



The INAO's 2014 Annual Report

May 2015



RÍKISENDURSKOÐUN

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Introduction by the Auditor General



Draft legislation for public finances was submitted to the Althingi for the second time last autumn. The bill was initially submitted during the spring session but, due to lack of time, was not processed before the end of the session. A large steering committee under the leadership of Guðmundur Árnason, Permanent Secretary to the Ministry of Finance and Economic Affairs, was involved in preparing the bill as of early 2011. The undersigned was a member of this steering committee, and representatives from the INAO were members of three of its sub-groups. In my introductions to the Annual Reports in recent years, I have mentioned this work and discussed various elements contained in the bill. There is no need to repeat such discussion here. It is my belief that the bill will mean significant improvements that will, should the bill be enacted, substantially strengthen public financial management here in Iceland. It is my hope that the Althingi will be able to finalise the bill this spring.

Also submitted to the Althingi for the second time during the autumn session was a legislative bill for a new comprehensive Act on the activities of the Icelandic National Audit Office (INAO). This was originally submitted at the beginning of last year. The draft for the bill was composed by a three-member committee under the Chairmanship of Þuríður Bachman, former member of parliament, and was completed in early 2013. The undersigned was a member of that committee. The bill, entitled *Draft Legislation on the Auditor General and the Auditing of Central Government Accounts*, contains a number of innovations and changes to the legislation currently in effect. The principal aspects are as follows:

- ✓ That the Auditor General be elected by the Althingi for a term of six years and that he may be re-elected once only (Article 2).
- ✓ That the Auditor General is responsible for selecting his deputy (Article 19).
- ✓ That audits are carried out in accordance with generally accepted standards and rules of procedure that apply to the audits of public bodies (Article 9). That the Auditor General will for this purpose be authorised to adopt the ISSAIs (Article 20).
- ✓ That the procedures carried out by the INAO be subject to clear rules. These include rules on employee confidentiality (Article 12), employee competence (Article 13), the entitlement of those undergoing the Office's examination or monitoring to submit their opinion (Article 14) and the public's access to data held by the Office (Article 15).
- ✓ That clearer rules be established on the preparation of reports and dissemination of information than can be found in the legislation currently in effect (Article 16) as well as rules on the report requests of the Althingi (Article 17).
- ✓ That the Act on Auditors should not apply to the Auditor General or his employees (Article 21).

The first debate on the bill took place in October 2014 and, on its completion, was referred for discussion to the Constitutional and Surveillance Committee. The Committee requested opinions on the bill from a number of entities, including that of the INAO.

In the Office's opinion, the bill and the changes that it entails are generally welcomed, although comments on three issues were submitted. First, the INAO does not think it necessary to require the Auditor General to be certified public accountant (CPA). This requirement is stated in the legislation currently in effect and in the bill. Second, the Office objects to the title of the bill. In the opinion of the Office, there is no reason to make any reference to the government accounts or the Central Government Accounts. Third, the Office proposes certain changes to the phrasing of Article 16 of the bill. It is my hope that the bill will receive proper discussion and coverage in the Committee and subsequently in the parliament and that it will be possible to complete the process before the end of the parliamentary session.

The INAO has been a long-time member of EUROSAl and taken an active part in its activities. It should be noted that the INAO had a representative on the Organisation's board during 2005–2011. There has been considerable discussion within the Organisation in recent years on the changes to the operating environment of national audit offices, due in part to the development of information technology and demands for increased transparency in public operations. During the EUROSAl Congress this

past summer, held in The Hague in the Netherlands, these and other related matters were specifically discussed. The central theme during the Congress was “innovation”. The final resolution of the Congress encouraged member offices to seek new and innovative means to fulfil their role and duties, using e.g. a greater diversity of methods than they do at present to disseminate their conclusions. The INAO has taken this encouragement to heart.

Overall, the operation of the INAO proceeded as normal in 2014. No significant changes were made to the nature or scope of the operation between years. All the Office’s operating units delivered excellent work during the year.

Summit Hassan

Legal Status, Role and Strategy of the INAO

Althingi's
independent
monitoring body

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 such other bodies that are 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.

Legislation and
rules pertaining
to the operation

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. Examination of the internal controls and security of IT systems. Suggestions on what improvements may be made to accounting, the preparation of financial statements, internal controls and the operation and security of IT systems.

