



The INAO's 2015 Annual Report

June 2016

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Introduction by the Auditor General



In December last year, the Icelandic Parliament passed a new law on public finances (Act No. 123/2015) featuring a wide range of reforms and laying the foundations for better management of public finances. The new legislation will greatly improve upon existing public finance policy, with the adoption of multi-annual financial policy and financial plans, and bolster ministerial supervision of the institutions under their jurisdiction. It will also give ministries greater flexibility to manage funding within policy domains and fields. Ministries are required to prioritise projects and services, in consultation with the agencies reporting to them, with due regard to budgetary considerations. The new law also provides for a better supply of information to the Budget Committee and more options available to the Committee to supervise public finances. Budgets and accompanying documentation will be presented differently from now, with greater emphasis on classifying government expenditure by policy area and sector. The Act also lays down that public accounts should be signed off and presented according to international accounting standards for public sector entities.

It is very important that this legislation will be implemented properly. In connection with this task, it was decided to seek advice from the International Monetary Fund (IMF). In mid-March 2015, IMF representatives met with interested parties to give an account of the experiences of other countries in implementing similar legislation. They also discussed specific aspects of the new legislation with the government and how best they could be implemented. This is without doubt a complex and extensive task and time is limited. It is very important to complete work on the basic elements, such as new budgeting procedures

and changes in financial and settlement systems. Interested parties will clearly need to make this work a priority over the coming months in order to enable compliance with the new law.

Early on in the current parliament, a bill on the Auditor-General and auditing public accounts was moved for the third time. On the two previous occasions, MPs did not manage to reach a decision on the bill before the end of the parliamentary session. Various parties, including the Icelandic National Audit Office, have submitted their official comments on the bill to the Constitutional and Supervisory Committee. The bill contains some major changes from current law, which I set out in my foreword to the Audit Office's 2014 annual report and will not be repeated here. The bill was referred to the Constitutional and Supervisory Committee after the first reading in the autumn of 2015. The Committee, to my great surprise, has yet to complete its discussions on the subject. I genuinely hope that the Icelandic Parliament will be able to reach a decision on the bill before the end of this session.

The Icelandic National Audit Office focuses on good communication and co-operation with its sister agencies abroad on various common areas of interest and on the professional development of our operations. Foreign relations were relatively low-key in 2015, with the exception of our participation in Nordic co-operation. An annual meeting of Nordic Auditors-General was held in Finland, the main topic of which was macro-level risk analysis. The method involves analysing the various risks and challenges facing the State and public finances as a whole, as well as targeting project selection and planning on the basis of the findings of this analysis.

No major changes were made to the projects the Icelandic National Audit Office undertook last year, compared to previous years. The Financial Audit Division completed the implementation of the International Standards of Supreme Audit Institutions (ISSAI) governing financial audit and 189 auditing projects were concluded, including projects outsourced to external auditing companies. The Performance Audit Division completed 29 reports over the course of the year. Two reports on monitoring budget implementation were published, and the Audit Office issued two memoranda on the subject to the Budget Committee. Reports were published on the submission of financial statements by certified funds, cemeteries and parishes, and extracts of financial statements from ten political organisations were published. In addition, the Office produced official opinions for parliamentary committees and other interested parties.

In 2015, the institution ran a ISK 10.8 million surplus, as compared to a ISK 12.9 million deficit in 2014. In previous years, the Office's operating results have fluctuated considerably from year to year in phase with fluctuations in its funding. The new law on public finances will make it easier to organise the running of the Office, as it will be possible to presuppose that funding for each three-year period will be in line with the overall financial plan.

Salaries and related expenses amounted to ISK 456.3 million, up ISK 31.3 million (7.4%) on the previous year. Full-time-equivalent daily wages rose 9.8%. Net expenses, i.e. expenses net of user fees, amounted to ISK 488.7 million, up ISK 30.3 million (6.6%) on the previous year. Undistributed appropriations at the end of 2015 amounted to ISK 34.5 million.

Funding in 2015 amounted to ISK 499.5 million, up ISK 54.0 million (12.1%) on the previous year. When the budget was passed, the Office was expected to have some 42 full-time equivalents. In 2015, there were 40.8, down from 40.9 the previous year. Further information on the Office's operations and financial position may be found in the financial statements and accompanying notes on pages 28-34.

In conclusion, I should like to note that the Office's staff has always endeavoured to discharge their duties with integrity and professionalism. 2015 was no exception in this regard. All the reports and other material issued by the Office are testimony to this. I should like to express my heartfelt thanks to all Office staff for all their efforts over the year.

Sumar Bragason

Legal Status, Role and Strategy of the INAO

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

The INAO operates in accordance with the National Audit Act No. 86/1997 as well as other legislation pertaining to its operations. These include the Government Financial Reporting Act (No. 88/1997) and the Act on the Rights and Obligations of Government Employees (No. 70/1996). Furthermore, the Office is entrusted tasks according to the Act on Funds and Institutions Operating According to Approved Charters (No. 19/1988), the Act on Cemeteries, Burials and Cremations (No. 36/1993) and the Act on the Finances of Political Parties and Candidates and Their Duty to Provide Information (No. 162/2006). The Office's employees take account of the standards and guidelines of the International Organisation of Supreme Audit Institutions (INTOSAI) and, as applicable, the standards of the International Federation of Accountants (IFAC). Moreover, employees take account of the Office's Code of Professional Conduct. As the National Audit Office operates under the auspices of the Althingi, the Administrative Procedures Act and the Information Act do not apply to the activities of the Office. Nevertheless, a number of unwritten principles of administrative justice apply to the Office, such as rules on competence. Taking into account acts of law, rules, standards and guidelines, the National Audit Office has defined its principal tasks in the following manner:

Financial auditing

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

Performance auditing

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

Monitoring the implementation of the Government Budget

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

Monitoring the finances of self-owned organisations (foundations)

