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26 June 2018

DOCUMENT
C-M(2018)0032-AS1

**IBAN AUDITS ON THE 2015 AND 2016 FINANCIAL STATEMENTS OF THE NATO
FORACS OFFICE**

ACTION SHEET

On 25 June 2018, under the silence procedure, the Council noted the IBAN reports on the 2015 and 2016 financial statements of the NFO attached to C-M(2018)0032, endorsed the recommendations of the RPPB for the NFO to be able to retain and operational reserve fund in accordance with the express needs of the NFO Nations, and approved the public disclosure of the financial statements and the associated audit reports.

(Signed) Jens Stoltenberg
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2018)0032.

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11 June 2018

DOCUMENT
C-M(2018)0032
Silence Procedure ends:
25 Jun 2018 17:30

**IBAN AUDITS ON THE 2015 AND 2016 FINANCIAL STATEMENTS OF THE NATO
FORACS OFFICE**

1. I attach the International Board of Auditors for NATO (IBAN) reports on the audits of the 2015 and 2016 financial statements of the NATO FORACS Office (NFO).
2. The IBAN reports set out qualified opinions on the financial statements and on compliance for both financial years 2015 and 2016. The IBAN reports have been reviewed by the Resource Policy and Planning Board (RPPB) at annex.
3. I do not believe that this matter requires discussion in the Council. Consequently, **unless I hear to the contrary by 17:30 hours on Monday 25 June 2018**, I shall assume that the Council has noted the IBAN reports on the 2015 and 2016 financial statements of the NFO, endorsed the recommendations of the RPPB for the NFO to be able to retain an operational reserve fund in accordance with the express needs of the NFO Nations, and approved the public disclosure of the financial statements and the associated audit reports.

(Signed) Jens Stoltenberg

Annex 1: RPPB report
Enclosure 1: IBAN report on 2015 FS
Enclosure 2: 2015 FS
Enclosure 3: IBAN report on 2016 FS
Enclosure 4: 2016 FS

1 Annex
4 Enclosures

Original: English

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**IBAN AUDITS ON THE FINANCIAL STATEMENTS OF THE NATO FORACS OFFICE
FOR THE FINANCIAL YEARS 2015 AND 2016**

Report by the Resource Policy and Planning Board

References:

- A. IBA-AR(2017)22 (IBAN audit on 2015 financial statements)
- B. IBA-AR(2017)27 (IBAN audit on 2016 financial statements)

INTRODUCTION

1. This report covers the audits of the 2015 and 2016 financial statements of the NATO FORACS Office (NFO).

BACKGROUND

2. The NATO Naval Forces Sensors and Weapons Accuracy Check Sites (FORACS) provides naval testing facilities to eight NATO Nations at three ranges under the jurisdiction of Norway, Greece and the United States. Member Nations maintain oversight through the NATO FORACS Steering Committee. The NATO FORACS Office (NFO) which consists of 4 positions at the NATO headquarters in Brussels, provides technical direction, quality control and maintains a data bank of test results.
3. Normal operations and maintenance of NATO FORACS activities are funded by member Nations on a cost-sharing basis. Fixed facilities and capital costs are common funded through the NATO Security Investment Programme (NSIP). Budgetary responsibility for the three test ranges rests with the host nations and they operate under their own national budgeting and financial rules. The financial statements relate only to the NFO.

DISCUSSION

4. The IBAN issued a qualified opinion on the financial statements and on compliance for both financial years 2015 and 2016.
5. Of the four observations that impacted the audit opinion on compliance on the 2015 financial statements two had been settled, one was outstanding and one was superseded by an observation on the 2016 financial statements. One observation impacted the audit opinion on both the financial statements and on compliance and this too was superseded by an observation on the 2016 financial statements. Of the two further observations that did not impact the audit opinion on the 2015 financial statements one had been partially settled and one was outstanding in the audit on the 2016 financial statements. This report will therefore focus on the audit findings on the 2016 financial statements.

Observations that impacted the audit opinion on the financial statements and on compliance

6. The IBAN found that the NFO used budgetary credits to fund a service that was to be rendered in 2017 which was not in compliance with the NATO Financial Regulations (NFRs) and affected the financial statements too. The IBAN recommended that expenses should be recognised when goods and services are received to ensure that the financial statements give a fair and true view. In their formal comments the FORACS Steering Committee agreed in principle with the recommendation but noted that the agent who let the contract on behalf of the NFO required transfer of the full amount at the outset in order to ensure that they would not be exposed to any financial risk.

7. The IBAN also reported a number of misstatements and errors in the financial statements which amounted to material weaknesses in internal control over financial reporting. The FORACS Steering Committee agreed with the need to make improvements in this area.

Other observations

8. The IBAN found that the NFO continues to use a “management reserve fund” which is not in compliance with the NFRs. This issue continues to be the basis for a qualified audit opinion on compliance. The IBAN found that uncommitted appropriations had been retained without a clearly identified purpose to be used in case of emergency funding needs instead of being lapsed. The IBAN recommended that if the FORACS Steering Committee believed that such a management reserve fund was necessary that they should make a request to Council for a deviation from Articles 24.2 and 29.3 of the NFRs.

9. At their meeting on 3 November 2017, the Steering Committee reaffirmed that they consider the continued provision of an operational reserve¹ to be essential to meet the needs of the FORACS as they have for the past ten years. This reserve is funded solely from the direct financial contributions of the NATO FORACS MOU nations; it does not involve any Common or broader NATO Funds. The FORACS Steering Committee has previously agreed that the fund should be limited to no more than 20% of the NATO FORACS annual operating budget (the current limit of the fund would therefore be EUR 1M).

10. The NFO is a multi-national NATO entity which must abide by the NFRs. Deviations from the NFRs would normally be subject to separate advice to Council. Council has endorsed similar requests from the governing bodies of NAPMO², NAGSMO³ and the NSPO⁴. The RPPB supports the NFO Steering Committee’s decision to retain an

¹ The size of the reserve at the end of 2016 was €547,623.09

² PO(2015)0751

³ C-M(2017)0011

⁴ C-M(2017)0048

operational reserve fund up to a limit of 20% of the annual operating budget in accordance with the express needs of the member Nations.

11. The RPPB also notes that the NFO still has work to do to comply with the NFRs on internal control, risk management and internal audit albeit that this effort must be commensurate with its size and scale of activities and operations.

RECOMMENDATIONS

12. The RPPB recommends that Council:

12.1. Note the IBAN reports (references A and B);

12.2. Note that the NFO Steering Committee has reaffirmed that the continued provision of an operational reserve to be essential;

12.3. Endorse the approach taken by the governing body of the NFO to retain an operational reserve fund up to a limit of 20% of the annual operating budget in accordance with the express needs of the member Nations; and,

12.4. Approve the public disclosure of this report, the IBAN audits and the associated 2015 and 2016 financial statements.