Performance auditing

Evaluations of the performance of public bodies, state-owned enterprises and parties that accept contributions from the State. Assessment of economy, efficiency and effectiveness of public bodies and suggestions on ways to improve these aspects.

Monitoring the implementation of the Government Budget

Monitoring whether the finances and financial decisions of public bodies 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 operating in accordance with approved charters.

Monitoring the finances of political parties and political candidates

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

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, however, the Office determines the approach to the subject matter, the methods used, when the report is completed and the manner in which the conclusions are presented. According to the National Audit Act, the staff of the Office shall be completely independent of those Ministries and organisations they are auditing.

The INAO notifies the appropriate public bodies, the Althingi and the public of the results of its investigations through electronic reports and press releases published on its website, www.rikisend.is. Results that touch on sensitive internal issues of public bodies, however, are not made public. The Althingi discusses the reports of the 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.

Independence

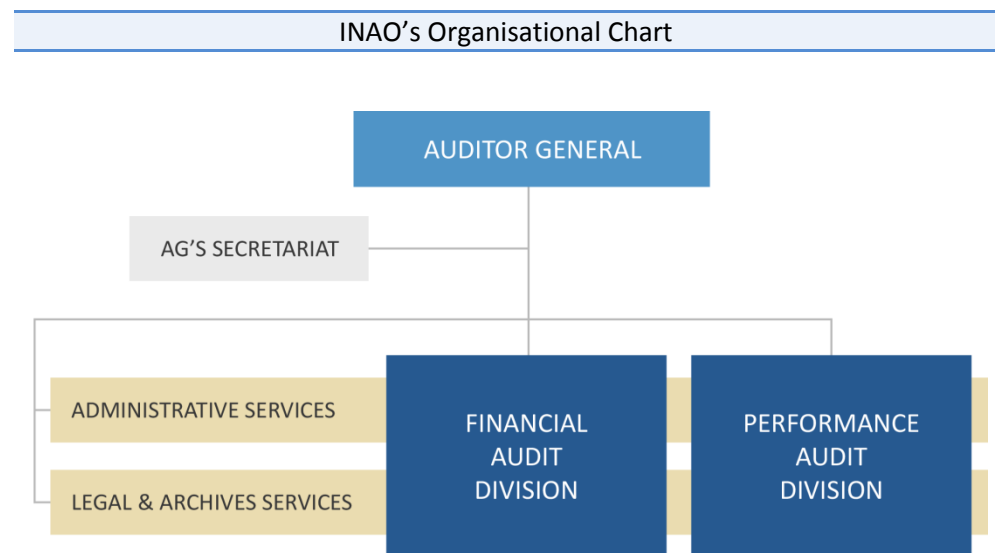
10 key goals

General information on Activities and Operation in 2014

Organisation of operations

The INAO's organisational chart came into effect on 1 April 2014. There are two core divisions: 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 8 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 2014. 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 four employees at year end, i.e. in addition to the Auditor General. The total number of employees at the INAO at year-end 2014 were 43.

