



RÍKISENDURSKOÐUN  
*ICELANDIC NATIONAL AUDIT OFFICE*

# Annual Report 2005

Icelandic National Audit Office

# Annual Report 2005



February 2006



*Annual Report 2005*

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# Introduction by the Auditor General

SIGURDUR THÓRDARSON

OVER THE PAST TWO DECADES, central government authorities have been engaged in implementing new management methods in the public sector. These include performance management agreements between ministries and public bodies. The agreements provide for goal setting, specify required service levels and finances, and presume that the parties will agree on a system to measure results. Ministers have also received authorisation to negotiate with parties both in and outside the public sector concerning long-term projects to improve services and efficiency.

The National Audit Office's survey on the progress of implementing new management techniques within the public sector revealed that performance management agreements exist with the majority of public bodies. There is, however, some way to go before such agreements have been implemented as an integral part of public bodies' administrative system and many performance targets are reached. In addition, measurable criteria are often lacking.

One of the main reasons that the implementation of new management practices has not been as successful as it should have been is that only a small group of administrators has adopted policy-targeted work practices. Politicians also need to join the ranks and lead the implementation of new work practices. In many countries we compare ourselves with, politicians formulate policies and set measurable targets for individual issues, and subsequently monitor the progress of the matter closely by measuring performance.

It is no less important to encourage civil servants to obtain results through reformed management practices and to use their considerable knowledge and experience in that area. Finally, it is vital that those implementing changes and providing services submit their suggestions for improvement in the performance management system.

One of the principal functions of the National Audit Office is to inform central government authorities of possible improvements to public services along and point out how cost effectiveness, efficiency and results may be increased. This is done by revealing how services are provided and in what way they can be improved. Issues are usually assessed from the point of view of taxpayers and those using the services.

In recent years, the National Audit Office has addressed various political issues, e.g. nursing and elderly services and issues related to secondary schools and universities, and has submitted pertinent information. In these studies, assessments have been made of service levels, quality and costs, and possible improvements indicated. In order to assess the current position, note has been taken of not only comparable domestic operations, but also comparisons with overseas entities providing the same services. This information has certainly been important in the public discourse and been useful in the formulation of policies.



In past years, the annual report of the National Audit Office has described the efficiency and quality of the institution's work by reporting on its principal indicators of activities and performance. The Office has measured employee productivity and the cost of individual projects, and efforts have been made to manage them in accordance with the goals of the Office. This information has also been used for comparison with planning and earlier results. Over the past two years, the output of financial audits has decreased in relation to certified annual accounts, owing to, among other things, a reduction in the number of working hours, problems with processing information from the government financial systems and decreased efficiency. The same applies to performance auditing. The Office plans to increase the efficiency of its operation in 2006, ensuring that the decline of the last two years is effectively over.

One of the benchmarks the Office uses to evaluate the operation is interest in published reports. The number of times reports were accessed on the Office's website during the years 2002-2005 show that in 2005 they were accessed approximately 22,000 times, compared with 9,000 in 2002. This indicates that public interest in the work carried out by the National Audit Office has increased substantially.

Total expenditures in 2005 amounted to ISK 375 million, compared with ISK 339 million in 2004. This is an increase of 10.6%. User fees amounted to approximately ISK 34 million, decreasing by ISK 3 million from the year before. Nevertheless, the National Audit Office achieved a budget surplus of ISK 18 million in 2005 and strengthened its financial position even further from the period 2002-2003 when there was a budget deficit in the operation. Since 1987, the National Audit Office has only twice overrun its budget. By year-end 2005, there was an approximately ISK 20 million surplus on the principal, which is 5.5% of the budget appropriation for 2005.



# Mission and Objectives

THE NATIONAL AUDIT OFFICE is an independent body operating under the auspices of Iceland's parliament, the Althingi, pursuant to Act No. 86/1997. It has two main responsibilities: financial auditing and performance auditing.

The role of the National Audit Office is, first, to certify that central government accounts accurately represent operations and finances in accordance with generally accepted accounting principles, inspect the internal control of public bodies and enterprises and assess whether such control ensures adequate performance. Second, the Office shall monitor public spending, i.e. whether government bodies ensure economy and efficiency in their activities and comply with applicable legal requirements in this respect. The Office also provides parliamentary committees and central government bodies with various advice and guidance, including the drafting of Government Budgets.

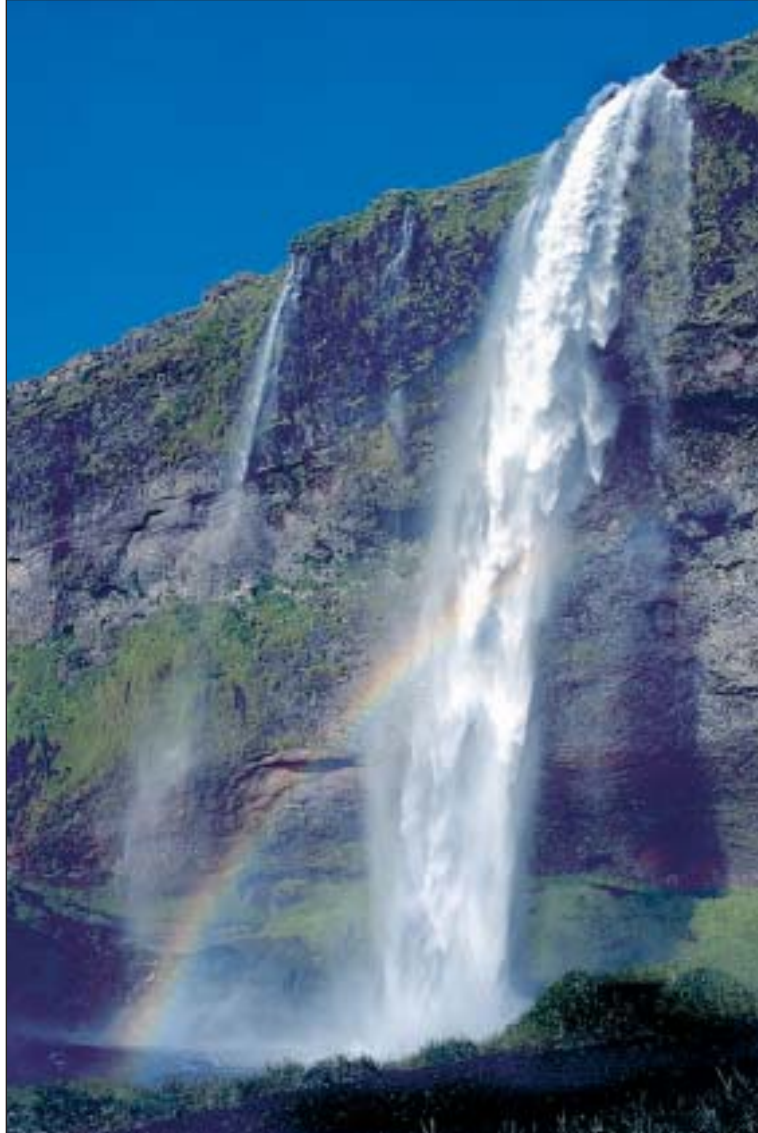
The National Audit Act clearly stipulates that the Office is independent in carrying out its duties and that its staff shall be completely independent of any ministries and other public bodies under audit. The Office also decides where and when to perform audits. However, the Presidential Committee of 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 six years. The Auditor General recruits other staff.

