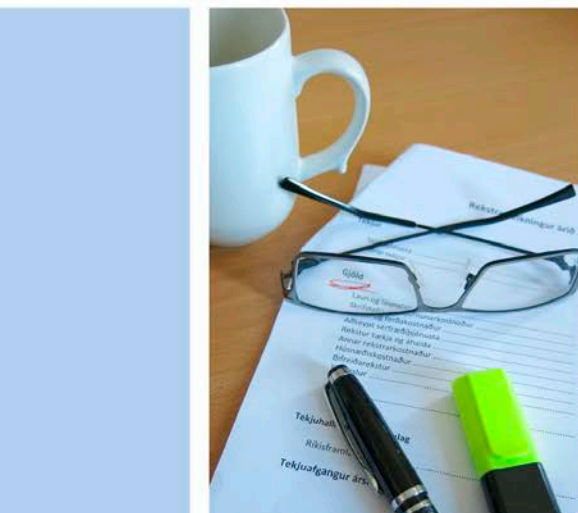


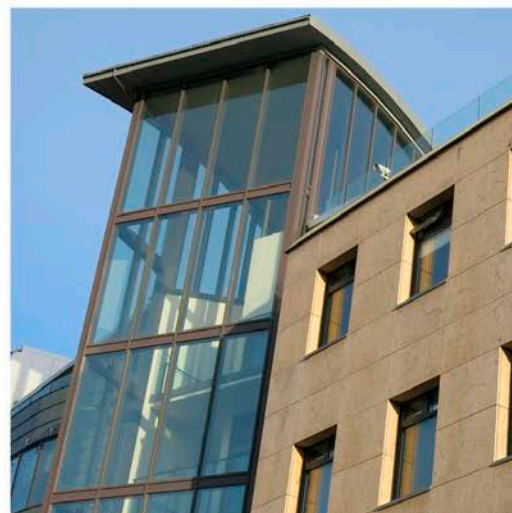
INTEGRITY



INDEPENDENCE



PROFESSIONALISM



# THE INAO's ANNUAL REPORT 2012

JUNE 2013

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## INTRODUCTION BY THE AUDITOR GENERAL, MR. SVEINN ARASON



During the past few years the Budget allocations to the INAO have been substantially cut back. The annual allocation to the Office was cut by nearly one third in real terms during the period 2008–2012. The allocation was a little less than ISK 482m in 2008 and slightly more than ISK 430m last year. The office had accrued unused budget appropriations from earlier years which have been used in part to respond to the cutbacks. At the same time a variety of cost-restraint measures have been applied among those not hiring any new employees for any vacant positions. During this period the number of Office employees was reduced by a total of seven, from 49 to 42. It is obvious that such reduction of the staff must affect the Office's capacity to carry out its tasks. I think that we have now reached the limit in these matters and that we will not be able to take further steps regarding cutbacks without at the same time taking into consideration changing the tasks of the INAO and to reduce its statutory responsibilities. It should be mentioned that the Office's staff have shown understanding of the difficult financial situation; they have carried out their responsibilities showing a sense of duty and pride and performed with good efficiency in spite of the adversity. I wish to use this opportunity to thank the staff for a job well done during recent years.

Last autumn the Office suffered severe criticism in the public venue because of delays in the completion of the report on the government financial data system (Orri) and its

submission to the Althingi Presidential Commission. The committee initially asked for the report in 2004 but due to reasons that will not be related here the project had not been completed. A very incomplete draft report from 2009 was available at the Office. This draft was leaked to the TV show *Kastljós* on the RUV station which discussed the draft report in sensational style at the end of September. During the debates that ensued there were unfortunately put forth various misleading allegations regarding the purchase of Orri, the processing of the report, the INAO and myself as its Executive Officer. The office attempted to respond to this crossfire, to correct misunderstandings and to explain the issue. But the undercurrent in the debate was heavy and it is evident that some period of time will have to pass before the reputation damage, which the office suffered, will be fully repaired. I wish to use the opportunity here and reiterate some aspects concerning this matter: The delays in the processing of the report were unacceptable. And I carry of course the full responsibility for these delays. I gave a full account of the reasons for these delays in a special memo that I sent to the Speaker of the Althingi in early October. The Speaker did not make any objections to my explanations. Furthermore, measures have been taken in order to ensure that events of this sort can not be repeated. By the end of September the Speaker of the Althingi instructed me to submit a final report regarding the purchase of and implementation of Orri by the end of October. The report was submitted to the Speaker on 30 October and it was also released officially. The report is very different from the incomplete draft that had been leaked to the *Kastljós* TV show, both in terms of its presentation and its material conclusions. Behind this final report lies a great amount of careful work and its conclusions are well reasoned. Admittedly it is quite noteworthy that very little public discussion has taken place regarding this report, which again says something about its quality.

The INAO has endeavoured to maintain optimum relations with the standing committees which the Office's activities are primarily related to, namely the Budget Committee and the Constitutional and Supervisory Committee. Unfortunately the "Orri"- case resulted in the chairmen of the said parliamentary committees saw a reason to announce that there had been a breach of confidence between the majority of these committees and the INAO. Following this the relations between the INAO and these committees have been minimal and the INAO has not been summoned to present its reports at their meetings. This is very unfortunate and can not continue in this manner in the long run. Last year the Althingi amended the Althingi Procedures Act so that now the Constitutional and Supervisory Committee is mandated to discuss all INAO reports but prior to that the Budget Committee would discuss reports concerning the implementation of the Budget and the audit of the Central Government Accounts. The Constitutional and Supervisory Committee may however refer any report for discussions in another parliamentary committee if the subject matter of the report merits this. Although the INAO supports the view that it is reasonable that one permanent committee has an overview over all reports that are sent by the Office to the parliament, it can not be escaped, that it may be difficult for the Constitutional and Supervisory Committee to deal with having to address all the Office's reports. This is true in particular when the committee is busy dealing with other tasks as has been the case recently. For these reasons the committee's mandate



to refer reports to other permanent committees is essential and contributes to the reports being most useful to the parliament in its monitoring of the executive branch.

The Presidential Committee of the Althingi decided in late 2011 to appoint a three member committee to review the National Audit Act. Member of Parliament Thuríður Backman was the chairman of the committee. Other members of the committee were Stefán Svavarsson, Chartered Accountant and the undersigned. The committee held a total of 15 meetings and interviewed various parties who are knowledgeable about auditing and supervision work of the type that the Office conducts. It also called for written recommendations from ministries concerning possible amendments to the Act. Furthermore the work of the committee consisted to a large extent in examining the legal environment of the INAO's sister offices in neighbouring countries, in particular in other Nordic states. In February of 2013 the committee submitted a bill for a new National Audit Act accompanied by detailed explanatory notes. The bill includes several novelties compared with the current act, e.g. regarding the appointment of the Auditor General, access to data at the Office and other issues. The bill contains in my opinion timely reforms that will undoubtedly strengthen the Office, if it becomes an act of law. It is my expectation that Althingi will discuss the bill during the next regular session so that a new National Auditing Act will enter into force in the year 2014.

In 2011 the Minister of Finance appointed a steering group lead by Guðmundur Árnason, Permanent Secretary in the Minister of Finance to prepare a bill for a new act of law on public finances to replace the current Government Financial Reporting Act. The undersigned is a member of this group. A great deal of work has been put in the writing of the bill and it is now in its final phase. It includes various novelties compared with the current act. Among other things there is a focus on increasing firmness in all decision making connected with the forming and putting together of the Budget, and more responsibility is placed on those who carry out its implementation and the supervision of the central government finances. Plans concerning central government finances shall be made for terms of five years and changed methods of preparing financial statements in accordance with *International Public Sector Accounting Standards – IPSAS*. It is hoped that the bill will be submitted for presentation during this spring and that the parliament will discuss it this autumn. It is desirable that this issue will be carefully discussed in the parliament and that a new act on public finances enters into effect as soon as possible.