**Summary Note for Council
by the International Board of Auditors for NATO (Board)
on the audit of the Financial Statements of the NATO FORACS Office
for the year ended 31 December 2015**

The NATO Naval Forces Sensors and Weapon Accuracy Check Sites (NATO FORACS) provide a comprehensive calibration of sensors associated with the weapon systems of NATO naval units such as surface ships, submarines and anti-submarines helicopters. These tests are conducted at three FORACS ranges under the jurisdiction of Norway (NFN), Greece (NFG), and the United States (NFA).

The overall management of the programme is the responsibility of the FORACS Steering Committee. The NATO FORACS Office is located at the NATO Headquarters in Brussels and serves as the executive staff of the Steering Committee. The NATO FORACS Office budget for 2015 (including brought forward) amounted to EUR 3.05 million while budget expenses amounted to EUR 885,894.

During the audit, the Board made seven observations. The main findings are listed below.

Four observations impact the audit opinion on compliance:

1. Use of a Management Reserve Fund not in compliance with the NFRs.
2. Late issuance of financial statements.
3. No issuance of Statement of Internal Control.
4. Unsupported budgetary credits carried forward.

One observation impacts the audit opinion on both the financial statements and compliance:

5. Material weaknesses in internal control over financial reporting.

Two observations do not impact the audit opinions:

6. Significant delays in providing information required for the audit.
7. Efforts to achieve compliance with the revised NATO financial regulations, particularly those articles on internal control, risk management and internal audit.

The Board also followed up on the status of four outstanding observations from its previous years' audits and noted that one was outstanding, resulting in a current year audit qualification on compliance, and the other three were superseded by a current year observation.

For the NATO FORACS Steering Committee's formal comments, see the Appendix to Annex 3.

15 December 2017

INTERNATIONAL BOARD OF AUDITORS FOR NATO

**AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF
NATO FORACS OFFICE (NFO)
FOR THE YEAR ENDED 31 DECEMBER 2015**

**REPORT OF THE INTERNATIONAL BOARD OF AUDITORS
FOR NATO TO THE NORTH ATLANTIC COUNCIL**

Report on the Financial Statements

The International Board of Auditors for NATO (Board) audited the accompanying financial statements of NATO FORACS Office (NFO), which comprised the Statement of Financial Position as at 31 December 2015, the Statement of Financial Performance, Statement of Changes in Net Assets and Cash Flow Statement for the year then ended and a summary of significant accounting policies and other explanatory notes. The Board also audited the Statement of Budgetary Operations for the year ended 31 December 2015.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the NATO Accounting Framework and the requirements of the NATO Financial Regulations (NFRs) as authorised by the North Atlantic Council. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit, which is conducted in accordance with our Charter and international standards on auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, due to fraud or error. In making those risk assessments, internal control relevant to the entity's preparation and presentation of financial statements is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion on the Financial Statements

The Board did not obtain sufficient evidence that payables in the Statement of Financial Position are fairly presented as a detailed list reconciling to the balance in the Statement of Financial Position could not be obtained. In addition, the lack of revaluation for the monetary items in foreign currencies at year-end had a material impact on the balances of the Statement of Financial Position. Finally, Project Accumulated Surplus was reported under Net Assets whereas it was reported under payables in 2014. This is a change in accounting policy and the reasons justifying the change were not provided to the Board or disclosed in the notes to the financial statements. Further details are provided in observation 4 in the Letter of Observations and Recommendations accompanying this report.

Qualified Opinion on the Financial Statements

In our opinion, except for the effects and possible effects of the matters described in the section Basis for Qualified Opinion on the Financial Statements, the financial statements present fairly, in all material respects, the financial position of NATO FORACS Office (NFO) as of 31 December 2015, and of its financial performance and its cash flows for the year then ended in accordance with the NATO Accounting Framework.

Report on Compliance*Management's Responsibility for Compliance*

In addition to the responsibility for the preparation and presentation of the financial statements described above, management is also responsible for ensuring that the financial transactions and information reflected in the financial statements are in compliance with the NFRs and the NATO Civilian Personnel Regulations as authorised by the North Atlantic Council.

Auditor's Responsibility

In addition to the responsibility to express an opinion on the financial statements described above, our responsibility includes expressing an opinion on whether the financial transactions and information reflected in the financial statements are, in all material respects, in compliance with the NFRs and the NATO Civilian Personnel Regulations. This responsibility includes performing procedures to obtain reasonable assurance about whether the funds have been used for the settlement of authorised expenditure and whether their operations have been carried out in compliance with the financial and personnel regulations in force. Such procedures include the assessment of the risks of material non-compliance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion on Compliance

We found that NFO at 31 December 2015 held EUR 481,000 of Project Accumulated Surpluses. These Project Accumulated Surpluses are to be used in cases of emergency funding needs, and are a management reserve. Such a management reserve does not comply with Articles 24.2 and 29.3 of the NFRs, which require, respectively, that appropriations which have not been committed shall lapse at the end of the financial year, and that each contribution instalment shall be calculated to restrict total currency holdings to the minimum to meet forecast payments prior to receipt of the following contribution instalment.

The NFRs require the financial statements to be submitted for audit to us by the Financial Controller not later than 31 March following the end of the financial year. The NFO Financial Statements for the year ended 31 December 2015 were not submitted until 22 July 2016. The NFRs also require the Statement of Internal Control to be signed annually by the Head of NATO Body and the Financial Controller. No Statement of Internal Control was issued for 2015.

The NFRs require the establishment of a system of internal control. We found material weaknesses in internal control over financial reporting at NFO. Material misstatements and other errors were identified during the audit which had not been prevented or detected by internal controls over financial reporting.

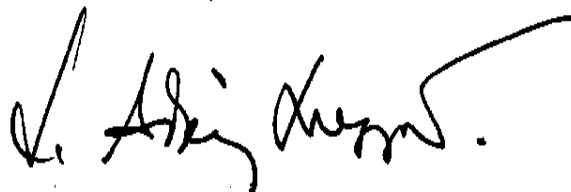
We also were not provided with support for EUR 135,000 of budgetary credits carried forward. Furthermore, there was no review of such commitments to determine whether they should have been carried forward or lapsed. EUR 52,000 of these credits carried forward were subsequently lapsed.

Finally, we also found that bank balances were not being reconciled during 2015. This represents a material weakness in internal control over financial reporting.

Qualified Opinion on Compliance

In our opinion, except for the matters described above in the *Basis for Qualified Opinion on Compliance* paragraph, in all material respects the financial transactions and information reflected in the financial statements of NFO are in compliance with the NFRs and the NATO Civilian Personnel Regulations.