Under law, the Office may call for financial statements from public bodies, associations, funds and any other entities receiving Government funds or guarantees. Furthermore, the Office 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. It may also request reports on the use of grants and other public money.

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 annual 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 monitors the reactions of the audited party to its comments. These 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 its own assessment of importance and risk. As other Supreme Audit Institutions, its principal aim is to support the prudent use of Government funds. 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, partly based on the Code of Ethics of the International Organisation of Supreme Audit Institutions (INTOSAI). The key points of the Code of Conduct include credibility, independence, integrity and professionalism.





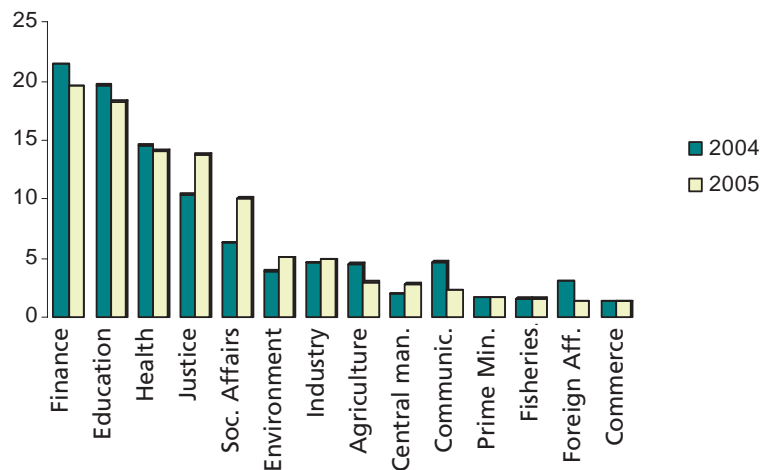
# Operations in 2005

**MAN-YEARS AT THE NATIONAL AUDIT OFFICE** increased by approximately 1 from 2004 to 2005. As usual, the greatest amount of time was spent on financial auditing. The Office's output decreased a little from 2004, while its financial position strengthened considerably.

The staff of the National Audit Office delivered a total of 73,992 active man-hours in auditing-related work in 2005, compared to 71,856 hours in 2004. That is an increase of 2,136 hours or 3%, which corresponds to approximately one man-year. Additionally, the Office purchased services from 11 auditing firms, corresponding to 3,722 work hours, compared with 3,780 hours in 2004. There is still some way to go before the Office is able to turn in as many work hours as in 2003 (76,444), when its output was greater than ever before.

The Office spent 56.9% of all active work hours on financial auditing. Approximately 16.8% was spent on performance audits, 9% on audits of information systems, 7.5% on legal and environmental projects, 4.5% on internal controls and 5.3% on other projects. The biggest change from the previous year was a decrease by 21% in performance audit, while the proportion of financial auditing and audits of information systems increased. In comparison with other Nordic Supreme Audit Institutions, with the exception of the Office of the Faeroe Islands, the proportion of financial auditing is rather high in Iceland, as the National Audit Office publishes audited annual accounts for almost all public bodies. In other countries, comparable auditing offices generally make do with a sample. The proportion of performance auditing is generally greater than in Iceland.

**Proportional division of working hours by ministries**



In 2005, the National Audit Office spent 56,500 hours auditing individual ministries and their institutions. This equals to the time spent in 2004 but is 3,500 hours less than in 2003. The greatest amount of time was spent on auditing the budgets of the Ministry of Finance (19.6%), the Ministry of Education (18.3%), the Ministry of Health and Social Security (14.1%) and the Ministry of Justice (13.8%). As usual, there was some transfer of hours between ministries from the previous year.

## Financial Auditing

In 2005, the number of working hours the Office spent on financial auditing increased slightly from 2004, corresponding to half a man-year. Overall, however, there was a 5.5% drop in output in this field when compared with the previous year. The Office certified a total of 344 annual accounts and produced 238 audit reports, compared with 357 annual accounts and 259 audit reports in 2004. It is clear that the implementation of a new government financial system caused that the auditing generally took longer than before. This is expected to improve in 2006. The number of audit reports, in particular, will be increased. Moreover, efforts will be made to complete the certification of financial statements earlier in the year than has been the case, so that they can be of greater use to public bodies. The prerequisite here, however, is that public bodies close their accounts earlier than they have done in previous years.

In addition to certifying that the financial statements present the audited body's operations and financial position fairly and accurately, and are in accordance with generally accepted accounting principles, the National Audit Office is expected to examine how they dispose of budget appropriations from the Althingi, which are laid down in the Government Budget, their scope of activities and their performance. The results of this work by the National Audit Office in 2005 were published in its report *Audit of the Central Government Accounts 2004*. This report also contains the results of the Office's annual review of a number of aspects of the operations of public bodies and enterprises. The main objective is to raise standards of prudent management in government departments, improve stewardship of public money and assets, and strengthen internal controls. Four issues were addressed this time: the housing issues of public bodies, employee home-use of computer equipment, arrangement of telecommunications and purchased services relating to information matters. These items were examined in approximately 240 public bodies, and the review should provide a fairly clear image of the actual position these matters are in.

## Internal Control

In addition to examining the financial internal controls of public bodies and enterprises during financial auditing, the National Audit Office has placed emphasis on educating their management on what internal controls involve, as well as principal risk elements in public sector operations. Among the things particularly pointed out in the past are the risks involved if a public body or enterprise does not attain 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 with regard to sensitive activities in their own operations. They have generally not, however, 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 attaining their goals.

