



ANNUAL REPORT 2006

Icelandic National Audit Office

# Annual Report 2006



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*Annual Report 2006*

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# Contents

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<b>INTRODUCTION BY THE AUDITOR GENERAL</b> .....	5
<b>MISSION AND OBJECTIVES</b> .....	7
<b>OPERATIONS IN 2006</b> .....	9
FINANCIAL AUDITING.....	10
INTERNAL CONTROL.....	11
IT AUDITING.....	11
PERFORMANCE AUDIT.....	12
LEGAL AND ENVIRONMENTAL DIVISION.....	13
STAFF.....	14
FINANCES AND EXPENDITURE.....	14
INTERNATIONAL RELATIONS.....	15
<b>30TH ANNIVERSARY OF THE LIMA DECLARATION</b> .....	17
<b>PUBLIC SERVICES</b> .....	19
<b>IT AUDITING</b> .....	21
<b>FRAUD IN THE WORKPLACE</b> .....	23
<b>INDICATORS OF ACTIVITIES AND PERFORMANCE</b> .....	25
THE OFFICE'S SERVICES.....	25
INTERNAL PROCESSES.....	28
STAFF AND DEVELOPMENT.....	29
FINANCE.....	32
<b>PUBLIC REPORTS 2006</b> .....	33
<b>FINANCIAL STATEMENTS 2006</b> .....	34



*The National Audit Office, Skulagata 57, Reykjavik*

# Introduction by the Auditor General

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SIGURDUR THÓRDARSON

ACCORDING TO LAW, the National Audit Office has a very broad mandate. The Office may request financial statements from public bodies, associations, funds and other entities that receive government funds. Furthermore, the Office has access to original documents to verify the content of invoices and payment obligations. The Office may also request reports on the use of grants and other public money.

In recent years, the National Audit Office has managed to audit and certify the annual accounts of almost all government bodies. Currently, there are over 400 such bodies. The Office has not, however, managed to adequately follow up on examining and confirming that funds allocated by the Althingi to bodies outside the public sector are in fact used to provide required services or whether grants are used for their intended purposes.

The government has entered into contracts with a large number of parties outside the public sector and has allocated substantial amounts to such parties. The National Audit Office has not audited the majority of these contracts or requested information on the disposal of the funds. In order for the Office to discharge its statutory duties in this field, it is necessary to make a particular effort to cover these matters. This will be done by, on the one hand, by directing a larger share of the current work to these areas and, on the other, by seeking additional funds.

In 2006, the National Audit Office published the guideline *Indicators of Fraud*. The aim of the Office with the publication of such guidelines is to show managers and employees of central government bodies ways of improving management and efficiency. This publication points out three main reasons why individuals misuse the funds of public bodies or enterprises. The first is the incentive of the perpetrators to obtain increased funds for themselves. The second is the opportunity which arises if supervision of the funds or assets is insufficient, and the third is the impaired moral values of the perpetrator. It is important to fight financial misconduct as energetically as possible. In its publication, the National Audit Office points out several measures that have been useful for managers of enterprises and public bodies in this respect.

During my nearly forty years within the public sector, my experience is that government employees are generally responsible and honest people. Fortunately, exceptions are few, and it is rare that employees give in to the temptation to misuse funds they are entrusted with. Nevertheless, it is important to use systematic measures to lessen the likelihood of financial misconduct. In the near future, the National Audit Office will place particular emphasis on actions to prevent such infringements when reviewing internal auditing in ministries and public bodies.

Many of our overseas counterparts have formal policies on how to carry out project selection and will establish their priorities several years at a time. Such formulation ensures that limited funds and efforts are used as efficiently as possible. At the same time, it means



that there is a greater stability and continuity in the operation than would otherwise have been the case. As yet, the National Audit Office has only minimally organised its operation for terms longer than one year at a time. This will, however, change in the near future. In the future, it is anticipated that guidelines for the work will be prepared in a three-year plan, in which the principal tasks for each period and the aspects of finances and management to be emphasised will be stated. A framework programme has already been prepared for performance auditing, and a comparable programme is being prepared for financial auditing.

The operation and results of the National Audit Office in 2006 were, in all principal respects, similar to those of 2005, and in both cases, the number of man-years was just over 49. However, there were an unusual number of changes in human resources, and employee turnover was 15%, as compared with 10% in 2005. In the years preceding 2005, employee turnover in the Office was negligible. This development is somewhat in tune with general developments in Icelandic companies. A high rate of employee turnover, particularly among employees with little professional experience, is costly when account is taken of the time it takes to train them, even if they are specialists. In addition, the knowledge gained through professional experience is not repaid in their future positions.

Total expenditures of the National Audit Office in 2006 amounted to ISK 402 million, as compared with ISK 376 million in 2005. This is an increase of approximately 6.9%. User fees amounted to ISK 29 million, decreasing by ISK 5 million from the year before. Thus, expenditures in excess of user fees amounted to ISK 373 million, an increase of ISK 31 million from 2005, up by 9.1%. State contributions amounted to ISK 393 million. Therefore, the budget surplus in 2006 amounted to ISK 20 million, which is an improvement of ISK 2 million from 2005. At year-end 2006, there was an ISK 38.8 million surplus on the principal, which is 9.9% of the budget appropriation for 2006.



*From a staff meeting at the National Audit Office*

# Mission and Objectives

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THE NATIONAL AUDIT OFFICE is an independent body operating under the auspices of the Althingi (Iceland's parliament) and is responsible for the auditing of the Central Government Accounts and the accounts of entities that are responsible for operations and finances on behalf of the Government. Moreover, the Office may carry out performance audits and may audit environmental projects. Finally, the Office is responsible for monitoring the implementation of the Government Budget and provides both parliamentary committees and government bodies with assistance in work related to public finances.

The National Audit Act No. 86/1997 clearly stipulates that the Office is independent in carrying out its duties and that its staff shall be completely independent of the entities under audit. However, the Presidential Committee of the Althingi may, either on its own initiative or in accordance with requests from Members of Parliament, call for reports from the Office on any specific matter falling under the Office's mandate. In such cases, the Office decides how to prepare and write the report. The Presidential Committee also appoints the head of the Office, the Auditor General, for a term of 6 years. The Auditor General recruits other staff.

According to legislation, the National Audit Office has a very broad mandate. It may call for financial statements from public bodies, associations, funds and other bodies that receive Government funds or guarantees. Furthermore, it is permitted access to original documents or 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, it may request reports on the disposal of grants and other contributions of public money and assess whether the contributions have achieved the intended results.

The Office accounts for most of its projects in reports or opinions. These are, as a rule, sent to the audited bodies and ministries to which they belong. Some reports are also made public and sent to the Althingi. This applies in particular to performance audit reports and the Office's yearly report on its audit of the Central Government Accounts. The delivery of its reports normally marks the conclusion of its work on the project in question. In some cases, however, the Office finds that it has to correct comments or statements that are made about its reports. Furthermore, the Office monitors the reactions of the audited party to its comments. This may lead to a new audit.

A large part of the Office's audit work is statutory. In other respects, the Office decides and plans its projects based on their financial scope and its own assessment of importance, risk and possible improvements. As with other Supreme Audit Institutions, its principal aim is to improve public administration and management of government funds and promote the prudent use of these funds for the benefit of the general public.

The Office bases its work on Icelandic law and internationally accepted accounting standards. These are intended to ensure sound procedures in the auditing of public bodies. Furthermore, the Office has established a Code of Conduct for its staff, based partly on the Code of Ethics of the International Organisation of Supreme Audit Institutions (INTOSAI). Our four values are: credibility, independence, integrity and professionalism.