Two core divisions, two support units and the AG's Secretariat



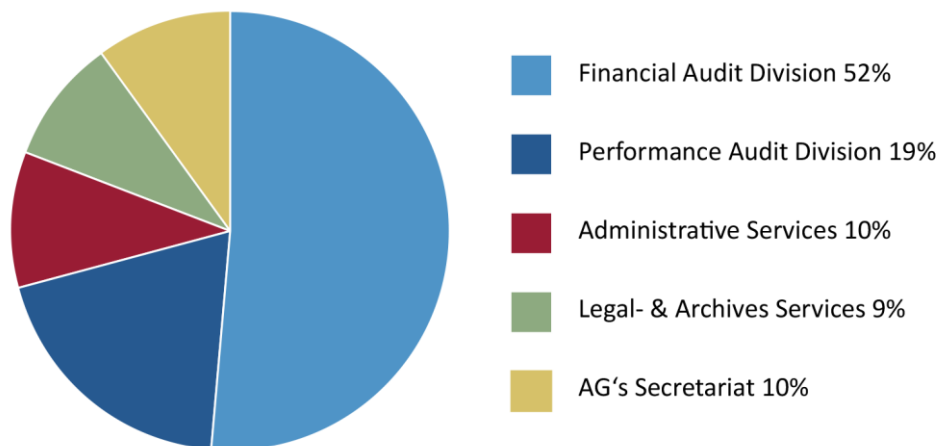
Total of 70 thousand active man-hours

Division of work contribution between divisions

The active man-hours of the employees of the INAO were a total of over 70 thousand in 2014. 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 just over 36 thousand, or 52% of the total number. Active man-hours in the Performance Audit Division were just over 14 thousand, or 19% of the total number. Administrative services were responsible for just over 7 thousand (10%), legal and archive services were responsible for just over 7 thousand (9%) and the AG's Secretariat for just under 7 thousand (10%).

Proportional division of active man-hours between divisions in 2014



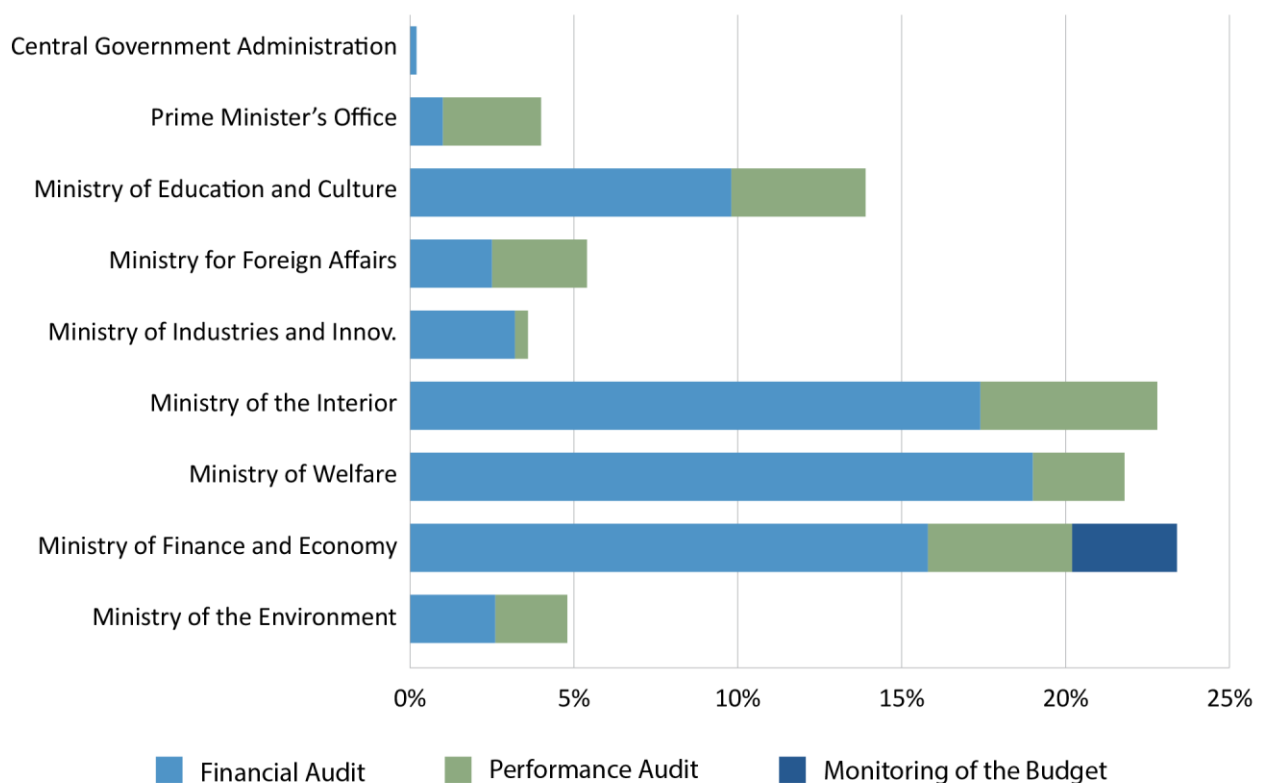
Division of work contribution between ministries

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

In 2014, the Office focused primarily on three ministries and entities under them, i.e. the Ministry of Finances and Economic Affairs, the Ministry of the Interior and the Ministry of Welfare (see following figure). A total of around 70% of the time was allocated to auditing and monitoring these three ministries and their agencies. Less time was spent on auditing and monitoring of other ministries and the central government administration. The division 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 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.

