NATO	NORTH ATLANTIC COUNCIL	
OTAN	CONSEIL DE L'ATLANTIQUE NORD	

NATO UNCLASSIFIED

15 September 2005

DOCUMENT
C-M(2005)0087
Silence Procedure ends:
28 Sep 2005 18:00

REVIEW AND REQUIREMENTS FOR NATO'S AGENCIES - GUIDELINES ON CORPORATE GOVERNANCE

Note by the Secretary General

1.   Please find attached Guidelines on Corporate Governance for the NATO Agencies. The document, which is one of the actions arising from the implementation of the Review of NATO's Agencies, approved by the Council last year[1], has been drafted in close consultation with Agencies and Agency Boards of Directors and has been agreed by the Executive Working Group (EWG) reinforced with experts.

2.   Accordingly, the Guidelines are submitted to the Council for notation. Therefore, unless I hear to the contrary by **18.00 hrs on Tuesday, 20 September 2005** I shall assume that the Council has noted the document on Corporate Governance which then will be promulgated.

(Signed) Jaap de Hoop Scheffer

1 Annex

1 Appendix

Action Officer: Bob REEDIJK
Original: English

---

[1] C-M(2004)0106

DMS 1437694

GUIDELINES FOR THE CORPORATE GOVERNANCE OF NATO ORGANISATIONS

INTRODUCTION

1.   These Guidelines set out the characteristics and requirements of Corporate Governance in the public sector. They are intended to:

a.   advise Boards of Directors of NATO Agencies on the structures and processes which they should institute and follow to meet those requirements;

b.   offer guidance to the authorities appointing Board Members so that they can make selections with due regard to the appropriate qualities, background and experience required.

The principles of good governance set out in this document apply to all Agencies, and while differences in the roles and structures of the NATO Agencies may require differences in the implementation of the Guidelines, they should not be unnecessarily deviated from.

GOVERNANCE IN THE PUBLIC SECTOR AND IN NATO

2.   Over the last decade, Corporate Governance has developed both in the private and the public sector. Developments in the public sector primarily reflect changes in the role of government, which have resulted in greater devolution of authority to managers and moves towards greater transparency and accountability. A key purpose of Corporate Governance is to provide for a clear distinction of responsibilities between Boards of Directors and Executive Managers. There is evidence that good governance leads to better outcomes.

3.   The definition of Corporate Governance accepted within NATO is as follows:

"Corporate Governance refers to the processes by which organisations are directed, controlled and held to account, and is underpinned by the processes of openness, integrity and accountability. Governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the top of organisations."[2]

These Guidelines therefore take the agreed definition as its starting point and are based on the IFAC Document from which it is drawn. The document itself recognizes that governance within nations is underpinned by different legislations and cultures and, accordingly, expresses the position in an international context.

---

[2]   International Federation of Accountants (IFAC): "Governance in the Public Sector;
A Governing Body Perspective," Study 13, August 2001.

4.   Against this background, it is essential that the Alliance, as a public body of the highest prominence and reputation, identifies and follows good governance practice through the whole range of its activities.

THE GUIDELINES, THE PRINCIPLES AND DIMENSIONS OF GOVERNANCE

5.   There are three major principles underpinning governance:

- Openness;
- Integrity;
- Accountability.

These principles inform the "dimensions" of the governance of public sector organisations, which are:

- Standards of Behaviour;
- Organisational Structures and Processes;
- Control;
- External Reporting.

These Guidelines are set out under the headings of the four dimensions.

STANDARDS OF BEHAVIOUR

6.   Openness, integrity and accountability are the cornerstones of governance and Boards are responsible for exercising strategic oversight of their organisation to ensure that these standards are maintained and that the organisation operates with propriety, regularity and acts within the law.

7.   They should adopt a code of conduct which sets out required standards and they should also consider how best to ensure that these standards are being met and maintained. Key areas to be covered are:

- probity and propriety;
- conflicts of interest;
- political interests;
- gifts, hospitality and entertainment;
- relationships within the organization;
- relationships with suppliers.

ORGANISATIONAL STRUCTURES AND PROCESSES

8.　　Boards need to ensure that effective organisational structures and processes are in place, particularly in the areas set out in paragraphs 9 to 20 below.