In connection with internal control, the National Audit Office completed two extensive reports during the year, one concerning Landsvirkjun and the other concerning the National Land Survey of Iceland. Internal control staff participated in the preparation of two other official reports of the Office; one involved the implementation of the

Government Budget, and the other the Housing Financing Fund. Like the Office's reports on financial audits, its internal control reports are never made public, as they often deal with sensitive internal issues of the audited body.



## Performance Auditing

Active working hours spent on performance auditing decreased by 13.5% between 2004 and 2005, corresponding to just a little less than one man-year. For this reason there was a decrease in the number of performance audits carried out by the Office, from 6 to 5. As usual, these reports are fairly extensive in scope. Three of them cover individual government bodies: the University of Iceland, Landspítali University Hospital and the Blönduós Healthcare Centre. Two other reports address particular issues: services to the elderly and purchases of expert services by ministries and government bodies.

Through its performance audits, the National Audit Office focuses on economy, efficiency and effectiveness, and whether public bodies comply with applicable legal requirements. Some of the audits are prepared at the request of the Presidential Committee of Althingi, individual ministries or government bodies and some on the initiative of the Office itself, where account is taken of, among other things, the importance of the subjects, costs and risks. The Office has, in past years, placed increased emphasis on strengthening these audits through the use of various comparisons, both domestic and foreign. 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. Good examples of publications of this type are the reports concerning the University of Iceland, Landspítali University Hospital and services to the elderly.

In 2005, the National Audit Office adopted the innovation of directly surveying the views of a selected group of individuals from outside the office, on the quality of the Office's performance audits, their strengths and weaknesses. Two such surveys were made, one for the report *The University of Iceland* and one for *Services to the Elderly*. Readers were requested to submit their views on 8 material and formal items to which the Office pays particular attention when preparing reports. The answers were rated on a scale of 1 to 10 and the average ranking calculated. This rank proved to be 7.7 for the former report and 7.4 for the latter. This is an acceptable result in the opinion of the National Audit Office, and at the same time, encouragement to do even better. Of particular satisfaction was that the majority of readers considered the reports accessible and logically constructed, and written in good and understandable language. Thus, the efforts of the Office in recent years to improve these matters and cater to the general public have clearly been successful.

In the latter part of 2005, organisational changes were made to the Performance Audit Division of the Office when some of its tasks were reassigned to the Office of the Auditor General. The changes are intended, on the one hand, to increase the efficiency of the Division by defining its tasks more clearly than has been the case, and to place increased emphasis on preliminary investigation and team-work. As a result, projects are expected to be completed in a shorter time than has been the case and to better meet the needs of the entities that use the reports. On the other hand, the changes seek to improve work practices when preparing reports and, in doing so, take account of both the methods developed by the UK National Audit Office and the comments made in the aforementioned quality surveys carried out by the National Audit Office in 2005.

## IT Auditing

The number of working hours spent on IT auditing increased substantially between the years 2004 and 2005, from 3,502 hours to 6,657 hours. In addition to handling IT auditing, the 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 due to the implementation of a new financial system adopted in the State Accounting Office in 2005. The department also handled all internal computer matters of the National Audit Office in other respects.

Audits performed in the field of IT auditing in 2005 were sent only to the public bodies being audited and to the relevant ministry. These audits regularly involve sensitive internal matters of the public bodies, e.g. computer systems security. The National Audit Office believes it would be irresponsible to discuss these matters publicly, as information on their weaknesses could become common knowledge before they could be rectified.

## Legal and Environmental Division

The operation of the Legal and Environmental Division was similar in 2005 to previous years. In addition to monitoring funds and entities operating under confirmed charters, a considerable number of its projects involved consultation services and preparing reports on diverse questions relating to central governmental administration. Two of the Office's public reports in 2005 were either wholly or partly prepared within this Division. These



addressed, on the one hand, the possible eligibility of Prime Minister Halldór Ásgrímsson to discuss the sale of the Government's shareholding in Búnadarbankinn to the S-Group and, on the other, the Housing Financing Fund. 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 was described in a public report in early 2006: *The Convention on Biological Diversity*.

## Staff

On 31 December 2005, the National Audit Office's permanent employees totalled 49. That is the same number as in the preceding year. In addition, several worked for part of the year. Man-years were just over 49 and increased by one. Five employees retired in 2005 and were replaced by an equal number of new recruits, making employee turnover 10.2%.

Of permanent staff, 28 (57%) were men and 21 (43%) were women. This is a similar proportion as in the past two years. If only management positions and experts are taken into account, then men accounted for 63% and women 37%. The average age of employees was 47.8 years and the average length of service 10.8 years. A total of 83.7% 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 31, hold a degree in business administration. Moreover, three hold degrees in political or administrative sciences, two are lawyers, one is economist, one has a B.Sc. in computer sciences and one holds an MA degree in Icelandic studies. There are currently 7 certified accountants employed by the Office, one has certification in IT auditing (CISA) and one in internal auditing (CIA).

## Finances and Expenditure

The National Audit Office's budgetary appropriation under the 2005 Government Budget and Supplementary Budgets totalled ISK 360 million, an increase of 41 million from the preceding year, or 12.9%. Total expenditures net of user fees, on the other hand, were upwards of ISK 342 million, up by ISK 40 million from 2004. The Office kept within budget by ISK 18 million.

As the summary of the income statement shows, payroll costs were approximately 85.4% of the Office's expenses, net of user fees, an increase of ISK 33 million (12.7%) between years. Operating costs and purchased assets, however, increased by ISK 4 million (5%). The largest single operating cost item is bought-in expert services from 11 audit firms, for approximately ISK 30 million. User fees, on the other hand, were ISK 3 million (8.1%) lower than in 2004.

According to time sheet, the costs incurred by the Office's individual operating divisions were as follows: the Financial Audit Divisions I-III cost ISK 193 million, i.e. 56.4% of the Office's expenses; the Performance Audit Division, the IT Division and the Internal Control Division cost ISK 101.5 million (29.7%); the operation of the Legal and Environmental Division cost ISK 25.5 million (7.5%) and Central Management cost ISK 22 million (6.4%). This is similar proportion as in the past few years. Total costs for each full-time equivalent position were ISK 7.0 million, compared with ISK 6.6 million in 2004, increasing by 9%.