*Some of the employees of the National Audit Office*

# Operations in 2006

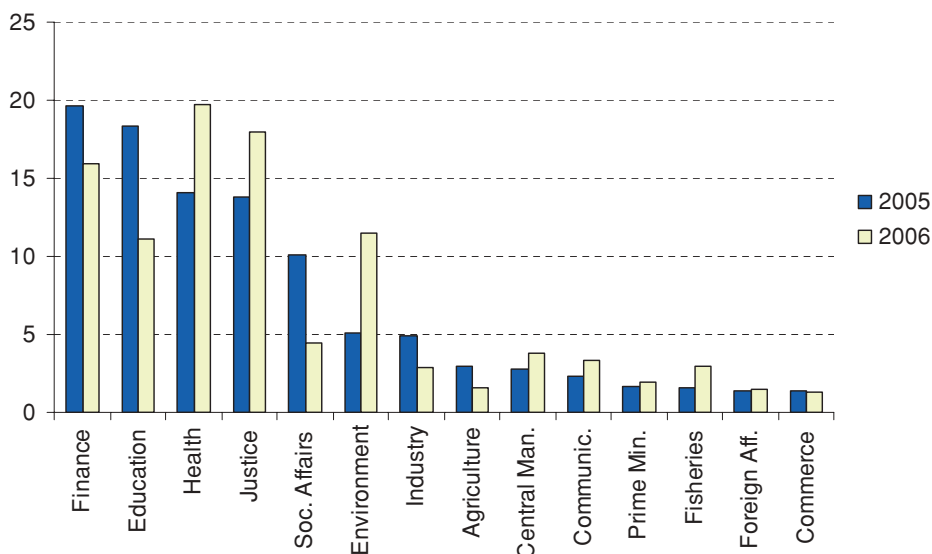
THE NATIONAL AUDIT OFFICE delivered approximately the same number of man-years in 2006 as in 2005, i.e. just over 49. This is three man-years fewer than projected. In broad terms, the operation of the Office and its results were similar to those of recent years. However, there were unusual changes in human resources, and staff turnover was 14.9%.

In 2006, active man-hours in auditing-related work numbered approximately 72,600, i.e. 1,400 (1.9%) fewer than in 2005. In addition, the Office purchased services from 14 auditing firms, corresponding to 3,650 man-hours, compared with 3,722 hours in 2005. In total, therefore, the staff of the National Audit Office, and others who worked on its behalf, delivered 76,250 man-hours in auditing in 2006.

As usual, the Office spent most of the time on financial auditing, or approximately 58% of all active man-hours in auditing. Approximately 17% was spent on performance audits, 6% on internal controls, 6% on IT audits, 6% on legal and environmental projects and 7% on management and other projects such as quality monitoring and assistance to other divisions of the Office. In comparison with other Supreme Audit Institutions in neighbouring countries, the proportion of financial auditing is rather high, as the National Audit Office endorses the annual accounts of the majority of public bodies and enterprises. In other countries, comparable auditing offices generally make do with a sample. The proportion of performance auditing in other countries' offices is generally greater than in Iceland.

In 2006, the National Audit Office spent 54,500 hours auditing individual ministries and their public bodies. This is approximately 2,000 hours fewer than in 2005. This year, the greatest amount of time was spent on auditing budgetary items that come under the Ministry of Health and Social Security (19.7%), the Ministry of Justice (18%), the Ministry of Finance (15.9%), the Ministry for the Environment (11.5%) and the Ministry of Education (11.1%).

Proportional division of working hours by ministry



As usual, there was some transfer of hours between ministries from the previous year. This time, the greatest proportional increase was in the hours spent in auditing budgetary items that come under the Environment, Justice and Health Ministries. The hours spent on auditing the budgets of the Ministry of Education, the Ministry of Social Affairs and the Ministry of Finance, on the other hand, dropped. As may be expected, the greatest amount of time is spent on auditing the Ministries responsible for the largest and most cost-intensive issues.



*Linda Sigurdardóttir is responsible for monitoring funds*

## Financial Auditing

According to law, the National Audit Office shall audit the Central Government Accounts and the accounts of the bodies responsible for operations and finances on behalf of the State, whether public bodies and enterprises or private entities from whom the State purchases mandatory services. The goal of the audit is to assess whether the accounts give a clear view of operations and financial positions in accordance with generally accepted accounting principles; to examine the internal controls of public bodies and enterprises and whether they ensure acceptable results; to ensure that accounts are in compliance with the Fiscal Budget, the Supplementary Fiscal Budget and other Acts, lawful instructions and contracts; and to scrutinise and certify the reliability of key indicators of the scope and results of the operation of public bodies if they appear in the annual accounts. In these activities, the National Audit Office uses accepted principles for financial auditing, i.e. the INTOSAI auditing standards and the standards followed by auditors working in other fields.

The National Audit Office published an overall summary of its work in this respect in the report *Audit of the Central Government Accounts 2005*. In addition to certifying the reliability of the financial information stated in the Central Government Accounts, the National Audit Office reported on the financial auditing of 418 public bodies and enter-

prises. As usual, there were various comments issued in this respect, among others to 54 institutions where expenses exceeded the budget appropriations set by Government Regulation on the Implementation of the National Budget by 4% or more. Furthermore, emphasis was placed on public bodies operating in accordance with the principles of risk management, strengthening their internal controls and taking necessary security measures with respect to their information systems. Finally, the report contains the principal results of the annual survey performed by the Office on selected items in the operation of public bodies. The following issues were addressed this time: income registration, operation of canteens and food allowances and accompanying documents (invoices) of public bodies and enterprises. These items were examined in approximately 260 public entities. The survey should provide a fairly clear image of the actual position of these matters.

In the report *The Implementation of the Government Budget in 2005*, the income and the expenses of the State Treasury for 2005 are compared with budget appropriations according to the State Budget and the same period from the previous year, and an examination made of the position of the public bodies and budgetary items of several selected ministries. Moreover, an account is given for the Treasury's contracts with respect to such expenses in a short report titled *Restructuring and Composition of Public Expenditures 2005*.

## Internal Control

In addition to examining the internal controls of public bodies and enterprises, the National Audit Office has sought to educate their management on what internal controls involve, as well as the principal risk elements in public sector operation. Among the things particularly pointed out in the past are the risks involved if a public body or enterprise does not achieve its goals, particularly its service goals with respect to the general public and the business sector.

The internal control audits of the National Audit Office have revealed that many public bodies have taken action in order to cope with sensitive activities in their own operations. In general, however, they have not defined the risk factors they face or prepared a formal risk assessment. This lack of risk analysis, formal risk assessment and decisions on actions may cause damages and prevent public bodies from achieving their goals.

Nine extensive reports on internal controls were completed by the National Audit Office during the year. In recent years, such reports have numbered 2 to 6. This is, therefore, a considerable increase in the number of reports. The Office's internal control reports are never made public, as they often deal with the sensitive internal issues of the audited body. Furthermore, the employees of internal control participated in the preparation of three official reports: *Restructuring and Composition of Public Expenditures 2005*, *The Implementation of the Government Budget* and *The Audit of the Central Government Accounts*.

## IT Auditing

IT auditing is closely linked to both the financial auditing and the internal controls of the National Audit Office. The goal of this field of auditing is to examine whether computer and information systems of central government bodies are secure and efficient and to point out what improvements can be made. In 2006, work was started on several reports

and commentaries, three of which were completed. Furthermore, employees of the Division participated in other projects. Reports on the audit of information systems are sent only to the public bodies being audited and to the relevant ministry, as such reports regularly involve information on the sensitive internal issues of the public bodies, e.g. on the security of information and computer systems. Moreover, the Division prepared the guideline *Indicators of Fraud*.

In addition to handling IT auditing, employees of the Division examined computer-related issues in various auditing projects carried out by other divisions within the Office. Furthermore, a considerable amount of work went into assisting Financial Auditing staff with computer issues due to the implementation of a new financial system adopted in the State Accounting Office in 2005, some for example related to formatting outputs from the system. Moreover, the Division was responsible for running the National Audit Office's own computer systems.

## Performance Audit

Through its performance audits, the National Audit Office seeks to monitor and evaluate the handling and utilisation of public spending, i.e. whether government bodies and enterprises ensure economy and efficiency in their activities and comply with applicable legal requirements in this respect. 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. A proportion of the audits are, as a rule, performed at the request of the Presidential Committee of the Althingi, individual ministries or public bodies. Others are performed on the initiative of the National Audit Office, and the matters addressed are selected among other things according to their financial scope, risk assessment, scope for improvement and earlier audits performed by the Office.