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

Monitoring the finances of political parties and political candidates

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

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

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

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

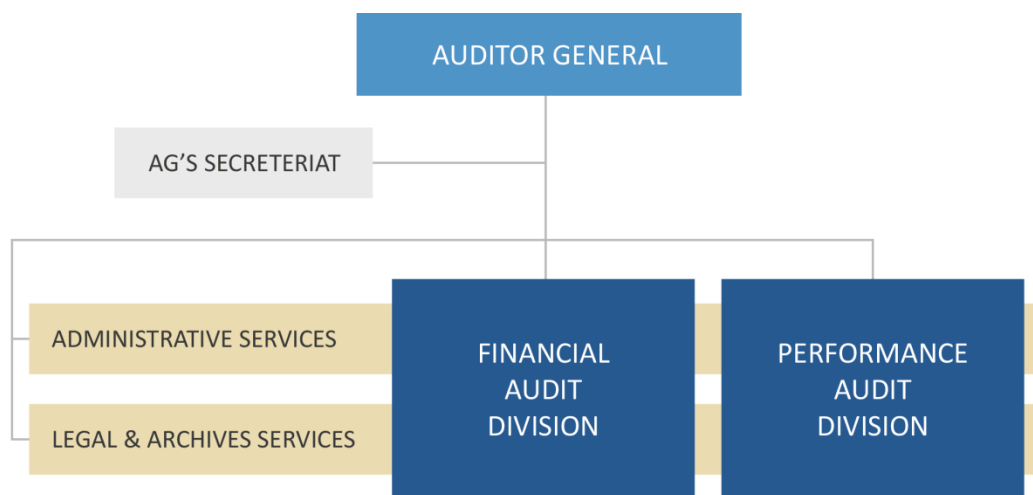
The INAO has formulated for itself a comprehensive strategy based on the balanced scorecard methodology. The Office's strategy map contains a total of 10 key goals. They apply to the four "dimensions" of the operation, which are service, procedure, human resources and finances. The INAO's values are integrity, independence and professionalism. Employees are to be guided by these values, whether at work or not

General information on Activities and Operation in 2015

Organisation of operations

There are two core divisions within the INAO: the Financial Audit Division and the Performance Audit Division. The former is responsible for financial auditing according to Article 8 of the National Audit Act and consisted of 22 employees at year-end. The latter is responsible for performance auditing according to Article 9 of the Act and employed 7 employees at year-end. Each core division is managed by a Director, and under him are Division Managers, four in the Financial Audit Division and two in the Performance Audit Division, who guide the work of experts. In addition, there are two support units responsible for diverse centralised tasks and for providing services to the main divisions: Administrative Services and Legal and Archives Services. Each support unit consisted of four employees at year-end 2015. In addition, the Auditor General's Secretariat is responsible for various monitoring tasks as regards the state's finances and operations, public relations, international communications and assistance to the Auditor General. The Office had three employees at year-end, i.e. in addition to the Auditor General. The total number of employees at the INAO at year-end 2015 was 41.

INAO's Organisational Chart

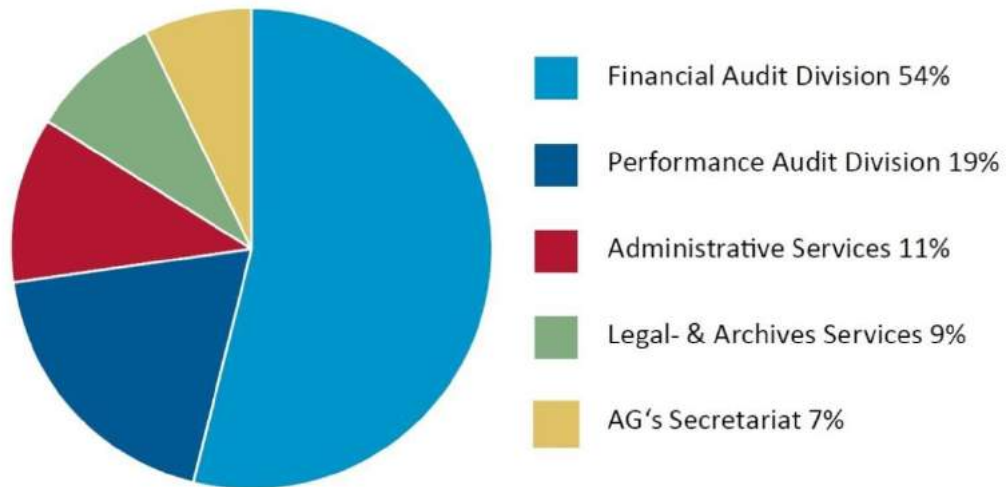


Division of work contributions between divisions

The active man-hours of the employees of the INAO were a total of over 66 thousand in 2015. Active man-hours refer to the hours employees are at work, with absences, due to illness or vacation for example, excluded. Active man-hours in the Financial Audit Division were 54% of the total number. Active man-hours in the Performance Audit Division were 19%

of the total number. Administrative services were 11%, legal and archive services were responsible for 9% and the AG's Secretariat for 7%.

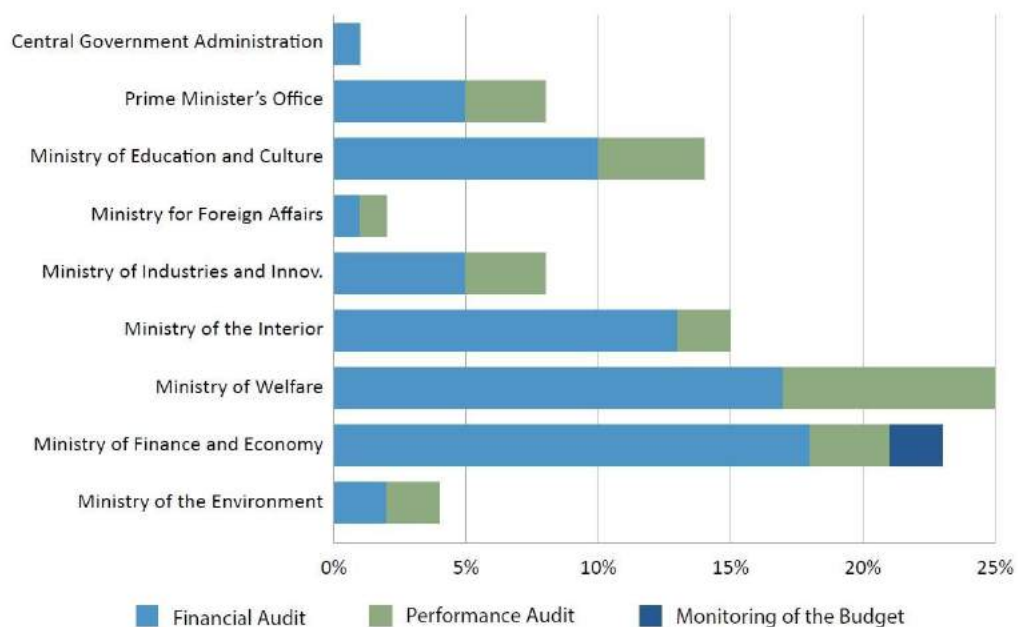
Proportional division of active man-hours between divisions in 2015



Division of work contribution between ministries

Approximately two-thirds of the active man-hours were allocated to auditing and monitoring tasks directly involving the ministries and their agencies. One-third was allocated to other monitoring tasks, professional development, internal operations, central management, and support services.