Focus on three
ministries

Proportional division of active man-hours allocated to auditing and monitoring tasks according to ministries and their agencies 2014



Revenue and expenditure

The total expenditures of the INAO amounted to ISK 501.2m in 2014, increasing by ISK 32.2m between years, or by 8%. The increase can, for the most part, be attributed to increased payroll costs. The man-years of permanent employees in daytime work increased by 1.4 compared to 2013, and wages rose in accordance with the provisions of collective wage agreements but nothing in excess thereof. Special income amounted to ISK 42.8m, and the state contribution amounted to ISK 445.5. The deficit in the operation amounted to ISK 12.9m, which was a turnaround from 2013 when there was a surplus of ISK 29.6m.

Wage increases according to collective wage agreements

| Summary of 2013 and 2014 profit and loss statement (ISK millions) | | | | |
|---|--------------|--------------|--------------|--------------|
| | 2014 | 2013 | Change | % |
| Salary and salary-related costs | 424.9 | 392.6 | 32.3 | 8% |
| Other operating expenses | 73.1 | 76.5 | -3.4 | -4% |
| Formation expenses | 3.2 | 3.2 | 0 | 0% |
| Cost and expenses total | 501.2 | 472.3 | 28.9 | 6% |
| Special revenue | 42.8 | 47.8 | -5 | -10% |
| Expenses minus income | 458.4 | 424.5 | 33.9 | 8% |
| Government contribution | 445.5 | 454.1 | -8.6 | -2% |
| Revenue surplus (deficit) | -12.9 | 29.6 | -42.5 | -144% |

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.

Two employees left the INAO in 2014, and an equal number were recruited. The number of staff, therefore, remained constant, at 43 both at the beginning and end of the year. 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 5% in 2014. This is the same proportion as in 2013, as opposed to the year before when staff turnover was unusually high, or 14%.

The average age of employees at year-end 2014 was approximately 55 years. In comparison, the average age of employees in the Government Offices of Iceland was just under 50 years in 2014. The ratio of employees with at least three years' experience at the Office was 88%, and the average length of service was around 16 years.

Number of staff remained constant between years

| Key figures in human resources | | | | |
|-----------------------------------|----------|----------|----------|----------|
| | 2014 | 2013 | 2012 | 2011 |
| Employee turnover | 5% | 5% | 14% | 4% |
| Average age of employees | 55 years | 53 years | 53 years | 52 years |
| Average length of service at INAO | 16 years | 15 years | 14 years | 13 years |
| 3-year work experience at INAO | 88% | 91% | 87% | 94% |

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).

The majority hold degrees in business administration

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. Two employees participated in an online course on IT auditing in 2014. The course was held by the INTOSAI Development Initiative, which offers various courses each year for the employees of member Offices.

Discrepancies between the Althingi Procedures Act and rules on the parliamentary treatment of reports

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 reports of the INAO

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 whom recommendations are made are given the opportunity to present their views in the meetings of the Committee. The managers of the INAO attended numerous CSC meetings in 2014 and presented the Office's reports. The Committee issued an opinion on three reports from 2013 and one from 2012.

In additions, the AG and the Office's managers attended quite a few 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 one report from 2013 during the year. It should be noted that the Committee's opinion on the reports on the audit of the 2011 and 2012 Central Government Accounts was published in January 2015.

Financial Audit

The regular financial audit of public bodies and enterprises is the most extensive task undertaken by the INAO. By the end of 2014, the Financial Audit Division had a total of 22 employees, an increase of one from year-end 2013. The employees of the Division were responsible for around 52% 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:

Objectives of government financial auditing

- ✓ That the financial statements present a fair view of operations and financial position in accordance with generally accepted accounting principles.
- ✓ That internal controls are examined to ascertain whether they ensure adequate results.
- ✓ That accounts are in accordance with Budget authorisations, the supplementary Budget or other appropriate laws, lawful instructions, business practices or service contracts.
- ✓ 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 2013 (*Audit of the 2013 Central Government Accounts*) was published in December 2014.

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

Few assessment-based items in the accounts of Group A bodies

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.