In recent years, performance audits of the National Audit Office have especially been directed toward health and social security matters, financial matters and educational matters, as public spending is highest in these areas. In the work plan for 2007–2009, however, the intention is to place increased emphasis on the following sectors: labour market issues, family and welfare issues, policing and legal systems, overseas economic aid and peacekeeping, foreign services, public finances and administration and fisheries issues. Particular attention will be paid to performance management, the productivity of the labour force and finances, processing and turnaround times, organisational structure and division of tasks and responsibility, quality of service and human resources management.

In 2006, three extensive reports were completed in the field of performance auditing: *Verkmenntaskóli Austurlands. Finances and Operations 2002–2005*, *The Environment and Food Agency of Iceland. Performance Audit* and *The National Commissioner of the Icelandic Police. Performance Audit*, as well as several smaller reports, including *The Hvalfjörður Tunnel and Sundabraut. Assessment of the advantages and disadvantages of private construction*. These are fewer reports than in recent years, a fact attributable, among other things, to considerable changes in the staff of the Performance Audit Division, as well as organisational changes within the Office. Three additional reports were, in fact, well on their way to completion at the end of the year. Moreover, several smaller projects were underway, among others, a review of the reaction of public bodies to recommendations made in the reports of the National Audit Office in 2003.



In recent years, the National Audit Office has sought to strengthen its performance audits and the recommendations put forward therein with various types of comparisons, both Icelandic and foreign. A good example of this is the report *The National Commissioner of the Icelandic Police*, where, for example, the processing time of economic crimes is compared with processing times in Norway and Sweden. The reports, therefore, provide not only specific information about individual bodies, but also information on their position within the field to which they belong or even on the position of a particular field as a whole.

## Legal and Environmental Division

The operation of the Legal and Environmental Division was similar in 2006 to that of previous years. In addition to monitoring legally chartered funds and entities, a considerable number of its projects involved consultation services and preparing reports on diverse questions relating to central governmental administration. This Division was moreover engaged in several projects in the field of environmental auditing, where attention is given to diverse obligations, goals, plans and actions which have an effect, or could have an effect, on the environment. One of these projects was discussed in a public report at the beginning of the year: *The Convention on Biological Diversity. Environmental Audit*. Moreover, the reports *Notes due to new data on the sale of the State's share in Búnadarbankinn*, *The privatisation of public bodies* and *The Environment and Food Agency of Iceland. Performance Audit* were partly or wholly prepared within this Division.



*Brynja Pétursdóttir, Kristinn Hermannsson and Hólmfríður Kristinsdóttir in the Cafeteria of the National Audit Office*



## Staff

On 31 December 2006, there were a total of 47 permanently employed members of staff working for the National Audit Office, two less than on 31 December 2005. In addition, several worked for part of the year. Man-years were almost the same as in 2005, that is just more than 49. Seven employees retired in 2006, and were replaced by five new recruits. Staff turnover was therefore approximately 14.9%, which is an unusually high proportion when compared with recent years.

Of permanent staff, males are 27 (57.4%) and females 20 (42.6%). This is a similar ratio as in the past three years. If only management positions and experts are taken into account, then males accounted for 64% and females 36%. The average age of the staff was 48.7 years, an increase of just less than one year from 2005. Moreover, the average length of service was 11.5 years. A total of 80.9% of employees had at least 3 years' work experience at the Office.

The Office is committed to hiring well-educated staff, and its percentage of employees with a university degree has stayed close to 80% in the past few years. The majority, or 27, hold a degree in business administration. Five hold degrees in political or administrative sciences, and there are three economists, two lawyers and one employee with a degree in Icelandic studies. There are currently 6 certified accountants employed by the Office, two with certification in internal auditing (CIA) and one with certification in IT auditing (CISA).

## Finances and Expenditure

The National Audit Office's budgetary appropriation under the 2006 Government Budget and Supplementary Budgets totalled ISK 393 million, an increase of 33 million, or 9.2%, from the preceding year. Total expenditures net of user fees, on the other hand, were ISK 373 million, up by ISK 31 million, or 9.1%, from 2005. Thus the Office kept within budget by ISK 20 million (5.4%).

As the summary of the income statement shows, payroll costs rose by ISK 9 million (3.1%) between years and amounted to 81% of the expenses of the Office, net of user fees. Operating costs and purchased assets, however, increased by a total of ISK 17 million (20.2%). The largest single operating cost item is bought-in expert services from 14 audit firms, for just under ISK 39 million. User fees, on the other hand, were ISK 5 million (14.7%) lower than in 2005.

Profit and loss account in ISK millions	Year		Change	
	2006	2005	Amount	%
Items				
Payroll	301	292	9	3.1
Other operating expenses	93	81	12	14.8
Purchased assets	8	3	5	66.7
<b>Total costs</b>	<b>402</b>	<b>376</b>	<b>26</b>	<b>6.9</b>
User fees	29	34	-5	-14.7
Costs net of user fees	373	342	31	9.1
State contribution	393	360	33	9.2
<b>Surplus</b>	<b>20</b>	<b>18</b>	<b>2</b>	<b>11.1</b>

The costs incurred by the Office's individual operating divisions were as follows: The Financial Audit Divisions cost ISK 193 million, i.e. 51.6% of the Office's expenses; the Performance Audit Division, the IT Division and Internal Controls Division cost ISK 128 million (34.3%); the Legal and Environmental Division cost ISK 27 million (7.1%); and Central Management cost ISK 26 million (7%). This is a similar proportion as in the past few years. There was a slight transfer (4-5%), however, from the auditing divisions to other divisions. Total costs for each full-time equivalent position were ISK 7.6 million, an increase of ISK 600,000 (10.9%) from the preceding year.

## International Relations

International relations are of extreme importance in enabling the National Audit Office to acquaint itself with the most up-to-date methods and procedures for auditing public bodies. In this manner, among others, the Office ensures that its employees are able to meet the diverse demands made of them. Moreover, steadily increasing international trade, as well as the increasing effects of multinational organisations and agreements, have obviously demanded increased harmonisation and collaboration in auditing between nations. Evidence of this can be seen in international auditing and accounting standards and the impact such standards have on the legislation of individual nations. This international integration can also be seen in various types of co-operative projects in auditing multinational institutions and partnerships, such as the European Union, or projects that extend across traditional borders, such as environmental projects or international aid. Finally, the increased participation of Iceland in developmental projects has placed obligations on the National Audit Office to audit such projects on behalf of the Icelandic Government and assist other nations in professional development in auditing.

As in recent years, the National Audit Office participated in diverse international co-operation in 2006. The largest single event of this nature in which the Office participated was the XXXI Board Meeting of the European Organisation of Supreme Audit Institutions (EUROSAI), held in Reykjavík on 11 September. The meeting was attended by approxi-



*From the XXXI Board Meeting of EUROSAI in Reykjavík in 2006*

mately 40 members from 15 European countries, i.e. Auditors General from all eight countries which have a seat on the Board of the Organisation, including Sigurdur Thórdarson, Auditor General, and observers from seven other countries, as well as assistants. Among the subjects discussed were the operation of the institutions over the past year and their future projects. In 2006, the Auditor General also attended the 1st Conference of EUROSAI-ARABOSAI in Tunis, where discussions took place on privatisation and its effects on the operation of public services. Moreover, one member of staff attended the annual meeting of the EUROSAI Environmental Committee; and two other members of staff attended meetings held by EUROSAI on the Implementation of Government Budgets and on Information on Transparency and Tax Discounts.

As regards Nordic co-operation, particular note may be made of the annual working meeting of Nordic Auditors General and co-operative representatives of the Institutions held in Stockholm on 27 to 29 August. Moreover, three members of the Office's staff attended the working meeting of the Nordic Audit Offices on performance auditing in Denmark. Here in Iceland, two other working meetings of these Institutions were held, on the one hand on information sharing and, on the other, on human resources and retraining.