Profit and loss account in ISK millions	Year		Deviations	
	2005	2004	Amount	%
Items				
Payroll	292	259	33	12.7
Other operating expenses	81	80	1	1.3
Purchased assets	3	0	3	-
<b>Total costs</b>	<b>376</b>	<b>339</b>	<b>37</b>	<b>10.9</b>
User fees	34	37	-3	-8.1
Costs net of user fees	342	302	40	13.2
State contribution	360	319	41	12.9
<b>Surplus</b>	<b>18</b>	<b>17</b>	<b>1</b>	<b>5.9</b>

## International Relations

As before, the National Audit Office took part in diverse international co-operation in 2005, although to a lesser extent than in 2004. A part of this work involved the Office's projects of auditing the European Organisation of Supreme Audit Institutions (EUROSAI). In addition to this work, the Office's representatives attended conferences and meetings of various international associations. These included the 6th Annual EUROSAI Conference in Bonn, the Annual INTOSAI Working Group on Environmental Auditing Assembly Meeting in Moscow and a meeting in the EFTA Audit Commission. A highlight of events hosted in Iceland was the visit of the Assistant Auditor General of China, Mr. Ling Huan, and three Chinese Area Managers.

At the Annual EUROSAI Conference, Mr. Sigurdur Thórdarson, the Auditor General of Iceland, was elected to the eight-member Board of the Institution for the next six years. This is the first time that an Icelander has taken a seat on the Board. Mr. Thórdarson has been the Institution's auditor along with the Auditor General of Belgium in recent years. The Conference also decided that the next board meeting would be held in Iceland in the fall of 2006.

Other international relations include the annual meeting of Nordic Auditors General, held in Vega in Norway, and several Nordic working meetings. The close of 2005 saw the retirement of Bjarne Mørk-Eidem, Auditor General in Norway for many years. Mr. Mørk-Eidem was once a frequent visitor to Iceland owing to his work on Nordic issues, a particular area of interest to him. Moreover, he took an active part in the work of INTOSAI and EUROSAI, and was for a while a member of the Board of these institutions. On this occasion, the National Audit Office of Iceland thanks Mr. Mørk-Eidem for particularly enjoyable relations and sends him best wishes for the future.

There is no doubt that international relations are of extreme importance in enabling the Office to acquaint itself with the most up-to-date methods in auditing and to compare itself with other equivalent institutions. In this context, it is worth noting that the Nordic Supreme Audit Institutions have for three years been jointly developing indicators for their performance. Furthermore, the globalisation of recent years and the substantially increased importance of international organisations and agreements have intensified the need for international consultation and collaboration in auditing.

# The Office's Role as a Service Provider

LÁRUS ÖGMUNDSSON, HEAD OF THE LEGAL AND ENVIRONMENTAL DIVISION

The National Audit Act, Article 1, states that the role of the National Audit Office is to carry out auditing of the Annual Accounts of the Central Government and such other bodies that are charged with government operations and guardianship. Moreover, the Office may carry out performance audits. It shall also monitor the execution of the Budget and assist parliamentary committees in the discharge of their functions relating to governmental fiscal affairs.

Given the above, one can see that the National Audit Office is not limited to provide auditing in the narrowest sense of the word. Its role is more extensive. The monitoring aspect is for example of great importance, indeed so important that many perceive it as the Office's main task. It is interesting to compare this with the general but legally binding description of the role of independent auditors in Article 1 of the Auditors Act No 18/1997 where auditors are not responsible for any monitoring other than what is directly related to accounts and their reliability.

On the other hand, the Act allows auditors to provide a wider range of services than auditing. Auditors may therefore provide consultancy and services in related fields, insofar as this does not affect their objectivity. In general, related fields are quite broadly defined in the sense of the Act, allowing auditors to provide substantial consultancy and services in accounting, tax and company laws, as well as on other financial and managerial issues related to enterprises and public bodies. They are, moreover, often involved in the establishment, joining, merging and sale of enterprises and shares. Consultancy and services of this type have, in general, been regarded as a normal part of their work. Sometimes it is said that the main role of independent auditors is to serve the business sector in its varied forms, irrespective of whether the enterprises are large or small, by building trust between the users of accounts and those who submit them.

As mentioned above the Office is required by the National Audit Act to assist parliamentary committees in the discharge of their functions relating to governmental fiscal affairs. The Act has no other provisions related to the Office's role as a service provider. On closer inspection, however, it becomes obvious that the Office has a wider role in that area because the same legal obligations apply to its auditors as to the auditing profession in general. Thus, there is no distinction made between auditors working for public and private bodies and their obligations are the same.

For this reason, it is quite natural that, entities the National Audit Office is required by law to audit, occasionally ask for consultancy and other related services from the Office. Mostly these are services or consultancy in the field of central government financial affairs in its broadest sense. However, as the National Audit Office shall audit all enterprises in which the state has a majority shareholding it may have to provide these companies with as diverse services in "related fields" as is the case for auditors and companies in the private sector.

From the above, it may be concluded that public auditors and public bodies such as the National Audit Office rarely limit themselves to auditing accounts and other financial information, even if it remains their primary obligation. As is the case with their private sector colleagues, they often work on various other tasks, like consultancy and services within related professional fields. For this reason, it is important for the Office to employ people with a wide ranging educational background and who have experience and knowledge on financial and managerial issues.



# Work Practices in Performance Auditing

ÓLI JÓN JÓNSSON, HEAD OF THE PERFORMANCE AUDIT DIVISION

ONE OF THE TASKS of the National Audit Office is to investigate how well ministries and public bodies use public funds. All such investigations are designated as performance auditing and are an important aspect of the monitoring role of the Office.

The aim of performance auditing is to assess whether the operation of the bodies is economic, efficient and effective. The tasks can be very diverse, anything from examining how a public body handles a particular project it has been entrusted with, to addressing how a whole government sector is managed. Various methods are used in the evaluation, and these are garnered from, among others, social sciences and management sciences. Each evaluation results in a report in which conclusions and suggestions for possible improvements are published. The reports are intended to be useful for Althingi, the ministries and government bodies in the formulation of legislation and policy and for improvements in management and operation.

The procedure used in performance auditing is generally three-fold:

- Pre-study
- Main study
- Reporting

The aim of the pre-study is to define and delimit the audit, find the correct method to perform the audit and to estimate the time and the workforce required. The results of the pre-study are issued in an audit plan, where the main emphasis is on the principal questions the audit is intended to answer. The main study consists of collecting information, analysing such information and drawing conclusions which provide the answers to the principal questions of the audit. Next is the preparation of a report, which is also the final step of the audit. A draft of the report is always sent for review to the party undergoing the audit, whether public body or ministry, before a final version is prepared and published.