Brussels, 15 December 2017



Hervé-Adrien Metzger
Chairman

15 December 2017

INTERNATIONAL BOARD OF AUDITORS FOR NATO

LETTER OF OBSERVATIONS AND RECOMMENDATIONS

FOR THE NATO FORACS OFFICE (NFO)

FOR THE YEAR ENDED 31 DECEMBER 2015

Introduction

The International Board of Auditors for NATO (Board) audited the NATO FORACS Office (NFO) Financial Statements for the year ended 31 December 2015 and issued a qualified opinion on the financial statements and on compliance.

Observations and Recommendations

During the audit, the Board identified seven observations.

Four observations impact the audit opinion on compliance:

1. Use of a Management Reserve Fund not in compliance with the NFRs.
2. Late issuance of financial statements.
3. No issuance of Statement of Internal Control.
4. Unsupported budgetary credits carried forward.

One observation impacts the audit opinion on both the financial statements and compliance:

5. Material weaknesses in internal control over financial reporting.

Two observations do not impact the audit opinions:

6. Significant delays in providing information required for the audit.
7. Efforts to achieve compliance with the revised NATO financial regulations, particularly those articles on internal control, risk management and internal audit.

The Board also followed up on the status of four outstanding observations from its previous years' audits and noted that one of them was outstanding, resulting in a current year audit qualification on compliance, and the other three were superseded by a current year observation.

This Letter of Observations and Recommendations was formally cleared with the NATO FORACS Steering Committee, and the formal comments are included (Appendix, Annex 3).

OBSERVATIONS AND RECOMMENDATIONS

1. USE OF A MANAGEMENT RESERVE FUND NOT IN COMPLIANCE WITH THE NFRS

Reasoning

1.1 Article 24.2 of the revised NFRs requires that appropriations which have not been committed shall lapse at the end of the financial year. Article 25.6 of the revised NFRs states that the finance committee if empowered by the governing body may agree, before 31 December, to a special carry forward of uncommitted appropriations for a clearly identified purpose following receipt by 1 December of a special request with suitable justification. Furthermore, Article 29.3 of the revised NFRs requires that each contribution instalment shall be calculated to restrict total currency holdings to the minimum to meet forecast payments prior to receipt of the following contribution instalment.

Observation

1.2 The Board found that the NFO as at 31 December 2015 held EUR 481,000 of Project Accumulated Surpluses. The financial statements state that a substantial proportion is expected to be used to fund the upgrade of an Information Technology system to be used by FORACS for its operations. However, during the audit, the Board was told that this was not the case. Rather, the Project Accumulated Surpluses were to be used in cases of emergency funding needs and not for a clearly identified purpose (i.e., management reserve). Since these appropriations are not committed, they should be lapsed and total currency holdings should be restricted to comply with Article 29.3 of the revised NFRs.

Recommendation

1.3 The Board recommends that NFO comply with Article 29.3 of the revised NFRs and restrict currency holdings to the minimum to meet forecast payments prior to receipt of the following contribution instalment. Alternatively, if the NFO Steering Committee strongly believes that such a management reserve is necessary, a request for deviation from Articles 24.2 and 29.3 of the revised NFRs should be made to Council.

2. LATE ISSUANCE OF FINANCIAL STATEMENTS

Reasoning

2.1 Article 35 of the NFRs states that “An annual financial statement for each NATO body, consolidated where applicable and appropriate, shall be submitted for audit to the International Board of Auditors for NATO by the Financial Controller not later than 31st March following the end of the financial year.”

Observation

2.2 The 2015 NFO Financial Statements were not received by the Board until 22 July 2016, not respecting the requirement of the NFRs. This does not enable the Board to properly plan and carry out financial statement audits and to report its results to the Council on a timely basis. This limits, in part, the usefulness of the financial statements.

Recommendation

2.3 The Board recommends that NFO submit future financial statements by 31 March, the deadline defined in the NFRs.

3. NO ISSUANCE OF STATEMENT OF INTERNAL CONTROL

Reasoning

3.1 According to the NFRs paragraphs 3.1 and 3.2, the Head of NATO Body is responsible and accountable for sound financial management and shall put in place the necessary governance arrangements to ensure and maintain this. This shall include, but is not limited to, the establishment and maintenance of financial governance, resource management practices, internal controls and financial information systems to achieve the efficient and effective use of resources. The adherence to the mentioned above is confirmed annually by signature of the Financial Statements and Statement of Internal Control. Both documents should be signed by the Head of the NATO Body and the Financial Controller.

Observation

3.2 A Statement of Internal Control, signed by the Project Manager and Technical Director and the Financial Controller, was not issued for NFO for 2015.

Recommendation

3.3 The Board recommends that NFO provide the Board with the signed Statement of Internal Control at the time of the issuance of the financial statements.

4. UNSUPPORTED BUDGETARY CREDITS CARRIED FORWARD

Reasoning

4.1 As per Article 25.3 of the NFRs, appropriated funds which have been committed, supported by a legal obligation, and for which goods and services have not yet been rendered by the end of the financial year shall be automatically carried forward to be used as soon as possible within the next two following financial years.

Observation

4.2 The Board found that NFO carried forward all the open commitments as at 31 December 2015 into 2016 without reviewing them to determine whether they should be lapsed. The total amount carried forward to 2016 was EUR 135,003. The detailed listing of these open items was requested by the Board but was not provided as of the date of this audit report. The Board noted that according to the 2016 NFO Budget Execution Statement the credits brought forward from 2015 was EUR 133,455, and at the end of 2016, EUR 52,048 of these credits were not used and lapsed.

Recommendation

4.3 The Board recommends that NFO review open commitments at year-end in order to determine whether to carry them forward to the next year or to lapse them.

5. MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**Reasoning**

5.1 The NFRs require the Financial Controller to exercise the responsibility of budgeting, accounting and reporting activities of the NATO entity. This includes being responsible for the financial internal control system established, and for the preparation of the financial statements in accordance with the NATO Accounting Framework.

Observations

5.2 The Board found the following material misstatements or unsupported balances:

- a) The detailed sub-ledger for payables does not reconcile with the balance reported in the Statement of Financial Position. This is made up of a number of differences which net to EUR 36,480. This is material for NFO. The Board made inquiries about these differences but NFO was not able to provide an explanation.
- b) The financial statements were issued without a foreign currency revaluation of monetary assets and liabilities. The Board was not able to quantify the impact on payables as the details of this account has not been fully available (see a) above); however the result of lack of foreign exchange revaluation is an understatement of cash by an amount of EUR 21,188 and an overstatement of receivables by EUR 46,820. Furthermore, Note 2 of the financial statements stated that monetary assets and liabilities at year-end which were denominated in foreign currencies were converted into EUR using the NATO rates of exchange that were applicable at 31 December 2015.