Finally, it may be noted that three members of staff visited the UK National Audit Office and acquainted themselves with policy formulation and planning in performance auditing. Moreover, the Auditor General paid a brief visit to the National Audit Office of the People's Republic of China.

Among the international auditing projects in which the National Audit Office participated in 2006 was the audit of EFTA. Furthermore, the Office has, for a number of years, audited development projects in Africa which are supported by ICEIDA. Finally, it may be mentioned that in late 2006, preparations began on a pan-European examination of the actions taken by nations to stimulate the employment participation of the disabled. The National Audit Office will be participating in this project.



*Lárus Ögmundsson and Margrét E. Arnórsdóttir compare notes*

# 30th Anniversary of the Lima Declaration

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THIS AUTUMN will mark 30 years since the International Organisation of Supreme Audit Institutions (INTOSAI) approved the “Lima Declaration of Guidelines on Auditing Precepts” at its IX meeting in Lima in Peru.

The Lima Declaration has long been considered one of the most reliable cornerstones of high-quality public auditing, and its value is, first and foremost, to be found in the concise but comprehensive summary of the position and scope of authority of these activities within the public sector, its goals, principal tasks, powers of investigation and the manner in which the audits shall be performed. Among other things, account was taken of the Declaration when the Icelandic Althingi enacted, for the first time, the National Audit Office Act in 1986 and laid down the main goals in its activities. Therefore, this Declaration has, without a doubt, considerable value for the Office and its activities.

The Lima Declaration clearly states the importance of providing National Audit Offices with the necessary legal protection against any form of interference that could effect their independence and their ability to accomplish their auditing tasks. This means, i.a. that they shall have complete independence from the executive branch of government and its public bodies, i.e. that they are in all respects independent of the parties being audited and the authorities to which they are subject. This means both financial independence and that the Supreme Audit Institutions have substantial authority in deciding how they select their tasks and the manner in which they perform their auditing activities and preparation of reports. Likewise, they must be unbound by the instructions or requests of others, even when they operate under the authority of the legislature and undertake auditing activities according to its instruction.

These requirements of independence mentioned here are clearly stated in the current National Audit Act No. 86/1997. The Act not only states the principal role of the Office, its obligations and tasks, but also places a great deal of emphasis on the fact that it is “independent in carrying out its duties” and that its staff “shall be completely independent of those Ministries and organisations where the audit is being carried out”. It is also pointed out that the Office decides for itself “where and when auditing shall be carried out”. The Presidential Committee of the Althingi may, however, call for reports on specific matters that fall under the mandate of the Office, and in such cases, the Office shall decide its own approach.

The independence and impartiality of the National Audit Office is, without a doubt, the principal basis for the trust it enjoys in society and its ability to carry out its surveillance duties in such a manner that no doubt is cast on its impartiality and credibility. The Office must reiterate this position in all its activities. This is best done by following fully the laws and regulations applicable to the Office and generally accepted auditing standards.

The Lima Declaration states that the specific objective of auditing is to promote the proper and effective use of public funds. This, the Offices shall do by revealing deviations from

accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of State financial management. Moreover, they shall seek, as far as possible, to recommend necessary improvements in these matters, make those accountable accept responsibility or point out measures that can be taken to prevent the recurrence of such violations. Furthermore, the Supreme Audit Institutions may also evaluate the performance of public bodies or the central government in individual projects. In all these activities, however, the Supreme Audit Institutions are under obligation to state the views of the parties being audited and to provide them with the opportunity to submit comments to the results of the audit within specified time limits.

From what has been stated in the above, it may be inferred that the Supreme Audit Institutions shall have very extensive authorisation to audit the finances and performance of public bodies and entities that the State supports or purchases mandatory services from, and examine whether they comply with laws and regulations applicable to the operation. It also reveals that the Institutions shall approach their tasks in a critical though objective and fair manner. The goal is to promote sound financial management and organised public administration, i.e. effective use of public money and good and efficient services.



*Vidar H. Jónsson performing a financial audit*



# Public Services

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THE PRINCIPAL GOAL in public operations is to provide public services. According to legislation, the National Audit Office shall monitor these services, both the services provided by public bodies and enterprises, as well as the services provided by municipalities and private entities which are paid, in part or wholly, by the State.

In addition to certifying the accounts of these entities, the National Audit Office is authorised to evaluate the direct results or benefits of their activities, i.e. whether Treasury funds are spent in an economical and efficient manner and in accordance with the provisions of laws, regulations and the applicable work or service contract, if such contracts have been made. One aspect in such audits is to assess the manner in which the service is provided and whether it is possible or even necessary to strengthen the service or improve in any way. The National Audit Office plans to place increased emphasis on such aspects in coming years in its performance audits.

The following reports issued by the National Audit Office: *The National Commissioner of the Icelandic Police* (2006), *Services to the elderly* (2005), *Pharmaceutical costs: Use, pricing and supply of pharmaceuticals in Iceland* (2004), *FSA University Hospital* (2004), *The Merger of the Reykjavík Hospitals* (2003) and *Sólheimar in Grímsnes* (2002), give an account on several performance audits that partly or wholly relate to public services. The reports address the time it takes administrative and service institutions to process matters submitted by the public or to meet their legitimate requirements for services, the efficiency and quality of these services and the cost they may entail, both for the Treasury and those who require the services.

Assessments of services is inevitably problematic to some extent, although as a basis for reference, the National Audit Office takes account of, among other things, the goals of the authorities or the public bodies themselves on how the services shall be provided, available standards applicable to such provision and the manner in which such matters are conducted in countries that Icelanders compare themselves with. Account is also taken of the attitudes of users, or demand for services, and whether it can be considered that lawful impartiality is ensured, e.g. whether citizens generally have equal access to mandatory services, irrespective of location or their physical and mental condition or ability. Finally, account has been taken of whether there is any substantial difference between the nature, scope, quality and price of the services provided depending on who provides them.

For obvious reasons, the National Audit Office should not encourage increased expenses for the Treasury with its audit reports and the comments and recommendations put forward therein, irrespective of whether they relate to services to the public or other operational aspects. Rather, the Office shall promote economy in operation and favourable use of resources, i.e. that citizens receive as good, efficient and much service as is possible to provide for the amount that the central government has agreed to allocate. For this reason, the proposals of the National Audit Office generally indicate some form of restructuring, such as through the improved organisation of service institutions and their increased co-operation or division of responsibilities, and that they prioritise their tasks according to importance or choose cheaper or more economical solutions than have previously been



chosen without, however, lessening the services in any way. In some of its reports, however, the Office has pointed out the necessity of the central government defining some form of minimum criteria with respect to the services provided and paid for, to ensure that all those entitled to the service have equal access and receive equal amounts and good services within the time generally considered reasonable.

In its reports and other comments on public services, the National Audit Office has generally emphasized that the central government make written work or service contracts with the parties providing mandatory services in exchange for payment and monitoring that the funds allocated by the Treasury are used as intended. It is unacceptable for contractors to decide for themselves the manner in which these funds are disposed of. It is important that such contracts clearly state what the service shall involve, its scope, volume and quality. Moreover, such contracts shall state the minimum requirements made of the service provider with respect to professional knowledge and appropriate facilities for the service. Furthermore, the central government must monitor closely that all income and expenses are entered into the accounts of the service provider and that the expenses are in accordance with the scope and the nature of the operation. Finally, the manner in which to react to disputes between the contracting parties or defaults of the contract must be clear.



*Ingunn Ólafsdóttir, Óli Jón Jónsson, Margrét E. Arnórsdóttir and Snorri Gunnarsson discuss performance audits*

THE MAIN GOAL of the National Audit Office in auditing information systems is, for the most part, twofold. On the one hand, it is a part of general financial auditing. On the other, it is a part of the internal controls of public bodies.

