

NEGOTIATING POSITION OF ICELAND

Chapter 32
Financial Control

I. Summary of the negotiating position

1. Iceland accepts the *acquis communautaire* with respect to Chapter 32 on Financial Control as of 2 February 2011.¹
2. Iceland will have implemented any outstanding *acquis*, as of that date, under this chapter and recognised international standards and best practices where relevant by the date of accession.
3. Iceland considers that while complying with the relevant international standards and EU best practices, specific arrangements can be made that would take into account the small size of many public agencies.
4. This chapter is not relevant under the EEA.

II. Legislative framework

II.a. Public internal financial control and external audit

Public Internal Financial Control

The current legislation with relevance to Public Internal Financial Control (PIFC) is the Government Financial Reporting Act No 88/1997. It is a general legislation without any specific framework for internal financial control, such as internal audit. The legislation is presently under revision.

The execution of the Government Finances is based on Regulation No 1061/2004 for the implementation of the fiscal budget and the accountability for Treasury Finances of the A-budget.

A preliminary gap assessment indicates that improvement needs to be made in the field of public internal financial control. The Ministry of Finance performs the role of a central harmonization unit, but procedures regarding internal financial management and control will need to be formalized in line with international standards and EU best practices. Managerial accountability is in place according to the preliminary gap assessment and other parts of the financial management and control system seem to be in line with EU best practices.

¹ Date of bilateral screening meeting.

A thorough PIFC and external audit gap assessment in collaboration with EU experts will start before end of year 2011. Following that a PIFC Policy Paper with an action plan that includes a time schedule will be prepared and adopted by Iceland in close cooperation with the European Commission.

The action plan will be based on Iceland's gap analysis on its legal framework and administrative capacity of PIFC and external audit and prepared in accordance with international standards and EU best practices.

External Audit

The current legislation as regards External Audit (EA) is the Government Financial Reporting Act No 88/1997 and the National Audit Act No 86/1997.

The Icelandic National Audit Office (INAO) adheres to the standards and guidelines of the International Organisation of Supreme Audit Institutions (INTOSAI) and also to the standards of the International Federation of Accountants (IFAC) and the International Financial Reporting Standards (IFRS) where applicable. Furthermore, the Office has established a Code of Conduct for its employees, based on both the INTOSAI Code of Ethics and the Government Employees Act No 70/1996.

The independence of the INAO is ensured by the National Audit Act No 86/1997, based on Article 43 of the Icelandic constitution².

According to the Act, the INAO is an independent institution which functions under the auspices of Althingi. It shall carry out auditing of the Annual Accounts of the Central Government and other bodies are charged with government operations and guardianship (Art. 1). The Speaker's Committee of Althingi appoints the head of the INAO, the National Auditor, for a six-year term (Art. 2). The Act clearly stipulates that the National Auditor has autonomy in his/her work, and is not subject to Government direction regarding individual aspects of the work. The staff employed in the INAO is to be independent of those ministries and organisations where the audit is being carried out and not subject to direction from them (Art. 3). This entails the requirement that the Office initiates the selection and organization of projects and that its procedures are objective, professional and in conformance with generally accepted auditing principles and rules.

The INAO's budget is submitted to the Althingi by the Minister of Finance, but the Auditor General is entitled to present amendments. The Office notifies Althingi of the results of its audits through printed reports. Althingi discusses the reports in accordance with the Act on Parliamentary Procedure No 55/1991.

The INAO will cease all internal audit activities as soon as internal audit is otherwise secured in a structured manner in all relevant public agencies.

² For further clarification, the basis for the task of the INAO is to be found in Article 43 of the Constitution of Iceland No 33/1944, which reads as follows: "The financial accounts of the State, its institutions and administrative bodies, shall be subject to an audit by, or under the supervision of Althingi, as provided by the law."

The INTOSAI international audit standards (ISSAI), including the LIMA declaration, will be fully adopted by INAO by end 2012.

II.b. Protection of EU's financial interests and protection of the Euro against counterfeiting

The current legislation with relevance to the protection of EU's financial interests and protection of the Euro against counterfeiting is the Penal Code No 19/1940 and the Code of Criminal Procedure, Act No 88/2008.

Protection of EU's financial interests

Iceland's current legislation protects public funds without distinction of their origin. Fraud is criminalised and as stated in the negotiating position of Chapter 23 on Judiciary and Fundamental Rights. Iceland is for the most part already in line with the *acquis* in the area of anti-corruption and will be able to fully implement it by the date of accession.

Iceland commits to adopt the PFI Convention and its protocols with necessary alignment of its legal and institutional framework before the date of accession.

Legal definitions of irregularities, fraud and corruption need further analysis and other concepts related to criminal offences will also come under scrutiny.