Recently, the National Audit Office has sought ways to improve work practices in performance audits. With the organisational changes established in the beginning of October 2005, increased emphasis was placed on pre-studies. In the future, these will be prepared, in part, in the office of the Auditor General. There, the principal direction of the audit will be developed, and the Performance Audit Division will subsequently be in charge of further development and planning. An attempt has been made to define audits in a more detailed manner than has previously been the case, and to tie up any loose ends, of which there are always plenty at the beginning of a project. In this respect, models have been sought from, among others, the British National Audit Office, which has developed procedures in performance auditing which have proved highly successful.



In addition to emphasis on quality preliminary investigations, an attempt has been made to make the reporting more targeted. Performance auditing involves the examination of different aspects of the item under review – it is investigated and analysed in various ways. In so doing, a large amount of information is collected on anything and everything relating to the item. Then when the time comes to prepare a report, items must be chosen from this flood of information so that the emphasis is placed on the key issues. In such work, it may be helpful for the person who is “immersed in the flood”, so to speak, to receive assistance from someone who has not been as involved. Recently, therefore, efforts have been made to change working procedures so that those not directly responsible for the audit participate in forming the outlines of the report from the beginning. Among other things, special working meetings have been held to discuss how best to present the conclusions of audits so that the material is as accessible as possible to readers.

In this respect, it must be remembered that the target groups of the National Audit Office are varied, as is the nature of the information that they require. Members of the Althingi, for instance, are often interested in different aspects in the reports than the management of public bodies and experts, not to mention the media and the general public. In each case, the correct balance between simplicity and accuracy in presentation must be found. Sometimes an attempt is made to simplify information in reports to make them more understandable to laymen. This can be problematic, and there are various dangers that must be avoided. The National Audit Office believes that such efforts are nevertheless necessary in order for the Office to fulfil its role. However, efforts are also made to ensure that more detailed information is included, in e.g. separate annexes, making the reports useful to managers and experts as well.



# Risk Management and Internal Control

INGI K MAGNÚSSON, CIA, HEAD OF THE INTERNAL AUDIT DIVISION

ALL OPERATION INVOLVES UNCERTAINTY, and managers must therefore decide to what degree such uncertainty is acceptable with regard to projected profitability. The uncertainty involves both risk and opportunity, i.e. assets may disappear or increase. Risk management enables managers to address such risk in an effective manner and to link together risks and opportunities to increase the value of the operation.

Risk management has been defined as *“a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding achievement of entity objectives.”*

Managers are expected to prepare plans, chose methodologies and define secondary goals in accordance with the overall goals of the operation. Risk management is primarily intended to meet four goals: appropriate policies, effective and economic operation, reliable reporting and compliance with laws and regulations. Sometimes a fifth category, maintenance of assets, is also described.

Risk management is based on the following eight interrelated components. These are derived from the way management runs an enterprise and are integrated with its process.

- **Internal environment.** This involves the operating environment of public body or enterprises, their moral values and risk tolerance. As such, it is a key element when risks are assessed and treated by employees, and is the foundation of risk management.
- **Setting goals.** Goals are necessary so that managers are aware of the elements that can affect their policies. These goals must be in accordance with the purpose of the public body or enterprise and its risk tolerance.
- **Analysis of events.** Various internal and external events can affect the ability of public bodies and enterprises to reach their goals. A distinction has to be made between risks and the opportunities linked to them. New opportunities can affect the methods used to reach goals that have been set.
- **Assessment of risk.** When evaluating a risk, the odds of it becoming a reality and what its effect would be must be assessed. Without such evaluation, the risk cannot be controlled. The risk is assessed with respect to whether it is inherent or external.
- **Risk response.** Risks must be responded to in an appropriate manner, i.e. by eliminating it, accepting it, lessening it or spreading it.
- **Control points.** A policy must be formulated and procedure established to ensure that risk responses are effective.
- **Information and communication.** The information required and the form it shall be in must be defined. It must be ensured that it is received in time so that employees can respond in accordance with their obligations and moreover, such information must be disseminated unhindered within the public body or enterprise.

- **Inspection.** All procedures in risk management must be constantly reviewed and necessary changes made in accordance with altered circumstances.

Internal control is linked to risk management and is an integral part of it. It is defined as a procedure which depends on managers and employees, and is designed to provide public bodies or enterprises with adequate assurance that the following goals can be achieved: efficient and economic operation, reliable financial information and operation in accordance with laws and regulations.

This definition reflects some of the basic characteristics of internal control. First, it is a process, it is a mean to an end, not an end in itself. Second it depends not only on recorded instructions and procedures, but also on employees on all levels of the operation. Third, it can be expected to provide only reasonable assurance, not absolute assurance, that objectives will be achieved. Fourth, it is geared to the achievement of objectives on one or more separate but overlapping categories.

Risk management and internal control are thus directed at the same three elements, i.e. operation, information provision and consistency. Risk management, however, covers a larger field and is based on a broader ideology concerning risk. There, the information element is much more far reaching and involves all information, financial and otherwise, that is created within a public body or enterprise, and irrespective of use within the public body or without.

Risk management, moreover, involves the terms *risk appetite* and *risk tolerance*. Risk appetite is the amount of risk an entity is willing to accept in pursuit of value. Risk tolerance is the acceptable level of variation relative to achievement of a specific objective, and often best measured in the same units as those used to measure the related objective. In setting risk tolerance, management considers the relative importance of the related objective and aligns risk tolerance with risk appetite. Operating within risk tolerance helps ensure that the entity remains within its risk appetite and, in turn, that the entity will achieve its objectives.

With increased emphasis on risk analysis, risk management broadens the procedures which internal control uses to evaluate risk and divides it into four categories: goal setting, event analysis, risk assessment and risk response. The term *risk portfolio* is also important within the field of risk management. With internal control, attention is directed at one risk element at a time, its relation to set goals and possible measures to deal with the risk. Risk management, on the other hand, attempts to view the overall structure of risk elements, i.e. the risk portfolio.



# Development of Environmental Auditing

KETILL SIGURJÓNSSON, ATTORNEY AT LAW, LEGAL AND ENVIRONMENTAL DIVISION

SINCE THE ADOPTION of the current National Audit Act (No. 86/1997), the National Audit Office has had the role of auditing various projects in the field of environmental issues. In general, these auditing projects are known as environmental auditing.

Environmental auditing involves primarily investigating and evaluating various results in the field of environmental issues, e.g. how laws or international agreements on environmental issues are upheld and the advantages that such instruments have. Also evaluated are diverse results, economy and costs in the field of environmental issues. Environmental auditing provides information on the position of this important issue, which in recent years has gained increased attention.