As a part of normal financial auditing, IT auditing is intended to examine whether the information systems of public bodies and enterprises are in accordance with the needs of the operation, operate in a normal fashion and contain correct and adequate accounts. In this respect, its object is to confirm the scope and reliability of the items stated in the annual accounts and to certify the operating results of the operation. As a part of internal controls, however, it is intended to examine and evaluate whether the information systems of public bodies and enterprises are technically so secure that break-downs; interruptions; and human error or external interference, such as break-ins and computer viruses, do not harm the operation, or that dishonest people cannot use the systems in an illegal manner, such as to profit at the cost of other individuals, enterprises or tax-payers or to access personal information to which they are not entitled.

It is clear that information and computer technology plays a key role in the basic services of a great many public bodies and enterprises, both here in Iceland and elsewhere. This technology has, without a doubt, opened many new and exiting ways to streamline operations and decrease costs, while at the same time increasing and improving services to customers. Good examples of this are various forms of electronic services, e.g. electronic transactions which can be undertaken almost wherever and whenever one chooses and thus save both service providers and their customers time and effort, in addition to the direct cost involved on mailing payment invoices. The more important that such services are in the operation of public bodies and enterprises, the more important it is that the information systems used are properly operated and properly audited.

There is no doubt that electronic transactions have, in some respects, made the work of auditors easier, as automatic registrations have clearly decreased the risk of human error, such as incorrect accounting, when entering figures or when balancing accounts. The risk, however, has increased substantially in other fields. Using electronic transactions, for instance, has substantially decreased the quantity of traditional auditing evidence, i.e. signed and pre-numbered paper documents. At the same time, the formal distinction between a superior, a cashier and an accountant has altered. Conditions may even occur within enterprises where the same employee can, in a single action, order a product, pay for it and enter the transaction into the accounts. Finally, personal relations with customers have decreased and in some cases do not exist at all. Due to all this, auditors must increasingly take into account the security and monitoring aspects that are built into the information systems used, such as electronic signatures, access limitations, personal passwords, error testing and computer log books, where it is possible to see, among other things, who is responsible for individual entries.

For the reasons mentioned here, the auditing of information systems is steadily becoming a more important part in the auditing of enterprises. In recent years, the National Audit Office has placed considerable emphasis on instructing public bodies and enterprises on the

general security requirements that are made to information systems, both as regards the choice and settings of new systems as well as the improvement of older systems. This has been done through the publication of guidelines such as *The Operating Security of Information Systems* (1998), *Electronic Transactions* (2000) and *Reliability of Data in Information Systems* (2002) and through specific audits of the information systems of individual bodies. In these instructional activities, the National Audit Office has principally sought to make the management of public bodies and enterprises aware of the problems inherent in the use of information systems, the risks that must be taken into account in daily operations and the actions that must be taken to meet the requirements of public bodies for secure, while at the same time, efficient operation.

In addition to preventive measures of this nature, the National Audit Office has addressed several cases where suspicions of illegal or fraudulent actions have arisen. In most cases, these matters have involved employees who have utilised unnaturally extensive access to the information systems of their public bodies and knowledge of loopholes in their security and monitoring equipment to misappropriate funds and then hide their tracks in the accounts. The weakness here has been, on the one hand, insufficient distinction between positions, i.e. between those who approve payments, those who make the payments and those who make entries into the accounts, and, on the other, in insufficient surveillance actions, both within the information systems themselves and outside them. Such cases are often discovered only by coincidence or "mistakes" made by the criminal, although they can later be traced through the system.



*Hrafnhildur Óskarsdóttir, Hilmar Thórisson, Gudbrandur R. Leósson and Ingi K. Magnússon meet to discuss internal auditing*

# Fraud in the Workplace

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IN RECENT YEARS, Supreme Audit Institutions all over the world have endeavoured to fight any form of fraud within public bodies and enterprises, not least employee theft or abuse of the funds and assets of public bodies, their corruption with profit in mind and fraudulent accounting. The principal reasons for this are well-grounded indications that such violations are generally increasing and that their effects are becoming more and more serious for the public bodies involved.

A survey performed by *PricewaterhouseCoopers* in 2005, among 3,634 companies in 34 countries all over the world, revealed that 45% believed that they had been subjected to some form of fraud over the past two years, as compared with 37% of companies in 2003. If Iceland's nearest neighbours are examined, this proportion was 42% in Norway and 21% in Denmark in 2005. In the majority of cases (approximately 70%), the fraud's perpetrators were employees of the companies, and in approximately 25% of cases, they held management positions. The investigation performed by the international Association of Certified Fraud Examiners from 2004 furthermore revealed that fraud costs a typical US organization approximately 6% of its annual revenues. It also points out that only a small proportion of violations is detected, and then just as likely by accident or through tips from individuals than through external or internal auditing. As a result, public bodies and enterprises have sought suitable means to prevent such violations and to discover those that occur.

In 2006, the National Audit Office issued the guideline *Indicators of Fraud*, in which the conclusions of the abovementioned investigation in the US are described and linked to Icelandic conditions as appropriate. In this context, it may be mentioned that the National Audit Office has, in recent years, addressed almost 20 cases that are categorised as fraud. Some have been discovered through the Office's audit of the accounts and finances of public bodies, while others have been discovered through information given by the employees or management of the public bodies themselves or by external parties. In general, it is not possible to see any fundamental difference between such violations here in Iceland and elsewhere, with the exception that corruption, e.g. in the form of bribes, is not noticeable here. Furthermore, there appears to be little danger of public bodies preparing fraudulent accounts, as the impetus to do so, e.g. in the form of performance-linked salaries, is little or non-existent. In Iceland, the greatest risk is in the form of theft, embezzlement or other form of employee misuse of the funds and assets of public bodies.

No attempt has been made to put a value on the damages resulting from fraud in public bodies in Iceland. However, if account is taken of overseas investigations and the Icelandic cases which have been discovered in recent years, it is clear that considerable amounts are involved which, in the end at least, are largely paid by tax-payers. As Icelandic public bodies and enterprises are, in most cases, small operating units, one could expect their damages to be greater than that of large enterprises, although the likelihood of fraud is, in fact, less than in the larger enterprises. Small enterprises, moreover, find it more difficult to protect themselves with powerful internal controls than the larger enterprises.

The guideline *Indicators of Fraud*, issued by the National Audit Office, points out the three main reasons why individuals misuse the funds of public bodies or enterprises. These reasons are often combined. First, there is the incentive of the perpetrator or pressures on him to obtain increased funds to maintain some costly needs or addictions. Second, the opportunity that arises because the institution or enterprise does not sufficiently monitor its finances or assets. Third, there is the impaired moral values of the perpetrator, who often tries to rationalise his actions and convince himself that his actions are neither wrong nor illegal or that he will compensate for his actions later. Obviously, the risk is greatest among employees who have direct access to the funds and assets of an enterprise or public body. As a matter of fact, the most serious violations are performed by their managers.

It is clear that the best and most economical method to fight fraud is to prevent, as far as possible, its occurrence at all, as it is quite well known that enterprises or public bodies are never compensated fully for the damages that they suffer even if a violation is discovered, neither for their financial damages nor the shock of a damaged image, worsening morale in the work place, decreasing morality of employees or the broken confidence of customers. The following measures have proved to be the most appropriate:

- That the management is aware of where the risk of fraud is the greatest and the manner in which such risk can be decreased or eliminated.
- That the management acquaint itself with the history of applicants when recruiting new employees, set them clear codes of conduct and rules of procedure and make sure that they are aware of the consequences of misusing the funds or assets of the institution, i.e. that the consequences inherent in such violations are always greater than any possible benefit.
- The establishment of active internal controls for funds, assets and accounting data and the clear division of responsibility between those responsible for such aspects, so as to limit, as far as possible, their opportunity to practice fraud.
- That the employees are generally knowledgeable about what external characteristics or behaviour patterns may indicate that something is wrong and how best to react to such situations.

No monitoring system is so perfect that no loopholes may be found in it and used for illegitimate purposes. To discover the violations that occur, it is important to ensure that people are able to supply information anonymously. Experience has shown that it is extremely difficult to submit such information openly, even if the information proves to be completely legitimate, as such information often involves close colleagues or superiors.