5.3 In addition, the Board also found the following errors in the financial statements:

- a) The project accumulated surplus was reported under Net Assets whereas it was reported under payables in 2014. This is a change in accounting policy and the reasons for it were not disclosed in the notes to the financial statements, which is required by the NATO Accounting Framework. The Board inquired as to the reasons for the change, but did not receive a reply (See also observation 1.3).
- b) An invoice from the NATO Communications and Information Agency for administration costs related to a project was not correctly recorded in 2015. As a result, expenses were understated and prepayments (asset) were overstated by EUR 9,470.
- c) In the Budget Execution Statement an amount of EUR 19,590 is shown as budget transfers within different chapters of 2014 budgetary credits brought forward to 2015 even though no transfer had occurred and it was just a result of a different classification in the new Enterprise Resource Planning system.
- d) In Note 2 to the financial statements, it was stated that NFO had no non-current liabilities. However, the Statement of Financial Position reported an amount of EUR 25,844 under non-current liabilities.
- e) The figures in the Cash Flow Statement did not reconcile with the balances in the Statement of Financial Position, as should be the case. For instance, the increase in payables was reported as EUR 4,390,377 in the Cash Flow Statement, whereas it was EUR 3,673,795 according to the Statement of Financial Position.

Recommendations

5.4 The Board recommends that NFO:

- a) Establish robust internal procedures which would define responsibilities, requirements and controls for the preparation of the financial statements in order to ensure that they are free of material misstatements and other errors or omissions.
- b) Present monetary assets and liabilities in currencies other than Euro in the financial statements after revaluation with official NATO exchange rates applicable at year-end.
- c) Report in the Statement of Financial Position only the assets and liabilities which are supported by appropriate evidence and to retain supporting documentation for audit purposes.

- d) Improve internal controls over financial reporting to ensure that all expenses are being recorded in the financial statements.

6. SIGNIFICANT DELAYS IN PROVIDING INFORMATION REQUIRED FOR THE AUDIT

Reasoning

6.1 The Board follows the International Standards of Supreme Audit Institutions (ISSAIs). ISSAI 1260, *Communications with those Charged with Governance*, requires the auditor to communicate significant difficulties encountered during the audit.

Observation

6.2 During the audit of the 2015 NFO Financial Statements, there were significant delays in the International Staff Office of Financial Control providing required information for the audit. Furthermore, some of the information requested was never received. This does not enable the Board to properly carry out its financial statement audits and resulted in significant delays reporting the results to the Council. This limits, in part, the usefulness of the financial statements.

Recommendation

6.3 The Board recommends that the IS Office of Financial Control provide required information to the Board in a timely manner. In order to meet the Board's deadlines, less flexibility will be provided in future audits.

7. EFFORT TO ACHIEVE COMPLIANCE WITH THE REVISED NATO FINANCIAL REGULATIONS, PARTICULARLY THOSE ARTICLES ON INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT

Reasoning

7.1 The North Atlantic Council (Council) approved the revised NFRs effective as from 4 May 2015. This was the first time in more than 30 years that the NFRs were revised. While Article 36 of the revised NFRs states that "the NFRs will take effect immediately (i.e. 4 May 2015)", Council also agreed that full implementation was only expected by the end of 2015. Furthermore, Article 4 of the revised NFRs states that "the finance committee shall approve a set of Financial Rules and Procedures (FRPs) that provide additional guidance to ensure the effective implementation of the revised NFRs."

7.2 The revised NFRs are more explicit than the previous version in the areas of Risk Management (Article 11), Internal Control (Article 12), Internal Audit (Article 13) and the establishment of an Audit Advisory Panel (Article 16). They require the establishment of effective, efficient and economical risk management procedures, that there are necessary

management functions in place to support effective internal control, and that NATO bodies have access to a permanent, adequately resourced, internal audit function that is compliant with internationally accepted Internal Auditing Standards. They also require the establishment of an Audit Advisory Panel. Article 25 authorises the commitment of budgetary credits for goods and services to be rendered during the financial year.

7.3 These revised NFRs provide an opportunity for NATO bodies to solidify and codify their overall internal control framework, including risk management. They also provide internal audit functions, whether in-house or outsourced, with clear expectations that they must be in a position to fully evaluate the effectiveness and efficiency of operations and internal controls, including risk management. Finally, the Council will ensure that the detailed FRPs are consistent, to the maximum extent possible, across NATO.

Observations

7.4 The Board found that NFO made limited progress towards achieving compliance with the revised NFRs.

7.5 This result, though, is not unexpected considering that the more detailed FRPs, which were required by Article 4 of the revised NFRs, were not approved until the end of February 2016. Furthermore, these changes to the NFRs are significant, and the Board understands that some time is needed to implement them properly. It is expected that in doing so will increase the likelihood that the benefits accruing to the NFO will be real, rather than just being an exercise to demonstrate compliance with the revised NFRs.

7.6 As a result, 2016 continues to be a transition year for the NFO. The Board expects compliance to be achieved in 2017. It has again chosen to report on the progress against certain of these revised Articles of the NFRs, and to make recommendations against that progress. The compliance audit opinion will not be impacted in 2016 as a result of these observations.

7.7 The Board reports the status of the following areas:

Article 11 Risk Management

7.7.1 The Board found that NFO had a risk management process, including risk registers, which focused on operational risks. Financial reporting and compliance risk management standards were not established yet. Therefore, NFO's risk register did not incorporate financial reporting and compliance risks.

Article 12 Internal Control

7.7.2 Article 12 of the NFRs requires a periodic assessment and review of the risk and the sound functioning of the internal control system. FRP XII 3) (e) requires the Statement on Internal Control to make a reference to the internal control framework used for the assessment.

7.7.3 The Board found that NFO had not yet formally adopted a specific Internal Control Framework to be used to assess the system of internal control in place as required by FRP XII. A number of other NATO bodies, including the Allied Command Operations, the Allied Command Transformation, the NATO Communications and Information Organisation, the NATO EF 2000 and Tornado Development, Production and Logistics Management Agency, and the NATO Airborne Early Warning and Control Programme Management Agency, have adopted the Committee of Sponsoring Organisations of the Treadway Commission (COSO) Framework. The adoption of a specific framework by these NATO bodies is an important step forward. It is essential in order to ensure and to clearly demonstrate to others that a complete system of internal control and risk management is in place. Until the NFO adopts a specific internal control framework, and completes its documentation and assessment of its internal control system against it, the Board will not be in a position to state that there is a full system of internal control in place that is in accordance with Article 12 of the revised NFRs.

Article 13 Internal Audit

7.7.4 The Board found that no internal audit activities were performed related to the NFO. As a result, it cannot yet be stated that the NFO undertook internal audit activities to fully evaluate, throughout the organisation, the risk exposures and the effectiveness of internal controls in managing risk within the governance, operations and information systems as required by Article 13.