Much has happened from the time of the collapse of the large banks and the enactment of the emergency act in the autumn of 2008. The government deficit has steadily been decreasing during this period but there has been a great contraction in business operations and investments. At the same time taxes and various charges that go to the Treasury have been increased for the purpose of making ends meet in the operation. Under these circumstances the Ministry of Finance and the Budget Committee have been under a lot of stress and have borne the brunt of putting together the Budget and the Supplementary Budget. It is rather interesting that these parties have found it difficult to foresee all the fallout from the collapse which fell on the Treasury, even though this fallout was entirely foreseeable. This is reflected in an

increased state revenue deficit in the central government accounts compared to the Budget and the Supplementary Budget.

The INAO has for decades taken part in the international cooperation of national audit offices which has returned many benefits to the Office. Thus the Office is a member of INTOSAI and EUROSAI, the Auditor General was a member of the latter organisation from 2006 until 2011. But most of the interaction has however been with the sister offices in the Nordic countries. It should be mentioned that following the banking collapse the participation of the INAO in international cooperation was greatly cut back, for instance the Office resigned from its participation in two working groups on behalf of EUROSAI. However we endeavoured to continue to participate in Nordic cooperation as best we could. At the annual meeting of the Nordic supreme auditors in Stockholm last year a decision was made to review the cooperation of these offices. Thus far several joint working groups have been operated, e.g. working groups on financial auditing and performance auditing which have held annual meetings or biannual meetings. In lieu of these small meetings it is now being discussed to hold one large annual convention that on each occasion would be dedicated to a particular theme which is in some way related to the activities of the offices. The objective of these changes is to put the funds that these offices use for Nordic cooperation to better use, and thereby contribute to the maximum benefit being obtained from these funds. This matter was discussed at the meeting of the main contacts of the Nordic cooperation which was held here in Iceland but the final decision will be made at the meeting of the Nordic auditor generals next summer.

In 2011 I sent a request to Ms. Saskia Stuiveling, requesting that her office would undertake the leadership in a peer review of the operation of INAO. It is quite common that supreme audit institutions are subjected to such reviews which are preformed in accordance with a special standard, the INTOSAI (ISSAI 5600). The Dutch auditor general accepted this request and the auditor generals of Norway and Sweden were also asked if they would take part in the peer review, which they accepted to do. In January of 2012 an agreement was signed to the effect that during that particular year a peer review of the work procedures of INAO during a performance audit, and that a peer review of the work procedures applied in carrying out a performance audit should be carried out in 2013. In June of last year a five man team of specialists arrived here in Iceland staying for a week and met with the staff of INAO, ministerial representatives and representatives of agencies and with the Constitutional and Surveillance Committee of the Althingi. Prior to this the specialist team had selected eight of the Office's reports for examination and received them and various related papers in English translation. A draft report was received in the autumn and a final report was received in December. Overall there emerges a positive image of the work procedures of the Performance Audit Division but at the same time a number of items are pointed out that might be considered for improvement. In my view this process has been one of education and usefulness for the Office and it will no doubt strengthen the good work being performed here. I expect that a peer review of the work procedures of the INAO during the financial auditing which is being prepared at this time will likewise be of benefit to the Office in the future.

This report discusses a wide range of subjects concerning the operation and activities of the INAO during 2012. Chapter 1 discusses general aspects of the activities during the year: the work contribution by the employees, revenues and costs, human resources, internal organisation and performance measurements. Chapter 2 deals with financial auditing and chapter 3 deals with performance auditing. Chapter 4 discusses various other tasks of the Office, i.a. monitoring projects, publishing and international relations. Finally the Office's annual financial statement for 2012 is shown.

*Sumit Basu*

# ROLE AND LEGAL STATUS OF THE ICELANDIC NATIONAL AUDIT OFFICE

## PART OF THE LEGISLATIVE BRANCH'S MONITORING OF THE EXECUTIVE

The INAO is an independent body operating under the auspices of the Althingi (Iceland's parliament). The Office is a part of the legislative branch and its monitoring of the executive branch. The Office audits the central government accounts and the accounts of agencies and organisations that are involved in running an operation or in the management of funds for the government. Its role is also to monitor and promote improvements in the financial management of such entities and in their more economical operation, efficiency and performance. The Office's vision is to be a leader in professional government auditing.

## ACTS OF LAW APPLICABLE TO THE ACTIVITY

The INAO operates in accordance with the legislation applicable to it (No. 86/1997) and, as applicable, the Act on Auditors (No. 79/2008), as well as various other acts of law applicable to its operation, such as the Act on State Finances (No. 88/1997) and the Civil Servants Act. (No.70/1996). Furthermore the Office has had various responsibilities and tasks allocated to it under other acts of law, such as the Act on Funds and Organisations that operate under a Charter (No. 19/1988) and the Act on the Finances of Political Groups and Candidates and on their duty to disclose (No. 162/2006). The Office takes account of the standards and guidelines of the International Organisation of Supreme Audit Institutions (INTOSAI) and the standards of the International Federation of Accountants (IFAC). Moreover its employees follow the Office's Code of Professional Conduct. As the INAO 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 INAO has defined its principal tasks in the following manner:

## PRINCIPAL TASKS

### 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 financial statements, internal controls and the operation and security of IT systems.



## PERFORMANCE AUDITING

Reviews of the performance of public bodies, state-owned enterprises and parties that accept contributions from the State. Assessment of economy, efficiency and effectiveness in operations. Suggestions on how performance may be improved.

## 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 finances of funds and public bodies operating in accordance with approved charters.

## MONITORING THE FINANCES OF POLITICAL PARTIES AND POLITICAL CANDIDATES

The receipt, processing and publication of information on the income and expenditures of political parties and candidates in pre-elections.

By law, the INAO has a very broad mandate for auditing. 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 concurrently with invoices issued to the Government, in order to verify the content of the invoices and the Treasury's payment obligations. Finally, the Office may call for reports on the disbursement of grants and other contributions from public funds and assess whether such payments have achieved the intended results.

## BROAD MANDATE FOR AUDITING

The INAO selects and organises its own projects and is not dependent on any entity, 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, the methods used, when the report is completed and the manner in which the conclusions are presented. Under the Act that applies to the Office the staff of the INAO shall be completely independent of those Ministries and organisations where the audit is being carried out.

## INDEPENDENCE

The INAO notifies the appropriate public bodies, the Althingi, the media and the public of the results of its investigations through electronic reports, press releases and its website, [www.rikisend.is](http://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 INAO in accordance with the Althingi Procedures Act and the rules applying to the parliamentary treatment of reports from the Office.

The INAO's strategy map which is based on the balanced scorecard methodology has altogether 13 key objectives. These objectives cover the four basic dimensions of the operation which are: services, procedure, human resources and finances. The objectives of the services dimension of the strategy map pertain to the services that



## POLICY MAKING

the Office provides for the Althingi, the government administration and the public. The objectives of the procedure dimension pertain to the procedures and processes that the Office applies in order to provide maximum quality services. The human resources dimension in the scorecard contains the objectives that concern the capabilities and resources of the staff. These objectives contribute in a certain manner to the attaining of the objectives of the procedure dimension. The objectives of the finances dimension pertain to economy and good financial management. They advance the attainment of the objectives of all the other dimensions. The values of the INAO are integrity, independence and professionalism. The staff is expected to keep these values in mind both in their work as well as outside work.