# Indicators of Activities and Performance

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THE NATIONAL AUDIT OFFICE'S statutory duties include examining and certifying the reliability of indicators of the activities and performance of public entities if reported in their annual accounts. Indicators of activities and performance not only have informational value, but can also have various practical uses in management by indicating how public bodies and enterprises are progressing towards achieving their goals. In the past few years, the Office has monitored its own performance in a targeted manner. To this end, it has developed a number of performance indicators to assess four key aspects in its operations: 1) Services, 2) Internal Processes, 3) Staff and Development and 4) Finances.

## The Office's Services

THE NATIONAL AUDIT OFFICE endeavours to provide opinions and information which are useful in the decision-making of public bodies and enterprises as well as the central government.

The National Audit Office publishes the results of its audits principally in the form of reports and memoranda. These documents generally fall into two categories. On the one hand are those that are intended only for the public bodies to which the audit was directed and the ministries to which they belong. To this category belong the majority of reports in the field of financial auditing and internal control, as well as the Office's reviews of the information systems of central government bodies. It is the National Audit Office's opinion that these reports have been beneficial in many ways, although no direct assessment has been made. Indications to this effect include the fact that in recent years, the Office has made fewer comments concerning the handling of accounting documents by government agencies. Managers of government bodies are generally well informed about problems relating to internal controls and information systems.

The other category is composed of the public reports of the Office, which describe the audits of individual public bodies or issues. On average, these number 10-12 annually. The majority are printed in 300-500 copies and sent to the Althingi, ministries, public bodies and the media for presentation and discussion. They are also published in digital format on the Office's website. These reports have often drawn considerable attention and discussion in the public sphere, and sometimes they have been the instigators of change or improvement within the administrative level. An example of this is the report on *The National Commissioner of Police* (2006). Moreover, it is telling that public bodies, ministries and the Althingi increasingly request audits from the National Audit Office. It may be disputed, however, whether the reports go through suitable channels in the Althingi and its committees and whether the comments and suggestions of the Office are adequately followed up.

At the end of 2006, the National Audit Office took the first steps towards evaluating the actual effect of its public reports, by assessing the response of the administration and public



bodies to two performance audits from 2002 and 2003. Such investigations on follow ups have a twofold purpose. First, they should reveal whether the Office's principal suggestions were put forward in a clear and concise manner that allowed for an accurate assessment of whether there had been a response to them. Secondly, an assessment was made as to whether or not the public bodies and the central government had, in whole or in part, taken the suggestions into account, that is, whether or not they had led to improvements, been ignored or been rejected for legitimate reasons.

The overall results of the surveys carried out in December 2006 and January 2007 are as follows: of the Office's 16 principal suggestions in the two reports, 15 were assessed and one appeared to be too general and unclear. The National Audit Office is of the opinion that the central government or public bodies took 12 of the suggestions into account to some extent. However, there was no response in three cases, and the central government or public bodies were particularly divided about the reasoning behind them. As a whole, 12 (75%) of the 16 suggestions produced the intended result.

In addition to such investigations, the National Audit Office has, over the past few years, measured the public's interest in its reports by monitoring how often they are accessed on the Office's website. It is clear that there has been a substantial increase in interest in these matters over the past two years, not least in 2006 when the 212 reports which are in the Office's database were accessed a total of 31,586 time, i.e. an average of 150 times each during the course of the year. It may be mentioned that in 2005, a similar number of reports were on average accessed 106 times each. The increase between years is therefore approximately 41%.

Number of reports accessed on the Office's website					
Year	Q1	Q2	Q3	Q4	Total
2004	3,275	3,422	2,944	3,015	12,656
2005	3,765	6,856	4,882	6,211	21,714
2006	7,440	9,112	6,037	8,977	31,586

The most popular report on the Office's website in 2006 was *The University of Iceland. Performance Audit (2005)*, which was accessed 774 times. The same report was also in first place in 2005, when it was accessed 1,047 times. As the following table shows, there was a 14% decrease between years with respect to the 5 most popular reports even though there was a 41% increase on the whole. This indicates a more generalised interest in the reports than often before.

Five most-read reports on the Office's website				
	2005		2006	
1	The University of Iceland (2005)	1,047	The University of Iceland (2005)	774
2	Implementation of the Government Budget (2005)	749	Services to the elderly (2005)	677
3	Privatisation (2003)	660	Landsp. University Hospital (2005)	562
4	Directorate of Customs (1999)	600	Implementation of the Government Budget (2006)	500
5	The Meteorological Office (2003)	428	Annual Report of the NAO (2006)	470
<b>Total</b>		<b>3,484</b>		<b>2,983</b>

As a rule, the National Audit Office issues a press release when a new report is published, outlining the main results and recommendations of the study. According to measurements, these releases are by far the most popular reading matter on the Office's website. In 2006, five of them were accessed more than 1,200 times, and two of them more than 1,600 times. The media has also often used these releases in their coverage, so it is clear that they are seen by a large proportion of the public. Subscriptions to the press releases of the Office are available, and there are currently 130 parties who enjoy this service.

Obviously, the Internet will, in the future, play an increasingly important role in the endeavours of public bodies and enterprises to disseminate information and services. The National Audit Office, therefore, has always sought to improve its website, and this has had the effect of steadily increasing traffic on the site over recent years. In 2006, there were 37,159 registered visits by 13,591 guests (computers) to the Office's website, as compared with 24,770 visits by 10,346 guests in 2005. The increase is between 9% and 31%, depending on calculations.

In 2006, there were a large number of changes made to the website to make it easier for the disabled to access the material published there. In connection with these changes, the Office also formulated an access policy for the disabled and published it with its policies. Almost all material on the website of the National Audit Office currently meets the reference criteria for access issues that the working group Web Content Accessibility Guidelines Working Group has established in the Standard WCAG 2.0, type A. This means that the website is, among other things, accessible to the blind who use websites with the assistance of screen readers, the visually impaired who need particularly large letters, dyslexics who need a background colour other than is commonly used and the physically disabled who find it difficult to use a mouse to navigate on websites. It may be expected that many of these items also make it easier for the elderly to use the Office's website.



*Two of the Office's publications in 2006*

## Internal Processes

THE NATIONAL AUDIT OFFICE aims to operate efficiently and provide quality services.

The National Audit Office places a strong emphasis on efficiency and quality in its work and endeavours to fulfil its projections. One of the Office's most important criteria for measuring its efficiency is its output, i.e. the number of financial statements and reports prepared. In recent years, we have managed to issue the audited annual accounts of almost all public bodies in Group A of the Central Government Accounts, as well as public bodies belonging to Groups B, C, D and E. In the past two years, the number of such annual accounts has, in fact, fallen somewhat due to the lower work contribution of staff and difficulties in the processing of information from the financial systems of the central government. In 2006, the Office certified a total of 337 accounts and prepared 241 audit reports. These numbers are almost the same as in 2005, although it represents a 5.1% decrease since 2004. If purchased services are included, annual accounts certified number 396 and auditing reports prepared number 292, as compared with 403 annual accounts and 289 auditing reports in 2005.

Financial audits	2004	2005	2006
Certified annual accounts	350	338	337
Audit reports	259	238	241
<b>Total</b>	<b>609</b>	<b>576</b>	<b>578</b>

Looking at other reports issued by the Office, i.e. performance audit reports, information systems audit reports and internal control reports, one can see that there was some increase in 2006. In total, there were 23 such reports, i.e. four more than in 2005 and two more than in 2004. In particular, the number of memoranda increased, while actual performance audit reports decreased substantially. In total, the National Audit Office issued 13 public reports in 2006, i.e. two more than in 2005 but the same number as in 2004.