Proportional division of active man-hours allocated to auditing and monitoring tasks according to ministries and their agencies 2015



In 2015, the Office focused primarily on four ministries and entities under them, i.e. the Ministry of Finances and Economic Affairs, the Ministry of the Interior, the Ministry of Education, Science and Culture and the Ministry of Welfare (see figure above). Three quarters of the total time was allocated to auditing and monitoring these three ministries and their agencies. Less time was spent on auditing and monitoring other ministries and the central government administration.

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

Revenue and expenditure

The total expenditures of the INAO amounted to ISK 533m in 2015, up ISK 32m on the previous year, or by 6%. The increase can, for the most part, be attributed to increased payroll costs in accordance with provisions of a collective wage agreement. Special income amounted to ISK 46.6m, and the state contribution amounted to ISK 499.5m. The surplus in the operation amounted to ISK 10,2m, which was a turnaround from 2014 when there was a deficit of ISK 12.9m.

Summary of 2014 and 2015 profit and loss statement (ISK millions)				
	2015	2014	Change	%
Salary and salary-related costs	456,3	424,9	31,4	7%
Other operating expenses	71,6	73,1	-1,5	-2%
Formation expenses	5,4	3,2	2,2	69%
Cost and expenses total	533,3	501,2	32,1	6%
Special revenue	44,6	42,8	1,8	4%
Expenses minus income	488,7	458,4	30,3	7%
Government contribution	499,5	445,5	54	12%
Revenue surplus (deficit)	10,8	-12,9	23,7	184%

Human resources

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

Four employees left the INAO in 2015, and two were recruited. The number of staff, therefore, decreased by two, from 43 at the beginning of the year to 41 at the end of the year. The aim is to recruit four employees by the end of 2016, which will bring the total number of employees to 45.

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

approximately 10% in 2015. This is double the proportion of the last two years when staff turnover was 5%.



The average age of employees at year-end 2015 was approximately 56 years. The ratio of employees with at least three years' experience at the Office was 88%, and the average length of service was around 17 years.

Approximately 80% of employees had a university degree; many held two degrees. The vast majority had degrees in business administration. Several had degrees in law, political science, archives and information, computer sciences or the humanities. Furthermore, there were five chartered accountants and three with certification in internal auditing (CIA). One of them is also a Certified Government Auditing Professional (CGAP), and another has certification in IT auditing (CISA).

Key figures in human resources				
	2015	2014	2013	2012
Employee turnover	10%	5%	5%	14%
Average age of employees	56 yrs.	55 yrs.	53 yrs.	53 yrs.
Average length of service at INAO	17 yrs.	16 yrs.	15 yrs.	14 yrs.
3-year work experience at INAO	88%	88%	91%	87%

The INAO endeavours to ensure that its staff maintains and strengthens their professional abilities through continuing education. To this end, employees are able to attend a range of courses in conjunction with their work. These usually involve short courses held in Iceland on issues relevant to the activities of the Office. There are also examples of employees attending courses overseas or participating in on-line courses held by foreign entities.



Communications with the committees of the Althingi

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

CSC regularly calls meetings with a representative from the INAO to present the Office's reports and to discuss their substance. In addition, the entities to which recommendations are made are given the opportunity to present their views in the meetings of the Committee. The managers of the INAO attended 25 CSC meetings in 2015 and presented the Office's reports. The Committee issued an opinion on two performance audit reports from 2011.



In addition, the AG and the Office's managers attended 12 meetings with the Parliamentary Budget Committee, either to present reports or to discuss issues relating to state operation and finances. The Committee returned an opinion on two reports during the year. The AG attended a meeting with the Welfare Committee and an annual summer meeting of the Speakers' Committee discussing the Parliament's supervisory bodies.

Performance measurements – service dimension

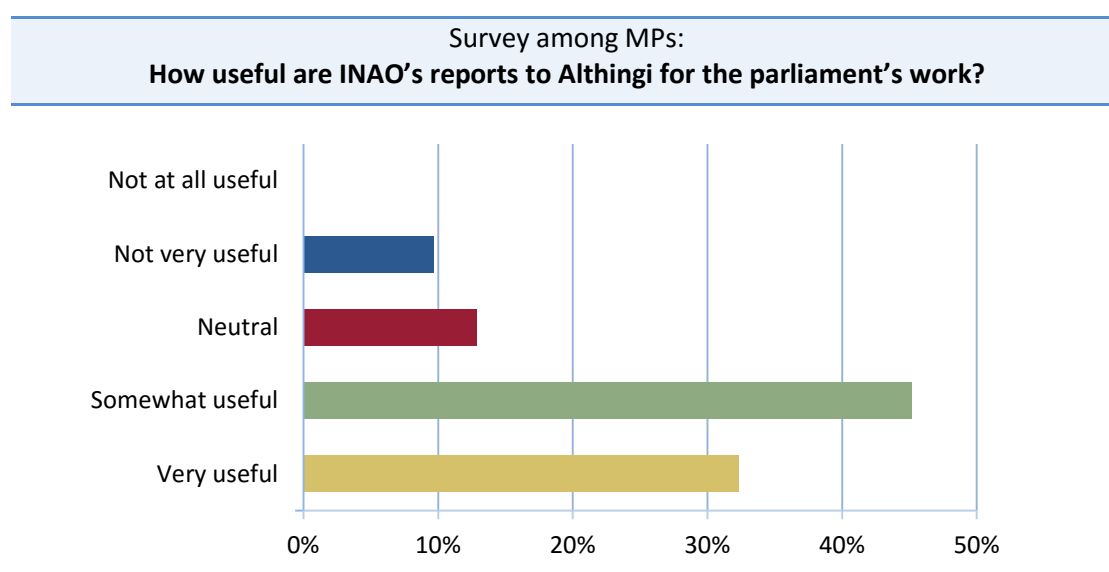
The INAO seeks to evaluate its performance biennially and reports selected evaluation results in its annual report. The agency's strategy map contains a total of 10 key goals: two in the service dimension, three in the procedures dimension, three in the human resources dimension and two in the finances dimension. The service goals are on the one hand to "promote reform in government-run operations" and on the other hand to "provide reliable and useful information". The following table shows how these goals are defined.

