

# ANNUAL REPORT 2007



RÍKISENDURSKOÐUN

# Icelandic National Audit Office

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## Annual Report 2007



March 2008

*Annual Report 2007*  
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Supervision and editorial: *Thórir Óskarsson*  
Photographs: *Kristín Bogadóttir*, except on pages 19  
(*Jón L. Björnsson*) and 24 (*Gudbrandur R. Leósson*)  
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*Staff of the National Audit Office.*

# INTRODUCTION BY THE AUDITOR GENERAL

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## SIGURDUR THÓRDARSON

THE MAIN ROLE of the Icelandic National Audit Office, Ríkisendurskoðun, is to strengthen and improve public administration and the management of public money, protect the interests of tax payers and ensure that government funds are spent for the benefit of the public. The Office addresses this role by certifying information on finances and other issues in the annual accounts of public bodies, by performing audits of sectors and establishments and by providing opinions on individual projects.



In 1987 Iceland's Parliament, Althingi, implemented the National Audit Act No. 12/1986. The Act states that the National Audit Office shall discharge its functions under the auspices of Althingi while securing its complete independence and full access to necessary information. Moreover, the Act assigns various new tasks to the Office. On this occasion, it is appropriate to look back at what has been achieved over the last two decades.

The independence and autonomy of a monitoring agency such as the National Audit Office is best ensured by its financial independence from the entities that it audits, i.e. the executive branch. The Office has enjoyed such independence at all times, as Althingi has ensured the provision of sufficient funds to perform the necessary tasks.

The credibility of the Office is also very important. It is governed by the quality of its work and professional work practices. In order to evaluate these aspects, regular performance measurements have been made in recent years, and its findings published in the Office's Annual Report. In addition, the opinion of clients on quality and usefulness of the audits has been examined, and public interest in reports evaluated by counting how often they are accessed on the Office's website. This monitoring has revealed a steadily growing interest. Furthermore, an examination of responses to its recommendations and comments on internal auditing and performance auditing revealed that approximately 70% of them are acted on.

The National Audit Act states that the Office shall audit the accounts of Central Government and its bodies. In the last few years, it has audited an average of around 330 annual accounts and issued approximately 250 audit reports each year. It has now achieved the goal of auditing the annual accounts of all central government bodies and major projects. In comparison, only a very small number of annual accounts were audited twenty years ago. This year the Office expects to issue around 10,000 pages of information in the form of annual accounts and audit reports. This material is sent to relevant parties.

Another principal function undertaken by the Office is performance auditing. The 1986 Act provided for such tasks for the first time; the Office had previously undertaken them only

to a limited extent. Since 1987, a total of 77 performance audits have been completed. Such auditing has undergone a number of changes since the Act came into force. Sister institutions overseas have often been a source of advice in such matters. In addition, the Office has increasingly sought international benchmarking for comparison with Icelandic figures.

Altered procedures and the use of computer technology have brought emphatic changes in auditing, adding the tasks of auditing IT systems and internal control systems. The Office did not address matters of this nature in the late 80's, but now six man-years are allocated to such tasks.

The 1986 Act requires the Office to monitor the implementation of the Budget and to assist parliamentary committees in the discharge of duties that relate to governmental fiscal affairs. In the last two decades, the Office has prepared annual reports on the implementation of the Budget. The Office has also fulfilled requests from parliamentary committees for reports on particular issues. Moreover, it has sent all performance audit reports to Althingi.

In many countries, there are established rules of procedure covering the manner in which reports from Supreme Audit Institutions (SAIs) are handled. Two years ago, the Speaker of Althingi decided that the Office's Annual Report should be considered by the Parliamentary Budget Committee. In February 2008, the Presidential Committee of Althingi approved rules on the parliamentary treatment of the Office's reports. The Office approves of this move and is of the opinion that the involvement of the legislature in National Audit Office activities will further ensure that the Office functions successfully.

International co-operation is vital for the National Audit Office and its employees, i.a. to acquaint them with procedures used by other public auditors. At first, such relations were mostly with other Nordic countries, and through membership of INTOSAI. In recent years, contact with the UK National Audit Office has increased substantially. Moreover, I am a member of the Government Board of EUROSAI; one representative from the Nordic countries has been a member of the Board since it was established.

The Office's operations and results in 2007 were favourable. Most targets were met, although active working hours in auditing decreased by two man-years. Furthermore, financial auditing was completed as targeted in the third quarter of the year. The efficiency of this work has increased by 8% over the past two years despite considerable employee turnover. The same can be said of other aspects in the Office's operations – less real time has for the most part been counterbalanced by increased efficiency.

The total expenditure of the Office in 2007 was ISK 442m, compared with ISK 402m in 2006. User fees amounted to ISK 32m, an increase of ISK 3m between years. Thus, expenditure in excess of user fees amounted to ISK 410m, an increase of ISK 37m (9.9%) from the year before. State contributions amounted to ISK 417m, leaving a budget surplus of ISK 7m. At year-end 2007, there was a surplus of ISK 45.8m on the principal, which is 11% of the budget appropriation for the year. The reason for this accumulation is that new employees have not been recruited into vacated positions.

# OBJECTIVES AND ROLE

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THE ICELANDIC NATIONAL AUDIT OFFICE is an independent body operating under the auspices of Iceland's Parliament, Althingi. Its main tasks are to audit the Central Government Accounts and the accounts of agencies and enterprises under state ownership. Furthermore, it is required to monitor these entities' operations and ensure that public taxes are spent in an economical, efficient and effective manner in accordance with laws and other decisions made by the legislature. The Office, moreover, 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 Office bases its work on Icelandic law and the standards of INTOSAI, which are intended to ensure secure and professional work practices when auditing in the public sector. The Office has established a Code of Conduct for its staff based on the INTOSAI Code of Ethics and the Government Employees Act No. 70/1996. Our four values are: credibility, independence, integrity and professionalism.

The credibility of the Office is governed by its autonomy and independence toward the executive branch of government and the entities that it audits, its integrity and confidentiality with respect to these same entities, and the abilities of its staff, their professionalism, objectivity and fairness. The autonomy and independence of the Office, on the other hand, is dependent on it selecting and organising its own projects. Selection is based, among other things, on projects' financial scope and importance, their financial or operational risks and the potential for improvements.

Some part of the regular auditing and monitoring activities of the Office is statutory, e.g. the auditing of the Central Government Accounts and the implementation of the Government Budget. Furthermore, the Presidential Committee of 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 it's mandate. The Office, however, generally decides on the manner in which such reports are prepared, their content, the approach used and scope, when they are completed and the manner in which the results are published.

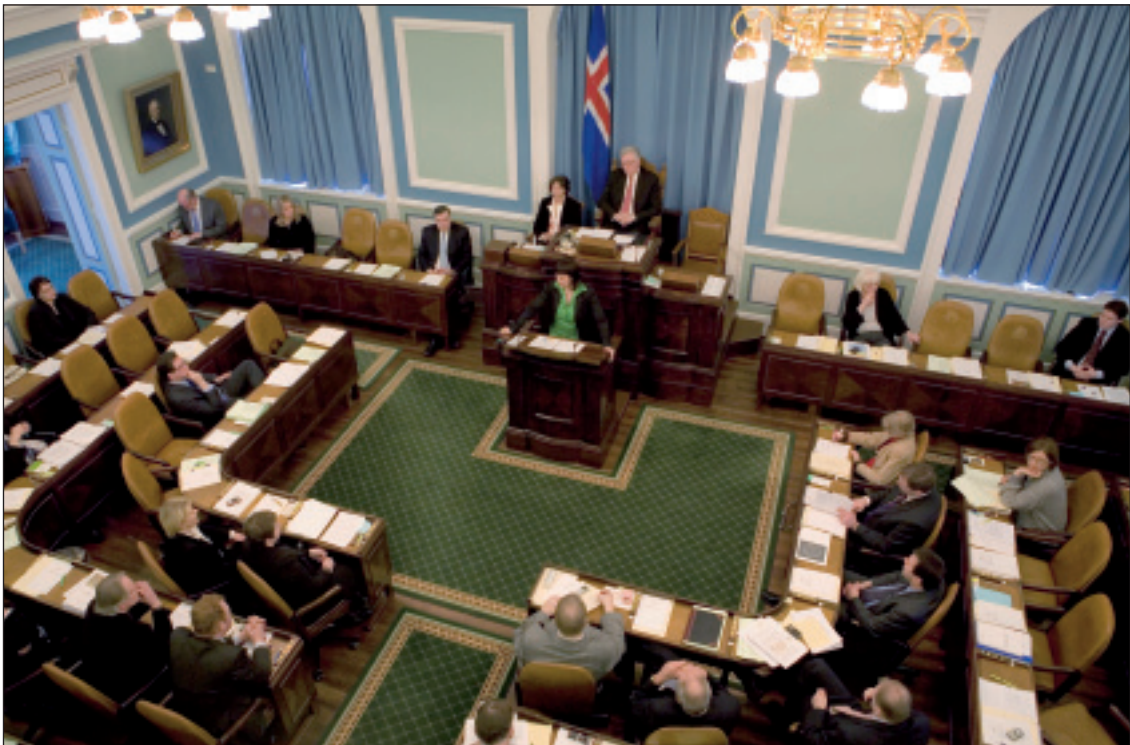
According to legislation, the Office has a very broad mandate for auditing. It may call for financial statements from public bodies, associations, funds and any other bodies that receive Government funds or guarantees. Furthermore, it is permitted access to original documents and reports prepared in 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 disposal of grants and other contributions of public funds, and assess whether such payments 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 to the ministries to which they belong. Some reports, however, are made public and sent to Althingi. This applies in particular to the Office's reports on the



auditing of the Central Government Accounts and the implementation of the Government Budget, its Annual Accounts, performance audit reports and reports specifically requested by the Presidential Committee of Althingi. Such reports are also sent to the media and published on the Office's website.