Article 16 Audit Advisory Panel

7.7.5 The Board found that the Audit Advisory Panel of the International Staff also includes project offices, such as NFO, for which the International Staff exercises financial control. The first meeting of this panel took place in the last quarter of 2017.

Article 25 Commitments and Carry Forwards

7.7.6 Article 25.1 (a) of the NFRs states that on approval of supplementary budgets NATO Bodies are authorised to enter into commitments for goods and services to be rendered during the financial year. The Board found that budgetary credits that lapsed at the end of 2014 were used to fund a supplementary budget based on a pre-approval from the Steering Committee in November 2014. However, the Board found that the 2015 supplementary budget credits were also used to make commitments for goods and services to be rendered in future years.

Recommendations

7.8 The Board recommends that NFO:

- a) Ensure its risk management policy and risk registers include financial reporting and compliance risks.

- b) As required by FRP XII 3) (e), choose a specific internal control framework that it will use to assess its system of internal control. The assessment is required by Article 12 of the NFRs. Since other NATO entities have already adopted COSO as their internal control framework, and it is a framework that can be used by entities of all sizes, the NFO should consider adopting COSO as their internal control framework.
- c) In coordination with the IS, where applicable, begin the work of assessing and documenting the system of internal control and risk management procedures to support compliance with NFR Articles 11 and 12, FRPs XI and XII, and the internal control framework that it chooses.
- d) Through outsourcing if considered to be more cost effective, ensure internal audit activities are evaluating NFO risk management and internal control.
- e) Ensure that the supplementary budget credits are only used to enter into commitments for goods and services to be rendered during the financial year. Contract authority should be used for goods and services to be received in future years.

FOLLOW-UP OF PREVIOUS YEAR'S OBSERVATIONS

The Board reviewed the status of the observation and recommendation arising from the previous audit. The observation and its status are summarised in the table below.

OBSERVATION / RECOMMENDATION	ACTION TAKEN	STATUS
Audit Report FY 2014 IBA-AR(2015)18 para. 1.6 Weaknesses in The Financial Statement Preparation And Review Process Board's recommendation The Board recommends that the preparation, review and publication of the financial statements be completed by the required deadline of the NFRs.	The 2015 financial statements were only issued in July 2016, and without a Statement on Internal Control.	Observation Superseded by current year observation 2 and 3.
Audit Report FY 2014 IBA-AR(2015)18 para. 1.7 Weaknesses in the Financial Statement Preparation And Review Process Board's recommendation The Board recommends establishing robust internal procedures which would define responsibilities, requirements and controls for the preparation of the financial statements in order to ensure that they are free of any mathematical errors, non-reconciling items, or any other errors.	Material weaknesses in internal control over financial reporting remain. See current year observation 3.	Observation Superseded by current year observation 5.
Audit Report FY 2014 IBA-AR(2015)18 para. 2.3 Segregation of Duties – Bank Reconciliations Board's recommendation The Board recommends that a bank reconciliation report is prepared regularly, and not only at year-end. In addition, the NATO FORACS Office should ensure that the segregation of duties is adequate: bank reconciliations should be signed both by the preparer and the Head of Treasury (or deputy) as reviewer.	No monthly bank reconciliations have been done for 2015. Due to the implementation of the ERP system, reconciling differences remained outstanding unreconciled throughout 2015.	Observation Outstanding.
Audit Report FY 2013 IBA-AR(2014)23 para. 1.2 Accumulated surpluses Board's recommendation The Board recommends that NFO and the Steering Committee work to reduce the amount held in the supplementary budget reserve so it is in line with the amount approved.	The amount held in the supplementary budget reserve at 31 December 2015 was EUR 481,169, which is within the limit (20% of the combined operating budget) approved by Steering Committee.	Observation Superseded by current year observation 1.

**NATO FORACS STEERING COMMITTEE FORMAL COMMENTS ON THE
LETTER OF OBSERVATIONS AND RECOMMENDATIONS**

OBSERVATION 1: PARA 1.3

USE OF A MANAGEMENT RESERVE FUND NOT IN COMPLIANCE WITH THE NFRS

NATO FORACS Steering Committee's Formal Comment:

The Steering Committee notes the Board's recommendation. At the NATO FORACS Steering Committee meeting on 3 November 2017, the Committee reaffirmed that they consider the continued provision of an Operational Reserve to be essential to the operation of the FORACS Project, as they have for the past ten years. Application for a deviation from the revised NFRs will be sought.

OBSERVATION 2: PARA 2.3

LATE ISSUANCE OF FINANCIAL STATEMENTS

NATO FORACS Steering Committee's Formal Comment:

Agreed. The 2016 financial statements were issued on time.

OBSERVATION 3: PARA 3.3

NO ISSUANCE OF STATEMENT OF INTERNAL CONTROL

NATO FORACS Steering Committee's Formal Comment:

Agreed. The 2016 financial statements included a Statement of Internal Control.

OBSERVATION 4: PARA 4.3

UNSUPPORTED BUDGETARY CREDITS CARRIED FORWARD

NATO FORACS Steering Committee's Formal Comment:

Agreed. An end-of-year review process is in place. The situation was due to the learning curve in applying the new NFRs for what concerns commitment practices.

OBSERVATION 5: PARA 5.4

MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

NATO FORACS Steering Committee's Formal Comment:

Agreed.

OBSERVATION 6: PARA 6.3

SIGNIFICANT DELAYS IN PROVIDING INFORMATION REQUIRED FOR THE AUDIT

NATO FORACS Steering Committee's Formal Comment:

Agreed.

OBSERVATION 7: PARA 7.8

EFFORT TO ACHIEVE COMPLIANCE WITH THE REVISED NATO FINANCIAL REGULATIONS, PARTICULARLY THOSE ARTICLES ON INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT

NATO FORACS Steering Committee's Formal Comment:

The recommendations are agreed.

The operational risk matrix is formally reviewed biannually by the NATO FORACS Strategic Planning Group and approved annually by the NATO FORACS Steering Committee.

The NFO will formalize the adoption of COSO as its internal control framework.

For what concerns internal audit, NFO benefits directly from the IS internal audit activity since all the administrative, human, financial support it gets is provided by NATO-IS which is subject to internal audit by the IS Internal Audit Service. Other internal audit activities would have to take into account the cost benefit considering the relatively small size of the NFO budget.

**PREVIOUS YEAR'S OBSERVATIONS AND RECOMMENDATIONS
PARA 2.3 SEGREGATION OF DUTIES – BANK RECONCILIATIONS**

NATO FORACS Steering Committee's Formal Comment:

Agreed. The ERP automatically reconciles, on a daily basis, most cash transactions and provides an up-to-date report of unreconciled cash movements and their dates. IS staff conduct reconciliations between bank statements and the accounting system's cash management module. In addition, it is putting in place reconciliations at the level of General Ledger.