At present, the Althingi is processing a legislative bill on public finances which will replace the Government Financial Reporting Act. The bill assumes the adoption of the *International Public Sector Accounting Standards* (IPSAS). These standards impose heavier requirements for the financial statements of public bodies than is the case at present. Their adoption will have a significant impact on the conduct of financial audits. The adoption of IPSAS, if effected, 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, the ratification of the Act will mean that 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.

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.

Items and bodies audited in 2014

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 2014, the INAO and auditing firms operating on its behalf audited a total of 149 items in Group A (i.e. for the 2013 accounting year) and 20 entities in Groups B to E. In

Takes account of potential operational risks

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 193 auditing tasks undertaken during the year.

**Total of 193
auditing
assignments**



Current employees of the Financial Auditing Division, from left: Álfheiður D Gunnarsdóttir, Grétar Bjarni Guðjónsson, Telma Steingrímsdóttir, Péter Szklenár, Karlotta Aðalsteinsdóttir, Óskar Sverrisson, Brynja Pétursdóttir, Sigurgeir Bóasson, Auður Guðjónsdóttir, Albert Ólafsson, Kristín Þ Jónsdóttir, Ingi K Magnússon, Thelma Hillers, Guðbrandur R Leósson and Svafa Þóra Hinriksdóttir. Missing from the photograph are Einar Þorgilsson, Þorbjörg Guðnadóttir, Sigríður H Sigurðardóttir, Geir Gunnlaugsson, Helga Guðmundsson, María Bjargmundsdóttir and Viðar H Jónsson.

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, due to, among other things, lack of sufficient staff. 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 year 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. Of a total of 193 audit reports prepared in 2013 (for the 2012 accounting year), 25 contained recommendations. In total, there were 58 recommendations, 35 of which, or around 60%, were reiterated.

**60% of comments
from 2013
reiterated in 2014**

| Follow-up of 2014 financial auditing | | | |
|--------------------------------------|----------|------------|----|
| Auditing reports | Comments | Reiterated | % |
| 25 from 2013 | 58 | 35 | 60 |

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 10 auditing firms had effective contracts in 2014. These firms audited a total of around 30 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. In 2011, the adoption of the ISSAI standards began in the Office, involving, for example training employees to use them. The plan is to complete the adoption of the standards in 2015.

Plans for
completing the
adoption in 2015

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 Auditing Division are responsible for the auditing of IT systems, one of whom was recruited in 2014. The employees participated in a course held by the INTOSAI Development Initiative (IDI) on IT auditing during the year. The course was for the most part held on-line. As a result of the course, the Office has enjoyed the help of IDI experts in auditing its payroll systems, which are part of the state's accounting and human resources system (Orri). The audit is expected to be completed in 2015. 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.

System errors can
prove costly

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 Performance Audit Division had a total of eight employees at year-end 2014, one fewer than at year-end 2013, and was responsible for approximately a fifth (19%) of the total active man-hours in the Office. The employees of the Performance Audit Division completed a total of 30 reports in 2014, a new record. Thereof, there were 10 main audits and 20 follow-up reports. The Director of the Performance Audit Division is Kristín Kalmansdóttir.



Current employees of the Performance Auditing Division, from left: Hilmar Pórisson, Hrafnhildur Ragnarsdóttir, Jakob G. Rúnarsson, Elísabet Stefánsdóttir, Hrafnhildur Óskarsdóttir, Þórir Óskarsson, Auður Hanna Guðmundsdóttir and Kristín Kalmansdóttir. Missing from the photograph is Margrét E Arnórsdóttir.

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 one exception, that were completed in 2014 were at the Office's initiative.

Risk -assessment

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 2013 to 2015. 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. When preparing the plan, the following aspects were specifically taken into account: the changes that have occurred in government operations in recent years, the focus of government authorities on public finances, budget allocations, 2011 Central Government Accounts, the results of an employee survey by SFR in 2012 and an analysis of the financial positions of individual budget items. 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 2014

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 a recommendation has not had the desired effect, such recommendation is 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%.