Accountability for Public Funds

9.　　Boards need to satisfy themselves that arrangements exist to ensure that the organization's funds are properly safeguarded and are used economically, efficiently, effectively, with due propriety and in accordance with the regulations that govern their use. The exercise of this function may be delegated to a subsidiary body, for example a sub-committee of the Board, although the overall responsibility remains with the Board.

Communications with Stakeholders

10.　　There is a wide range of potential stakeholders, which can include the North Atlantic Council, NATO staffs, Boards of Directors, Agencies, customers, Governments, contractors and the media.　This area may include reporting against performance standards, processes for stakeholders' involvement in the organization's activity and procedures for enquiries and complaints.　These provisions should be underpinned by a commitment to openness, bearing in mind issues of security and commercial confidentiality, and an assumption that information is a public resource not the property of the organization.

Roles and Responsibilities for Corporate Governance within the Organisation

11.　　Roles and responsibilities should be explicitly defined, drawing as necessary on these Guidelines, so that the authority of the Board of Directors and Executive Management of the Agency are separate and balanced and that authority is located so that no single group can dominate the conduct of business.　The relationship between Boards and Management should be both balanced and productive.

The Board of Directors from a Corporate Governance Perspective

12.　　Boards will comprise a Chairperson and Members, and may be assisted by national experts who may participate in discussions.　Board meetings may also be attended by observers, as agreed by the Board, who may also participate in discussions. Only full Board Members or their nominated substitutes are able to participate in the decision-making process.

13.　　Boards should aim for open-mindedness and a readiness to accept innovation. They should oversee the Agency from a strategic level and provide appropriate guidance. They should meet regularly, and should be focused on their collective responsibility for the stewardship of the organisation, in particular:

- providing policy direction to the Agency;
- defining the Agency's mission and long-term plans;
- overseeing the delivery of results against targets set by the Board;
- taking a forward-looking perspective;
- evaluating the performance of the organisation and its subsidiaries;
- approval and adoption of the Annual Report; the programme of work and the budget.

Boards should also concern themselves with overseeing:

- the appointment and development of senior managers;
- the implementation of an effective communications policy;
- the establishment of effective systems of internal control and information;
- the identification and monitoring of principal risks.

Appointments to the Board

14. Appointments should be made in accordance with specified criteria laid down by sending nations, drawing on these Guidelines, and on merit. The background, experience and skills of potential members should be considered, as should the needs of the Board as a whole to comprise a balanced mixture of skills. Sending Nations may wish to consult the Chairperson of the Board when considering these issues.

15. Boards and Nations should, balancing the benefits of availability, continuity and rotation, consider whether service on the Board should be subject to a specified time limit.

16. Sending Nations, consulting the Chairperson as necessary, are responsible for ensuring that new Board Members have the necessary competences, skills and experience to fulfil their role and that they receive suitable preparation for that role, whereby:

- they are properly aware of the role and operations of the organisation;
- they have access to appropriate key information about the organization's performance;
- they are made aware of their responsibilities as members of the Board.

The Chairperson

17. Chairpersons will be selected according to procedures established within NATO. In some cases a member of the International Staff will act as the Chairperson of the Board. The Chairperson derives his or her authority from the Board of Directors and/or the Charter, or as otherwise agreed by the NAC. He/she must account to that Board for all actions which he/she may take in accordance with the Organisation's Charter and the decisions taken by the Board of Directors.

18.   The appointment of the Chairperson is critical, and the selected individual is required to have both the necessary competences and the time to devote to the office. Specifically, the Chairperson must:

-       provide leadership;
-       ensure that key and appropriate issues are discussed by the Board in a timely - manner;
-       enable all Board members to contribute;
-       ensure effective review of the Board as necessary;
-       ensure all Board members have access to necessary information;
-       ensure the Board is properly supported;
-       ensure all issues are considered in decision-making;
-       ensure that regular meetings are held;
-       be able to represent the views of nations/participants to other stakeholders.