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FC(2016)086

NATO FORACS OFFICE
FINANCIAL STATEMENTS AS AT 31/12/2015
FINANCIAL YEAR 2015

Annexes :

- 1 Statement of financial position
- 2 Statement of financial performance
- 3 Cash flow statement
- 4 Changes in net assets
- 5 Budgetary operations 2015
- 6 Budgetary operations 2014
- 7 Explanatory notes to the financial statements

NATO UNCLASSIFIED

NATO FORACS OFFICE
STATEMENT OF FINANCIAL POSITION
As at 31 December 2015

(All amounts in Euro)				
	Notes	Current Year	Prior Year	Variance
		2015	2014	CY - PY
ASSETS				
CURRENT ASSETS				
Cash and Cash Equivalents	3 & 4	7,324,293.54	5,363,140.54	1,961,153.00
Short Term Investments	3	-	-	-
Receivables	5	1,134,199.98	367,600.19	766,599.79
Prepayments	6	11,969.58	13,724.06	-1,754.48
Other Current Assets	6	-	0.00	0.00
Inventories	7	-	-	-
Total Current Assets		8,470,463.10	5,744,464.79	2,725,998.31
NON CURRENT ASSETS				
Receivables	5	-	-	-
Property, Plant and Equipment	8	-	-	-
Other Non-current Assets	8	25,844.17	-	25,844.17
Total Non-Current Assets		25,844.17	-	25,844.17
TOTAL ASSETS		8,496,307.27	5,744,464.79	2,751,842.48
LIABILITIES				
Current Liabilities				
Payables	9	7,181,511.47	3,507,716.44	3,673,795.03
Deferred Revenue	10	-	78,977.47	- 78,977.47
Advances	11	760,577.60	781,623.20	- 21,045.60
Short Term Provisions	12	-	-	-
Other Current Liabilities	13	47,205.09	-	47,205.09
Total Current Liabilities		7,989,294.16	4,368,317.11	3,620,977.05
NON CURRENT ASSETS				
Long Term Provisions	14	0.00	0.00	0.00
Non Current Deferred Revenue	14	25,844.17	0.00	25,844.17
Other Non Current Liabilities	14	-	0.00	0.00
Total Non Current Assets		25,844.17	0.00	25,844.17
TOTAL LIABILITIES		8,015,138.33	4,368,317.11	3,646,821.22
NET ASSETS	15	481,168.94	1,376,147.68	-894,978.74

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ANNEX 2 to
FC(2016)086

NATO FORACS OFFICE
STATEMENT OF FINANCIAL PERFORMANCE
as at 31 December 2015
(All amounts in EUR)

	Notes	Current Year	Prior Year	Variance
		31-Dec-15	31-Dec-14	CY - PY
Revenue	11			
Revenue from non exchange transactions		884,893.59	874,018.96	10,874.63
Revenue from exchange transactions			0.00	0.00
Financial Revenue			6,336.72	-6,336.72
Other revenue			0.00	0.00
Total Revenue		884,893.59	880,355.68	-880,355.68
Expenses	12			
Wages, salaries and employee benefits		580,659.09	635,823.42	-55,164.33
Supplies and consumables used		304,234.50	238,195.54	66,038.96
Financial Costs			741.59	-741.59
Other expenses (to be reimbursed to nations)			5,595.13	-5,595.13
Total Expenses		884,893.59	880,355.68	-880,355.68
Surplus/Deficit for the period		0.00	0.00	0.00

NATO FORACS
Statement of Cash Flow
As at 31 December 2015

(All amounts in euros)

	2015	2014
Cash flow from operating activities	1,961,153.30	1,191,660.61
Surplus/(Deficit)		
Non-cash movements	0.00	0.00
Depreciation/ Amortisation		
Impairment		
Increase /(decrease) in payables	4,390,377.46	1,378,831.79
Increase/ (decrease) in other current liabilities	-1,664,441.57	156,068.02
Increase/ (decrease) in provisions		666.11
(Gains)/losses on sale of property, plant and equipment		
Increase/ (decrease) in other current assets	-24,089.69	13,525.94
Decrease/ (Increase) in receivables	-766,599.79	-357,431.25
Increase/ (decrease) in other NON current liabilities	25,906.89	
Net cash flow from operating activities	1,961,153.30	1,191,660.61
Cash flow from investing activities		
Purchase of property plant and equipment / Intangible assets	0.00	0.00
Proceeds from sale of property plant and equipment	0.00	0.00
Net cash flow from investing activities	0.00	0.00
Cash flow from financing activities	0.00	0.00
Net cash flow from financing activities	0.00	0.00
Net increase/(decrease) in cash and cash equivalents	1,961,153.30	1,191,660.61
Cash and cash equivalent at the beginning of the period	5,363,140.54	4,171,479.93
Cash and cash equivalent at the end of the period	7,324,293.54	5,363,140.54

NATO FORACS

STATEMENT OF CHANGES IN NET ASSETS AS AT 31/12/2015

(in EUR)

	Accumulated surpluses/(deficits)
Balance at 31 December 2014	1,376,147.88
Net gains (losses) recognized directly in net assets/equity	-894,978.94
Currency translation differences	0.00
Surplus on property revaluation	0.00
Surplus (deficit) for the period	0.00
Net for the period	-894,978.94
Balance at 31 December 2015	481,168.94

(1) fixed assets in progress

Statement of budget execution as at 31 December 2015

(amounts in euro)	Initial budget	Transfers	BA2	Transfers	BA3	Transfers	Final budget	Commitments	Expenses	Total spent	Carry forward	Lapsed
FORACS												
Chapter 1	2,654,033.00	-	2,654,033.00	-	2,654,033.00	-	2,654,033.00	123,067.47	592,967.55	716,035.02	-	1,937,997.98
Chapter 2	319,252.00	-	319,252.00	-	319,252.00	-	319,252.00	7,334.17	228,683.85	236,018.02	-	83,233.98
Chapter 3	2,000.00	-	2,000.00	-	2,000.00	-	2,000.00	-	-	-	-	2,000.00
Total FY 2015	2,975,285.00	-	2,975,285.00	-	2,975,285.00	-	2,975,285.00	130,401.64	821,651.40	952,053.04	-	2,023,231.96
FORACS												
Chapter 1	-	-	-	12,167.85	12,167.85	-	12,167.85	-	4,601.08	4,601.08	-	7,566.77
Chapter 2	53,917.89	-	53,917.89	7,422.15	61,340.04	-	61,340.04	4,601.51	58,641.11	63,242.62	-	(1,902.58)
Chapter 3	19,590.00	-	19,590.00	(19,590.00)	-	-	-	-	-	-	-	-
Total FY 2014	73,507.89	-	73,507.89	-	73,507.89	-	73,507.89	4,601.51	63,242.19	67,843.70	-	5,664.19
FORACS												
Chapter 1	-	-	-	-	-	-	-	-	-	-	-	-
Chapter 2	-	-	-	-	-	-	-	-	-	-	-	-
Chapter 3	-	-	-	-	-	-	-	-	-	-	-	-
Total FY 2013	-	-	-	-	-	-	-	-	-	-	-	-
Total all budgets	3,048,792.89	-	3,048,792.89	-	3,048,792.89	-	3,048,792.89	135,003.15	884,893.59	1,019,896.74	-	2,028,896.15