The INAO's service goals	
PROMOTE REFORM IN GOVERNMENT-RUN OPERATIONS	The INAO endeavours to promote reform in the financial management and performance of government bodies and other entities that receive contributions from the Treasury
PROVIDE RELIABLE AND USEFUL INFORMATION	The INAO endeavours to provide reliable and useful information concerning financial statements, financial management and the performance of government bodies and other entities that receive contributions from the Treasury

The INAO surveyed the attitude of members of parliament, permanent secretaries of ministries and selected heads of agencies in January 2016. The survey included all 63 MPs and 161 permanent secretaries and heads of agencies. The response rate was approximately 50% amongst MPs and 60% amongst others. The respondents answered different questions based on the nature of their relations with the INAO in 2015. Most of the respondents were

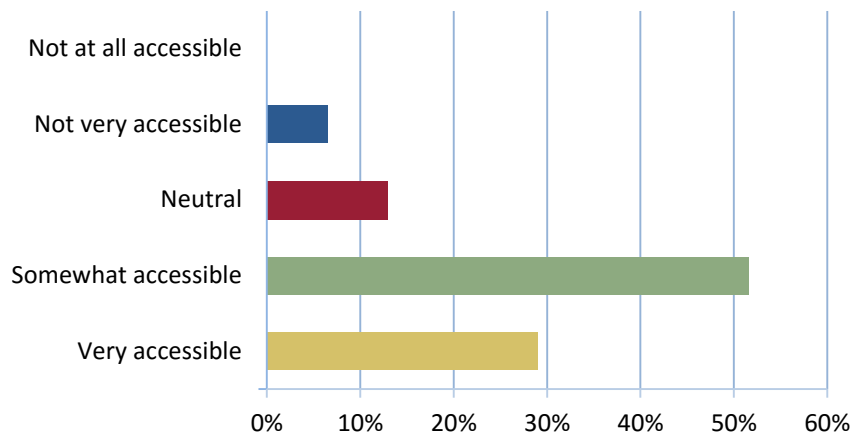
asked about their attitude regarding auditor's letters (reports on audit findings) which the INAO sends out to them following the completion of the annual financial audit. Only a part of the respondents were asked about their attitude regarding performance audits, i.e. only the managers of the ministries and agencies which the performance audits of 2015 pertained to. In the same manner only a part of the respondents were asked about their attitude to the Office's reports on the execution of the budget and the report on the auditing of the 2014 central government accounts.

MPs were asked about the usefulness of INAO's reports to Althingi for the parliament's work, e.g. for monitoring the executive branch. Respondents could answer on a five point Likert-scale, ranging from "Not at all useful" to "Very useful". A third of respondents said INAO's reports to Parliament were very useful, and 45% said they were somewhat useful. A total of 13% said they were neutral to the question and 10% said the reports were not very useful. No respondent said the reports were not at all useful.



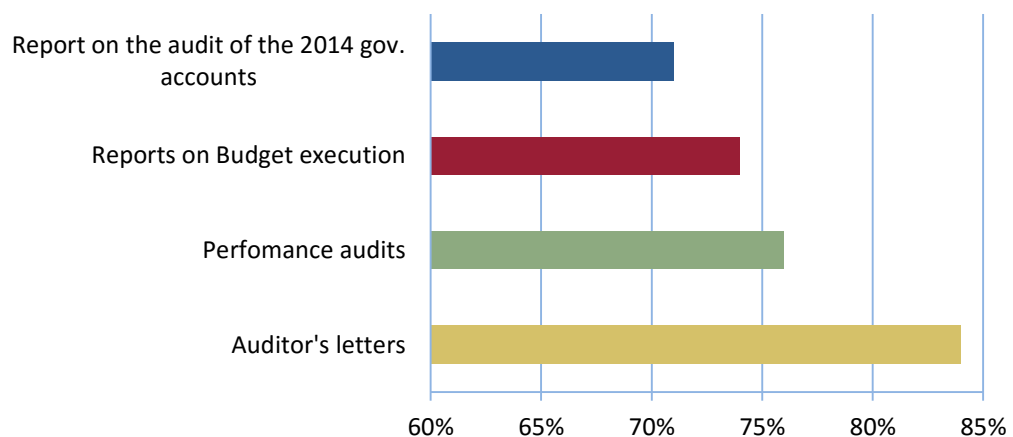
MPs were also asked about the accessibility of INAO's reports to Althingi. Possible answers were given on a five point Likert-scale, ranging from "Not at all accessible" to "Very accessible". A third of respondents said INAO's reports to Parliament were very accessible and just over half said they were somewhat accessible. A total of 13% of respondents were neutral to the question and 7% said they were not very accessible. None said the reports were not at all accessible.

Survey among MPs:
How accessible are INAO's reports to Althingi?



Permanent secretaries and agency heads were asked how useful the reports and auditor's letters were for improving financial management. Answer options were given on a five point Likert-scale, ranging from "Not at all useful" to "Very useful". All respondents were asked about the usefulness of auditor's letters, of which 84% of respondents said the letters were somewhat or very useful. A total of 17 permanent secretaries and agency heads were asked about the usefulness of reports on performance audits, of which 76% claimed the reports were somewhat or very useful. A total of 19 permanent secretaries and agency heads were asked about the usefulness of reports on Budget execution, of which 74% said such reports were somewhat or very useful. A total of 13 permanent secretaries and agency heads were asked about the usefulness of the report on the audit of the 2014 government account, of which 71 % said the report was somewhat or very useful.

Survey among permanent secretaries and agency heads
Usefulness of reports for financial management improvement
(ratio of those who found the reports somewhat or very useful)



The INAO believes the results of the survey to be favourable to the Office, but at the same time considers them to be an incentive to do even better to attain the service goals of the Office's strategy map

Communications and public relations

The INAO's communication policy is in accordance with INTOSAI's *Principles of Transparency and Accountability* (ISSAI 20) and *The Value and Benefits of Supreme Audit Institutions* (ISSAI 12). It furthermore takes account of the communication policies of Nordic sister agencies. According to the policy, dynamic and high-quality external publication of information is one of the prerequisites of the National Audit Office's ability to fulfil its role and achieve results. It also states that the Office intends to take the initiative in the dissemination of information on its role and activities.