Executive Management

19.   As far as Boards of Directors are concerned, they should be supported by the General Manager of the Agency, who has full line responsibility for all aspects of general management, and, as necessary, by his or her staff. Boards should seek, either from within the Organisation or outside as appropriate, advice on compliance or procedural matters when this is necessary.

CONTROL

20.   There are a number of areas in which Boards need to exert overall control; these are set out in the following Section. Boards will, advised by executive management as appropriate, adopt accepted international standards in these areas wherever possible.

Risk Management

21.   Boards need to ensure that effective risk management procedures are in place. They will recognize that risk management involves:

-       understanding an organization's wider objectives;
-       identifying the risks involved in achieving them;
-       assessing them, in terms of likelihood and impact;
-       developing procedures to identify them;
-       monitoring, evaluating and where possible mitigating them.

22.   They will also recognize that risk management is not a static process, and that an ongoing process is necessary to identify new risks, quantify potential liabilities, review past risks and ensure that all staff in the organisation is aware of the risks it faces.

Internal Audit

23.   Public bodies need an internal audit function which should perform to acceptable standards, report directly to the General Manager and enjoy the respect and cooperation of the Board. Boards should bear in mind that an in-house Internal Audit function may not be justified if its costs outweigh its potential benefits and should, taking advice as necessary, engage a suitable, independent outside entity for the purpose.

24.   Specifically, Boards should look to the functions of Internal Audit to:

- assess the relevance of existing policies and plans;
- review the adequacy of existing internal guidance;
- review operations and programmes;
- assess whether assets and interests are properly safeguarded and accounted for;
- assess the adequacy of management information;
- assess the economic and efficient use of resources;
- assess the integrity of IT systems;
- report on follow-up actions taken in respect of previous cases.

Audit Committees

25.   An Audit Committee is a high-level sub-committee of the Board, supported by an Organization's Head of Internal Audit, which assesses, on behalf of the Board, the outcomes of internal and external audit processes[3]. An Audit Committee should be chaired by a member of the Board of Directors or by an individual selected specifically for that task, and should comprise fellow Board Members or their designees (or independent members where this is feasible) and should be supported by the internal auditors. Its key roles should include:

- oversight of the effectiveness of internal control systems;
- review of the adequacy of compliance policy;
- review of the adequacy of financial information;
- assurance that the Internal Audit function is properly resourced;
- review of the activities of Internal Audit.

26.   Agencies will wish to consider the relative costs and potential benefits of setting up a separate Audit Committee, or of allocating the role to the Finance Committee (see para 34 below).

---

[3]   In the case of NATO Agencies, external audit is carried out by the International Board of Auditors (IBAN)

Internal Control

27.   Internal Control is a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

-    effectiveness and efficiency of operations;
-    reliability of internal and external reporting;
-    compliance with applicable laws and regulations and internal policies.

Boards need to assure themselves that an appropriate and effective framework of Internal Control exists.

Budgeting

28.   Budgeting is an element of the financial planning, control and evaluation processes of the public sector. Budgeting should preferably be linked to the identification of objectives, priorities and activities and budget documents should provide a clear explanation of the rationale for the proposed allocation of resources. Regular monitoring against the budget is vital.

29.   To be effective, budgeting needs to be integrated with accounting that will provide the necessary information for planning, controlling and evaluation, whatever basis of accounting is chosen. Annual budgeting is most successful if it is linked to a medium-term framework. Boards need to oversee and ensure that procedures are in place that will result in effective and efficient budgeting.

Financial Management

30.   Boards need to assure themselves that effective Financial Management systems are in place and that they support the management of the organisation and the achievement of its outcomes.

31.   A sound financial management system needs to be supported by appropriate legislation, regulations, instructions and systems. It is essential that staff are trained and competent and that they are informed by an efficient information system. There should be guidelines, manuals or instructions setting out the procedures and regulations, and these documents need to be regularly reviewed and updated where necessary.

32.   Financial Management includes:

-    daily cash management;
-    formulation of financial objectives, policies and strategies;
-    the planning and control of capital expenditure;
-    the management of working capital;
-    funding and performance decisions.

33.   Agencies will recognise the need to comply with the NATO Financial Regulations (NFR). The Financial Regulations of the individual Agencies must be consistent with the NFR and must ensure the cost efficient and cost effective use of resources and incorporate the two basic principles of accountability and transparency.