**25 out of a total of 87
recommendations
were reiterated**

In 2014, there were 16 such follow-ups on performance audits from 2011, containing a total of 87 principal recommendations. Of these, the INAO saw reason to reiterate 25 (29%), while 62 were not reiterated (71%). 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. It cannot order the responses of ministries and public bodies to its recommendations and can only encourage their acceptance 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 2014.

| 2014 Follow-up of performance audits | | | |
|--------------------------------------|---------------------------|------------|----|
| Reports | Principal recommendations | Reiterated | % |
| 16 from 2011 | 87 | 25 | 29 |

The 25 recommendations that were reiterated were directed at a total of six entities. Twelve recommendations were directed at the Ministry of Finance and Economic Affairs, six at the Ministry of Education, Science and Culture, three at the Hólar University, two at the Ministry of Welfare, one at the Ministry for the Environment and Natural Resources and one at the University of Iceland. Another examination of the response to these reiterated recommendations will be carried out in three years' time.

Other Tasks

29% of active man-hours in 2014

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. The AG's Secretariat and the support units employed a total of 12 employees at year-end 2014 and were responsible for 29% of the total active man-hours of INAO.



Current employees of the Administrative Services unit, from left: Eypór Borgþórsson, Steinunn Gísladóttir, Ásdís Hauksdóttir and Sigurður Þorvaldsson.

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.

In the Act, the political parties are given until 1 October each year to submit the statements of the previous year to the Icelandic National Audit Office. A total of 10 political parties submitted their 2013 statements before 1 October 2014, and six parties submitted their statements after that date. INAO published a summary of the statements on its website once they had been reviewed.

Six parties submitted statements after the statutory deadline had expired

Municipal elections were held on 31 May 2014. According to law, candidates are under obligation to submit an audited statement of income and costs no later than three months after the date of the election. A total of 13 candidates submitted statements of income and costs due to participation in pre-elections in connection with the municipal elections. A further 93 candidates submitted statements to the effect that their expenditures due to participation in pre-elections had amounted to less than ISK 400 thousand. Summaries from the statements of income and costs of the candidates were published on the INAO's website.



Current employees of the Legal and Archives Services unit, from left: Lárus Ögmundsson, Linda Sigurðardóttir and Laufey Ásgrímsdóttir. Missing from the photograph is Elín Ingadóttir.

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.

570 entities out of a total of 746 had submitted statements at year end

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 2014, the INAO published a *Summary of self-owned organisations and funds that operate under an approved charter for the 2012 operating year*. This revealed that by 1 July 2014, only 432 entities, out of a total of 746 listed in the registry, had submitted annual financial statements for the 2012 operating year. By year-end 2014, 570 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.

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 2014, the Office had received the statements of 181 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 2014, the INAO had received the 2013 annual financial statements of 219 parishes out of a total of 271 operating parishes.

Monitoring the implementation of the Government Budget

In addition to regular financial auditing, the National Audit Office 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 2014, the INAO published one report containing the results of these monitoring duties:

- ✓ [Annual plans of public bodies and status of budgetary items at the end of May](#)

Legal opinions

Every year, the INAO must discuss a broad range of legal questions that relate to the role of the Office or which relate to the state's finances, asset management or central government administration. Such work often involves individual tasks in the field of financial and performance auditing. Legal questions also studied independently on occasion, e.g. if they concern the role or the investigative powers of the INAO.



The current employees of the AG's Secretariat, from left: Sveinn Arason, Brynja Baldursdóttir, Jón Loftur Björnsson and Óli Jón Jónsson.

Communications and public relations

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.

Transparency and
accountability

The INAO's communication policy is in accordance with INTOSAI's *Principles of Transparency and Accountability* (ISSAI 20) and 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.

Every effort is made to prepare the reports of INAO to the Althingi in such a way that members of parliament find them easy to read. Readers are not expected to have extensive prior knowledge of the material, although they are expected to know the principal tasks of the Government and the manner in which the administration is arranged. Efforts are made to explain the substance of reports in a simple and easily understandable manner in press releases published on the Office's website and sent to the media and others who subscribe to the Office's electronic mailing list. The employees of the INAO respond to numerous enquiries from the media and the public every year. Such enquiries generally involve the individual tasks, role or working methods of the Office.

The INAO maintains a website, www.rikisend.is where all its public reports may be accessed. Visits to the site in 2014 numbered more than 18 thousand and the number of users just less than 11 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 13 meetings, seminars and conferences overseas in 2014.