In order to formalise the communications between the National Audit Office and Althingi, and to ensure that the Office's reports are discussed in parliamentary standing committees and, as appropriate, by Althingi itself, Althingi approved the *Rules on the Parliamentary Treatment of Reports from the National Audit Office* at the beginning of 2008. These rules state that the Speaker of Althingi may, after taking into account the content of the reports, send them to a standing committee for discussion. The committee must then make a decision regarding further processing, e.g. call the parties to a meeting with the committee to discuss the content of a report, or request a written statement. The committee may also submit an opinion on reports, in the event the committee regards this as being necessary, and may submit proposals for parliamentary resolutions on their content. The National Audit Office regards this innovation as an important improvement.



*From discussions in Althingi.*

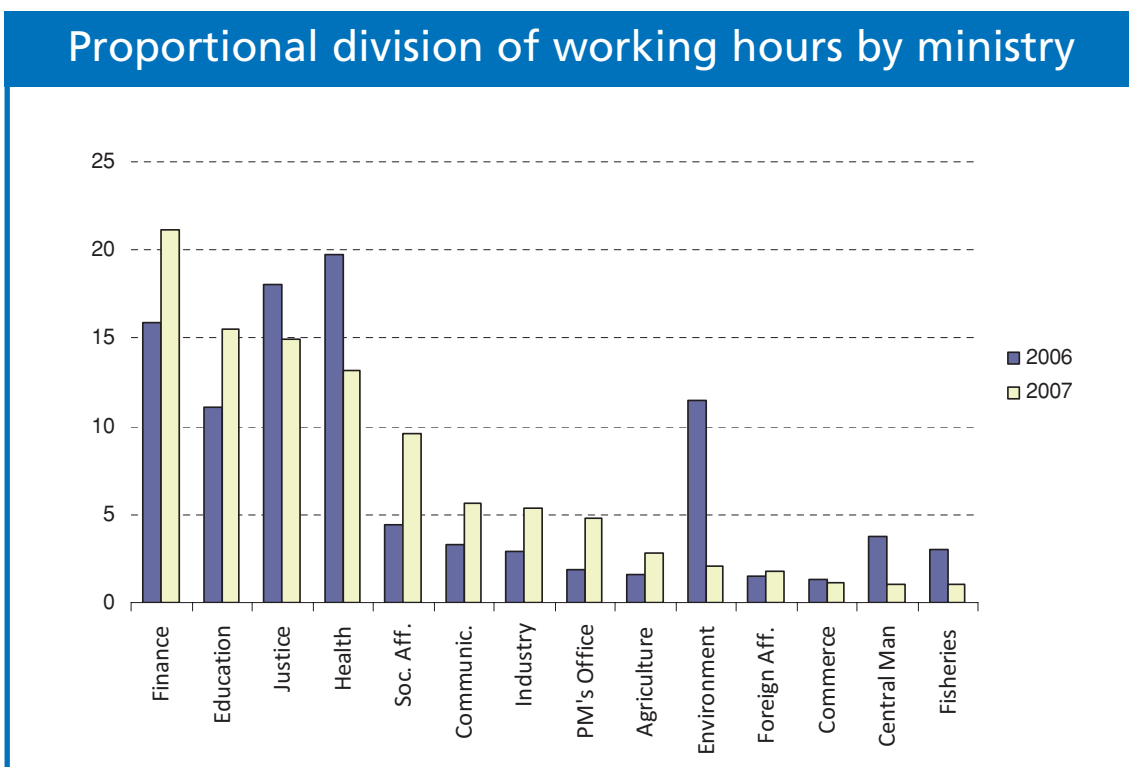
# OPERATIONS IN 2007

## Time spent on audits

THE NATIONAL AUDIT OFFICE delivered approximately 47 man-years in 2007. This is two man-years fewer than in 2006. Despite this, the Office met its main objectives regarding the number of projects it was involved in and their completion times. In total, the Office certified 328 annual accounts for public bodies and government-owned companies, prepared 230 audit reports and issued 24 reports and opinions, 14 of which were made public. On the whole, productivity was similar to that of the past two years.

As usual, the Office spent most of the time carrying out financial audits, approximately 57% of all active man-hours. Around 16% was spent on performance audits, 10% on internal controls, 10% on IT audits and 10% on other tasks, including providing legal opinions, quality monitoring and assistance to other divisions of the Office.

In total, the Office spent 50,600 hours auditing individual ministries and their public bodies in 2007. This is approximately 3,900 hours fewer than in 2006. This year, the greatest amount of time was spent on auditing the budgets of the Ministry of Finance (21.1%), the Ministry of Education (15.5%), the Ministry of Justice (14.9%) and the Ministry of Health and Social Security (13.2%).



As usually, the greatest amount of time was spent on auditing the ministries responsible for the largest and most cost-intensive issues. Apart from this, the hours spent depend on the choice of projects at any particular time and risk assessments. Entities that administer their own funds are generally more closely audited than others due to issues relating to the monitoring and security of funds.



*In 2007, an audit of measures against the importation of illicit drugs was carried out.*

## Financial Auditing

The National Audit Office audits annually the Central Government Accounts and the accounts of ministries, agencies, funds and other parties whose costs and expenses or financial loss is funded by the Treasury. By law, the financial audits must determine the following in particular:

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

The Office applies generally accepted procedures for the auditing, including standards used by INTOSAI. The procedures used are revised and improved regularly, and significant changes will be introduced in 2008, when the Office begins to use an electronic project and document management system to organise its work, among other things with respect to risk, and to manage schedules and results. This will bring further improvements in quality and conformity in the auditing process.

The National Audit Office published an overall summary of its financial auditing in the report *Audit of the Central Government Accounts 2006*. In addition to certifying the reliability of the financial information presented in the Central Government Accounts, the Office reported on the audit of Treasury revenue and the financial audits of 402 public bodies and enterprises.

During the audit of Treasury revenues, three principal tasks were highlighted: firstly, the audit of value added tax settlements, which is by far the biggest source of revenue for the Treasury; secondly, the audit of payroll tax settlements and, thirdly, an evaluation of the write-down of the balance due at year end. In addition, revenue systems were reconciled with accounting systems, and external confirmation was obtained where needed. Furthermore, the sale of Treasury assets was examined in greater detail.

The report *The Audit of the Central Government's Accounts 2006* also contains the main results of the Office's survey of two selected items in the operations of public bodies: the implementation of collective wage agreements and wages projected from May of 2006, and external confirmation of the sums disclosed by government agencies and enterprises in their balance sheets. The objective of the survey is to raise the standard of prudent management in government departments, improve the stewardship of public money and assets and strengthen internal controls.

In addition to *The Audit of the Central Government Accounts 2006*, the Office issued several reports in 2007 concerning public finances and the finances of individual public bodies, enterprises or projects. Four of them were made public: *The Finances of Byrgid ses., Binding Contracts by Ministries and Government Grants in 2006, The Purchase and Renovation of the Grímsey Island Ferry and Implementation of the Government Budget 2006*. In addition, a report was prepared on *Debt Restructuring and Composition of Public Levies*.

## Performance Auditing

Through its performance audits, the Office seeks to evaluate the performance of public bodies and state-owned enterprises, i.e. to what extent they practice 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, entities in which the State owns at least half of the shares, or those that enjoy contributions from the State Treasury for the services they provide. Some of these audits are 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. Usually the audit issues are selected according to their financial scope, risk assessment, scope for improvement and earlier audits.

The work schedule of the Office's Performance Audit Division for 2007–09 places special 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, fisheries issues and research and development. Particular attention will be paid to performance management, labour force productivity and finances, processing and turnaround times, organisational structure of sectors, division of tasks and responsibility, quality of service and human resources management.



*The Office will place increased emphasis on fisheries during the next few years.*

In 2007, five performance audits were published: *Administration of Safety and Health, Costs, Efficiency and Quality of University Teaching, Service Agreement for Heilbrigdisstofnun Sudurlands Health Care Facility, St. Jósefsspítali – Sólvangur Hospital* and *Measures Against the Importation of Illicit Drugs*. This is the same number of reports as planned for this year.

The Office continually seeks to improve the quality of its performance audits and make them as targeted and clear as possible. The Office believes that this will lead to the audits being of most use. In recent years, particular emphasis has been placed on improving auditing processes and on ensuring professional work procedures. The structure of reports and the presentation of material have also been reviewed. Special attention was paid to highlighting all principal outcomes, comments and recommendations, and to phrasing them in such a manner that responses to them could be evaluated objectively, i.e. the concrete results of the Office's work.