NATO FORACS OFFICE

BUDGETARY OPERATIONS FOR FINANCIAL YEAR 2014
(n = 2014)

(in EUR)

CHAPTER Article		BUDGET AUTHORISATIONS			COMMITMENTS	EXPENDITURES	BUDGETARY SURPLUS	
		BUDGET (ref.) NFO/R(2014)2	AUTHORIZED TRANSFERS	ADJUSTED CREDITS			Credits carried forward to n+1	Lapsed credits
		(1)	(2)	(3) = (1)+(2)	(4)	(5)	(6) = (4) - (5)	(7) = (3) - (4)
I.	PERSONNEL COSTS							
01.01	Basic salaries, allowances & recruit	623,500.00	0.00	623,500.00	592,478.34	592,478.34	0.00	31,021.66
01.02	Training	2,000.00	0.00	2,000.00	1,125.58	1,125.58	0.00	874.42
01.04	Administrative support	45,000.00	0.00	45,000.00	42,219.50	42,219.50	0.00	2,780.50
	Financial year n	670,500.00	0.00	670,500.00	635,823.42	635,823.42	0.00	34,676.58
	Carried forward:							
	Financial year n-1	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Financial year n-2	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		670,500.00	0.00	670,500.00	635,823.42	635,823.42	0.00	34,676.58
II.	COMMON OPERATING COSTS							
02.01	Transport on official duty	96,074.00	0.00	96,074.00	83,033.45	82,310.19	723.26	13,040.55
02.02	Office and computer supplies/ maintenance computer equipment	4,403.33	0.00	4,403.33	1,174.18	970.59	203.59	3,229.15
02.03	Communications	3,400.00	0.00	3,400.00	2,783.39	2,200.20	583.19	616.61
02.05	Buildings	25,050.00	0.00	25,050.00	23,548.71	23,548.71	0.00	1,501.29
02.06	Support of meetings	9,000.00	0.00	9,000.00	4,572.13	4,572.13	0.00	4,427.87
02.07	Library	250.00	0.00	250.00	174.86	174.86	0.00	75.14
02.09	Equipment and services	847,946.67	0.00	847,946.67	120,177.10	67,769.25	52,407.85	727,769.57
02.10	Cost of courses	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Financial year n	986,124.00	0.00	986,124.00	235,463.82	181,545.93	53,917.89	750,660.18
	Carried forward:							
	Financial year n-1	13,877.02	0.00	13,877.02	6,167.61	6,167.61	0.00	7,709.41
	Financial year n-2	252.29	0.00	252.29	0.00	0.00	0.00	252.29
		1,000,253.31	0.00	1,000,253.31	241,631.43	187,713.54	53,917.89	758,621.88
III.	CAPITAL COSTS							
03.03	Equipment	64,529.00	0.00	64,529.00	60,910.85	41,320.85	19,590.00	3,618.15
	Financial year n	64,529.00	0.00	64,529.00	60,910.85	41,320.85	19,590.00	3,618.15
	Carried forward:							
	Financial year n-1	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Financial year n-2	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		64,529.00	0.00	64,529.00	60,910.85	41,320.85	19,590.00	3,618.15
	GRAND TOTAL							
	Financial year n	1,721,153.00	0.00	1,721,153.00	932,198.09	858,690.20	73,507.89	788,954.91
	Carried forward:							
	Financial year n-1	13,877.02	0.00	13,877.02	6,167.61	6,167.61	0.00	7,709.41
	Financial year n-2	252.29	0.00	252.29	0.00	0.00	0.00	252.29
	GRAND TOTAL	1,735,282.31	0.00	1,735,282.31	938,365.70	864,857.81	73,507.89	796,916.61

**EXPLANATORY NOTES TO NATO FORACS OFFICE
2015 FINANCIAL STATEMENTS****NOTE 1: GENERAL INFORMATION**

FORACS' mission is to measure the bearing, range, position and heading accuracy of sensors and navigation systems and to provide communications systems and interoperability testing in surface ships, submarines and maritime aircraft to satisfy national requirements and to meet NATO material readiness standards.

The NATO FORACS Memorandum of Understanding was signed in 1974 by seven NATO nations: Denmark, Germany, Greece, Italy, Norway, the United Kingdom and the United States. In September 1994, Canada became the eighth signatory.

Three NATO FORACS (Naval Forces Sensor and Weapons Accuracy Check Sites) test ranges were authorized under the management of a NATO FORACS Steering Committee (NFSC).

NATO FORACS Office (NFO) was established at NATO Headquarters in January 1977. This office provides technical direction for the project, quality control over test procedures, and maintains a data bank of test results for national summary reports.

NATO FORACS Norway (NFN) began routine testing in 1978.

NATO FORACS Greece (NFG) was opened for routine operation in 1985.

In 1994 the US FORACS range at AUTECH (Atlantic Underwater Test and Evaluation Center) became an affiliated NATO FORACS test range called NATO FORACS AUTECH (NFA).

Nations maintain oversight of the project through the NATO FORACS Steering Committee. The Steering Committee executes its responsibility through an executive Project Manager at the NFO in Brussels.

Normal operations and maintenance of NATO FORACS activities are funded by the member nations on a cost-sharing basis. Non-member nations utilize the resources and capabilities based on a calculated 'day rate' for services. Fixed facilities and capital costs are commonly funded through the NATO Security Investment Programme (NSIP). NATO International Staff Financial Control provides accounting and budgeting for the NATO FORACS Office and handles annual calls to nations to fund operations for the Project.

These financial statements relate only to the NATO FORACS Office (NFO). The three NATO FORACS ranges (NFA, NFG and NFN) are responsible for executing their own budgets and issuing their own financial statements under their national budgeting and financial rules.

NATO FORACS conducts tests for eight Alliance nations in response to NATO's tasking to provide mission capable platforms. This testing also supports Nation's acquisition and upgrade programmes testing ship, submarine and maritime aircraft. Having systems in ships, submarines and maritime aircraft aligned and calibrated to the same common reference and to clearly defined accuracy standards aligns with the Connected Forces Initiative and improves interoperability of maritime systems within and between nations. In 2013, FORACS adopted a strategic tag line: *Operational Confidence Through Accuracy*

The NATO FORACS Project continues to demonstrate a quality management culture based on ISO 9001:2008 and in 2014 achieved recertification for a further three years. Routine internal and external annual audits took place in 2015.