# GENERAL INFORMATION ON THE ACTIVITIES AND OPERATION OF THE INAO IN 2012

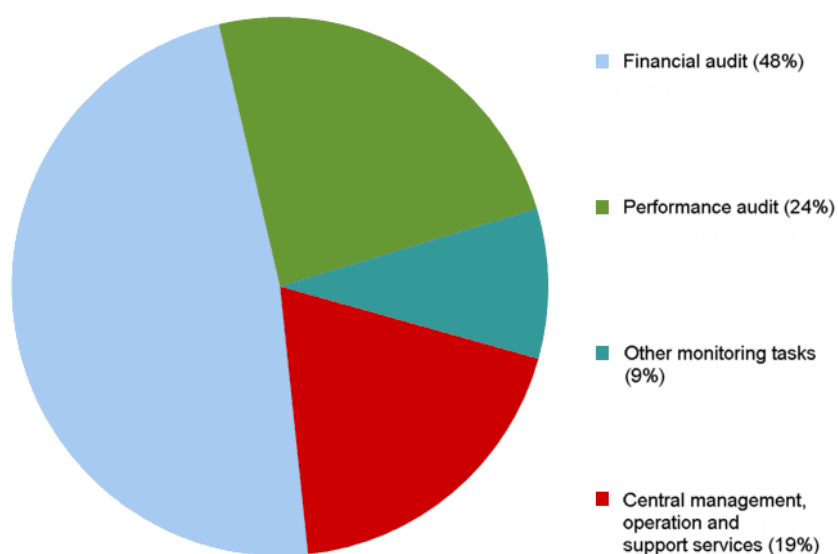
## DIVISION OF WORK CONTRIBUTION BETWEEN TASKS

In 2012, the active working hours of the INAO's employees came to a total of just under 72,000, decreasing slightly from the previous year, or by 12%. Active man-hours refer to the hours employees are at work, with absences due to illness or vacation for example, excluded. The reason for the decrease in man-hours between the years is that the number of employees was fewer in 2012 than in 2011. In addition to the work contribution of employees, the Office purchased services from auditing firms corresponding to approximately 3.300 working hours.

**NUMBER OF ACTIVE  
WORKING HOURS  
DECREASED BY 12%**

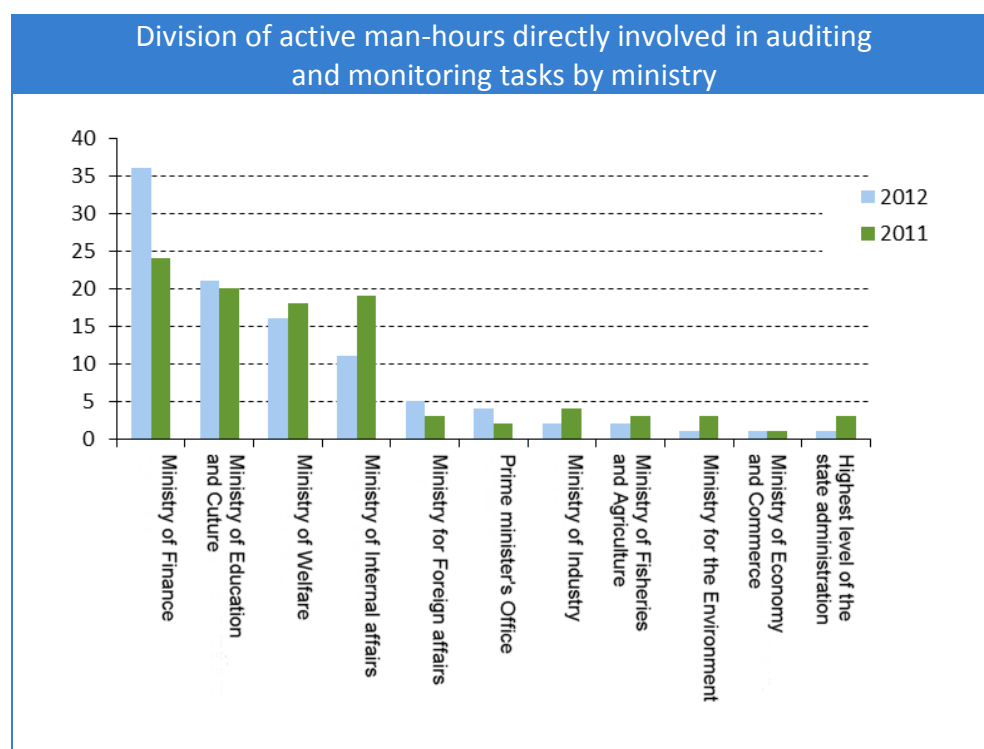
As in recent years, the largest proportion of active man-hours by far was spent on financial auditing. The proportion was slightly less than half of active man-hours. Approximately a quarter of man-hours were spent on performance auditing, one tenth part on other monitoring activities and one fifth part was spent on central management, operations and support services. The division of active man-hours between tasks was overall similar to what it was in 2011.

Division of active man-hours of the employees according to tasks in 2012



**CONSIDERABLE  
CHANGES FROM LAST  
YEAR**

More than half of the active man-hours were spent directly on auditing and monitoring tasks involving ministries and their agencies. More than one third of the active time was spent on auditing and monitoring budgetary items that come under the Ministry of Finance which is a relatively higher proportion than it was in 2011 as is shown in for following graph. Approximately one fifth of the time was spent on the budgetary items of the Ministry of Education and Culture which is a similar proportion as in 2011. Approximately 16% was spent on the auditing and monitoring of the budgetary items of the Ministry of Welfare and approximately 11% was spent on the items of the Ministry for Foreign Affairs. Less time was spent on the auditing and monitoring of other Ministries and the central government administration. A proportional division of active man-hours that were spent directly on the auditing and monitoring of ministries is dependent upon risk assessment and the selection of tasks at any given time. Thus performance audits generally focus on different ministries from year to year, and this can have an effect on the division.



## REVENUE AND EXPENDITURES

The total expenditures of the INAO amounted to ISK 481.3m in 2011, increasing slightly between years or by 1%. Special revenues amounted to ISK 42.4m and the state contribution amounted to ISK 430.4m which is a slightly better result than in 2011 when there was an ISK 34m operating deficit. The Office had unused budget appropriations from earlier years that were used to cover the deficit. Further information on the Office's operations and financial position may be found in the financial statements and accompanying notes on pages 29–35.

### Summary of 2011 and 2012 profit and loss account (ISK millions)

	2012	2011	VARIATION	%
SALARY AND SALARY-RELATED COSTS	394,8	367,0	27,8	8%
OTHER OPERATING COSTS	105,3	112,3	-7	-6%
FORMATION EXPENSES	1,8	2,0	-0,2	-10%
TOTAL EXPENSES	<b>501,9</b>	<b>481,3</b>	<b>20,6</b>	<b>4%</b>
SPECIAL DEDICATED REVENUES	42,4	41,6	0,8	2%
EXPENSES MINUS REVENUES	459,5	439,7	19,8	5%
STATE CONTRIBUTION	430,4	405,8	24,6	6%
REVENUE SURPLUS (DEFICIT)	<b>-29,1</b>	<b>-33,9</b>	<b>4,8</b>	<b>-14%</b>

Budget allocations to the INAO have been significantly reduced in real terms in recent years. In 2008 the allocations amounted to ISK 481.8m which corresponds to approximately ISK 641.8m at February 2013 price levels. Last year it was ISK 430.4m which corresponds to approximately ISK 444.0m at February 2013 price levels. Based on a fixed price level the allocations have therefore been reduced by close to one third part during the last five years.