As the INAO operates under the auspices of the Althingi and is part of its monitoring of the executive branch, its reports are for the most tailored to the needs of the parliament or individual parliamentary committees. At the same time, the Office endeavours to tailor its dissemination of information to the needs of the ministries and public bodies, as the recommendations issued by the Office for improvements are usually directed toward these entities. These focus points accord with those of the Office's sister agencies in neighbouring countries. However, the information dissemination of these agencies is not directed exclusively to national assemblies and public administrations. There is a general consensus that national audit offices should endeavour to inform the media, and thereby the public, about their role and work. This encourages increased transparency in the disposal of public funds and clearer accountability in the executive branch.

The INAO maintains a website, www.rikisend.is, where all its public reports may be accessed. Visits to the site in 2015 numbered more than 20 thousand and the number of users just less than 12 thousand.

International relations

In order to ensure that the operation of the National Audit Office develops in tune with international trends, the Office focuses on good relations and co-operation with its overseas counterparts. The Office has a long history of co-operation with the national audit offices of the Nordic countries, as well as participation in the work of the European and international associations in this field, i.e. EUROSAI and INTOSAI. Moreover, the National Audit Office participates in the auditing of multinational bodies, associations, funds and programmes of which Iceland is a member. Employees of the National Audit Office attended a total of nine meetings, seminars and conferences overseas in 2015.

Ingi K. Magnússon, Director of the Financial Audit Division, is INAO's representative on the EFTA Board of Auditors (EBOA) and attended two meetings, in Brussels and Zürich, in 2015. INAO's representative to the committee's working group which audits the grants allocated by the EFTA Development Fund (EFTA Financial Mechanism) is Auður Guðjónsdóttir, expert in the Financial Auditing Division. Auður Guðjónsdóttir attended the working group's meeting in Oslo.

The INAO is involved in the audit of the External Borders Fund, of which Iceland is a member as a member of the Schengen co-operation. The Fund is tasked with strengthening the monitoring and external security of the Schengen area. Ingi K Magnússon, Director of the Financial Audit Division, attended a meeting in Brussels for the audit of the Fund.

Several working groups operate under the auspices of EUROSAI and address various issues that relate to public auditing. Due to economisations in its operation in recent years, the INAO has only taken part in the work of one such working group, i.e. the Task Force for Audit & Ethics. It was decided to withdraw from the group in 2014. INAO did not participate in any of EUROSAI's working groups in 2015.

The national audit offices of the Nordic countries have co-operated closely for a number of years. A dedicated working group is responsible for the organisation and management of the co-operation. Óli Jón Jónsson, Communications and International Relations Officer, is the INAO's representative in this group and attended its meeting in Helsinki. The Auditors General of the countries meet every year. The meeting was held in Helsinki in 2015. In addition, the employees of the INAO took part in two Nordic seminars. Albert Ólafsson, Division Manager in the Financial Audit Division, attended one seminar on macro-level risk analysis and another on IT security.

INAO's IT experts, Albert Ólafsson and Sigríður H. Sigurðardóttir, attended a meeting in Budapest with experts from INTOSAI Development Initiative (IDI) who are assisting the INAO with its IT audit of the government's payroll system.

Representatives of several foreign audit agencies, international organisations or governments have visited the INAO, e.g. due to collaborative projects. The Deputy Director General of Shanghai Municipal Auditing Bureau visited INAO in 2015 with her delegation. The Deputy Secretary-General of Jiangxi Department of Audit, with his delegation, also paid the INAO a visit in 2015.



Wang Dianjun, the Deputy Secretary General of Jiangxi Department of Audit, and Sveinn Arason, the Auditor General.

Wu Yindie, the Deputy Director General of Shanghai Municipal Auditing Bureau, and Sveinn Arason, the Auditor General

Financial Audit

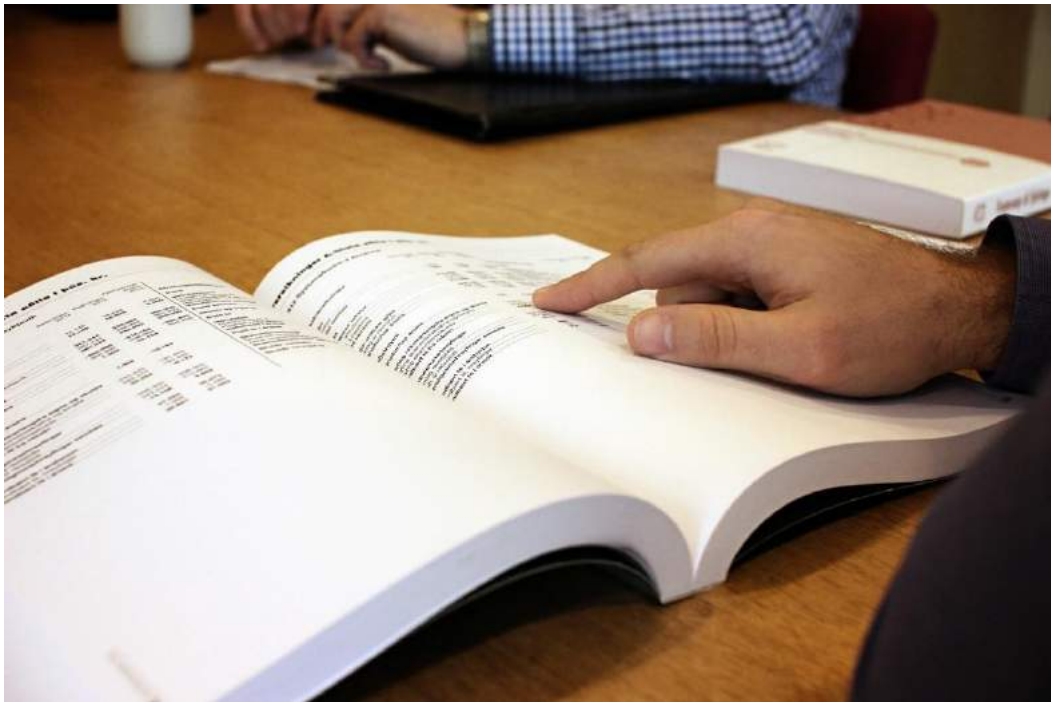
The regular financial audit of public bodies and enterprises is the most extensive task undertaken by the INAO. By the end of 2015, the Financial Audit Division had a total of 22 employees, the same as year-end 2014. The employees of the Division were responsible for around 54% of the Office's active man-hours. The Director of the Financial Audit Division is Ingi K. Magnússon.