The National Audit Office plans to assess its performance in this respect within a period of three years from each audit. In 2007 and early 2008, the Office prepared follow-up reports on five audits from 2004 and sent them to the ministries and public bodies involved. It turned out that the suggestions led to improvements in about 60.5% of cases.

## Internal Control

Internal control means any regular actions performed by the management and employees of enterprises and public bodies that are intended to encourage successful and efficient operations, safeguard assets, valuables and sensitive documents, provide trustworthy financial information and ensure that operations comply with laws and regulations. Such controls are generally based on analyses and assessments made by public bodies and enterprises of possible operational risks, and they are issued 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.

As mentioned earlier, a regular financial audit performed by the National Audit Office includes examining the internal controls of public bodies and enterprises and whether they ensure satisfactory results. Besides, some of the Office's employees constantly work on extensive audits of internal controls and on acquainting the management of public bodies with the importance of such controls and the principal risks involved in publicly run enterprises. These audits have frequently revealed weaknesses in the operation of public bodies, and many of their managers have taken the necessary measures to remedy the situation. In general, however, they have not set themselves measurable goals, defined the risk factors which their entities face, or prepared formal risk assessments in this respect. As a result, monitoring actions are not always sufficiently well focused. Furthermore, public bodies have generally not established for themselves a comprehensive security policy covering all facets of their operations.

In 2007, the Office published four reports concerning the internal controls of public bodies and funds. Reports of this nature are never disclosed to the public, as they frequently involve sensitive internal issues relating to the bodies or enterprises. In addition, five follow-up reports were completed on audits performed during 2003 and 2004. The investigation revealed that the suggestions led to improvements in about 70% of cases.

In 2007, an audit of internal controls at the ministries' administrative offices was initiated. The audit examined the manner in which the offices had organised their internal controls and how the monitoring of agencies, collective items, contracts and grants was handled. This project is expected to be concluded before the middle of 2008.

## 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 central government bodies' computer and information systems are secure and efficient and to make recommendations for improvements. Usually, reports on IT audits are sent only to the public bodies being audited and to the relevant ministry, as these reports regularly include information on sensitive internal issues, such as the security of information and computer systems. It would be irresponsible to publish such reports and allow information on the possible weaknesses of the systems to become common knowledge before any such weaknesses could be remedied.

The largest project of this kind in 2007 was an audit of the state financial and accounting system (Oracle system). An official report may be expected in early 2008. In addition, various computer related issues were examined in auditing projects in the Office's other divisions. The staff involved in auditing IT systems were also responsible for operating the National Audit Office's computer systems, and they oversaw the implementation of a project management and document management system for use in the agency's financial auditing work.



*In 2007, the Office prepared a report on the agreement between the Icelandic Government and Landsvirkjun on the acquisition of water rights in the lower stretch of the River Thjórsá.*

## Legal memoranda and the control of the approved funds and finances of political parties

Every year, the National Audit Office draws up various legal memoranda on issues concerning government administration, in particular its finances and budget appropriations. This is done in accordance with the *Lima Declaration of Guidelines on Auditing Precepts*, which specifically states that SAIs “may provide Parliament and the administration with their professional knowledge in the form of expert opinions, including comments on draft laws and other financial regulations”. Three official reports of this nature were prepared in 2007: *Rules on the Financial Accounts of Political Parties*, *The Purchase and Renovation of the Grímsey Island Ferry* and *The Agreement Between the Icelandic Government and Landsvirkjun on the Acquisition of Water Rights in the Lower Stretch of the River Thjórsá*.

The previously mentioned *Rules on the Financial Accounts of Political Parties* were based on Act No. 162/2006 on the finances of political parties and political candidates and on their disclosure requirements. This Act apportioned the National Audit Office with a new and important role, which is to issue guidelines on the arrangement of the sale of services by political parties, guidelines for the financial accounting of these parties, to monitor their review and to publish each year a summary of their annual accounts indicating total income and total expenses. In this way, an effort is made to promote increased transparency regarding the finances of political parties and political candidates. The Office plans to issue rules on the provision of information by political parties during this year.

In addition to auditing the financial accounts of political parties, the Office has, for some time, audited close to 700 funds and public bodies that operate in accordance with a

government-approved constitution. This entails maintaining records of total income and total expenses as well as the assets and liabilities of all such funds and public bodies, including comments with the submitted accounts.

## Finances and Expenditure

The National Audit Office's budgetary appropriation under the 2007 Government Budget and Supplementary Budgets totalled ISK 416.8m, an increase of ISK 23.7m (6%) from the previous year. Total expenditure net of user fees, on the other hand, was ISK 410.5m, up by ISK 37m, (9.9%), from 2006. The Office, therefore, operated within budget by ISK 6.3m (1.5%).

As the summary of the income statement shows, payroll costs rose by ISK 19.3m (6.4%) between years and amounted to 78% of the Office's expenses, net of user fees. Operating costs and purchased assets, however, increased by ISK 21m (20.7%). The largest single operating cost item is expert services bought-in from auditing firms, for ISK 32.4m excl. VAT. Purchased assets, on the other hand, consist mainly of the renewal of housing, furniture and equipment. User fees were ISK 3.2m (11.1%) more than in 2006.

Profit and loss account (ISK millions)					
Items	Year		Amount	Change	
	2007	2006			%
Salaries	320.1	300.8	19.3	6.4	
Other operating expenses	106.2	93.3	12.9	13.8	
Purchased assets	16.3	8.2	8.1	98.8	
<b>Total cost</b>	<b>442.6</b>	<b>402.3</b>	<b>40.3</b>	<b>10.0</b>	
User fees	32.0	28.8	3.2	11.1	
Cost net of user fees	410.5	373.5	37.0	9.9	
<b>State contribution</b>	<b>416.8</b>	<b>393.1</b>	<b>23.7</b>	<b>6.0</b>	
<b>Surplus (deficit)</b>	<b>6.3</b>	<b>19.6</b>	<b>-13.3</b>	<b>-68.4</b>	

The costs incurred by the Office's individual operating divisions were as follows: the Financial Audit Division cost ISK 205m, which was 50% of the Office's expenses net of user fees; the Performance Audit Division, the IT Division and the Internal Controls Division cost ISK 148m (36%); the operation of the Legal and Environmental Division cost ISK 25m (6%) and Central Management cost ISK 33m (8%). This is proportionally similar to the past few years. There was a slight transfer, however, from the Auditing Division and Legal Division to other divisions. The total cost of each full-time equivalent was ISK 8.7m, an increase of ISK 1.1m (14.5%) from the preceding year.

## Staff

At the end of 2007, the National Audit Office had 47 permanent employees, which is unchanged from previous year. The average number of man-years, including overtime, was also 47, i.e. two less than in 2006. Eight employees resigned in 2007, and were replaced by the same number of new recruits. Staff turnover, therefore, was 17%, as compared to 14.9% in 2006.



Of the permanent staff, 28 (59.6%) were male and 19 (40.4%) female. The ratio of men rose slightly compared with the three previous years. The average age of employees was 49 years, remaining practically unchanged from 2006. The average length of service, on the other hand, decreased from 11.5 years in 2006 to 10.4 years. A total of 66% of employees had at least 3 years' work experience at the Office, and 36.2% of them had work experience of 10 years or more.

The Office is committed to hiring well-educated staff, and the percentage of employees with a university degree was just under 83% in 2007. The majority, 27, held a degree in business administration or economics. Five held degrees in political or administrative sciences, three were lawyers, two were computer or systems analysts and one employee had a degree in Icelandic studies. There were five chartered accountants and two with certification in internal auditing (CIA). One of them is also a Certified Government Auditing Professional (CGAP), and the other has certification in IT auditing (CISA).

## International Relations

International relations are of great importance in enabling the National Audit Office to acquaint itself with the attitudes, methods and procedures for auditing public bodies that are considered to be most appropriate in each case. This is one way in which the Office ensures that its operations undergo normal development, and that its employees are able to meet the diverse demands made of them. Moreover, steadily increasing international trade and 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 in different countries.

This international integration can also be seen in various types of co-operative projects for auditing multinational institutions and partnerships, such as the EEA and the EU, or projects that extend across traditional borders, such as environmental projects or international aid. Finally, Iceland's increased participation in developmental projects has placed obligations on the National Audit Office to audit those projects on behalf of the Icelandic Government and assist other nations in professional development in auditing. In this context, it may be mentioned that in recent years, the Office has audited several development projects in Africa that are supported by ICEIDA. In 2007, the ICEIDA operation in Uganda was audited.

In addition, the National Audit Office participated in several international co-operation initiatives in 2007. Two of the Office's employees attended the the XIX Congress of INTOSAI in Mexico City, held from 5 to 10 November, where most of the 188 member associations were represented. The Auditor General participated in the 32<sup>nd</sup> Government Board Meeting EUROSAI in Berne on the 13 and 14 of September. Nordic auditor generals and representative colleagues from sister agencies held their annual meeting in Egilsstaðir on 28 and 29 August. Members of staff participated in conventions and work meetings in both Nordic and European venues, covering subjects including internal auditing, performance auditing, financial auditing, the auditing of information systems and information dissemination. Finally, the Auditor General visited the National Audit Office of the Russian Federation in October, and signed a Letter of Intent with the Auditor General of the Russian Federation on closer relations between the two offices. This is the first time that the National Audit Office has formally agreed to co-operate with foreign sister offices in this way.