Over the past two years, the National Audit Office has, among other things, prepared reports in the field of environmental auditing on Icelandic compliance with the OSPAR Convention, relating to the protection of the sea, and compliance with the Convention on Biological Diversity, in addition to the environmental auditing of the Icelandic Forest Service and regional forestry projects. The Icelandic Radiation Protection Institute and the operation of the Environment and Food Agency are currently undergoing environmental auditing.

Environmental auditing is generally somewhat unique in comparison with other auditing projects. Some aspects of this form of auditing are quite similar, on occasion, to performance auditing and it is therefore natural that it is based to some extent on the experience gained there.

Environmental issues are by their nature international, and international co-operation is of considerable importance to environmental auditing. It is desirable to draw the attention and interest of environmental committees working on behalf of the European Organisation of Supreme Audit Institutions (EUROSAI) and the International Organisation of Supreme Audit Institutions (INTOSAI) to Icelandic interests, e.g. the protection of the sea from pollution and protection against undesirable climate change caused by humans. A policy of priorities has been formulated, and Iceland was one of the first countries to prepare an environmental audit on biological diversity after this issue was put on the list of priorities in the environmental committee of INTOSAI. A sign of the great interest shown by the Supreme Audit Institutions for this type of auditing is the fact that of all INTOSAI committees, the most popular committee by far is the Environmental Committee of INTOSAI, and the work carried out there has been very effective under the presidency of the Canadian Supreme Audit Institution.

Last year saw the approval of an action plan of INTOSAI member states promoting the performance of environmental and sustainable development audits. With regard to this the National Audit Office plans e.g. to embark a project on how Iceland has performed in complying with the Kyoto Protocol to the UN Framework Convention on Climate Change, i.e. in limiting emissions of greenhouse gases.



The Nordic countries have shown considerable interest in co-operation between the countries in the field of environmental protection, not least with regard to climate issues and pollution prevention. Such co-operation was initiated between Iceland and Norway, when the two countries embarked on informal co-operation in the environmental auditing of the OSPAR Convention. In Norway, moreover, there has been considerable interest in co-operative projects in the environmental auditing of fishing controls in Smugan, an international area of ocean surrounded by the exclusive economic zones of the North Atlantic states.

If account is taken of the results from projects performed in the field of environmental auditing in Iceland, it may be said that Iceland is doing an adequate job in environmental matters. Some things are very well done, while others have been put on the back burner. For example, pollution prevention with regard to the Icelandic marine area is, in general, good, although a greater effort must be made to fight pollution from land-based operations. With regard to nature (biodiversity), there are indications that a great deal more research is needed to gain the necessary knowledge of the country's nature, in spite of the wish of Althingi and the Central Government to treat it with care. Such knowledge, however, is the foundation for decision making on e.g. the utilisation of natural resources.





# Indicators of Activities and Performance

THE DUTIES of The National Audit Office include examining and certifying the reliability of indicators on the activities and performance of public entities if reported in their financial statements.

Indicators of activities and performance not only have informational value, but can also have various practical uses in the management of public bodies and enterprises by indicating how public bodies are progressing towards achieving their goals and developing their operation. In the past few years, the Office has monitored its own performance in a targeted manner. To this end, it has chosen a number of performance indicators to assess four key aspects of 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 that are useful in the decision-making of public bodies and enterprises.

The National Audit Office publishes its opinions and information principally in the form of reports. Such reports generally fall into two categories. On the one hand are those that are only intended for particular public bodies and the ministries to which they belong. To this category belong the majority of all reports in the field of financial auditing and internal control, and the Office's reviews of the information systems of central government bodies. No surveys have yet been made of the views of those using these reports to the suggestions made therein, although this is the objective. The reports have, however, clearly led to various improvements. Indication of such effect is the fact that in recent years, the National Audit Office has made fewer and fewer notes concerning the handling of accounting documents.

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 have 300-500 copies printed and sent to the Althingi, ministries, public bodies, and the media for presentation and discussion. They are also published 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. Moreover, it is telling that institutions, ministries and 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 notes and suggestions of the National Audit Office are adequately followed up.

In addition to the attitude surveys mentioned earlier concerning the quality of its public reports, the National Audit Office has, over the past five years, endeavoured to measure the public's interest in the reports by monitoring how often they are accessed on the

Office's website. After slow growth in 2001 and 2002, the number of accessed reports doubled in 2003. There came a small backlash in 2004, while 2005 shows an increased interest in this respect. As can be seen, the number of accessed reports has never been greater.

Number of reports accessed on the Office's website					
Year	1. Q	2. Q	3. Q	4. Q	Total
2002	1.822	1.840	2.462	2.962	9.086
2003	3.245	4.992	4.982	5.175	18.394
2004	3.275	3.422	2.944	3.015	12.656
2005	3.765	6.856	4.882	6.211	21.714

The 10 reports published by the Office in 2005 were accessed 3,689 times. This corresponds to each report being accessed 369 times on average. This is an increase from 2004, when the 11 reports from that year were on average accessed 307 times, a drop from 2003, when the 13 reports published were accessed 426 times on average.

The most popular report on the Office's website in 2005 was *University of Iceland. Performance Audit*, which was accessed 1,047 times. It is interesting how many reports from earlier years were on the list of those most often accessed. On its own, this gives an indication of their longevity and that they are taken into account when public bodies or state-related issues are under examination.

Five most-read reports on the Office's website				
	2004		2005	
1	Staff salary trends (2004)	562	University of Iceland (2005)	1.047
2	Implementation of the Government Budget (2004)	554	Implementation of the Government Budget (2005)	749
3	Pharmaceutical costs (2004)	461	Privatisation (2003)	660
4	Supplemental compensation (2004)	433	The Directorate of Customs (1999)	600
5	Was it a success? (2003)	420	The Meteorological Office (2003)	428
<b>Total</b>		<b>2.430</b>		<b>3.484</b>

As a rule, the National Audit Office issues a press release when a new report is published, outlining the main results of the study. These releases are by far the most popular reading material on the Office's website. In recent years, individual news items have commonly been accessed between 700 and 800 times annually, while in 2005, the visits more than doubled and three press releases were accessed more than 1,700 times. The media has also often used these releases in their coverage.

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 has sought to take account of this development and improve its website by providing users with the option of registering for its mailing list and allowing them to search its reports and news. Furthermore, in 2005, the website of the Office was expanded with the addition of numerous earlier reports. Currently, all reports since 1988 are accessible on the website.