Finance Committees

34.   Boards should establish a Finance Committee (or, where appropriate, identify an existing committee) to assist them in their responsibilities in the area of Financial Management. The key roles of the Finance Committee would be to:

-     review the Annual Budget and propose it to the Board for approval;
-     consider matters which arise and have potentially significant impact on the approved Budget;
-     consider the Audit Report and Executive Management's report of corrective actions;
-     review the Financial Statements and propose them to the Board for approval.

35.   Should there not be a separate Audit Committee (see para 27 above) then the Finance Committee should perform this role.

The Financial Officer

36.   Responsibility for financial matters and for the provision of financial advice needs to be vested in a senior official or executive.   In a number of NATO Organisations this function is carried out by the Financial Controller. Responsibilities can include ensuring the:

-     quality and accountability of financial systems;
-     accuracy of the organisation's accounts;
-     quality of financial information;
-     internal financial supervision;
-     financial risk management;
-     control of funds;
-     application of financial regulations.

Decision Making

37.   The Charter of a NATO Organisation will specify the basis upon which the Board of Directors will reach its decisions.

Staff Training

38. ·   Boards will wish to assure themselves that staff working in the areas of control is in possession of the relevant competencies and are appropriately trained.

EXTERNAL REPORTING

39.   Public sector bodies need to publish on a timely basis an Annual Report which presents an objective, balanced and understandable account and assessment of their activities, achievements, finances and performance. Guidelines on a standardised format for Annual Reports to the North Atlantic Council by NATO Agencies are set out at Appendix 1.

GUIDELINES FOR THE FORMAT OF ANNUAL REPORTS TO THE NAC
BY NATO AGENCIES

General Points

1.   These Guidelines:

a.   reflects the pattern of reporting across a range of public sector bodies from various nations. They are designed to assist NATO Agencies in identifying the essential information to be presented to the NAC and, through the presentation of Reports in a consistent and predictable format, to assist NAC members in their understanding and analysis of Agency activity;

b.   are designed to give Agencies freedom in compiling their Reports. They are drafted in recognition that Agencies have differing roles and structures, and may not necessarily perform all the functions set out in the Subject Areas.

2.   Reports should:

a.   be clear, concise, relevant and accessible to non-experts;

b.   give an overview of the past year and look forward to the future;

c.   describe Agency activity in terms of "what", "why", "how" and "for whom";

d.   be prepared by the Head of Agency, approved by the BOD and submitted to the NAC, or Agency parent committee in accordance with CM(62)18 paragraphs 33d and 46;

e.   be received at NATO HQ by the end of June.

Subject Areas for Inclusion in Reports

1.   Mandatory areas are:

a.   Organisation/Agency relevance to NATO goals, objectives and priorities;

b.   key achievements over the year, to include key contributions to NATO capabilities and transformation;

c.   key difficulties and areas for development;

d.   Performance Measures:
- how they are developed;
- targets and key programmes achieved, how achieved, constraints and proposed future targets;

e.   important changes in last year - (for example, organisational structure, corporate governance, business and operational environment, customers);

f.   longer term outlook for Organisation/Agency business including programme status and contracts;

g.   Financial Summary and financial systems used;

h.   key savings and efficiencies achieved;

i.   Corporate Governance - status, improvements or adjustments;

j.   audit status;

k.   end user satisfaction.

Optional areas are:

a.   any NAC decision or activity required to assist or enhance Organisation/Agency performance;

b.   risks and risk management;

c.   employment issues (recruitment, training, equal opportunities, industrial relations);

d.   significant trends;

e.   health and safety issues.

Executive Overview

3.   Reports should be covered by an Executive Overview. This should be concise (two A4 pages maximum), should cover:

a.   Organisation/Agency purpose and mission;

b.   analysis of performance in relation to:

c.   Capabilities and Transformation;

d.   NATO's Goals, Objectives and Priorities;

e.   key achievements;

f.   key challenges;

g.   outlook.

The Executive Overview is, in addition, an opportunity for the Organisation to bring to the NAC's attention issues.