Among noticeable visits to Iceland was that of the Auditor General of China, Mr. Li Jinua, in May. His visit was a part of an effort to strengthen relations between international agencies and to share the methods and procedures used by public auditing bodies considered most useful in each case. One particular point discussed in the meeting was development work that these offices are engaged in, including audits of information systems and the possibilities for increased communication between offices in the future. It should also be mentioned that the Audit Committee of the Greenland Parliament visited the National Audit Office in August and met with the Auditor General.



*From the meeting between the Auditor Generals of China and Iceland.*

# MEXICO DECLARATION ON INDEPENDENCE

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THE XIX CONGRESS OF INTOSAI in Mexico City in November 2007 approved a special declaration on the independence of Supreme Audit Institutions (ISSAI 10 – *Mexico Declaration on Independence*). The declaration is an affirmation and further elaboration of Articles 5 to 7 of the *Lima Declaration of Guidelines on Auditing Precepts* (1977). It states, among other things, that Supreme Audit Institutions (SAIs) can only be objective and effective if they are independent from the audited entity and are protected from outside influence. Such independence of the SAIs, however, can never be fully realised, as they are part of the state apparatus, but it is important that they enjoy sufficient independence as regards their internal organisation and operations.

The *Mexico Declaration on Independence* attaches particular importance to eight core principles that INTOSAI believes are fundamental to the work of national audit offices:

1. That effective and appropriate legislation is enacted for SAIs, with detailed provisions on the independence of the offices; Likewise, that measures are taken for the effective implementation of such legislation;
2. That the SAIs heads are ensured independence by law, including security of tenure and legal immunity in the normal discharge of their duties;
3. That the SAIs have a sufficiently broad mandate and full discretion to organise their activities and to perform normal SAIs functions; This includes, among other things, the selection of audit issues, planning, programming, reporting, and follow-up of their audits;
4. That the SAIs have unrestricted access to any necessary documentation and information that relates to their mandatory tasks;
5. That the SAIs have both the right and obligation to report on their auditing work;
6. That the SAIs are free to decide the content of their audit reports, and to publish and disseminate them;
7. That there is an effective follow-up mechanisms on SAI recommendations;
8. That the offices maintain financial and administrative autonomy, and are endowed with sufficient human, material and monetary resources.

At the time the declaration was presented, a survey was performed among selected SAIs around the world to ascertain whether they consider themselves to have the autonomy provided for in the declaration. Between 75% and 100% of the offices expressed the opinion that this was the case with regard to the first seven items, although many thought that these items could be further strengthened. Only 38%, on the other hand, felt that they had financial independence in all respects, i.e. that they receive an annual budget that is determined by the legislative authority, have complete power to dispense the budget and authority to refer any matters to the legislature if government contributions turn out to be so low that the offices find it difficult to perform their duties.

The position of the Icelandic National Audit Office can be said to be quite satisfactory as regards the issues covered by the *Mexico Declaration of Independence*, as the *Lima Declaration* was very much taken into account when laws were enacted for the Office. It might even be said that its position in this respect has grown stronger over the years. In this context, the aforementioned *Rules on Parliamentary Treatment of Reports from the National Audit Office*, approved by the Althingi in early 2008, come to mind. A more functional system than has hitherto been the case may be expected regarding the legislature's consideration of the suggestions contained in the Office's reports, its evaluation of them and the ensuing course of action as the case may be, e.g. in the form of parliamentary resolutions on their substance. In recent years, the Office itself has strengthened its own follow-up procedures for its suggestions in separate follow-up audits.

Although the National Audit Office undoubtedly enjoys significant autonomy in the performance its duties, the *Mexico Declaration* provides the Office and the Althingi with the necessary checks and criteria and, as such, provides an important addition to the compilation of internationally accepted standards on the auditing of public bodies.



*Representatives from the National Audit Office attending the XIX Congress of INTOSAI.*

# 20 YEARS OF PERFORMANCE AUDITING

---

ÓLI JÓN JÓNSSON

*Office Manager, Performance Auditing Division*

LAST YEAR marked the 20<sup>th</sup> anniversary of the entry into force of the National Audit Act No. 12/1986. The Act was based on a legislative Bill prepared by a committee appointed in 1983, which had the task to set out proposals on how to make the administrative system more effective and to improve administrative governance. The committee considered, among other things, ways to improve the legislature's supervision of the executive branch of government. Accordingly, the committee recommended the transfer of the National Audit Office from the authority of the Minister of Finance to the authority of the Althingi.

Another innovation in the Bill, and subsequently the Act, was the authorisation of the National Audit Office to carry out performance audits. Article 9 of the Act provides that the Office may perform performance audits on state enterprises. Such performance auditing includes an examination of the treatment and utilisation of public funds. The Office shall alert the authorities of any weaknesses in their activities and propose improvements. Explanatory notes to the Bill reveal that the object of this provision is to strengthen the legislature's supervision of the implementation the budget and in the operation of public bodies and state enterprises.

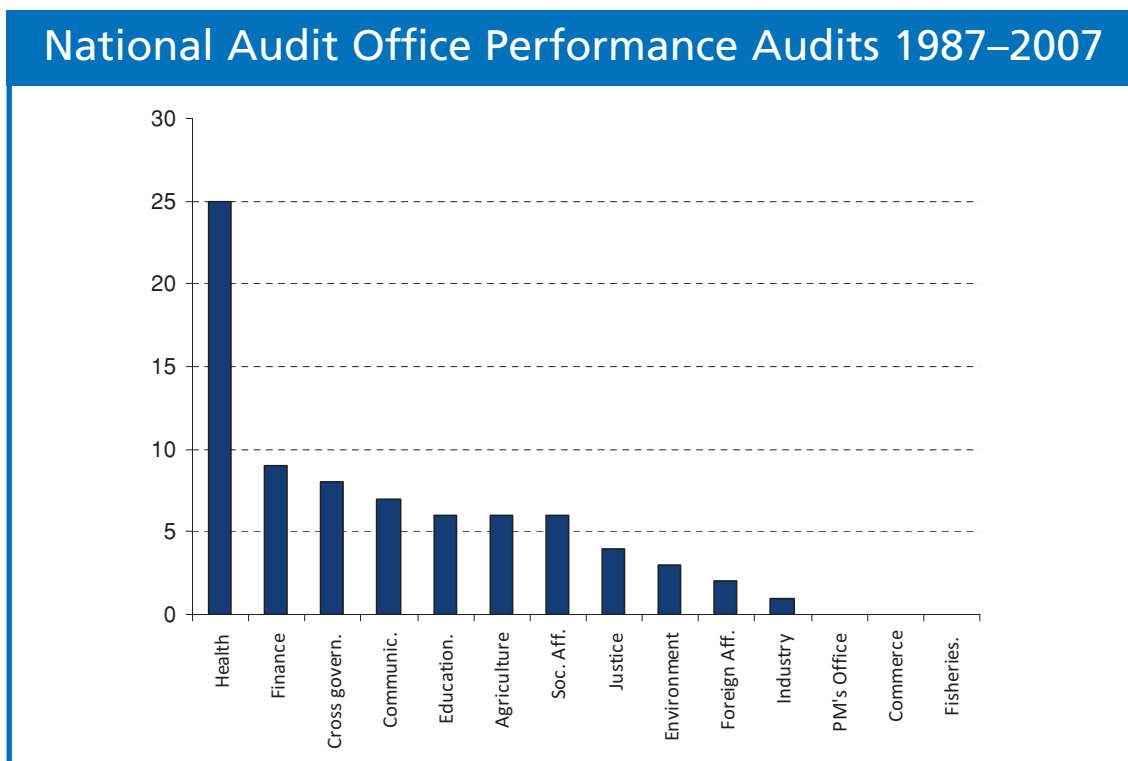
## Monitoring to ensure accountability

Performance auditing is one of the principal tasks of Supreme Audit Institutions around the world. When Act No. 12/1986 entered into force, the sister offices of the Icelandic National Audit Office in neighbouring countries had long had legal authority to perform such audits. Performance auditing is considered an important feature of the controls the national parliaments have over the executive branch of government. Underpinning this is the idea that government authorities are responsible to the legislature, which has the fiscal power, for the prudent handling of public funds. In order for such responsibility to be effective, the legislature must, at any given time, have clear information on the activities of the executive branch, and performance auditing is one way of obtaining this information.

According to INTOSAI's standards, performance auditing revolves around three concepts: economy, efficiency and effectiveness. It is an assessment of the performance of those who carry out the tasks of the State, how well they manage to keep costs down, how efficiently they spend public funds and whether objectives have been met. Government tasks are extremely diverse, and as a result, it is obvious that performance audits of this nature have to be based on a number of methods and criteria, which are often garnered from social sciences and management theory and adjusted for each project.

## Seventy-seven Reports

Since 1987, the National Audit Office has carried out a total of 77 performance audits. The vast majority have involved Ministry of Health projects, as they consume a larger proportion of government expenditures than those of other ministries. The following figure shows the National Audit Office's division of performance audits between ministries from 1987 to 2007.