According to the measurements of the National Audit Office, the traffic on the Office's website has increased considerably in the past few years. The website was visited 24,770 times in 2005, i.e. an average of 2,064 visits a month. Measurements indicate that visits continue to increase. On average, there were 2,250 visits a month during the last six months of 2005, compared with 1,878 a month in the first six months and 1,532 a month in the latter part of 2004. The same development can be seen if the number of individual guests who have visited the Office's website in recent years is examined.

In December 2005 the Prime Minister's Office and The Association of Local Authorities in Iceland introduced the audit "Hvad er spunnid í opinbera vefi?" (How are public websites spun?). The audit evaluated 246 websites belonging to the Government and the municipalities with respect to electronic services, i.e. content, usefulness and accessibility. The website of the National Audit Office received a high ranking with regard to content and usefulness but was ranked much lower when accessibility was evaluated. Some immediate alterations were, therefore, made to the website at the end of the year and improvements made to the principal issues. Further such changes are planned in 2006.

## Internal Processes

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

The Office places a strong emphasis on efficiency and quality in its work. It endeavours both to fulfil the projections made from time to time and to meet the needs of those who make decisions on the operation of the public bodies and enterprises by completing reports in such a timely manner that they are of some use. In recent years, we have managed to issue the audited annual accounts for 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 certified annual accounts and audit reports has somewhat fallen due to lower work contribution of staff and difficulties in the processing of information from the financial systems of the central government. This decrease is 5.5% between the years 2004 and 2005.

Financial audits	2003	2004	2005
Certified annual accounts	370	357	344
Audit reports	274	259	238
<b>Total</b>	<b>644</b>	<b>616</b>	<b>582</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 dwindling in 2005 in comparison with the past few years. The Office issued a total of 8 public reports, two fewer than in 2003 but one fewer than in 2002. In addition, 11 memoranda were written, compared with 15 in 2004 and 17 in 2003.

Other reports	2003	2004	2005
Performance audits	9	10	8
Memoranda, etc.	17	15	11
Other publications	2	0	0
<b>Total</b>	<b>28</b>	<b>25</b>	<b>19</b>

The Office has evaluated its efficiency by measuring, among other things, the time it takes to perform certain tasks. The dates of certified financial statements, for example, are an important indicator of whether the Office's internal processes are working properly. Comparison of the last three years, concerning the time it takes to prepare and write the report *Audit of the Central Government Accounts* from the time that *Government Accounts* is issued, shows that the Office did a good job in 2005. The Office is nevertheless of the opinion that it is important that the auditing of the Central Government Accounts is completed earlier in the year than has been the case, so that the work will be of greater use to the Althingi when preparing the fiscal budget for the coming year.

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

Year	Central Government Accounts	Audit of the Central Government Accounts	No. of days
2003	21.08	06.11	76
2004	30.09	19.11	50
2005	26.09	22.11	57

## 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.

To measure the Office's human resources, the following items, in particular, are considered: the number of audit hours, the ratio of staff with a university degree, the number of vocational retraining days, 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 Office delivered little more active man-hours in 2005 than in the previous year. There is yet some way to go before the Office is able to turn in as many work hours as in 2003, when the output of the Office was greater than ever before.

#### Number of audit work hours

	2003	2004	2005
Icelandic National Audit Office	76.440	71.856	73.992
Bought-in services	3.971	3.780	3.722
<b>Total</b>	<b>80.411</b>	<b>75.636</b>	<b>77.714</b>

The ratio of staff with a university degree has remained fairly level in the past three years, or about and upwards of 80%. Looking solely at staff doing audit work, the ratio is significantly higher, or approximately 97.5%. As is stated elsewhere in this report, the education of the staff is diverse. Staff with business administration degrees, however, form the majority of the workforce.

### Ratio of staff with a university degree

	2003	2004	2005
All staff	80,4%	80%	81,6%
Audit staff	95,1%	95%	97,5%

The Office emphasises that staff should maintain and strengthen their knowledge through continuing education, to which they are expected to devote an average of 40 hours per year. In recent years, the time spent on career development and continued education has, in fact, exceeded the guideline, and in 2005, such time averaged approximately 70 hours for each expert, as compared to 52 hours in 2004. Included in this time is, among other things, the study time with which the Office provides those taking a masters degree in their professional field and certification in auditing. In 2005, the Office spent a total of ISK 14.2 million on career development, i.e. 4.1% of the Office's total expenditure, net of user fees. The corresponding percentage for the year 2004 was 3.4%.

The percentage of permanent employees with at least three years' professional experience at the Office has grown steadily and was 83.7% in 2005. Their average length of service has also increased slightly, now standing at 10.8 years, compared with 10.7 years in 2004.

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

31.12.2003	31.12.2004	31.12.2004
72,5%	78,7%	83,7%

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. staff's loyalty to the employer, their general satisfaction with the work environment, as well as the 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 2005 was 10.2%. This is a rather high ratio when compared with recent years, when it was nonexistent, but it is in line with current trends on the Icelandic labour market. It cannot, therefore be said to be unnaturally high.

According to a survey performed by The Institute of Labour Market Research, Icelandic employees in the general market were, on average, absent from work due to illness or accident for 8 days a year in the period between 2000 and 2004. There are indications that such absences are increasing. To some extent, they 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. Surveys also show that there are a greater number of illness absences among civil servants than those employed in the private sector, and a greater among general employees than superiors.



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 just under 6 days a year. In 2004, there were an unusual number of sick-leave days, or an average of 6.9. This can be traced to chronic illnesses in a number of staff members. In 2005, such absences decreased to 5.5 days on average, which is well below the average of past years. As a proportion of the total hours worked, illness absences decreased from 3.1% in 2004 to 2.4% in 2005

Number of illness days per employee			
	2003	2004	2005
Own illness	4,0	5,0	4,4
Illness of children	1,7	1,9	1,1
<b>Total</b>	<b>5,7</b>	<b>6,9</b>	<b>5,5</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 2005, the National Audit Office achieved an ISK 18 million surplus, compared with an ISK 16.5 million surplus in 2004. The Office has thus strengthened its position even further from the years 2002-2003, when budget deficits plagued the operation.