Other reports	2004	2005	2006
Performance audits	10	8	4
Memoranda, etc.	15	11	18
Guidelines	0	0	1
<b>Total</b>	<b>25</b>	<b>19</b>	<b>23</b>

In recent years, the National Audit Office has placed particular emphasis on completing the certification of financial statements as early in the year as possible so that they are of as much use as possible to the managers of the public bodies and enterprises and others who make decisions on their operation. As the following table shows, these endeavours have been quite successful. In 2006, the Office managed to certify 43.8% of all financial reports before the middle of the year and 78.3% of them before the end of the third quarter. This is a considerable improvement from 2004, when these proportions were 21.4% and 49.4%, respectively. The Office will, however, endeavour to do even better in the future.

The accumulated proportion of certified annual accounts within the year				
Year	Q1	Q2	Q3	Q4
2004	4.3%	21.4%	49.4%	100%
2005	4.4%	38.5%	57.7%	100%
2006	8.0%	43.8%	78.0%	100%

In addition to examining the date of certified financial statements, the National Audit Office has measured the Office's efficiency by examining the time it takes to perform certain tasks. Comparison of the last three years, concerning the time it takes to prepare the report Audit of the Central Government Accounts from the time that the Government Accounts is issued, is comparatively unfavourable for 2006, i.e. 73 days, as compared with 57 in 2005. It can, however, be considered positive that the report was issued much sooner than in recent years. This is in tune with the Office's policy that the work must be of as much use as possible to the Althingi when it is preparing the next year's budget.

Efficiency in the audit of the Central Government Accounts			
Year	Central Government Accounts	Audit of the Central Government Accounts	Number of days
2004	30.09	19.11	50
2005	26.09	22.11	57
2006	24.08	06.11	73

## Staff and Development

THE NATIONAL AUDIT OFFICE seeks to recruit well-trained and competent employees who are enthusiastic about improving and developing their skills and competencies. In addition, the Office endeavours to promote an encouraging morale in the workplace.

The employees of enterprises and public bodies are unquestionably their greatest resource. To measure such assets, the National Audit Office has chosen to consider the following items: the number of audit hours, the ratio of staff with a university degree, the number of vocational retraining days and the ratio of staff with more than three years' experience, their average length of service and the number of absent days due to illness.

The employees of the National Audit Office delivered approximately 1,400 fewer active man-hours in auditing in 2006 than in 2005 but 700 more than in 2004. Moreover, bought-in services were similar in extent to that of recent years. The asset involved in man-hours has therefore neither increased nor decreased to any great extent. Just less than two man-years are, however, needed to turn in as many man-hours as in 2003 (76,440).



*Employees of the National Audit Office attending a course*

### Number of man-hours in auditing

	2004	2005	2006
National Audit Office	71,856 (95%)	73,992 (95.2%)	72,600 (95.2%)
Bought-in services	3,780 (5%)	3,722 (4.8%)	3,650 (4.8%)
<b>Total</b>	<b>75,636 (100%)</b>	<b>77,714 (100%)</b>	<b>76,250 (100%)</b>

The proportion of employees with a university degree has remained fairly level in the past three years, or about and upwards of 80%. Looking solely at employees doing audit work, the ratio is 97.5%. Staff education levels are therefore quite high. As is stated elsewhere in this report, the education of the staff is diverse. As may be expected, staff with business administration degrees form the majority, while the number of staff with degrees in administrative sciences and economists has increased most in recent years.

### Proportion of staff with a university degree

	2004	2005	2006
All staff	80%	81.6%	80.9%
Audit staff	95%	97.5%	97.5%

The Office emphasises that staff should maintain and strengthen their knowledge through continuing education, to which the Office's experts are expected to devote an average of 40 hours per year. In recent years, the number of hours has substantially exceeded this guideline and was approximately 45 hours per expert in 2006, as compared with 70 hours in 2005. In 2006, the Office spent a total of ISK 9.2 million on career development and continuing education, i.e. approximately 2.5% of the Office's total expenditures. Corresponding figures for 2005 were ISK 14.2 million (4.1%).

The percentage of permanent employees with at least three years' professional experience at the Office has generally been around 80% over recent years and was 80.9% in 2006. The average length of service, however, has increased steadily every year and was 11.5 years in 2006, as compared with 10.8 years in 2005 and 9.6 years in 2003.

### The ratio of staff with at least 3 years' professional experience at the Office

31.12. 2004	31.12. 2005	31.12.2006
78.7%	83.7%	80.9%

A high ratio of staff with long professional experience certainly has its advantages and disadvantages. On the one hand, it is an indicator of workplace stability, i.e. the staffs' loyalty to the employer, their general satisfaction with the work environment, as well as team spirit and their interest in and knowledge of their field of work. Little personnel turnover also saves substantial amounts in relation to recruitment, the training of new employees and the knowledge lost when experienced staff members leave. The direct and indirect cost of losing one employee and hiring a replacement is sometimes believed to correspond to approximately one year's salary.

However, too little personnel turnover can be unfavourable if it prevents normal and necessary staff renewal, and if it continues for too long, it can cause an abrupt change in the workforce. As previously mentioned, staff turnover in 2006 was 14.9%. This is a





*Álfheidur D. Gunnarsdóttir, Kristjana Ó. Sigurdardóttir and Árni Sigurdsson relax with a cup of coffee*

somewhat higher ratio than in 2005, when the turnover was 10.2%, and much higher than in the preceding years, when staff turnover was negligible. It is, however, in tune with general conditions on the Icelandic labour market. In 2005, the staff turnover of Icelandic companies was commonly approximately 14.2%.

Both here in Iceland and elsewhere, absences due to staff illness has increased substantially in recent years. To some extent, these have been traced to work environments in which great demands are made of staff and work contribution has a substantial effect on career development. Under such conditions, the risk of mental and physical illness rises. According to a recent survey, employees of Icelandic companies have on average been absent from work due to illness or accident for 9.8 days in 2005. Illness days had increased by 1.5 from 2004. In general, there are a greater number of illness absences among civil servants than those employed in the private sector.

In the past few years, the staff of the National Audit Office have, on average, been absent from work due to their own illness or the illness of their children for approximately 6 days a year. In 2006, sick-leave days were, on average, 6.5, as compared with 5.5 days in 2005. As a proportion of the total hours worked, illness absences increased from 2.4% in 2005 to 2.9%. The corresponding percentage among Icelandic companies was 4.3% in 2005.

Number of sick days per employee			
	2004	2005	2006
Own illness	5.0	4.4	5.5
Illness of children	1.9	1.1	1.0
<b>Total</b>	<b>6.9</b>	<b>5.5</b>	<b>6.5</b>



## Finance

THE NATIONAL AUDIT OFFICE aims to maintain its operations within budget and to ensure that its work is performed in an economic manner.

In 2006, the National Audit Office achieved a surplus of just under ISK 20 million, as compared with an ISK 18 million surplus in 2005. The financial position of the Office, therefore, is quite strong.

### Aggregate operating surplus in millions of ISK

Year	Position at year-start	Surplus	Position at year-end
2004	-15.3	16.4	1.1
2005	1.1	18.1	19.2
2006	19.2	19.6	38.8

In order to assess economy in its operations, the Office has listed the costs resulting from, on one hand, the services of the Office's employees and, on the other hand, from bought-in services. The list covers three years and is based solely on financial auditing, as bought-in services were used mostly in that division. The conclusions indicate unequivocally that operating costs are well within normal limits of cost-efficiency.