In their early years, the Office's performance audits often addressed the general organisation and management of public bodies, the manner in which costs could be reduced and how to improve efficiency and results. More recently, attempts have been made to measure efficiency and effectiveness systematically by international benchmarking. This trend has been in line with the increasingly varied education of employees engaged in performance auditing. To begin with, auditors and business administrators were responsible for these audits but later political scientists were recruited. At the same time, the number of employees has increased, and now ten employees in two departments are involved in these tasks, some alongside other work.

Initially, audits were generally limited to a single public body or Budget item. Over the past ten years, however, the audits have increasingly been directed at whole sectors or projects that the State is expected to handle. This trend may be expected to continue, and it is anticipated that the demarcation of audits will change from being limited to individual organisational entities or budgetary items to covering state projects, in both the narrow and wider sense.

A number of organisational and procedural changes have been made in performance auditing methods since 1987, and models for such changes have often been sought from

sister offices overseas. For example, a policy on study selection for the period 2007–9 came into effect at the beginning of 2007. Work also began in 2007 on systematic follow-ups of earlier performance audits, which involved examining whether or to what extent suggestions in reports have been acted on. Moreover, work has been carried out on the development of work procedures, quality control and the presentation of information in reports.

## Future Developments: Increased Specialisation?

State activities are extensive in scope and cover a wide range of dissimilar activities. Up until now, the Office's performance auditors have not specialised to any significant degree; they have commonly carried out performance audits in many different fields. This is chiefly due to the small size of the Office. In larger sister offices overseas, staff generally specialise in particular sectors.

The National Audit Office's clients, the Althingi and taxpayers make extremely strong demands for professional quality work. The Office and its staff have always made every effort to meet these demands, and have performed their work with due professional diligence. Even more stringent demands may be expected in the future. In this respect, mention must also be made of the new rules on the parliamentary treatment of the Office's reports and increased public interest in such reports. It is very likely that greater staff specialisation in performance auditing will be one way of strengthening the operation of the Office in the future.



*A large number of the National Audit Office's performance audits have involved Ministry of Health and Social Security projects.*

# INTERNATIONAL AID WORK AND PUBLIC AUDITING

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EVERY YEAR, many countries are struck by various natural disasters: earthquakes, floods, avalanches, forest fires, drought and hurricanes. Such events can have a devastating effect on the communities involved. Icelanders have experience of this. An example is the sudden volcanic eruption on the Isle of Heimaey in 1973, when a large proportion of the town of Vestmannaeyjar was buried under lava and ash, and over 5,000 people had to be evacuated.

In addition to possible loss of life, disasters of this kind frequently destroy some part of the infrastructure; buildings and property, communications and energy systems, vegetation and agricultural land. In this context, it may be mentioned that the huge tsunami that struck Southeast Asia on Boxing Day in 2004, took the lives of 230,000 people, 166,000 in Indonesia alone. Damage to property in Indonesia, moreover, has been estimated at ISK 300bn. This is equivalent to the total expenditure of the Icelandic Government in 2004.

The international community, the public, associations of various types and the public authorities, have often reacted quickly to natural disasters, and played an active part in rescue, aid and rebuilding work in disaster areas as well as contributing considerable funds to such work. Icelanders are no exception in this respect. Every year, the authorities allocate substantial amounts to international aid and development work, including emergency aid. It is anticipated that this amount will be ISK 2.5bn in 2008. In addition, the public has often donated significant amounts of money to the official collections of NGOs such as the Red Cross.

As independent, autonomous, and non-political institutions, SAIs all over the world have increasingly undertaken the work of monitoring the flow of funds allocated to international aid, providing both donors and recipients with reliable and independent information on whether such funds have reached their intended targets and are being spent in an efficient and prudent manner in accordance with initial goals. In this manner, they seek to ensure transparency in the handling and use of these funds, and to meet growing demands made by authorities and the public as regards the responsibilities of those handling public funds.

As yet, the SAIs face many problems in performing this work adequately, as the necessary information is not always available. There are at least three reasons for this: firstly, the frequently vast geographical distances between the donor of aid and the recipients; secondly, the fact that some of the funds generally passes through the hands of parties who are not always well organised or do not keep accurate accounts; thirdly, unrest – and in some cases corruption – which is often the case in disaster areas, not to mention the great urgency which generally characterises emergency aid and results in parties sometimes bypassing formal procedures. As a result, it can prove difficult to trace the flow of funds and whether they actually end up at their intended destination and are used as initially intended.



A survey performed by the Norwegian National Audit Office in the autumn of 2007, concerning the fate of funds contributed by the Norwegian authorities towards tsunami-related aid in 2004 and 2005, revealed that the authorities did not know for certain what some the funds were used for. The reason for this was both a lack of detailed and harmonised reporting from aid organisations and aid recipients, and insufficient monitoring and follow up by the Norwegian authorities. Moreover, the Office pointed out the danger of aid organisations receiving more funds for disposal than they need or are able to use, as well as the risk that the funds will be used for other purposes than intended.

Following the tsunami disaster, INTOSAI established in 2005 a special *Task Force on the Accountability for and Audit of Disaster-related Aid* to evaluate how the aid work was carried out in Asia and to audit the methods used. Moreover, it was expected to learn from this event and to work out guidelines for authorities, international organisations and SAIs on the manner in which improvements may be made to the organisation and management of such actions in order to ensure that funds reach their intended targets, and that both donors and recipients receive reliable information on the use of such funds. It is anticipated that these guidelines will be submitted to the XX Congress of INTOSAI in South Africa in 2010.

The National Audit Office has yet to perform an independent audit on how the contributions of the Icelandic authorities to international development and aid work have been used. However, the Office has audited individual projects and examined related procedures and management. It is clear that the State substantially minimises its financial risk by paying the majority of its contributions to international organisations that are audited, such as ICEIDA or UN organisations. Nevertheless, this is a field that must be firmly addressed in the same manner as e.g. the state's project agreements or subsidies and contributions granted to third parties to fund certain services. The Office's experience of auditing of such projects should be an advantage in this respect.



*The future administrative building in Uganda, funded in part by the Icelandic authorities.*

# ON TAX EXPENDITURE

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INGI K. MAGNÚSSON

Office Manager of Internal Control

THE SIXTH EUROSAI CONGRESS, held in Bonn in June 2005, dealt with the audit of public revenues by Supreme Audit Institutions (SAIs). Many SAIs have noticed number of cases where cash flows that, strictly speaking, have the nature of expenditures are transferred to revenue budgets, especially in form of tax subsidies. Tax relief schemes of this kind have reached a considerable magnitude in some countries. However, up to now, there has been insufficient knowledge about the effectiveness of tax subsidies.

As a result, the Congress approved the establishment of three working groups to address this arrangement and submit proposals for a remedy. The groups addressed the following items:

1. Transparency and Subsidy Report
2. Corporate Income Tax
3. Value Added Tax

The Icelandic National Audit Office participated in the working group on transparency and subsidy report. The conclusions of the groups are currently available in draft form, and they are scheduled for presentation at the EUROSAI Congress in Krakow in June 2008. A summary of the principal proposals of the group that discussed transparency and subsidies report follows. The words *tax subsidy*, *tax expenditure* and *tax credit* are all used in a similar fashion in this article.

## Definition

The OECD has defined tax expenditure as “the transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure”. Tax expenditure can take various forms:

- exemptions – amounts excluded from the tax base
- allowance – amounts deducted from the benchmark to arrive at the tax base
- credits – amounts deducted from tax liability
- rate relief – a reduced rate of tax applied to a class of tax payers or taxable transactions
- tax deferral – a relief that takes the form of a delay in paying tax

Article 10 of the Government Financial Reporting Act No. 88/1997 states that tax credits that are not refundable must be subtracted from revenue. They must, however, be shown separately in the revenue summary of government accounts. Refundable tax credits and benefits must be entered as expenditures. Examples of such credit are child benefits and interest benefits. Other tax credits are generally deducted from revenues and not shown

specifically. Among them are various exemptions and payment deferrals on imports. They also include tax credits that are not refundable and which lapse if they are not utilised, such as personal tax allowances and mariner's allowances.

## Conclusion of the working group

The working group's investigation involved sending questionnaires to the countries participating in the working group. Moreover, the SAIs in these countries performed an independent investigation into the status of these matters in their own countries. Five meetings were held where the conclusions of individual investigations were discussed and harmonised with the results from the questionnaires.

The working group reached the conclusion that there were extensive weak points in legislation relating to tax credits. The wording of goals was too general, meaning that there was no way of assessing whether they had been achieved. There is considerable variation in how well costs are defined and the advantages of granting tax credit. The precise applicable periods are seldom stated, which limits the possibility of a regular reassessment of their effects.

## Proposals

The legislature must define unambiguous, clearly stated and verifiable objectives of tax subsidies. The analyses produced by government during the legislative process should be comprehensively documented. Furthermore, time limits for validity of tax subsidies should be imposed, if applicable.

At the national level, strategies, that permit systematic monitoring, analysis and evaluation of the tax subsidies, must be developed and implemented. Such evaluations need to be carried out regularly in order to provide assurance on the effectiveness and efficiency of the tax subsidies.

All tax subsidies are to be included in reporting. Therefore the government had to make clear what it considers to be a tax subsidy and what is excluded from its reports. Comprehensive and complete information is to be provided about the losses of tax revenue caused by the tax subsidy. On the whole, regular, up-to-date and full reporting on tax subsidies is necessary.