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

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

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

The INAO annually sends to the Althingi and publishes an official report on the Audit of the Central Government Accounts. The report also contains the main results of the financial audits of public entities as appropriate. Audit reports sent to individual public bodies are not published, although a copy thereof is sent to the Parliamentary Budget Committee. The report on the results of the financial audits for 2014 (Audit of the 2014 Central Government Accounts) was published in November 2015.



Diverse tasks

Government financial auditing is quite varied, anything from auditing simple financial statements in small Group A agencies to the auditing of complex financial statements of limited liability companies. The presentation of the Budget and of the financial statements of agencies belonging to Group A of the Central Government Accounts is relatively simple, and there are few evaluation-based items and accounting complications.

The reason for this is that investments and asset acquisitions are charged to the year in which they take place, pension obligations are not recorded in the financial statements of individual agencies and accrued holiday allowance is not registered. There are however a number of special rules that must be taken into account in the audit. In addition, there are several Group A agencies whose operations are large and complex, which calls for extensive auditing actions. Furthermore, there are a number of funds with extensive obligations as well containing many and varied contribution items.

Government financial auditing also includes examining whether financial statements and appropriations are in accordance with laws and rules. These examinations are referred to as compliance audits. Such audits examine the compliance of public bodies and enterprises with acts of law, regulations, code of ethics, policies, good governance and other generally recognised practices.

In accordance with the Act on Public Finances (no. 123/2015), which replaced the Government Financial Reporting Act on January 1 2016, the *International Public Sector Accounting Standards* (IPSAS) have been adopted. These standards impose heavier requirements for the financial statements of public bodies than before. The adoption of IPSAS is expected to have the effect of increasing the time used for the audit of individual public bodies and the Treasury as a whole than is presently the case. In addition, internal auditing within ministries and public bodies will be strengthened.

Assessment of internal controls and compliance with law and rules

As stated earlier, government financial auditing includes examining the internal controls of ministries, public bodies and state-owned enterprises. Internal control means diverse measures and actions intended to encourage successful and efficient operations; safeguard assets, valuables and sensitive data; provide trustworthy financial information; and ensure that operations comply with laws and regulations. Internal controls are generally based on analyses and assessments of possible operational risks and can be seen in work procedures of various types, e.g. regarding the division of tasks, the approval of expenses and recording of business transactions, and also in codes of conduct and human resources policies. In 2011, the INAO issued guidelines on the documentation of internal controls for agencies belonging to Group A.

Items and bodies audited in 2015

Central Government Accounts consist of around 450 budgetary items in Group A of the Treasury in addition to information on the financial statements of public bodies in Groups B to E. Due to the fact that the INAO is rather understaffed; it has not been able to audit all these items and entities. As a result, the Office annually has to carefully select the items that are to be audited. The selection is based on a special risk assessment that takes account of several different risk aspects. The methodology used is risk-based auditing.

In 2015, the INAO and auditing firms operating on its behalf audited a total of 139 items in Group A (i.e. for the 2014 accounting year) and 21 entities in Groups B to E. In addition, the staff of the Financial Auditing Department undertook various other auditing assignments, such as the auditing of multinational organisations and programmes. In total, there were 178 auditing tasks undertaken during the year.

The INAO's goal is to ensure that all Budget items are audited at least every three years. This goal has not been fully achieved in recent years. The plan is to reassess the Office's risk assessment to ensure the achievement of the above-mentioned goal.

Follow-up of recommendations from the previous year

The INAO seeks to follow-up on recommendations published in auditing reports sent to individual public bodies. Such follow-ups generally take place one to three years after the recommendations were issued and are intended to examine whether and the manner in which they have been responded to. These include recommendations on accounting practices, financial statements, internal controls and/or other aspects of financial management. Many public bodies are audited annually, but smaller public bodies are often audited triennially.

A total of 107 audit reports were prepared in 2015 (for the 2014 accounting year) out of which 39 contained recommendations. In total, there were 136 recommendations, 35 of which were reiterated.

Outsourcing of auditing tasks

According to Article 4 of the National Audit Act, the Office is entitled to appoint independent chartered accountants, or other experts in a specific field, to carry out specific assignments entrusted to the Office in legislation. The Office has taken advantage of this authorisation and has for a number of years outsourced various projects in the field of financial auditing. The projects are put out to tender in accordance with Act No. 84/2007 on Public Procurement. Alternatively, the Office negotiates with firms on the basis of the State Trading Centre's framework agreements on auditing, usually following a mini-tender. A total of eight auditing firms had effective contracts in 2015. These firms audited a total of 22 public bodies and enterprises owned by the state.



Adoption of international standards (ISSAI)

The International Organisation of Supreme Audit Institutions (INTOSAI) publishes standards on auditing public bodies (International Standards of Supreme Audit Institutions – ISSAI). Member institutions are not under obligation to follow these standards unless so ordered by law. However, they all endeavour to fulfil the requirements of the standards, given that they are based on the best knowledge and experience in the field of central government auditing. The INAO focuses on following in every respect the international standards that touch on the Office's activities. The Office completed the adoption of the standards in 2016 regarding financial auditing.

IT auditing

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

Supervisory Authority on the operation of the IT systems of parties subject to supervision in such work. Two of the employees of the Financial Auditing Division are responsible for the auditing of IT systems. In 2015 work continued on auditing a payroll system, which is part of the state's accounting and human resources system (Orri). The audit is expected to be completed in 2016.

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

It is important that the supervision of government IT systems is functioning and effective, as huge funds are transmitted through these systems, such as pension payments, salary payments and various benefits. Errors in these systems can lead to considerable costs for the Treasury. The owners of these systems need to have regular security audits and audits of the internal control mechanisms that apply. The INAO has recommended that the Ministry of Finance and Economic Affairs exert its influence in ensuring a harmonised audit of the main revenue and expenditure systems of the government to ensure that they are operating as they should and that the strictest security is observed.