Ingi K Magnússon, Director of the Financial Audit Division, is INAO's representative on the EFTA Board of Auditors (EBOA) and attended its three meetings in Brussels in 2014. In recent years, he has also been a member of the committee's working group which audits the grants allocated by the EFTA Development Fund (*EFTA Financial Mechanism*). In 2014, the INAO appointed a new representative to this working group, Auður Guðjónsdóttir, expert in the Financial Auditing Division.

The INAO is involved in the audit of the External Borders Fund, of which Iceland is a member and involves 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. In addition, the INAO participated in auditing projects that have received grants from the Northern Periphery Programme to which Iceland is a party. Albert Ólafsson, Department Head in the Financial Auditing Division, attended the meeting of the Board of Auditors of the Programme in Stockholm.

The Auditor General and the Office's International Relations Officer attended the EUROSAI Congress held in The Hague. Several working groups operate under the auspices of the Organisation and address various issues that relate to public auditing. Due to economisations in its operation in recent years, the INAO has taken part in the

Total of 13
meetings, seminars
and conferences
overseas

work of only one such working group, i.e. the Task Force for Audit & Ethics. Þórir Óskarsson, Head of Department in the Performance Audit Division, has been the INAO's representative in this group and attended two of its meetings in Lisbon and Bucharest. The group issued a total of four reports on the various aspects that relate to public auditing and ethics between 2012 and 2014. The INAO made the decision to withdraw from the group mid-year.

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. Hrafnhildur Óskarsdóttir, expert in the Performance Audit Division, is the INAO's representative in this group and attended its meeting in Torshavn in the Faeroe Islands. The Auditors General of the countries meet every year. The meeting was held in the Faeroe Islands in 2014. In addition, the employees of the INAO took part in two Nordic seminars. Jón Loftur Björnsson, Director of the AG's Secretariat, attended a seminar on the monitoring of limited liability companies owned by the state and their ownership policies in Helsinki, and Óli Jón Jónsson, Communications and International Relations Officer, attended a seminar on communications in Oslo.

In December, the INAO's experts in IT auditing, Albert Ólafsson and Sigríður H Sigurðardóttir, attended a meeting in Warsaw with the experts of the IDI who are assisting the INAO with its audit of the government's payroll system.

A number of representatives from overseas sister offices, international bodies and overseas authorities visit the INAO due to e.g. collaborative projects. At the beginning of 2014, the INAO was visited by experts from the National Audit Office of the Netherlands (*Algemene Rekenkamer*) who gave a presentation of the results of an international peer review of the INAO's financial auditing practice (see discussion in [The Icelandic National Audit Office Annual Report 2013](#)).

Financial Statements 2014

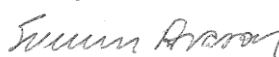
Report of the Management and Endorsment of the Financial Statements

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 2014, the Office's operations generated a deficit of ISK 12,9 million. According to the Balance Sheet, the assets of the Office amounted to ISK 28,7 million, liabilities amounted to ISK 5,0 million, and equity amounted to ISK 23,7 million at year-end 2014.

The Auditor General and the Financial Manager certify the Financial Statements of the National Audit Office for the year 2014 with their signatures.

The Icelandic National Audit Office, 30 March 2015



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 2014. 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 2014, its Balance Sheet as of 31 December 2014 and change in cash during the year 2014, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavík, 20 March 2015



Gunnar Sigurdsson
Chartered Accountant

Profit and loss Account 2014

| | 2014 | 2013 |
|--|-----------------------|--------------------|
| Operating revenues | | |
| Sale of services | 42.792.967 | 47.774.161 |
| Other income | 3.619 | 42.670 |
| | <u>42.796.586</u> | <u>47.816.831</u> |
| Operating expenses | | |
| Salaries and related expenses | 424.973.698 | 392.622.753 |
| Administrative expenses | 10.011.241 | 10.413.808 |
| Meeting and travel cost | 8.651.642 | 12.086.603 |
| Expert services | 17.532.203 | 17.556.482 |
| Operations of equipments | 1.473.640 | 1.218.648 |
| Other operating expenses | 4.882.116 | 5.651.970 |
| Housing | 28.528.725 | 28.242.671 |
| Operation of vehicles | 492.311 | 511.056 |
| Grants | 1.532.420 | 800.000 |
| | <u>498.077.996</u> | <u>469.103.991</u> |
| Purchased assets | 3.136.806 | 3.222.383 |
| | <u>501.214.802</u> | <u>472.326.374</u> |
| Operating profit (-loss) before Treasury contribution | (458.418.216) | (424.509.543) |
| Treasury Contribution | <u>445.500.000</u> | <u>454.100.000</u> |
| Profit for the year | <u>(12.918.216)</u> | <u>29.590.457</u> |