**ONE THIRD  
REDUCTION IN REAL  
TERMS BETWEEN  
2008 AND 2012**

## HUMAN RESOURCES

In 2012 six specialists retired from their jobs at INAO. Because of the difficult financial situation of the Office it was only possible to hire one new employee to replace one of these. Overall the number of employees fell by five between the years; they were 42 at the end of 2012 but had been 47 at the end of 2011. The cutting of the contributions during recent years has resulted in the Office having to reduce significantly its scope of activities. Between the years 2008 and 2012 the number of employees was therefore cut by seven, from 49 to 42. This reduction has principally been implemented by not hiring when positions have become vacant. It has however not been possible to prevent dismissals but these have fortunately been few.

Employee turnover is defined as the proportion of employees who resign during the year out of the total number of employees at year-end. As earlier mentioned six employees at the INAO resigned last year and the number of employees decreased overall by five which results in that the calculated employee turnover was relatively high during the year namely 14%. This is relatively more than in recent years. During the period 2009–2011 the annual employee turnover at the INAO was between 2%–4% but for comparison it should be mentioned that during the year of expansion in 2007 it was 17%.

**EMPLOYEE  
TURNOVER WAS  
GREATER IN 2012  
THAN IN THE MOST  
RECENT SEVERAL  
YEARS**

The average age of employees by the end of 2012 was 53 years. For comparison it could be mentioned that the average age of the employees at the government offices was more than 48 years during last year. The ratio of employees who had at least a three year work experience at the Office was 87% in 2012 and the average length of service was 14 years.

At year-end 2012 over 80% of the INAO had a university degree, many holding a master's degree. The majority had degrees in business administration, four had degrees in political or administrative sciences, three were lawyers and two had degrees in humanities. Furthermore, there were five chartered accountants and three



had certification in internal auditing (CIA). One of them is also a Certified Government Auditing Professional (CGAP), and another has certification in IT auditing (Certified Information Systems Auditor – CISA).

The INAO endeavours to ensure that the staff maintain and strengthen their professional abilities through continuing education. To this end, employees are able to attend a range of courses in conjunction with their work. The INAO does also enter into agreements with its employees concerning long-term organised studies, for instance studies for chartered accountants, studies for internal auditing certification and organised university studies while employed. The employees who enter into such an agreement for studies for chartered accountants have an opportunity to spend two weeks on pay (80 working hours) preparing each of the four examinations that must be completed to get authorisation. Those employees who enter into an agreement concerning studies for certification in internal auditing (CIA) get an opportunity to have a two week vacation (80 working hours) before each of the four examinations that they need to complete. The employees who enter into agreements for organised university studies may spend up to 4 hours of their working hours in study programmes for every credit unit they complete.

#### OFFERED AGREEMENTS FOR ORGANISED STUDIES

Key figures in human resources				
	2012	2011	2010	2009
EMPLOYEE TURNOVER	14%	4%	4%	2%
AVERAGE AGE OF EMPLOYEES	53	52	52	50
AVERAGE LENGTH OF SERVICE	14 YEARS	13 YEARS	12 YEARS	11 YEARS
AT LEAST 3 YEARS AT INAO	87%	94%	90%	71%

## STRATEGIC PLANNING AND PERFORMANCE MEASUREMENTS

The INAO's strategy map contains a total of 13 key objectives: three in the "services" dimension, four in the "procedures" dimension, four in the "human resources" dimension and two in the "finances" dimension. There are a total of 39 performance indicators on the scorecard, differing in number for each objective, ranging from between one and five and different in nature. These indicators show whether or how well the objectives are reached at any particular time. Some are relatively easy to use, e.g. criteria that involve the counting of some form of units that the operation puts forward. Others require a bit more effort, e.g. a number of performance indicators are based on examining the attitudes of the employees or stake holders. In addition to this the scorecard lays down criteria about results, i.e. which values on each indicator the Office expects to achieve as a minimum, or considers desirable or acceptable.

#### A TOTAL OF 39 INDICATORS

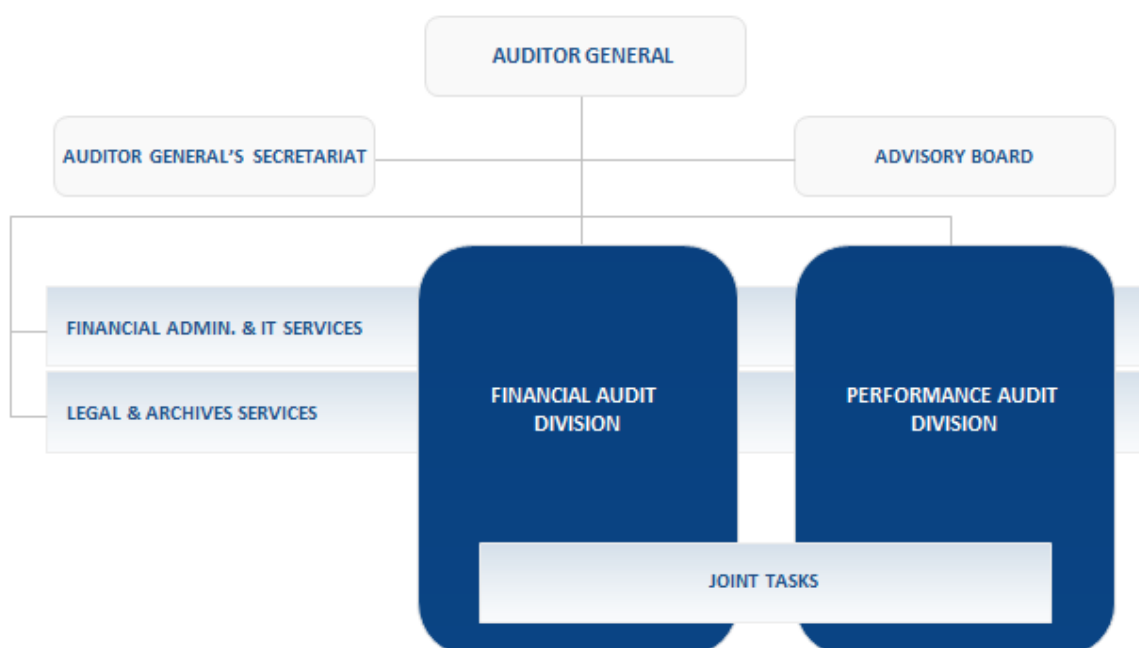
In order to evaluate how successful the INAO is in achieving its service objectives at any particular time the Office conducts surveys among members of parliament, government permanent secretaries and agency heads and among the public about the work and the procedures used by the Office. *Every second* year there is a survey made among members of the Althingi and the government permanent secretaries and agency heads. Such a survey was last conducted in 2012 and the next time will be

#### ATTITUDE SURVEYS AMONG TARGET GROUPS

in 2014. An attitude survey among the public (image survey) is made *every third* year. Such a survey was last made in 2011 and it will also be made in 2014. The outcomes of performance measurements that are based on these surveys will be published in the Office's annual report for that year. Examples of such measurements may be found in a chapter on performance auditing (see pg. 22). In order to assess the performance of the Office in achieving its human resources objectives at any particular time, the attitude of the Office's employees to a number of aspects in the management of the Office, the available resources at the place of work and other aspects are surveyed. Such a survey is made *every year*. In addition to criteria that are based on attitude surveys the Office also uses another type of criterion in order to assess its performance.