Protection of the Euro against counterfeiting

Iceland's legislation on protection against counterfeiting refers to both notes and coins. The Icelandic police investigate cases of counterfeited currency, including forensic work and the gathering and distribution of information on counterfeiting in cooperation with the Icelandic Central Bank and also with Interpol or Europol if necessary. Reporting of counterfeit bank notes is compulsory under Icelandic law and there is no distinction made between the domestic currency (Íslensk króna) and foreign currencies, such as the Euro. Failure to report a suspected counterfeiting activity is a crime. Current cooperation with EU Member States, the European Commission and the ECB takes place in terms of exchange of information (via Interpol and Europol).

Iceland will finalise its comparison of the domestic legislation and the Geneva Convention for Suppression of Counterfeiting Currency before the middle of 2012 with the aim of having ratified it by accession.

III. Institutional framework

III.a. Public Internal Financial Control and External Audit

Regarding the institutional structure, the core public bodies are the Ministry of Finance and line ministries, the Financial Management Authority, the Treasury Accounts Committee and the National Audit Office.

Public Internal Financial Control

The government financial management consists of authorized government expenditure and estimation of income stated in the budget and the supplementary budget and the execution of the budget. Iceland's public budget system consists of frame budgeting with a centralized treasury and centralized accounting. The budget is spent by 10 ministries and implemented through the ministries and 216 agencies. Apart from transfers received from the central government, the latter also dispose of some own income including from taxes through their municipalities' budget and accounting. The ministries have financial autonomy and they are responsible for efficient use of funds under their authority but all agencies under the ministries have also responsibility for their financial affairs. The Ministry of Finance has the overall supervision of the execution of the budget, giving horizontal advice and instructions that may include certain aspects for the internal control environment.

The agencies prepare annual financial and operational plans and send to line ministries for approval. Those plans are then used in comparison on monthly evaluation that is conducted through monthly cash flow statements and quarterly financial statements. The managers are responsible to make sure that the agencies operate within their budget and that the quarterly and annual statement is accurate.

The Financial Management Authority supports the system with a centralized accounting system in Oracle, centralized financial statement and through centralized payroll. These are complemented by guidelines from the Financial Management Authority and the Ministry of Finance. Each ministry has a financial management department, which is responsible for assessing the financial operations.

The Ministry of Finance monitors budget implementation by agencies on a monthly basis and can also inspect accounts. The Minister of Finance is advised by a Treasury Accounts Committee and the chairman of the Committee is currently the general manager of the Financial Management Authority. Serious suspected cases of financial irregularities and fraud by the agencies are reported to the National Audit Office, which performs the function of the Supreme Audit Institution of Iceland.

Due to the small size of the Icelandic administration in general, Iceland needs specific arrangements regarding the administrative setup. The majority of public agencies have less than 30 employees.

External Audit

The INAO is responsible for both financial and performance audits of all ministries, state bodies and companies where the state has majority share and has issued work plans for performance audit three years ahead. The municipalities are covered only to the extent there are joint operations with the central government. Municipalities issue their own external audit, mostly prepared by private firms. The INAO has been performing an internal audit function for the Housing Fund and for the Central Bank, but as aforementioned, this practice is to be discontinued.

III.b. Protection of EU's financial interests and protection of the Euro against counterfeiting

Concerning the institutional framework, the main bodies are the Minister of Finance, the Customs Directorate, the Directorate of Tax Investigation (Ministry of Finance), the Minister of Interior, the National Commissioner of Police and District Police Commissioners (Ministry of the Interior), the Minister of Economic Affairs, the Financial Surveillance Authority, (Ministry of Economic Affairs) and the Central Bank of Iceland.

Protection of EU's financial interests

The Customs Directorate and the Economic Crime Department of the Special Prosecutor's Office³ have already some experience regarding on-the-spot checks in cooperation with European Commission investigators (OLAF). Iceland intends to designate the Ministry of Finance as the national anti-fraud coordination service (AFCOS) for the cooperation with European Commission's Anti-Fraud Office (OLAF).

Protection of the Euro against counterfeiting

The Central Bank and the National Commissioner of Police work in close cooperation in cases of counterfeiting. They have already some experience regarding checks into such cases in cooperation with Europol.

Acceptance of the *acquis*

Iceland accepts the *acquis communautaire* in Chapter 32 on Financial Control as of 2 February 2011.

³ It should be noted that the Economic Crime Department was a part of the National Commissioner's Office of the Police, but merged with the Special Prosecutor's Office on September 1, 2011. This new entity has taken over the rights and obligations of the Department apart from inspection relating to money laundering and financing of terrorism activities, which will remain at the National Commissioner's Office.