Performance Audit

Performance auditing is one of the principal tasks of national audit offices around the world. The National Audit Act states that performance auditing covers the examination of the handling and utilisation of public funds, whether economy and efficiency is practised in the operation of public bodies and state-owned enterprises and whether applicable lawful instructions are being complied with in this context. It furthermore states that the Office shall report the findings of such work, draw attention to any faulty procedures and point out those matters which should be considered with respect to improvement. When performing this work, the INAO takes account of the National Audit Act, documents relevant to the interpretation of applicable acts (in particular, the explanatory notes accompanying the bills for acts concerning the Office) and the ISSAIs. In addition, account is taken of the legislation, rules, policies and schedules concerning the issues examined each time

The employees of the Performance Audit Division completed a total of 29 reports in 2015. Thereof, there were 9 main audits and 20 follow-up reports. The Director of the Performance Audit Division is Þórir Óskarsson.

The Performance Audit Division had a total of seven employees at year-end 2015, one fewer than at year-end 2014, and was responsible for approximately a fifth (19%) of the total active man-hours in the Office



Strategic Planning

According to law, the Office may carry out performance audits on all bodies that finance their activities with public money, bodies in which the state owns at least half of the shares and bodies that enjoy contributions from the State Treasury for the services they provide. By far, the majority of audits are carried out at the initiative of the Office, while some are at the request of the Althingi or the ministries. In all instances, however, the INAO is responsible

for delimiting the material, making decisions on methods, defining focus areas and presenting the results. All of the Office's performance audits, with two exceptions, that were completed in 2015 were at the Office's initiative

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

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

Follow-up 2015

Approximately three years after the issue of a report, an examination is made of whether and if so, in what manner, the Office's recommendations have been responded to, i.e. whether attention has been paid to the deficiencies or weaknesses described and whether anything has been done to improve the situation. In the event that recommendations are not responded to in a sufficient manner, such recommendations are reiterated in a follow-up report to the Althingi and published. The results of performance auditing are evaluated based on the proportion of recommendations the Office considers it inevitable to follow-up on with a reiteration. The INAO is of the opinion that this proportion should generally not exceed 30%.

In 2015, there were 20 such follow-ups on performance audits from 2012, containing a total of 84 principal recommendations. Of these, the INAO saw reason to reiterate 17 (20%), while 67 were not reiterated (80%). This is a quite good achievement in the opinion of the INAO. In this context, it should be kept in mind that the Office does not have executive powers and can only encourage the acceptance of its recommendations by careful reasoning and presenting them in a clear manner to the Althingi and other stakeholders. It should also be noted that recommendations are not reiterated in some cases even when such recommendation has not been responded to in full, e.g. if the Office can see that improvements are underway or if circumstances have changed to such an extent that the recommendation no longer applies. The following table contains a summary of the results of the follow-up of performance audits during 2015.

2015 Follow-up of performance audits			
REPORTS	PRINCIPAL RECOMMENDATIONS	REITERATED	%
20 from 2012	84	17	20

Other Tasks

The INAO's two support units, Administrative Services and Legal and Archives Services, are responsible for providing various services to the other divisions. The Administrative Services unit is responsible for the Office's general operation, canteen, switchboard services, reception, housekeeping and other tasks. The Legal and Archives Services unit is responsible for resolving various legal issues, filing issues and, moreover, for special monitoring tasks that relate to entities outside the public sector. This involves monitoring the finances of political parties and political candidates, chartered institutions (foundations) and that of cemeteries and parishes. The AG's Secretariat is responsible for publishing, public relations and international relations in addition to providing the Auditor General with many forms of assistance. In addition, the Secretariat is responsible for monitoring the implementation of the Government Budget and carries out various audits on the finances and operation of public bodies.



Monitoring the implementation of the Government Budget

In addition to financial auditing, the INAO is responsible for monitoring the implementation of the Government Budget in accordance with legislation applicable to the Office. This means examining whether public bodies comply with the provisions of the Budget, the Government Financial Reporting Act and the Regulation on the Implementation of the Government Budget. In 2015, the INAO published two reports containing the results of these monitoring duties.

Monitoring the finances of political parties and political candidates

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

According to the Act, the political parties have until 1 October each year to submit the statements of the previous year to the INAO. A total of nine political parties submitted their 2014 statements before 1 October 2015, and one party submitted their statement later. INAO published a summary of the statements on its website once they had been reviewed.



Monitoring chartered institutions

The INAO is responsible for monitoring the finances of entities operating in accordance with Act No. 19/1998 on Funds and Institutions Operating According to Approved Charters. These are self-owned organisations (foundations) that do not engage in business operations, such as various charities and memorial funds. These entities are under obligation to send their annual financial statements to the INAO, which is responsible for monitoring that they do so. In addition, the Office is responsible for maintaining a register of the revenues and expenditures of these entities, including the notes to the submitted statements

According to the Act, the entity who is responsible for a fund or an organisation with an approved charter must submit their annual financial statement to the INAO no later than 30 June each year. In July 2015, the INAO published a *Summary of self-owned organisations and*

funds that operate under an approved charter for the 2013 operating year. This revealed that by 1 July 2015, only 433 entities, out of a total of 706 listed in the registry, had submitted annual financial statements for the 2013 operating year. By year-end 2015, 455 entities had submitted statements. The INAO sends a letter and, as the case may be, an e-mail to the legal guardians of the funds and organisations that have not submitted the annual financial statements on time, strongly encouraging them to submit their statements. This, however, does not always prove sufficient, in which case the INAO refers the issue to the Sauðárkrókur District Commissioner.

A number of entities, which have not been operating for some time, are closed down each year. It can take considerable time to prepare to close down such entities. It must be ensured neither to impede financial nor emotional interests when a chartered institution, which does not have a legal guardian, is closed down. Before the District Commissioner takes a unilateral and a final decision to close down a chartered institution, it must be as certain as can be that no one has an interest in the institution or the right of representation.

Monitoring the annual financial statements of cemeteries and parishes

According to Act No. 36/1993 on Cemeteries, Burial and Cremation, the boards of cemeteries are under obligation to submit their annual financial statements to the INAO. The Office reviews the statements, checks if audit opinions are in order and balances the totals. In addition, the Office maintains a register containing information from the annual statements of cemeteries on their operation and financial standing. The boards of the cemeteries are under obligation to submit the financial statements from the preceding year to the INAO before 1 June each year. At the beginning of October 2015, the Office had received the statements of 188 cemeteries out of a total 242. In light of the poor return during recent years, the INAO has repeatedly urged that the option of further mergers of cemetery boards be examined.