## INTERNAL ORGANISATION

The INAO's current organisational chart came into effect on 1 April 2013. The organisational chart is slightly different from the one in 2012. Here we discuss the current organisational chart. The Office has two main divisions: the Financial Audit Division and the Performance Audit Division. The Financial Audit Division is responsible for carrying out financial audit and related tasks in accordance with Article 8 of the National Audit Act, while the Performance Audit Division is responsible for carrying out performance audit and related tasks in accordance with Article 9 of the same Act. In addition, there are two support divisions responsible for diverse centralised tasks and for providing services to the main divisions: Financial Administration and IT Services, and Legal and Archive Services. Furthermore the Auditor General's Secretariat covers a range of tasks involving public administration monitoring, monitoring the implementation of the government Budget, public relations and International Relations. Five employees have been appointed to an Advisory Board which addresses various issues that relate to the professional development of the Office's activities. Each main 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.



# FINANCIAL AUDITING

## NEARLY HALF THE ACTIVITY

Financial auditing is the most extensive task undertaken by the INAO. In 2012, a total of over 34 thousand work hours were spent on financial auditing, or the equivalent of nearly half of the total number of active man-hours spent by the Office. Employees of the Financial Audit Division at year-end were 20 in 19 full-time equivalent positions the numbers had been reduced by three during the year.

The INAO annually audits the Central Government Accounts and the accounts of ministries, agencies, funds and other parties where the cost or loss is paid by the Treasury. 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 internal controls are examined to ascertain whether they assure adequate results.
- That accounts are in accordance with Budget appropriations, the supplementary Budget or other relevant laws, lawful instructions, business practices or service contracts.
- That 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 in the Office's auditing activities as applicable.

The INAO annually sends to the Althingi and publishes an official report, *The Audit of the Central Government Accounts*, containing a summary of all the financial audits that it has performed during the year, the principal results of such audits, and notes. The financial audit report for the year 2011 was issued in November 2012.

## TO ASSESS WHETHER FINANCIAL STATEMENTS GIVE A TRUE AND FAIR VIEW OF THE OPERATION

## DIVERSE TASKS

Financial auditing of the government is very versatile, ranging from auditing simple financial statements of public bodies belonging to group A of the Central Government Accounts to the auditing of complex financial statements of limited corporations. The presentation of the Budget and of the financial statements of public bodies belonging to Group A of the Central Government Accounts is generally simple and there is little financial statement complexity. The reason for this is that investments

and asset acquisitions are charged to the year in which they take place and are not capitalised and depreciated, pension obligations are not recorded in the financial statements of individual agencies and accrued holiday allowance is not registered. This however does not mean that the auditing of group A public bodies is more simple than that of other entities outside this group. Many group A public bodies are large and complex which calls for extensive audit steps and careful work methods.

The Government Financial Reporting Act, the majority of which is since 1997, is currently under revision and a draft bill will be presented in the coming weeks. This bill proposes the adoption of the: *International Public Sector Accounting Standards* (IPSAS) for the public sector in Iceland. These standards impose heavier requirements for the financial statements of public bodies than now is the case. Their introduction will have a substantial impact on the conduct of financial audits. It may be expected that following the introduction more time will be spent on audits by individual agencies and by the Treasury as a whole than until now.

IMPLEMENTATION OF  
IPSAS WILL HAVE AN  
IMPACT

## ASSESSMENT OF INTERNAL CONTROLS AND COMPLIANCE

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 the analyses and assessments made by public bodies and enterprises concerning possible operational risks, and can be seen in work procedures of various types, e.g. regarding the division of tasks, the approval of expenditures and recording of business transactions, and also in codes of conduct and human resources policies.

The status of internal control in public bodies is generally quite good in INAO's opinion. However, not all public bodies have documented their internal controls so there is no overall view of all the supervisory actions that are used to monitor operations.

Government financial auditing also entails examining if the financial statements and financial management is in compliance with laws and regulations (*compliance audit*). This entails examining the compliance status of government agencies and undertakings regarding laws, regulations, codes of conduct, good management practices and other accepted procedures.

COMPLIANCE AUDIT

## ITEMS AND BODIES – SELECTION OF AUDITING SUBJECTS IN 2012

The Central Government Accounts consist of over 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 its scope, the INAO, is not in a position to audit all these parties before the issuing of the Central Government Accounts, which, in recent years, has been in June. Therefore the Office must select specific bodies for auditing. In 2012 the

INAO and auditing firms that work on its behalf audited a total of 251 accounting items and bodies (for the year 2011). This selection is for the most part based on special risk assessments.

**EMPHASIS ON  
AUDITING THE MOST  
EXTENSIVE ITEMS**

Usually the principal focus is on auditing the Budget items that are largest in scope because they are more important than the smaller items with respect to whether the Central Government Accounts will be considered to present a true and fair view of the operation and financial position of the Treasury as a whole. On the other hand the financial scope of many items is rather small. Thus there are approximately 270 items that represent expenditures that are less than ISK 500m each. The combined expenditures under these items only amount to approximately 10% of the total expenditures of the Treasury. In the report about the auditing of the Central Government Accounts for 2010 the Office stated its opinion that there would be every reason to decrease the number of Budget items and to form larger financial units. In this manner the financial management could be made more effective and the monitoring of the central government operation could be simplified.

Furthermore the INAO endeavours to ensure that all Budget items are audited no less frequently than every three years. Because of the limited funds and manpower which the Office controls and because of the emphasis placed on auditing the large items it may well be that more than three years will pass between the audits of smaller items.

According to law the INAO has only an obligation to audit the operation of Group A bodies and for which the Treasury is liable. Over the years the INAO has conducted the audit or paid for it for many agencies that do not come under the above definition. This primarily involves nursing homes and homes for the elderly which receive day charges from the Treasury. In 2012 these institutions were informed that they had to hire auditors themselves and carry the cost of their work.

## **AUDITING BALANCE SHEET ITEMS AND REVENUES**

**INCREASED EMPHASIS  
ON THE AUDITING OF  
BALANCE SHEET ITEMS  
AND REVENUES**

Following the collapse of the banks in 2008, the State's balance sheet has become much more complicated than was previously the case. Both borrowing and lending have increased substantially. In addition, the Treasury has been engaged in complicated financial transactions due to the restoration of the banking system. In response, the INAO has sought to spend more time than previously auditing the balance sheet. The collapse has also had extensive effects on the Treasury's revenue generation. The Althingi, for instance, has approved numerous actions to increase the income. In many cases this involves multiple and complicated amendments to legislation. The Office has tried to respond to this by spending more time analysing and auditing the State's income sources.

## **AUDITING PROCEDURES – 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. In 2010, INTOSAI published new and much more detailed standards on financial auditing than the Organisation had previously published. The new standards involve the adaptation of the standards of the International Federation of Accountants (IFAC) to the public sector. With the enactment of new legislation applicable to auditors in 2008, auditors were compelled to follow the latter standards in their work.

The INAO focuses on following in every respect the international standards that apply to the Office's activities. In 2011, the adoption of the ISSAI began in the Office, involving, for example training employees to use them. Each month specific standards have been focused on in the Financial Auditing Division; they have been thoroughly examined and there have been discussions on how they should be used. The plan is to complete the introduction of the standards following the completion of an international peer review of the INAO's financial audit practice. This is expected to be by the end of 2013.