Aggregate operating surplus in millions of ISK			
Year	Position at year-start	Surplus (deficit)	Position at year-end
2003	28,0	-43,0	-15,0
2004	-15,0	16,5	1,5
2005	1,5	18,0	19,5

In order to assess economy in its operations, the Office has listed the information of the average costs resulting from, on one hand, the services of the Office's employees and, on the other hand, services purchased from audit firms. 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 (%)
2003	7,037	5,015	2,022 (40.3%)
2004	7,313	5,104	2,209 (43.3%)
2005	7,789	5,646	2,143 (39.0%)

# Public Reports 2005

1. Annual Report 2004 (March)
2. University of Iceland. Performance Audit (April)
3. Eligibility of Halldór Ásgrímsson, Prime Minister, and former Foreign Minister, to discuss the sale of the Central Governments shareholding in Búnadarbankinn to the S-Group (June)
4. Implementation of the Government Budget 2004 (June)
5. Blönduós Healthcare Centre. Performance Audit (August)
6. Review of purchase of expert services (October)
7. Services to the elderly – Performance Audit (November)
8. Audit of the Central Government Accounts 2004 (November)
9. State Housing Fund. Concerning the formulation and preparation of the Fund's loan agreements with financial institutions with regard to risk management (November)
10. Landspítali University Hospital – Performance 1999-2004 (December)



# Financial Statements 2005

## 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 2005, the Office's operations generated a surplus of ISK 18,057 thousand. According to the Balance Sheet, the assets of the Office amounted to ISK 24,683 thousand, liabilities amounted to ISK 5,500 thousand, and equity amounted to ISK 19,183 thousand at year-end 2005.

The Auditor General and the Head of Financial Audit Division I certify the Financial Statements of the National Audit Office for the year 2005 with their signatures.

The Icelandic National Audit Office, 15 February 2006



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 2005. 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 2005, its Balance Sheet as of 31 December 2005 and change in cash during the year 2005, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavik, 15 February 2006



Gunnar Sigurdsson  
Chartered Accountant

## Profit and Loss Account 2005

	2005	2004
<b>Operating revenues</b>		
Sale of services .....	32.425.336	35.692.681
Other income .....	1.273.950	973.256
	33.699.286	36.665.937
<b>Operating expenses</b>		
Salaries and related expenses .....	291.686.070	259.299.335
Administrative expenses .....	11.550.501	9.766.345
Meeting and travel cost .....	9.927.698	10.964.285
Expert services .....	35.049.455	35.679.277
Operations of equipments .....	1.782.198	2.022.431
Other operating expenses .....	2.590.617	2.348.027
Housing .....	19.299.275	18.110.640
Operation of vehicles .....	594.667	275.734
Grants .....	550.000	550.000
	373.030.481	339.016.074
Purchased assets .....	2.611.564	0
	375.642.045	338.974.276
<b>Operating profit (-loss) before Treasury contribution</b>	(341.942.759 )	(302.350.137 )
Treasury Contribution .....	360.000.000	318.800.000
<b>Profit for the year</b>	18.057.241	16.449.863



## Balance Sheet, 31 Desember 2005

	2005	2004
<b>Assets</b>		
<b>Current assets</b>		
Treasury .....	18.227.856	3.241.365
Accounts receivable .....	6.053.665	5.878.963
Prepaid cost .....	184.080	0
Cash and cash equivalents .....	217.479	232.672
	24.683.080	9.353.000
<b>Total assets</b>	24.683.080	9.353.000
<b>Equity and Liabilities</b>		
<b>Equity</b>		
Equity at the beginning of the year .....	1.125.997	( 15.323.866 )
Profit for the year .....	18.057.241	16.449.863
<b>Equity</b>	19.183.238	1.125.997
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable .....	5.499.842	8.227.003
<b>Liabilities</b>	5.499.842	8.227.003
<b>Total equity and liabilities</b>	24.683.080	9.353.000

## Cash Flow Statement 2005

	2005	2004
<b>Cash flow from operations</b>		
<i>Cash flow from operating activities:</i>		
Profit.....	18.057.241	16.449.863
<b><i>Cash flow from operating activities</i></b>	<u>18.057.241</u>	<u>16.449.863</u>
 <i>Changes in current assets and liabilities:</i>		
Accounts receivable, decrease / (increase).....	( 358.782 )	6.772.404
Accounts payable, (decrease) / increase.....	( 2.727.161 )	2.729.671
	<u>( 3.085.943 )</u>	<u>9.502.075</u>
<b>Net cash provided by operating activities</b>	14.971.298	25.951.938
 <b>Cash flow from financial activities</b>		
 <i>Changes in balance with the Treasury:</i>		
Treasury contribution.....	( 360.000.000 )	(318.800.000 )
Received from the Treasury.....	345.013.509	292.848.982
<b>Net cash from financing activity</b>	<u>( 14.986.491 )</u>	<u>( 25.951.018 )</u>
 <b>Net increase in cash and cash equivalents.....</b>	( 15.193 )	920
 <b>Cash and cash equivalents at the beginning of the year.....</b>	<u>232.672</u>	<u>231.752</u>
 <b>Cash and cash equivalents at the end of the year</b>	<u><u>217.479</u></u>	<u><u>232.672</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.

## Notes

### 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 2005 anticipated similar activities as in the previous year. Allocations for salaries were increased in order to make them more in line with the Office's actual operations. Initially, the Office's budget was ISK 348,000 thousand. Additional appropriations during the year due to contractual salary increases were ISK 12,000 thousand. Thus in 2005, the Office's total budget amounted to ISK 360,000 thousand.

Operating expenses less sale of services totalled ISK 341,943 thousand and were ISK18,057 thousand less than budget. Operating expenses are specified as follows:

In ISK thousands	Initial	Total budget	Financial Statements	Differences
Sales of services .....	( 9.100 )	( 9.100 )	( 33.700 )	24.600
Salary and salary-related expenses.	260.500	272.500	291.686	( 19.186 )
Other operating expenses.....	92.600	92.600	80.795	11.805
Transfers.....	0	0	550	( 550 )
	<u>344.000</u>	<u>356.000</u>	<u>339.331</u>	<u>16.669</u>
Purchased assets.....	4.000	4.000	2.612	1.388
	<u>348.000</u>	<u>360.000</u>	<u>341.943</u>	<u>18.057</u>

Break-down in ISK thousand by type:

	2005	2004
Sales of services.....	( 33.699 )	( 36.666 )
101 Icelandic National Audit Office.....	373.030	339.016
601 Equipment .....	2.612	0
601 Building construction .....	0	0
	<u>341.943</u>	<u>302.350</u>

### Divisions

Profit and Loss Account by divisions in ISK thousands:

Office management .....	22.226	25.579
Financial Audit Divisions.....	192.856	176.300
Performance Audit Divisions .....	101.557	79.427
Legal Division.....	25.304	21.044
	<u>341.943</u>	<u>302.350</u>



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