Since few recipients benefit from tax subsidies while these subsidies are funded from the taxes paid by all taxpayers, this burden on all taxpayers can be justified only by increased transparency that discloses the effectiveness and efficiency of the exceptional provisions of tax law.

The Icelandic National Audit Office will publish the results of all the working groups on its website after the EUROSAI Congress in Krakow in June 2008.

# ACTIVITY AND PERFORMANCE INDICATORS

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REGULAR PERFORMANCE MEASUREMENTS are one of key aspects of modern management. Firstly, they provide more detailed information on the operation of enterprises and public bodies than traditional financial statements. Secondly, they provide indications of the enterprises' progression toward their goals. Thirdly, they provide both management and staff with necessary effectiveness controls by turning their attention to specific core aspects of the activity. Over the past five years, the National Audit Office has monitored its own performance in a targeted manner by choosing a number of indicators to assess four key aspects in its operations: 1) services, 2) internal processes, 3) staff and development and 4) finances.



*In 2007, the Office prepared a report on the Administration of Occupational Safety and Health.*

## 1. The Office's Services

*The National Audit Office endeavours to provide opinions and information that are useful in the decision-making processes of public bodies and enterprises as well as the central government.*

The Office provides annually opinions on financial reporting by government-owned bodies and enterprises, their internal controls and the results of their operation. Moreover, it is

responsible for monitoring the implementation of the Government Budget and provides diverse consultancy services in the field of government finances in general. The Office issues its results in reports and memoranda, some of which are published, while others are sent to the institutions and ministries involved.

The Office has not developed key indicators to measure its service in all these fields. Its work, however, has obviously been successful in many ways. This can be seen by the fact that the accounting and finance issues of government bodies and enterprises have improved in recent years, and the Office has made far fewer comments in its financial auditing. Moreover, managements' knowledge of internal controls and the security of information systems has increased substantially. Finally, requests for audits have increased considerably in recent years. This indicates that the Office enjoys a high level of trust in its operations.

To evaluate its services, the Office uses three main criteria: 1) the response of government and government bodies to its suggestions and comments; 2) opinion polls among its customers as regards the quality of the reports issued by the Office; 3) the number of reports accessed on the website of the Office. These criteria provide indications of, on the one hand, the actual results of the Office's reports and, on the other, general interest in the reports.

Over the past two years, the Office has assessed the response of the government and public bodies to its suggestions and comments through the use of follow-up assessments three years after the issue of the comments. As yet, such assessments are limited to internal controls and performance audits. Particular investigation has been made of whether the suggestions have led to actual improvements, or whether they have been ignored or rejected for legitimate reasons.

In 2007, the Office performed five follow-up audits in connection with internal controls and another five due to performance audits. The results were issued in reports sent to the institutions and ministries involved. A summary of these is given in the table below, shown with the proviso that there may be some disagreement as to whether and to what extent suggestions have been taken into account. Moreover, in some cases, issues are still being processed in ministries and public bodies.

### Responses to the suggestions of the National Audit Office

Division	Year	Reports	Suggestions	Performed	Results
Performance	2006	2	16	12	75.0%
Auditing	2007	5	38	23	60.5%
Internal Controls	2007	5	154	108	70.1%

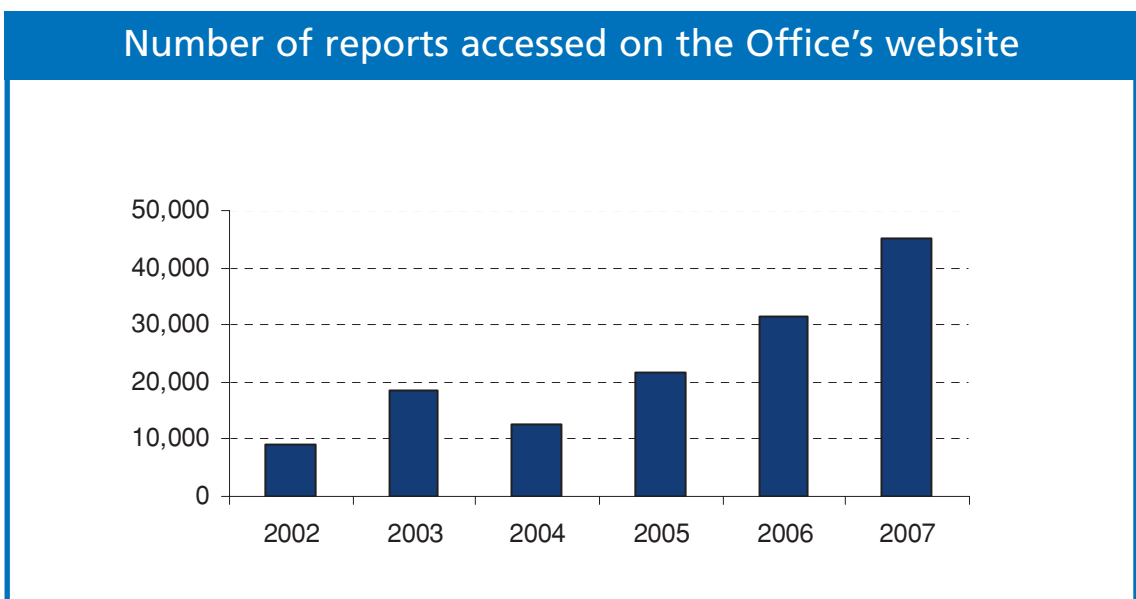
The Office has not established numbered goals concerning the fate of its suggestions – as it in fact has limited influence on the responses of the administration or public bodies. Furthermore, such performance measurements may not result in limiting the Office's suggestions to those that may safely be expected to lead to changes. However, it is clear that the Office does not make suggestions unless it believes them to be natural and legitimate. It must, therefore, be the Office's goal that as many as possible are taken into

account and preferably not fewer than 70%. Overall, the results of these follow-up audits (68.8%) can be considered acceptable.

For several years, the Office has made sporadic efforts to gain an insight into the opinion of those who can be termed the Office's clients as regards the quality and usefulness of the reports issued by the Office. Among such clients are the managers of public bodies and ministries covered by the auditing activities. This year, views on four performance audits from 2007 were examined, and the results are shown in the table below. The Office considers the results acceptable, although the low percentage of responses, approximately 20%, does detract from its reliability. The Office plans to continue these efforts and to try to find ways to improve the proportion of participants that respond.

Opinion poll on the quality of four performance audits in 2007					
Statements about the reports	Strongly agree	Somewhat agree	Neutral	Somewhat disagree	Strongly disagree
Factual descriptions were correct	30%	50%	10%	10%	0%
Results were properly reasoned	40%	20%	30%	10%	0%
Suggestions were useful	10%	60%	20%	10%	0%

In addition to such opinion polls the Office has, over the past six years, measured the public's interest in its reports by monitoring how often they are accessed on the Office's website. There has clearly been a considerable increase in interest over the past two years. The website has become, without a doubt, the Office's most important medium for the presentation information. In 2007, the 230 reports contained in the Office's database were accessed a total of 45,042 times, an average of 196 times each during the year. In comparison, it may be mentioned that in 2006, the 212 reports in the database at the time were opened a total of 31,586 times, which was an average of 149 times each. The increase between years, therefore, was 32–43%, depending on calculations. This must be considered highly acceptable.



The most popular report on the Office's website in 2007 was *The Finances of Byrgid ses.* (2007), which was accessed 4,383 times. Ever since the Office began its web measurements in 2001, no report has been opened as often in one year. The report *Cost, efficiency and quality of university teaching* (2007) was also very popular. As the following table shows, there was a substantial increase in traffic between years as regards the five most popular reports. The table also shows that the newest reports generally attract the greatest interest. In 2007, however, one report from 2003 was placed fifth: *The Privatisation of Major State Enterprises, 1998–2003*. It must be mentioned that the Office's annual report, *Implementation of the Government Budget*, has had a secure place on this list for the past four years.

### Five most-read reports on the Office's website

2006		2007	
1 The University of Icel. (2005)	774	The Finances of Byrgid ses. (2007)	4.383
2 Services to the elderly (2005)	677	Cost, efficiency and quality... (2007)	1.484
3. Landsp. University Hosp. 2005)	562	Implementation of the Govern. Budget (2007)	910
4. Impl. of the Govern. Budget (2006)	500	The purchase and renovation... (2007)	670
5. Annual Report of the NAO (2006)	470	Privatisation (2003)	660
<b>Total</b>	<b>2.983</b>		<b>8.101</b>

To find out the lifetime of the reports, an examination was made of the frequency of access of the 11 reports that were issued in 2005 during the years 2005–07. On the one hand, the three most-read reports from that year were considered: *The University of Iceland*, *Services to the elderly* and *Landspítali University Hospital*; on the other, all the reports were taken into account. It is worthy of note that interest in these reports has remained little changed between years, and was, in fact, at its highest in 2006. On average, each report was opened 1,066 times during the period, or 355 times a year. This indicates that the reports retain their value and interest for quite some time. Overall, the Office is pleased with the general interest in its reports.

