Contribution .....	<u>405.800.000</u>	<u>424.800.000</u>
<b>Profit for the year</b>	<u>( 33.856.465 )</u>	<u>16.794.121</u>

## BALANCE SHEET, 31 DECEMBER 2011 (ISK)

	2011	2010
<b>Assets</b>		
<b>Current assets</b>		
Treasury .....	34.692.049	67.414.835
Accounts receivable .....	12.244.387	9.104.779
Cash and cash equivalents .....	159.569	268.174
	<u>47.096.005</u>	<u>76.787.788</u>
<b>Total assets</b>	<u>47.096.005</u>	<u>76.787.788</u>
 <b>Equity and Liabilities</b>		
<b>Equity</b>		
<i>Equity:</i>		
Equity at the beginning of the year .....	69.925.177	53.131.056
Profit for the year .....	( 33.856.465 )	16.794.121
<b>Equity</b>	<u>36.068.712</u>	<u>69.925.177</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable .....	11.027.293	6.862.611
<b>Liabilities</b>	<u>11.027.293</u>	<u>6.862.611</u>
<b>Total equity and liabilities</b>	<u>47.096.005</u>	<u>76.787.788</u>

## CASH FLOW STATEMENT 2011

	2011	2010
<b>Cash flow from operations</b>		
<i>Cash flow from operating activities:</i>		
Profit.....	( 33.856.465 )	16.794.121
<b><i>Cash flow from operating activities</i></b>	<b>( 33.856.465 )</b>	<b>16.794.121</b>
<i>Changes in current assets and liabilities:</i>		
Accounts receivable, decrease / (increase).....	( 3.139.608 )	39.032.493
Accounts payable, (decrease) / increase.....	4.164.682	( 36.258.366 )
	<u>1.025.074</u>	<u>2.774.127</u>
<b>Net cash provided by operating activities</b>	<b>( 32.831.391 )</b>	<b>19.568.248</b>
<b>Cash flow from financial activities</b>		
<i>Changes in balance with the Treasury:</i>		
Treasury contribution.....	( 405.800.000 )	( 424.800.000 )
Received from the Treasury.....	438.522.786	405.409.162
<b>Net cash from financing activity</b>	<b>32.722.786</b>	<b>( 19.390.838 )</b>
<b>Net increase in cash and cash equivalents.....</b>	<b>( 108.605 )</b>	<b>177.410</b>
<b>Cash and cash equivalents at the beginning of the year.....</b>	<b>268.174</b>	<b>90.764</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>159.569</b>	<b>268.174</b>



# NOTES

## Accounting Policy

### Basis for the Financial Statements

The Financial Statements of the National Audit Office have been prepared in accordance with the Government Financial Reporting Act No. 88/1997, the Annual Accounts Act No. 3/2006, and the Government Regulation on the Presentation and Contents of Annual Accounts and Consolidated Financial Statements No. 696/1996.

According to the Government Financial Reporting Act, Group A entities shall not capitalise fixed assets, but charge them as expenses at the year of purchase. They shall generally not engage in long-term borrowing and may not undertake long-term obligations unless authorised by the Government Budget.

### Tax

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

### Recording of Revenue

The Office's revenue is recorded in the month in which invoices are issued.

### Recording of Expenses

Expenses are generally entered when invoices are received by the Office.

### Operating Divisions

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

### Accounts receivable

Accounts receivable 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 accounting principles of Group A of the Treasury, pension liabilities are not recorded in the annual accounts of individual Group A entities, but are recorded as one whole at the Treasury.

### Accounts Payable

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

## Accounting and Payment Functions

The State Accounting Office handles payroll matters, accounting and payment services for the Office.

## NOTES

### Budget and Operations

The Office's budget for 2011 anticipated similar activities as in the previous year. The Office's total budget was ISK 405.8 million.

Operating expenses less sale of services totalled ISK 439.7 million and were ISK 33.9 million more than budget. Operating expenses are specified as follows:

In ISK thousand	Initial	Total budget	Financial Statements	Differences
Sales of services .....	( 34.100)	( 34.100)	( 41.652)	7.552
Salary and salary-related expenses .....	331.500	344.400	366.978	( 22.578)
Other operating expenses .....	94.600	94.600	112.316	( 17.716)
	392.000	404.900	437.642	( 32.742)
Purchased assets .....	900	900	2.014	( 1.114)
	392.900	405.800	439.656	( 33.856)

### Break-down in ISK thousand by type:

	2011	2010
Sales of services .....	( 41.652)	( 67.210)
101 Icelandic National Audit Office .....	479.294	472.029
601 Equipment .....	2.014	3.187
	439.656	408.006