**PLAN TO COMPLETE  
THE IMPLEMENTATION  
BY END OF 2013**

## **INFORMATION TECHNOLOGY AUDITS**

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 regarding the operation of the IT systems of regulated entities.

The results of IT audits are presented in reports that are usually 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, e.g. 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. Such audits do not however release the owners of these systems from the responsibility to have regular security audits and audits of the internal control mechanisms that apply at any particular time.

# PERFORMANCE AUDITING

According to Article 9 of the National Audit Act a performance audit consists in

**“EXAMINING THE  
MANAGING AND  
UTILISATION OF  
PUBLIC FUNDS”**

examining the managing and utilisation of public funds, whether economy and efficiency is applied in the operation of agencies and enterprises owned by the state and whether current legislation is being enforced in this context.

The Act states furthermore that the Office shall report to the relevant public authorities on the outcome of a performance audit, to point their attention towards what it considers has gone wrong in the operation and to point out to them the aspects which the Office finds that have to be checked with a view to remedial action. Performance audits are, in reality, examinations of how successful ministries, public bodies and state enterprises are in the tasks entrusted to them. When performing this work, the Office takes account of the National Audit Act, documents relevant to the interpretation of applicable acts (in particular the explanatory notes accompanying the bills for the acts concerning the Office) and the standards and guidelines issued by INTOSAI.

**NEARLY A QUARTER  
OF THE ACTIVITIES**

In 2012, a total of just under a quarter (24%) of the total number of active man-hours spent by the Office were spent on performance auditing. This is a similar ratio as the previous year. By year-end the employees of the Performance Audit Division were 10, that is almost a quarter of the employees, which is the same number as by year-end 2011. In 2012 the staff of the Performance Audit Division completed a total of 25 public papers which is a similar number as the previous year.

Last year five specialists from three SAIs conducted a peer review of the INAO's performance audit practice. The principal result of this review was that the work procedures were in accordance with the standards of INTOSAI and that the operation was characterised by “an impressive drive to improve”.

According to the INTOSAI standards on performance audit (ISSAI 300 and 3000) these audits endeavour to assess whether the operation in question is economic, efficient and effective and to recommend ways to improve these aspects. This definition of performance audit is also clearly stated in the explanatory statements that accompanied the bill that later was passed as Act No. 86/1997 on the INAO. The explanatory notes contain a more detailed definition of performance audit than appears in Article 9 of the Act.

## REQUESTS AND OWN INITIATIVE

According to law, the Office may carry out performance audits of 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. Most audits are performed on the initiative of the Office based on analyses of either their financial or social importance or risks in their operation and operating environment. Usually a proportion of audits is carried out at the request of Althingi or the ministries. In all instances the INAO is responsible for delimiting the material, making decisions on methods, defining focus areas and presenting the results. Almost all performance audits carried out by the INAO that were completed in 2012 were carried out at the initiative of INAO.

## WORK PROCEDURE OF PERFORMANCE AUDITS

The INAO generally divides its performance audits into three main parts: *pre-study*, *main audit* and *follow-up*. *Pre-studies* are carried out in an effort to assess the possibility and legitimacy of initiating a performance audit. If a *pre-study* reveals that a *main audit* is premature or that its expected benefits will be less than costs, the *main audit* is not carried out. If a *pre-study* reveals that there would be significant benefits from a *main audit*, an audit plan is prepared containing the questions that the *main audit* is expected to answer, the scope is delimited, methods are defined and the time and manpower necessary to carry out the audit are specified. In *main audits*, all available data that is of importance is collected to answer the audit questions. Such data is analysed, assessed and interpreted objectively and professionally. Thereafter the conclusions are formulated and, as appropriate, also the recommendations for improvements. After the draft report has been reviewed in-house it is sent to the public body and/or ministry for review. The final report is later published and sent to the parties involved. One to three years after the completion of the *main audit*, the results of the audit must be assessed in a *follow-up* audit, i.e. the response of the public body, ministry or Althingi to the recommendations of the INAO. The results of this examination are published and sent to the parties involved. Such examination may lead to a new audit.

## PERFORMANCE AUDIT DIVISION'S OPERATING PLAN

The Performance Audit Division operates according to a three-year operating plan that is reviewed annually. The current operating schedule applies from 2013 – 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 in particular taken account of: the changes that have been in government operations in recent years, the focus of government authorities on public finances, budget allocations, central government accounts 2011, the results of an employee survey by SFR in 2012 and an analysis of the financial position of individual budget items. Audits will, as during recent years, primarily 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 Internal Affairs. It is emphasised that Althingi will be informed of the

audit results through reliable, comprehensive, objective, well structured and accessible reports.

## FOLLOW-UP OF PERFORMANCE AUDITS

### PROVIDES INDICATIONS CONCERNING THE QUALITY OF RECOMMENDATIONS

One of the methods applied by the INAO to evaluate the results or outcome of performance audit is by examining the response from the authorities and public bodies to the recommendations stated in the reports. Such follow-ups generally take place approximately three years after a report has been issued. Follow-ups, however, may take place sooner or later from the date of issue of the report. Results are evaluated based on whether the recommendations can be seen to have been implemented fully or in part. In this manner the Office endeavours to obtain some indications concerning the “quality” of the recommendations. The general rule is that the more realistic and thought-out a recommendation is, the more likely it is to be implemented. It should however be kept in mind that the INAO is not in command of the response of the Central Government to its recommendations. The Office can only encourage the acceptance of the recommendations by careful reasoning and can present them in a clear manner to the Althingi, the authorities and other stake holders.

### 13 RECOMMENDATIONS REITERATED

In 2012 the INAO followed up on five reports from 2009 in which 50 principal recommendations were made. Of these, the INAO considered that 34 had been implemented in full or in part. Three recommendations were abandoned as the Althingi had, after the issuing of the relevant reports, amended an act of law and consequently they were no longer relevant. On the other hand the Office reiterated 13 recommendations that had not been implemented. A summary of the results of the follow-up of performance audits from recent years may be seen in the table below. The results for the year 2012 is found by dividing the number of implemented recommendations into the total number of recommendations minus the three recommendations that were abandoned ( $34/47=0.723$ ). They are not included as they became invalid due to decisions that were not foreseeable when they were presented. The fact that these recommendations were abandoned is no indication of their merit and thereby it is not found to be correct to include them with recommendations that did not succeed. For comparison it may be pointed out that in 2010 a decision was made to abandon one recommendation made in a report from 2007 as the recommendation was not sufficiently thought-out. In the calculations of the results for the year it was not included with the recommendations that did not succeed.

Follow-up of performance audits 2008-2012						
Year	Reports	Principal recommendations	Implemented in full or in part	Results	Recommendations that are abandoned	Reiterated
2008	4 FRÁ 2005	42	38	90%		
2009	3 FRÁ 2006	29	22	76%		
2010	5 FRÁ 2007	45	32	71%	1	21
2011	12 FRÁ 2006–9	89	68	76%		24
2012	5 FRÁ 2009	50	34	72%	3	13
<b>TOTAL</b>	<b>29</b>	<b>249</b>	<b>189</b>	<b>76%</b>	<b>4</b>	<b>58</b>

The INAO's aim is that at least 80% of the aggregate recommendations in the performance audits of each year have been implemented within three years of their publication. According to the table above, this goal has not quite been achieved during the past three years. Nevertheless, the Office is of the opinion that the results are acceptable. The Office will in the near future seek ways to be better able to promote more effectively than before that performance audit recommendations be implemented, or that the authorities at least present a reasoned opinion concerning them.