### Lifetime of public reports from 2005 (how many times accessed)

	2005	2006	2007	Total
The University of Iceland (April 2005)	1.047	774	619	2.440
Services to the elderly (Nov. 2005)	370	677	561	1.608
Landspítali University Hospital (Dec. 2005)	168	562	371	1.101
Other reports from 2005	2.450	2.077	2.049	6.576
<b>All reports from 2005</b>	<b>4.035</b>	<b>4.090</b>	<b>3.600</b>	<b>11.725</b>
<b>Average access of reports from 2005</b>	<b>367</b>	<b>372</b>	<b>327</b>	<b>1.066</b>

As a rule, the Office issues a press release when a new report is published, outlining the main results and recommendations of the study. Measurements show that these releases are by far the most popular reading matter on the Office's website. In 2007, 20 press releases were issued on the website, each of which was accessed 614 times on average; two were accessed more than 1,000 times. The media, moreover, has often used the releases in their coverage, so they are clearly seen by a large proportion of the public. Subscriptions to the releases are available, and there were 170 subscribers at the end of 2007, as opposed to 130 at the end of 2006.

The Internet will obviously play an increasingly important role in the future endeavours of public bodies and enterprises to disseminate information and services. The National Audit Office has continuously sought to improve its website, and this has had the effect of steadily increasing traffic on the site over recent years. In 2007, there were 41,106 registered visits by 20,793 guests (computers) to the Office's website, as compared with 27,159 visits by 13,591 guests in 2006. This is an increase of 51–53%, depending on how calculations are made.

In December 2007, the Prime Minister's Office and The Association of Local Authorities in Iceland introduced the report: *How are public websites spun?* This was the second time a survey of this nature was carried out; the earlier one was performed in 2005. This time, 262 websites operated by 194 government bodies and 68 municipalities were taken into account. They were evaluated based on content, usefulness, accessibility and electronic services. The National Audit Office's website performed well overall, achieving an average of 70 points, which is well above the overall average and similar to the average score achieved by ministries.

### Evaluation of the National Audit Office website

	Content	Usefulness	Accessibility	Services	Average
National Audit Office	69	83	78	50	70
Average overall	61	59	41	61	56
Average among ministries	74	78	69	61	71

This survey shows that improvements made to the Office's website over the past two years have been successful, particularly a number of changes intended to facilitate navigation within the website. At the same time, the results were an encouragement to do even better in coming years. A working group has been appointed within the Office for this purpose.



*The National Audit Office audits the offices, funds and institutions of the Church of Iceland.*



## 2. Internal Processes

*The National Audit Office aims to operate efficiently and provide quality services.*

To evaluate efficiency, the Office takes account of three factors: 1) productivity in auditing; 2) accumulated proportion of certified financial statements within the year; 3) efficiency in the auditing of the Central Government Accounts. No measurement criteria have been developed to assess quality other than those mentioned in connection with the services of the Office.

An examination of the productivity of the Office, i.e. the number of financial statements and reports sent out, reveals that in recent years, the Office has 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 2007, the Office certified 328 annual accounts and prepared 230 audit reports. This is a decrease of approximately 4.6% from the past two years, and is in fact attributable to a reduction in the total number of public bodies due to mergers. If purchased services are included, annual accounts number 389 and auditing reports number 279, as compared with 410 annual accounts and 292 auditing reports in 2006.

Productivity in financial auditing			
	2005	2006	2007
Certified annual accounts	346	344	328
Audit reports	240	241	230
<b>Total</b>	<b>586</b>	<b>585</b>	<b>558</b>

Number of reports and memoranda issued by the Office in the field of performance auditing, internal controls and IT system reviews were 24, as compared with 23 in 2006. In total, the Office issued 14 public reports in 2007, which was one more than in 2006.

Reports and memoranda			
	2005	2006	2007
Performance audits	8	4	5
Memoranda, etc.	11	18	19
Guidelines	0	1	0
<b>Total</b>	<b>19</b>	<b>23</b>	<b>24</b>

On the whole, the Office's auditing productivity was similar to that of the past few years. This is considered acceptable, particularly after taking into account the fact that active man-years fell by two from the year 2006.

In recent years, the Office has placed particular emphasis on completing the certification of financial statements as early in the year as possible so that they are as useful as possible for managers of public bodies and enterprises and others who make decisions regarding their operation. As the following table shows, these endeavours have been quite successful. In 2007, the Office managed to certify 58.6% of all financial statements before the middle of the year and 93.4% before the end of the third quarter. This was a huge improvement over previous years.



In 2007, the Office performed an audit of the cost, efficiency and quality of university teaching.

### The accumulated proportion of certified annual accounts during the year

Year	Q1	Q2	Q3	Q4
2005	4,4%	38,5%	57,7%	100%
2006	8,0%	43,8%	78,0%	100%
<b>2007</b>	<b>9,4%</b>	<b>58,6%</b>	<b>93,4%</b>	<b>100%</b>

In addition to examining the date of certified financial statements, the Office has measured its efficiency by examining the time it takes to perform particular tasks. Comparison of the last three years as regards the time taken to prepare the report *Audit of the Central Government Accounts* from the time the Government Accounts were issued was favourable in 2007, i.e. 53 days as compared to 73 days in 2006. Another positive signal is that the report was issued more than a month earlier than in 2006, i.e. on 3 October. This is in tune with the Office's policy that the work must be as useful as possible for the Althingi during preparation of the following year's budget.

### Efficiency in the audit of the Central Government Accounts

Year	Central Govern. Accounts	Audit of the Central Govern. Accounts	Number of days
2005	Issued 26.09	Issued 22.11	57
2006	Issued 24.08	Issued 06.11	73
<b>2007</b>	<b>Issued 10.08</b>	<b>Issued 03.10</b>	<b>53</b>

### 3. Staff and Development

*The National Audit Office seeks to recruit well-trained and competent employees who are willing to improve and develop their skills and competencies. In addition, the Office endeavours to promote an encouraging morale in the workplace.*

To measure its human resources assets, the Office has chosen four items: 1) the number of audit hours; 2) the ratio of staff with a university degree and the number of their vocational retraining days; 3) professional experience and staff turnover; 4) absences due to illness.

The staff delivered 4,500 fewer active man-hours in auditing in 2007 than in 2006. Bought-in services were also slightly fewer than in recent years. In total, the number of active man-hours fell by 6%, or by two FTEs. This can be attributed to an unusually high rate of staff turnover. The Office plans to turn this development around in 2008 by increasing the number of staff. This is necessary as there has been an increase in the number of tasks performed by the Office during the past few years, and as a result, pressure has mounted.

Number of man-hours in auditing			
	2005	2006	2007
National Audit Office	73.992	72.600	68.100
Bought-in services	3.722	3.650	3.485
<b>Total</b>	<b>77.714 (100%)</b>	<b>76.250 (98,1%)</b>	<b>71.585 (92,1%)</b>

On the whole, educational matters at the Office are in good order. The ratio of staff with a relevant university education has been over 80% during the past six years; all those currently involved in auditing work have appropriate qualifications. As stated elsewhere in this report, employees with business administration degrees form the majority of the staff. The number of staff with education in political and administrative sciences has, however, increased the most in recent years. Moreover, the number of staff with master's degrees has increased substantially in recent years.

The Office, in accordance with the provisions of the INTOSAI auditing standards, emphasises that staff preserve and strengthen their theoretical and practical knowledge through continuing education and vocational training. Staff are expected to devote an average of 40 hours annually to matters of this nature. In recent years, this figure has been substantially exceeded, and was approximately 70 hours per employee in 2007. In 2007, the Office spent approximately 3% of the Office's total expenses net of user fees on career development and retraining.

Education			
	2005	2006	2007
Employees with university degrees	81,6%	80,9%	82,6%
Number of hours in vocational retraining	70 hours	45 hours	70 hours
Expenditure on educational issues	ISK 14.2m (4.1%)	ISK 9.2m (2.5%)	ISK 13.1m (3%)

Experience contributes significantly to productivity and quality in the workplace. The ratio of permanently employed staff with at least three years' experience in the Office grew steadily from 2002 to 2005, rising to 83.7%. At the same time, the average length of service rose to a peak of 11.5 years in 2006. There was a considerable turnaround in this respect in 2007, when the ratio of employees with at least three years' experience fell to 66% and the average length of service fell to 10.4 years. This can be attributed to increasing staff turnover during the past 3–4 years.

## Work experience and staff turnover

	2005	2006	2007
With 3 years' work experience at NAO	83,7%	80,9%	66%
Average length of service at NAO	10.8 years	11.5 years	10.4 years
Staff turnover	10,2%	14,9%	17%

There is every reason to worry about staff turnover, and efforts will be made to reverse this trend, not least because many of those who have left the Office have been young people. At the same time, it is clear that the turnover is in line with general trends on the Icelandic labour market. In 2005, employee turnover in Icelandic enterprises in general was 14.2% (10% in the public sector). No overall figures are available for the past two years.

According to recent surveys, employee absence in Icelandic enterprises and public bodies due to illness has fallen somewhat in recent years after peaking in 2001 and 2002. These absences are often regarded as indications of the work environments, the workload placed on the employees and general well-being in the workplace, although other factors can have an effect, such as employee lifestyle, age and social standing. There also seems to be a certain, although not absolute, correlation between employee satisfaction and absences due to illness.