Balance Sheet 31. December 2014 (ISK)

| | 2014 | 2013 |
|---|-------------------|-------------------|
| Assets | | |
| Current assets | | |
| Treasury | 21.930.784 | 31.298.753 |
| Accounts receivable | 6.527.360 | 9.322.444 |
| Cash and cash equivalents | 208.557 | 524.634 |
| | <u>28.666.701</u> | <u>41.145.831</u> |
| Total assets | <u>28.666.701</u> | <u>41.145.831</u> |
| Equity and Liabilities | | |
| Equity | | |
| <i>Equity:</i> | | |
| Equity at the beginning of the year | 36.590.338 | 6.999.881 |
| Profit for the year | (12.918.216) | 29.590.457 |
| Equity | <u>23.672.122</u> | <u>36.590.338</u> |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable | 4.994.579 | 4.555.493 |
| Liabilities | <u>4.994.579</u> | <u>4.555.493</u> |
| Total equity and liabilities | <u>28.666.701</u> | <u>41.145.831</u> |

Cash Flow Statement 2014

| | 2014 | 2013 |
|--|-------------------|-----------------------|
| Cash flow from operations | | |
| <i>Cash flow from operating activities:</i> | | |
| Profit..... | 12.918.216 | 29.590.457 |
| <i>Cash flow from operating activities</i> | <u>12.918.216</u> | <u>29.590.457</u> |
| <i>Changes in current assets and liabilities:</i> | | |
| Accounts receivable, decrease / (increase)..... | 2.795.084 | (1.619.327) |
| Accounts payable, (decrease) / increase..... | 439.086 | (740.474) |
| | <u>3.234.170</u> | <u>(2.359.801)</u> |
| Net cash provided by operating activities | (9.684.046) | 27.230.656 |
| Cash flow from financial activities | | |
| <i>Changes in balance with the Treasury:</i> | | |
| Treasury contribution..... | (445.500.000) | (454.100.000) |
| Received from the Treasury..... | 454.867.969 | 427.258.568 |
| Net cash from financing activity | <u>9.367.969</u> | <u>(26.841.432)</u> |
| Net increase in cash and cash equivalents..... | (316.077) | 389.224 |
| Cash and cash equivalents at the beginning of the year..... | <u>524.634</u> | <u>135.410</u> |
| Cash and cash equivalents at the end of the year | <u>208.557</u> | <u>524.634</u> |

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 2014 anticipated similar activities as in the previous year. The Office's total budget was ISK 445,5 million.

Operating expenses less sale of services totalled ISK 458,4 million and were ISK 12,9 million more than budget. Operating expenses are specified as follows:

| In ISK thousand | Initial | Total budget | Financial Statements | Differences |
|--|-----------|--------------|----------------------|-------------|
| Sales of services | (45.700) | (45.700) | (42.797) | (2.903) |
| Salary and salary-related expenses | 390.100 | 393.100 | 424.974 | (31.874) |
| Other operating expenses | 97.100 | 97.100 | 71.572 | 25.528 |
| Grants | 0 | 0 | 1.532 | (1.532) |
| | 441.500 | 444.500 | 455.281 | (10.781) |
| Purchased assets | 1.000 | 1.000 | 3.137 | (2.137) |
| | 442.500 | 445.500 | 458.418 | (12.918) |

Break-down in ISK thousand by type:

| | 2014 | 2013 |
|---|-----------|-----------|
| Sales of services | (42.797) | (47.817) |
| 101 Icelandic National Audit Office | 498.078 | 469.104 |
| 601 Equipment | 3.137 | 3.222 |
| | 458.418 | 424.509 |



The Icelandic National Audit Office – Bríetartún 7
PO Box 5350 – 125 Reykjavík
Tel. 569-7100
postur@rikisend.is – www.rikisendurskodun.is