### Average costs per hour in financial auditing in ISK, excluding VAT

Year	Bought-in services	National Audit Office	Difference (%)
2004	7,313	5,104	2,209 (43.3%)
2005	7,789	5,646	2,143 (39.0%)
2006	8,558	6,001	2,557 (42.6%)



*National Audit Office staff on a sightseeing trip*

# Public Reports 2006

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## Reports

1. The Convention on Biological Diversity. Environmental audit (January)
2. Verkmennaskóli Austurlands. Finances and Operation 2002–2005 (January)
3. Notes Due to New Data on the Sale of the State's Share in Búnadarbankinn (March)
4. Hvalfjörður Tunnel and Sundabraut. Assessment of the Advantages and Disadvantages of Private Construction (July)
5. Implementation of the Government Budget 2005 (August)
6. The Privatisation of Public Bodies (September)
7. The Environment and Food Agency of Iceland Performance Audit (September)
8. The National Commissioner of the Icelandic Police Performance Audit (October)
9. The Housing Financing Fund. Financial position (October)
10. Audit of the Central Government Accounts 2005 (October)

## Other publications

1. Annual Report of the National Audit Office 2005 (February)
2. Indicators of Fraud (May)



# Financial Statements 2006

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## Report of the Management and Endorsement of the Financial Statements

The Icelandic National Audit Office is responsible to the Icelandic Parliament and operates 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 2006, the Office's operations generated a surplus of ISK 19,596 thousand. According to the Balance Sheet, the assets of the Office amounted to ISK 46,755 thousand, liabilities amounted to ISK 7,976 thousand, and equity amounted to ISK 38,779 thousand at year-end 2006.

The Auditor General and the Head of Financial Audit Division I certify the Financial Statements of the National Audit Office for the year 2006 with their signatures.

The Icelandic National Audit Office, 28 February 2007



Sigurdur Thordarson, CPA  
Auditor General



Sveinn Arason, CPA  
Head of Financial Audit Division I

# 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 2006. The Financial Statements contain a Profit and Loss Account, a Balance Sheet, a Statement of Cash Flows and Notes. The Financial Statements are submitted by the management of the National Audit Office and are its responsibility in accordance with laws and regulations. My responsibility is to express an opinion on these Financial Statements based on my audit.

I conducted my audit in accordance with the provisions of the National Audit Act and generally accepted auditing standards. According to this, I am, inter alia, obliged to:

- obtain reasonable assurance that the Financial Statements are free of material misstatements,
- examine internal control and assess whether it ensures adequate results,
- examine whether the Financial Statements conform to the authorisations of the Government Budget, Supplementary Budgets and other laws, lawful instructions, standard procedures and projects, as applicable,
- examine and certify the reliability of financial ratios regarding the activities and performance of the operation if they are published together with the Financial Statements.

The audit includes examination, based on sampling, of evidence supporting the amounts and disclosures in the Financial Statements. The audit also includes assessing the accounting principles used and valuation rules which are used in their preparation and overall presentation as applied to Group A entities. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the Financial Statements give a true and fair view of the operation of the National Audit Office in the year 2006, its Balance Sheet as of 31 December 2006 and change in cash during the year 2006, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavik, 28 February 2007



Gunnar Sigurdsson  
Chartered Accountant

## Profit and Loss Account 2006

	2006	2005
<b>Operating revenues</b>		
Sale of services .....	27.816.649	32.425.336
Sale of assets .....	1.002.500	0
Other income .....	10.125	1.273.950
	<u>28.829.274</u>	<u>33.699.286</u>
<b>Operating expenses</b>		
Salaries and related expenses .....	300.805.547	291.686.070
Administrative expenses .....	9.175.051	11.550.501
Meeting and travel cost .....	13.384.622	9.927.698
Expert services .....	40.514.137	35.049.455
Operations of equipments .....	2.066.837	1.782.198
Other operating expenses .....	3.094.697	2.590.617
Housing .....	22.992.400	19.299.275
Operation of vehicles .....	396.046	594.667
Grants .....	1.698.500	550.000
	<u>394.127.837</u>	<u>373.030.481</u>
Purchased assets .....	8.205.489	2.611.564
	<u>402.333.326</u>	<u>375.642.045</u>
<b>Operating profit (-loss) before Treasury contribution</b>	( 373.504.052)	( 341.942.759)
Treasury Contribution .....	<u>393.100.000</u>	<u>360.000.000</u>
<b>Profit for the year</b>	<u>19.595.948</u>	<u>18.057.241</u>



## Balance Sheet, 31 Desember 2006

	2006	2005
<b>Assets</b>		
<b>Current assets</b>		
Treasury .....	37.781.856	18.227.856
Accounts receivable .....	8.662.200	6.053.665
Prepayed cost .....	0	184.080
Cash and cash equivalents .....	311.021	217.479
	<u>46.755.077</u>	<u>24.683.080</u>
<b>Total assets</b>	<u>46.755.077</u>	<u>24.683.080</u>
<b>Equity and Liabilities</b>		
<b>Equity</b>		
<i>Equity:</i>		
Equity at the beginning of the year .....	19.183.238	1.125.997
Profit for the year .....	19.595.948	18.057.241
	<u>38.779.186</u>	<u>19.183.238</u>
	<b>Equity</b>	
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable .....	7.975.891	5.499.842
	<u>7.975.891</u>	<u>5.499.842</u>
	<b>Liabilities</b>	
<b>Total equity and liabilities</b>	<u>46.755.077</u>	<u>24.683.080</u>

## Cash Flow Statement 2006

	2006	2005
<b>Cash flow from operations</b>		
<i>Cash flow from operating activities:</i>		
Profit.....	19,595.948	18,057.241
<b><i>Cash flow from operating activities</i></b>	<u>19,595.948</u>	<u>18,057.241</u>
<i>Changes in current assets and liabilities:</i>		
Accounts receivable, decrease / (increase).....	( 2,424.455)	( 358.782)
Accounts payable, (decrease) / increase.....	2,476.049	( 2,727.161)
	<u>51.594</u>	<u>( 3,085.943)</u>
<b>Net cash provided by operating activities</b>	19,647.542	14,971.298
<b>Cash flow from financial activities</b>		
<i>Changes in balance with the Treasury:</i>		
Treasury contribution.....	( 393,100.000)	( 360,000.000)
Received from the Treasury.....	373,546.000	345,013.509
<b>Net cash from financing activity</b>	<u>( 19,554.000)</u>	<u>( 14,986.491)</u>
<b>Net increase in cash and cash equivalents.....</b>	93.542	( 15.193)
<b>Cash and cash equivalents at the beginning of the year.....</b>	<u>217.479</u>	<u>232.672</u>
<b>Cash and cash equivalents at the end of the year</b>	<u><u>311.021</u></u>	<u><u>217.479</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 Government Financial Reporting Act No. 88/1997, the Annual Accounts Act No. 144/1994 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 2006 anticipated similar activities as in the previous year. Supplement to cover expenses of the XXXI Board Meeting of the European Organisation of Supreme Audit Institutions totalled ISK 6,000 thousand and supplement to cover expenses of a new car for the Office totalled ISK 3,000 thousand. Initially, the Office's budget was ISK 393,700 thousand. Decision made by the State Arbitration Court resulted in ISK 1,700 thousand decrease in salaries for 2006. The Office got a supplementary budget of ISK 1.100 thousand due to changes in salary assumption. Thus in 2006, the Office's total budget amounted to ISK 393,100 thousand.

Operating expenses less sale of services totalled ISK 373,358 thousand and were ISK 19,742 thousand less than budget. Operating expenses are specified as follows:

In ISK thousand	Initial	Total budget	Financial Statements	Differences
Sales of services .....	( 20.100 )	( 20.100 )	( 28.829 )	8.729
Salary and salary-related expenses .....	311.300	310.700	300.806	9.894
Other operating expenses .....	95.300	95.300	91.624	3.676
Transfers .....	0	0	1.699	( 1.699 )
	<u>386.500</u>	<u>385.900</u>	<u>365.299</u>	<u>20.601</u>
Purchased assets .....	7.200	7.200	8.205	( 1.005 )
	<u>393.700</u>	<u>393.100</u>	<u>373.504</u>	<u>19.596</u>

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

	2006	2005
Sales of services .....	( 28.829 )	( 33.699 )
101 Icelandic National Audit Office .....	394.128	373.030
601 Equipment .....	8.205	2.612
	<u>373.504</u>	<u>341.943</u>

### Divisions

Profit and Loss Account by divisions in ISK thousand:

Office management .....	26.279	22.226
Financial Audit Divisions .....	192.653	192.856
Performance Audit Divisions .....	128.062	101.557
Legal and Environmental Division .....	26.510	25.304
	<u>373.504</u>	<u>341.943</u>



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