In the past few years, the Office's staff were absent from work due to their own or their children's illness for an average of about six days a year. In 2007, staff took an average of 5.4 sick leave days, down by more than a day from 2006. As a proportion of the total hours worked, sick leave decreased from 2.9% in 2006 to 2.3% in 2007.

## Number of sick days per employee

	2005	2006	2007
Own illness	4,4	5,5	4,4
Illness of children	1,1	1,0	0,9
<b>Total</b>	<b>5,5</b>	<b>6,5</b>	<b>5,4</b>
<b>Proportion of working days</b>	<b>2,4%</b>	<b>2,9%</b>	<b>2,3%</b>

Staff sick leave days are unusually few when compared with Icelandic enterprises. According to a recent survey, employees of Icelandic enterprises in general, were absent from work due to illness and accidents for an average of 8.4 days in 2006. This corresponds to 3.8% of all working days. No figures are available for 2007. In general, there were a greater number of absences due to illness among civil servants than among those employed in the private sector.

## 4. Finance

*The National Audit Office aims to maintain its operations within budget and to ensure that its work is performed in an economical manner.*

In 2007, the Office achieved a surplus of just over ISK 6m, as compared to a surplus of just under ISK 20m in 2006. Financially, the Office stands on a sound footing.

### Aggregate operating surplus (ISK millions)

Year	Position at start of year	Surplus	Position at end of year
2005	1.1	18.1	19.2
2006	19.2	19.6	38.8
<b>2007</b>	<b>38.8</b>	<b>6.3</b>	<b>45.0</b>

In order to assess economy in its operations, the Office listed the costs resulting from, on one hand, the services of the Office's staff 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 were well within normal limits of cost-efficiency.

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

Year	Bought-in services	National Audit Office	Difference
2005	7,789	5,646	2,143
2006	8,558	6,001	2,557
<b>2007</b>	<b>9,253</b>	<b>6,887</b>	<b>2,366</b>



*From the obstetrics department of Landspítali University Hospital.*

# PUBLIC REPORTS 2007

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## Reports

1. *The Finances of Byrgid ses.* (January)
2. *Binding Contracts by Ministries and Government Grants in 2006* (March)
3. *Administration of Occupational Safety and Health* (March)
4. *Rules on the Financial Accounts of Political Parties, etc.* (March)
5. *Cost, Efficiency and the Quality of University Teaching: Business Administration, Law, Computer Sciences* (May)
6. *The Purchase and Renovation of the Grímsey Island ferry* (August)
7. *Implementation of the Government Budget 2006* (August)
8. *Service Agreement for South East Iceland Health Care Facility* (September)
9. *Audit of the Central Government Accounts 2006* (October)
10. *St. Jósefsspítali – Sólvangur Hospital* (November)
11. *Measures Against the Import of Illicit Drugs* (November)
12. *The Agreement Between the Icelandic Government and Landsvirkjun on the Takeover of Water Rights in the Lower Stretch of the River Thjórsá* (December)

## Other publications

1. Annual Report 2006 (March)



# Financial Statements 2007

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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 2007, the Office's operations generated a net income of ikr. 6.3 million. According to the Balance Sheet, the assets of the Office amounted to ikr. 59.2 million, liabilities amounted to ikr. 14.1 million, and equity amounted to ikr. 45 million at year-end 2007.

The Auditor General and the Head of Financial Audit Division certify the Financial Statements of the National Audit Office for the year 2007 with their signatures.

The Icelandic National Audit Office, 28 February 2008



Sigurdur Thordarson, CPA  
Auditor General



Sveinn Arason, CPA  
Head of Financial Audit Division

# 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 2007. 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 Financial Statements 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 Financial Statements 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 2007, its Balance Sheet as of 31 December 2007 and change in cash during the year 2007, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavik, 28 February 2008



Gunnar Sigurdsson  
Chartered Accountant



## Profit and Loss Account 2007

	2007	2006
<b>Operating revenues</b>		
Sale of services .....	31,614,250	27,816,649
Sale of assets .....	0	1,002,500
Other income .....	416,153	10,125
	<u>32,030,403</u>	<u>28,829,274</u>
<b>Operating expenses</b>		
Salaries and related expenses .....	320,072,215	300,805,547
Administrative expenses .....	14,912,317	9,175,051
Meeting and travel cost .....	16,467,103	13,384,622
Expert services .....	40,024,207	40,514,137
Operations of equipments .....	2,913,785	2,066,837
Other operating expenses .....	4,793,012	3,094,697
Housing .....	25,941,274	22,992,400
Operation of vehicles .....	531,269	396,046
Grants .....	583,600	1,698,500
	<u>426,238,782</u>	<u>394,127,837</u>
Purchased assets .....	16,323,741	8,205,489
	<u>442,562,523</u>	<u>402,333,326</u>
<b>Net income (-loss) before Treasury contribution</b>	( 410,532,120)	( 373,504,052)
Treasury Contribution .....	<u>416,800,000</u>	<u>393,100,000</u>
<b>Net income for the year</b>	<u>6,267,880</u>	<u>19,595,948</u>

## Balance Sheet 31 December 2007

	2007	2006
<b>Assets</b>		
<b>Current assets</b>		
Treasury .....	56,606,358	37,820,716
Accounts receivable .....	2,346,320	8,662,200
Cash and cash equivalents .....	222,246	311,021
	59,174,924	46,793,937
<b>Total assets</b>	59,174,924	46,793,937
<b>Equity and Liabilities</b>		
<b>Equity</b>		
<i>Equity:</i>		
Equity at the beginning of the year .....	38,779,186	19,183,238
Net income for the year .....	6,267,880	19,595,948
<b>Equity</b>	45,047,066	38,779,186
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable .....	14,127,858	8,014,751
<b>Liabilities</b>	14,127,858	8,014,751
<b>Total equity and liabilities</b>	59,174,924	46,793,937

## Cash Flow Statement 2007

	2007	2006
<b>Cash flow from operations</b>		
<i>Cash flow from operating activities:</i>		
Net income for the year.....	6,267,880	19,595,948
<b><i>Cash flow from operating activities</i></b>	<b>6,267,880</b>	<b>19,595,948</b>
 <i>Changes in current assets and liabilities:</i>		
Accounts receivable, decrease / (increase).....	6,315,880	( 2,424,455)
Accounts payable, (decrease) / increase.....	6,113,107	2,514,909
	12,428,987	90,454
<b>Net cash provided by operating activities</b>	18,696,867	19,686,402
 <b>Cash flow from financial activities</b>		
 <i>Changes in balance with the Treasury:</i>		
Treasury contribution.....	( 416,800,000)	( 393,100,000)
Received from the Treasury.....	398,014,358	373,507,140
<b>Net cash from financing activity</b>	<b>( 18,785,642)</b>	<b>( 19,592,860)</b>
 <b>Net increase in cash and cash equivalents.....</b>	<b>( 88,775)</b>	<b>93,542</b>
 <b>Cash and cash equivalents at the beginning of the year.....</b>	<b>311,021</b>	<b>217,479</b>
 <b>Cash and cash equivalents at the end of the year</b>	<b>222,246</b>	<b>311,021</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. All amounts are in Icelandic krona, ikr.

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.

## **Budget and Operations**

The Office's budget for 2007 anticipated similar activities as in the previous year. Initially, the Office's budget was ikr. 413.5 million. Budget appropriations amounting to ikr. 3.3m were transferred due to the price level increase of wages. Thus in 2007, the Office's total budget amounted to ikr. 416.8 million.

## Notes

Operating expenses less sale of services totalled ikr. 410.5 million and were ikr. 6.3 million less than budget. Operating expenses are specified as follows:

In ikr. thousand	Initial	Total budget	Financial Statements	Differences
Sale of services .....	( 20,700 )	( 20,700 )	( 32,030 )	11,330
Salary and salary-related expenses .....	334,400	337,700	320,072	17,628
Other operating expenses .....	95,500	95,500	105,583	( 10,083 )
Grants .....	0	0	584	( 584 )
	<u>409,200</u>	<u>412,500</u>	<u>394,209</u>	<u>18,291</u>
Purchased assets .....	4,300	4,300	16,324	12,024
	<u>413,500</u>	<u>416,800</u>	<u>410,532</u>	<u>6,268</u>

### Break-down in ikr. thousand by type:

	2007	2006
Sales of services .....	( 32,030 )	( 28,829 )
101 Icelandic National Audit Office .....	426,239	394,128
601 Equipment .....	16,324	8,205
	<u>410,532</u>	<u>373,504</u>

### Divisions

Profit and Loss Account by divisions in ikr. thousand:

Office management .....	32,843	26,279
Financial Audit Divisions .....	205,266	192,653
Performance Audit Divisions .....	147,791	128,062
Legal and Environmental Division .....	24,632	26,510
	<u>410,532</u>	<u>373,504</u>



**RÍKISENDURSKOÐUN**  
*ICELANDIC NATIONAL AUDIT OFFICE*

Skulagata 57, P.O. Box 5350, 125 Reykjavík, IS-Iceland  
Tel: +354 569 7100; Fax: +354 562 4546  
E-mail: [postur@rikisend.is](mailto:postur@rikisend.is)  
Homepage: [www.rikisendurskodun.is](http://www.rikisendurskodun.is)