According to an agreement with the national Church, the Bishop's Office is responsible for sending the annual financial statements of parishes to the INAO, where they are reviewed, checked to ensure whether auditor endorsements are in order and the totals balanced. In addition, the Office maintains a register containing information from the annual statements of parishes on their operation and financial standing. By October 2015, the INAO had received the 2014 annual financial statements of 221 parishes out of a total of 271 operating parishes.

Financial Statements 2015

Report of the Management and Endorsment of the Financial Statements

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

In the year 2015, the Office's operations generated a surplus of ISK 10,8 million. According to the Balance Sheet, the assets of the Office amounted to ISK 41,7 million, liabilities amounted to ISK 7,2 million, and equity amounted to ISK 34,5 million at year-end 2015.

The Auditor General and the Financial Manager certify the Financial Statements of the National Audit Office for the year 2015 with their signatures.

The Icelandic National Audit Office, 4 March 2016



Sveinn Arason, CPA
Auditor General



Eythor Borgthorsson
Financial Manager

Auditor's Report

To the Presidential Committee of the Icelandic Parliament

I have audited the Financial Statements of the Icelandic National Audit Office for the year 2015. The Financial Statements contain the management's statement, a Profit and Loss Account, a Balance Sheet, a Statement of Cash Flows, Accounting Policy and Notes.

Management responsibility for the annual accounts

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

Auditor's responsibility

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

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

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

Audit Opinion

In my opinion, the Financial Statements give a true and fair view of the operation of the National Audit Office in the year 2015, its Balance Sheet as of 31 December 2015 and change in cash during the year 2015, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavík, 4 March 2016



Gunnar Sigurdsson
Chartered Accountant

Profit and loss Account 2015

	2015	2014
Operating revenues		
Sale of services	44.555.711	42.792.967
Other income	3.157	3.619
	<u>44.558.868</u>	<u>42.796.586</u>
Operating expenses		
Salaries and related expenses	456.317.098	424.973.698
Administrative expenses	11.025.543	10.011.241
Meeting and travel cost	8.236.659	8.651.642
Expert services	15.001.065	17.532.203
Operations of equipments	1.591.653	1.473.640
Other operating expenses	5.357.069	4.882.116
Housing	29.017.174	28.528.725
Operation of vehicles	378.407	492.311
Grants	950.000	1.532.420
	<u>527.874.668</u>	<u>498.077.996</u>
Purchased assets	5.391.592	3.136.806
	<u>533.266.260</u>	<u>501.214.802</u>
Operating profit (-loss) before Treasury contribution	(488.707.392)	(458.418.216)
Treasury Contribution	<u>499.500.000</u>	<u>445.500.000</u>
Profit for the year	<u>10.792.608</u>	<u>(12.918.216)</u>

Balance Sheet 31. December 2015 (ISK)

	2015	2014
Assets		
Current assets		
Treasury	39.989.332	21.930.784
Accounts receivable	1.281.710	6.527.360
Cash and cash equivalents	405.108	208.557
	<u>41.676.150</u>	<u>28.666.701</u>
Total assets	<u>41.676.150</u>	<u>28.666.701</u>
 Equity and Liabilities		
Equity		
<i>Equity:</i>		
Equity at the beginning of the year	23.672.122	36.590.338
Profit for the year	10.792.608	(12.918.216)
Equity	<u>34.464.730</u>	<u>23.672.122</u>
Liabilities		
Current liabilities		
Accounts payable	7.211.420	4.994.579
Liabilities	<u>7.211.420</u>	<u>4.994.579</u>
Total equity and liabilities	<u>41.676.150</u>	<u>28.666.701</u>

Cash Flow Statement 2015

	2015	2014
Cash flow from operations		
<i>Cash flow from operating activities:</i>		
Profit.....	10.792.608	(12.918.216)
<i>Cash flow from operating activities</i>	<u>10.792.608</u>	<u>(12.918.216)</u>
<i>Changes in current assets and liabilities:</i>		
Accounts receivable, decrease / (increase).....	5.245.650	2.795.084
Accounts payable, (decrease) / increase.....	2.216.841	439.086
	<u>7.462.491</u>	<u>3.234.170</u>
Net cash provided by operating activities	18.255.099	(9.684.046)
Cash flow from financial activities		
<i>Changes in balance with the Treasury:</i>		
Treasury contribution.....	(499.500.000)	(445.500.000)
Received from the Treasury.....	481.441.452	454.867.969
Net cash from financing activity	<u>(18.058.548)</u>	<u>9.367.969</u>
Net increase in cash and cash equivalents.....	196.551	(316.077)
Cash and cash equivalents at the beginning of the year.....	<u>208.557</u>	<u>524.634</u>
Cash and cash equivalents at the end of the year	<u>405.108</u>	<u>208.557</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. 3/2006, and the Government Regulation on the Presentation and Contents of Annual Accounts and Consolidated Financial Statements No. 696/1996.

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

Tax

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

Recording of Revenue

The Auditor General and the Financial Manager certify the Financial Statements of the National Audit

Recording of Expenses

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

Operating Divisions

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

Accounts receivable

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

Cash and Cash Equivalents

The Office keeps no funds but has a bank account.

Pension Liabilities

The Office has accrued pension liabilities for its present and past employees. In accordance with the accounting principles of Group A of the Treasury, pension liabilities are not recorded in the annual accounts of individual Group A entities, but are recorded as one whole at the Treasury.

Accounts Payable

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

Accounting and Payment Functions

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

Notes

Budget and Operations

The Office's budget for 2015 anticipated similar activities as in the previous year. The Office's total budget was ISK 499,5 million.

Operating expenses less sale of services totalled ISK 488,7 million and were ISK 10,8 million more than budget. Operating expenses are specified as follows:

In ISK thousand	Initial	Total budget	Financial Statements	Differences
Sales of services	(46.300)	(46.300)	(44.559)	(1.741)
Salary and salary-related expenses	431.700	452.200	456.317	(4.117)
Other operating expenses	88.200	88.200	70.608	17.592
Grants	0	0	950	(950)
	473.600	494.100	483.316	10.784
Purchased assets	5.400	5.400	5.392	8
	479.000	499.500	488.707	10.793

Break-down in ISK thousand by type:

	2015	2014
Sales of services	(44.559)	(42.797)
101 Icelandic National Audit Office	527.875	498.078
601 Equipment	5.392	3.137
	488.707	458.418



Ríkisendurskoðun – Bríetartúni 7
Pósthólf 5350 – 125 Reykjavík
Sími 569-7100
postur@rikisend.is – www.rikisendurskodun.is