## OTHER MONITORING PROJECTS AND TASKS

### ONE TENTH OF THE ACTIVITIES

In 2012, the INAO spent approximately 6,600 of its active man-hours on monitoring tasks other than financial auditing or performance auditing. This is equivalent to approximately 9% of the total number of active man-hours during the year, a slightly higher proportion than the year before. These included monitoring the implementation of the Budget, monitoring the finances of political parties and political candidates and monitoring self-owned organizations not involved in regular business activity.

### ONE FIFTH OF THE ACTIVITIES

Over 13,600 man-hours were spent on management and support services, which is equivalent to a fifth of the total number of man-hours during the year. This includes the work of the Auditor General, the general operation of the Office, canteen, reception and computer services to employees. This also includes legal consultancy services to the Auditor General and the Office's divisions, internal and external communications, publications and international relations.

In total, the employees responsible for support services and monitoring tasks other than financial auditing or performance auditing numbered 11 at year-end 2012.

### MONITORING THE IMPLEMENTATION OF THE GOVERNMENT BUDGET

In addition to regular 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 2012, the INAO released a total of three reports with the results of this monitoring.

### MONITORING THE FINANCES OF POLITICAL PARTIES AND POLITICAL CANDIDATES

### DISCLOSURE BY POLITICAL PARTIES AND 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 elections. 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. The INAO subsequently publishes a summary of such statements. The accounts of political parties must be audited and certified by an auditor, and the accounts of a candidate must be endorsed by an auditor or an examiner familiar with accounting practices. Both political parties and candidates are not permitted, with some exceptions, however, to accept contributions from legal entities or private persons that exceed ISK 400,000 per year. The financial statements submitted by political parties and the accounts submitted by candidates must specify the names of all legal entities that have made contributions, irrespective of the amount contributed. The names of private persons who have contributed more than ISK 200,000 must also be stated.

In the Act, the political parties are given until 1 October each year to submit the statements of the previous year to the INAO. A total of 10 political parties or movements had submitted the statements for the year 2011 prior to 1 October 2012 but three parties submitted the statements after the time limit had expired. The INAO published a summary of the parties' statements after the Office had reviewed them.

Candidates to the elections for the President of Iceland that took place on 30 June 2012, were under obligation to submit information on the contributions and costs of their election campaign to the INAO prior to 1 October. Six of the seven candidates had submitted their information when the time limit expired and of these one candidate submitted an unaudited statement. The seventh candidate submitted the information shortly afterwards and the candidate who had submitted an unaudited statement did submit an audited statement at the beginning of 2013.

## MONITORING SELF-OWNED ORGANISATIONS THAT DO NOT ENGAGE IN BUSINESS OPERATIONS

According to Act No. 19/1988 on Funds and Institutions Operating According to Approved Charters, the INAO is responsible for monitoring the finances of more than 700 entities covered by the Act. Specifically, these are self-owned organisations (foundations) that do not engage in business operations, such as various sponsorship 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. Furthermore the Office has a responsibility to keep a register of the revenues and expenses of these entities including notes to the submitted statements. The Saudárkrókur District Commissioner keeps a register of funds and organisations with approved charters, what is referred to as the registry of funds. If no statements have been submitted for one calendar year, or if the statements prove to be inadequate in some manner, the relevant district commissioner at the behest of INAO may decide to ask the police to investigate the finances of the fund in question.

According to the Act the entity who is responsible for a fund or an organisation with an approved charter must no later than 30 June of each year submit the annual

**MAY REFER THE CASE  
TO THE DISTRICT  
COMMISSIONER**

statements for the last year. In August of 2012 the INAO published a [\*Summary of self-owned organisations and funds that operate under an approved charter for the operating year 2010\*](#) in which it was stated that as of 1 June of that year only 505 entities of a total of 707 that were registered at the time had submitted annual statements for operating year 2010. By year-end 2012 approximately 540 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 statements in time, wherein they are encouraged to submit the statements. However this is not always sufficient and the Office will then report this to the Söðarkrúkur District Commissioner.

## LEGAL OPINIONS

Every year, the INAO must discuss or provide its opinion on various legal questions relating to central government administration and finances. These are generally prepared in connection with individual tasks related to financial auditing and performance auditing but legal questions are also studied independently. In 2012 a written statement was released: [\*Compensation claims settlement with Ministry for Foreign Affairs employee for damage to household effects in April 2011\*](#) where such issues were discussed.

## PUBLICATIONS AND PUBLIC RELATIONS

As the INAO operates on behalf of the Althingi and is part of its monitoring of the executive branch its reports and other dissemination of information is basically based on the needs of the Althingi or that of individual parliamentary committees. At the same time the Office endeavours to tailor its dissemination of information to the needs of ministries and organisations as the recommendations by the Office regarding remedial action are generally addressed to these entities. These focus points are in harmony with the general practice among the sister agencies of the INAO in neighbouring countries. But the dissemination of information by these agencies is not only directed towards the national assemblies and the public administration. It is the opinion everywhere that supreme audit institutions must do their best to inform the media and the public about their role and work. By doing this they promote that their recommendations are implemented since the media discussion and the public opinion is able to put pressure on the authorities in the direction of change. Furthermore the publication of information to the media may result in a strengthening of public accountability.

The INAO's communication policy is in accordance with ISSAI 20 and takes account of the communication policies of Nordic sister offices. According to the policy, dynamic and high-quality external communication is one of the prerequisites of the INAO's ability to be able to fulfil its role and achieve results. It also states that the Office intends to take the initiative in the dissemination of information about its role and activities. The Office has formed a three year schedule for external communication based on the communication policy and with measurable objectives.

### VARIOUS LEGAL QUESTIONS

### IMPORTANT TO INFORM THE MEDIA AND THE PUBLIC

The INAO keeps a website where you will be able to access all of its publications ([www.rikisend.is](http://www.rikisend.is)). In 2012 there were a total of 20 thousand visits to the site. There is an effort made to explain the main points in the reports in a simple manner in news that is published on the website and sent to media and recipients who are registered on the Office's electronic mailing list. Over the last three years the INAO has released between 30 and 40 papers and 40 and 50 news items every year. The Office's employees reply every year to numerous enquiries by the media and the public regarding the role and tasks of the Office.

APPROXIMATELY 20  
THOUSAND VISITS IN  
2012

## INTERNATIONAL RELATIONS

In order to ensure that the operation of the INAO 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 SAIs 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 INAO participates in the auditing of multinational bodies and associations of which Iceland is a member, such as EFTA. In addition, the Office's staff has actively participated in the work relating to the discussions on Iceland's possible membership of the EU. A representative from the INAO is a member of the negotiation team on financial issues that operates under the auspices of Iceland's main negotiating committee. Finally, it should be noted that employees of the Office have participated in improvement and development projects in the field of government finances that the Icelandic government has embarked on in collaboration with the International Monetary Fund – IMF.

The employees of the INAO attended a total of 14 meetings and conferences abroad in 2012 which is a similar number to those of recent years. Approximately half the number of these meetings was related to the work of the *EFTA Board of Auditors* – EBOA and the auditing of the use of *EEA Grants*. Ingi K Magnússon, Director of the Financial Auditing Division, represents the INAO Office's participation in EBOA and has also participated in the committee's working group which audits the EEA Grants. Other meetings and conferences were related to Nordic co-operation and the Office's participation in EUROSAI. The annual meeting of national auditing offices from the Nordic countries was held in Stockholm in August and in connection with this meeting there was a conference on risk analysis in public auditing in which one employee participated. One employee participated in a Nordic conference on public administration auditing held in Oslo in September and one other attended a conference on the ownership role of the state held in Stockholm during the same month.

14 MEETINGS AND  
CONFERENCES  
ABROAD IN 2012

On behalf of EUROSAI there are several working groups that discuss various issues regarding public auditing. The following groups can be mentioned: *Working Group on Environmental Auditing* and a *Task Force on the Audit of Funds Allocated to Disasters and Catastrophes*. Due to cuts in the contributions to the INAO in recent years the Office has not participated in the work of the EUROSAI working groups since 2009. Last year the Office was offered to nominate a representative for a newly established

working group of the association (*Task force for Audit & Ethics*) and it was decided to accept this offer. An INAO employee attended the first meeting of the group in Lisbon in May.

Representatives of foreign sister offices, international organisations or foreign government officials relatively frequently visit the INAO either to study the activities of the Office or because of cooperation projects. Last year specialists from the Dutch, Norwegian and Swedish national audit offices visited Iceland twice because of an international peer review of the Office's performance audit practice (see next page). The Faeroese Public Auditor, Beinta Dam, visited the Office and had meetings with the Auditor General.



# FINANCIAL STATEMENTS 2012

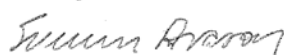
## REPORT OF THE MANAGEMENT AND ENDORSMENT OF THE FINANCIAL STATEMENTS

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 2012, the Office's operations generated a deficit of ISK 29,1 million. According to the Balance Sheet, the assets of the Office amounted to ISK 12,3 million, liabilities amounted to ISK 5,3 million, and equity amounted to ISK 7,0 million at year-end 2012.

The Auditor General and the Financial Manager certify the Financial Statements of the National Audit Office for the year 2012 with their signatures.

The Icelandic National Audit Office, 28 February 2013



Sveinn Arason, CPA  
Auditor General



Eytanor 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 2012. 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 2012, its Balance Sheet as of 31 December 2012 and change in cash during the year 2012, in accordance with laws and regulations and generally accepted accounting principles for Group A entities.

Reykjavik, 28 February 2013



Gunnar Sigurdsson  
Chartered Accountant

## PROFIT AND LOSS ACCOUNT 2012

	2012	2011
<b>Operating revenues</b>		
Sale of services .....	42.383.145	41.650.971
Other income .....	2.215	630
	<u>42.385.360</u>	<u>41.651.601</u>
<b>Operating expenses</b>		
Salaries and related expenses .....	394.807.410	366.978.442
Administrative expenses .....	10.463.859	9.269.648
Meeting and travel cost .....	11.728.085	10.012.709
Expert services .....	48.417.716	59.724.265
Operations of equipments .....	1.353.506	1.445.817
Other operating expenses .....	5.334.587	4.889.424
Housing .....	26.870.268	24.932.854
Operation of vehicles .....	413.425	566.126
Grants .....	700.000	1.475.000
	<u>500.088.856</u>	<u>479.294.285</u>
Purchased assets .....	1.765.335	2.013.781
	<u>501.854.191</u>	<u>481.308.066</u>
<b>Operating profit (-loss) before Treasury contribution</b>	( 459.468.831 )	( 439.656.465 )
Treasury Contribution .....	<u>430.400.000</u>	<u>405.800.000</u>
<b>Profit for the year</b>	<u>( 29.068.831 )</u>	<u>( 33.856.465 )</u>

## BALANCE SHEET, 31. DECEMBER 2012 (ISK)

	2012	2011
<b>Assets</b>		
<b>Current assets</b>		
Treasury .....	4.457.321	34.692.049
Accounts receivable .....	7.703.117	12.244.387
Cash and cash equivalents .....	135.410	159.569
	<u>12.295.848</u>	<u>47.096.005</u>
<b>Total assets</b>	<u>12.295.848</u>	<u>47.096.005</u>
 <b>Equity and Liabilities</b>		
<b>Equity</b>		
<i>Equity:</i>		
Equity at the beginning of the year .....	36.068.712	69.925.177
Profit for the year .....	( 29.068.831 )	( 33.856.465 )
	<u>6.999.881</u>	<u>36.068.712</u>
<b>Equity</b>		
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable .....	5.295.967	11.027.293
	<u>5.295.967</u>	<u>11.027.293</u>
<b>Liabilities</b>		
<b>Total equity and liabilities</b>	<u>12.295.848</u>	<u>47.096.005</u>

## CASH FLOW STATEMENT 2012

	2012	2011
<b>Cash flow from operations</b>		
<i>Cash flow from operating activities:</i>		
Profit.....	( 29.068.831 )	( 33.856.465 )
<b><i>Cash flow from operating activities</i></b>	<u>( 29.068.831 )</u>	<u>( 33.856.465 )</u>
<i>Changes in current assets and liabilities:</i>		
Accounts receivable, decrease / (increase).....	4.541.270	( 3.139.608 )
Accounts payable, (decrease) / increase.....	( 5.731.326 )	4.164.682
	<u>( 1.190.056 )</u>	<u>1.025.074</u>
<b>Net cash provided by operating activities</b>	<u>( 30.258.887 )</u>	<u>( 32.831.391 )</u>
<b>Cash flow from financial activities</b>		
<i>Changes in balance with the Treasury:</i>		
Treasury contribution.....	( 430.400.000 )	( 405.800.000 )
Received from the Treasury.....	460.634.728	438.522.786
<b>Net cash from financing activity</b>	<u>30.234.728</u>	<u>32.722.786</u>
<b>Net increase in cash and cash equivalents.....</b>	<u>( 24.159 )</u>	<u>( 108.605 )</u>
<b>Cash and cash equivalents at the beginning of the year.....</b>	<u>159.569</u>	<u>268.174</u>
<b>Cash and cash equivalents at the end of the year</b>	<u><u>135.410</u></u>	<u><u>159.569</u></u>

## NOTES

### Accounting Policy

#### Basis for the Financial Statements

The Financial Statements of the National Audit Office have been prepared in accordance with the Government Financial Reporting Act No. 88/1997, the Annual Accounts Act No. 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 Office's revenue is recorded in the month in which invoices are issued.

#### Recording of Expenses

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

#### Operating Divisions

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

#### Accounts receivable

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

#### Cash and Cash Equivalents

The Office keeps no funds but has a bank account.

#### Pension Liabilities

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

#### Accounts Payable

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

#### Accounting and Payment Functions

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

## NOTES

### Budget and Operations

The Office's budget for 2012 anticipated similar activities as in the previous year. The Office's total budget was ISK 430,4 million.

Operating expenses less sale of services totalled ISK 459,5 million and were ISK 29,1 million more than budget. Operating expenses are specified as follows:

In ISK thousand	Initial	Total budget	Financial Statements	Differences
Sales of services .....	( 35.900)	( 35.900)	( 42.385)	6.485
Salary and salary-related expenses .....	365.700	365.700	394.807	( 29.107)
Other operating expenses .....	99.700	99.700	104.581	( 4.881)
Tilfærslur .....			700	( 700)
	429.500	429.500	457.703	( 28.203)
Purchased assets .....	900	900	2.014	( 865)
	430.400	430.400	459.717	( 29.068)

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

	2012	2011
Sales of services .....	( 42.385)	( 41.652)
101 Icelandic National Audit Office .....	500.089	479.294
601 Equipment .....	1.765	2.014
	459.469	439.656