NOTE 2: ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below.

Declaration of Conformity

The NFO financial statements have been prepared in accordance with NATO Financial Regulations (NFR), the Financial Rules and Procedures (FRP) and the NATO Accounting Framework, which is an adapted version of the International Public Sector Accounting Standards (IPSAS).

Basis of Preparation

These financial statements relate only to the NATO FORACS Office (NFO).

For 2014, the NFO financial statements were produced using a transformational method which consisted in making specific entries for accruals based on an analysis of the budgetary commitments carried-forward at year-end, in order to determine the expenditure in the statement of financial performance and the matching earned revenue from budgetary contributions. The transformations were required since the IS IT financial system, used by NFO up until 2014, was a budgetary driven system with a strong cash basis. It did not have an accrual based accounting functionality.

NFO transitioned to full transactional accrual accounting with the implementation of an integrated Enterprise Resource Planning (ERP) solution early 2015.

These financial statements have been prepared on a going-concern basis. The assumption is that NFO is a going concern and will continue in operation and meet its objectives and obligations for the foreseeable future.

The financial year is from 1 January to 31 December.

The amounts shown in these financial statements are presented in EUR

FORACS applied IPSAS 9 Revenue from exchange transactions and IPSAS 23 Revenue from non-exchange transactions.

The following IPSAS have no material effect on the 2015 NFO financial statements:

- IPSAS 5: Borrowing Costs
- IPSAS 6: Consolidated and Separate Financial Statements
- IPSAS 7: Investments in Associates.
- IPSAS 8: Interests in Joint Ventures
- IPSAS 10: Financial Reporting in Hyperinflationary Economies
- IPSAS 11: Construction Contracts
- IPSAS 16: Investment Property
- IPSAS 21: Impairment of non-cash generating assets
- IPSAS 26: Impairment of Cash-Generating Assets
- IPSAS 27: Agriculture
- IPSAS 32: Service Concession Arrangements: Grantor

Changes in accounting policy

As from reporting year 2015, the cash-flow statement is presented using the indirect method when in the past it was done using the direct method. This change was required in order to adopt the recommended common layout structure approved by NATO end 2015 (AC/335-N(2015)0088).

Below is the cash-flow statement concerning 2014 presented using the direct method.

		Note	2014
OPERATING ACTIVITIES			
RECEIPTS		13	
	Contributions		964,620.00
	Financial Revenue		10,362.42
	Others		121,461.64
	TOTAL		1,096,444.06
PAYMENTS		13	
	Personnel Costs		(582,531.70)
	Operating Costs		(274,562.37)
	Miscellaneous Payments		(282.64)
	Financial Costs		(867.96)
	TOTAL		(858,244.67)
NET CASH FLOW FROM OPERATING ACTIVITIES			238,199.39
INVESTING ACTIVITIES		13	0.00
RECEIPTS			0.00
PAYMENTS			0.00
NET CASH FLOW FROM INVESTING ACTIVITIES			0.00
FINANCIAL ACTIVITIES		13	
RECEIPTS			0.00
PAYMENTS			0.00
NET CASH FLOW FROM FINANCING ACTIVITIES			0.00
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS			238,199.39
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		1	2,637,031.48
CASH AND CASH EQUIVALENTS AT END OF PERIOD		1	2,875,230.87
CASH HELD FOR THIRD PARTIES		13	
RECEIPTS			4,826,598.05
PAYMENTS			(3,873,136.84)
NET INCREASE (DECREASE) IN CASH HELD FOR THIRD PARTIES			953,461.22
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		1	1,534,448.45
CASH AND CASH EQUIVALENTS AT END OF PERIOD		1	2,487,909.67

Reclassification of Financial Statements of Previous Years

A reclassification of elements of the statement of financial position and of the budget execution report were required in order to adopt the recommended common layout structure approved by NATO end 2015 (AC/335-N(2015)0088). This reclassification did not result in any material change in the presentation and major accounting classes are not affected.

Use of Estimates

In accordance with generally accepted accounting principles, the financial statements include amounts based on estimates and assumptions by management, according to the most reliable

information available, judgement and assumptions. Estimates include accrued revenue and expenses. Actual results could differ from those estimates. Changes in estimates are reflected in the period in which they become known.

Foreign Currency Transactions

The NFO's budget is authorized and managed in EUR so the contribution calls are made in EUR. Foreign currency transactions as required are accounted for at the NATO exchange rates prevailing on the date of the transactions. Monetary assets and liabilities at year-end which were denominated in foreign currencies were converted into EUR using the NATO rates of exchange that were applicable at 31 December 2015.

Realised and unrealised gains and losses resulting from the settlement of such transactions and from the revaluation at the reporting dates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Financial Performance.

NFO does not have any unrealised gains or losses resulting from the translation of statements.

Financial Risks

NFO uses only non-derivative financial instruments as part of its normal operations. These financial instruments include cash, bank accounts and deposit accounts.

All the financial instruments are recognised in the statement of financial position at their fair value.

The organisation is exposed to a variety of financial risks, including foreign exchange risk, credit risk, currency risk, liquidity risk and interest rate risk.

a. Foreign currency exchange risk

The exposure to foreign currency risk is limited as the vast majority of NFO's expenditures are made in EUR, the currency of its budget. The current bank accounts are held in EUR.

b. Credit risk

NFO incurs credit risks from cash and cash equivalent held with banks and from receivables.

The maximum exposure as at 31 December 2015 is equal to the total amount of bank balances, short term deposits and receivables. There is very limited credit risk associated with the realization of these elements.

Concerning cash and cash equivalent NFO credit risk is managed by holding current bank accounts and short term highly liquid deposits that are readily convertible to a known amount of cash held with ING Bank (Belgium) which has the following short term credit ratings:

ING Bank	Credit Ratings as at 29/03/2016		
	Fitch	Moody's	S&P
Short term	F1	P1	A1

The NFO outstanding accounts receivable are managed by maintaining control procedures over receivables. Most cash receivables are due from NATO member nations, which are considered credit worthy.

c. Liquidity risk

The liquidity risk, also referred to as funding risk, is based on the assessment as to whether the Organisation will encounter difficulties in meeting its obligations associated with financial liabilities. A liquidity risk could arise from a short term liquidity requirement. There is a very limited exposure to liquidity risk because of the funding mechanism which guarantees contributions in relation to the approved budgets. Some limited risk could be due to the inaccuracy of budget forecasts. However, past history shows that this process results in surpluses and the budgetary rules provide for revised budgets.

d. Interest rate risk

Except for certain cash and cash equivalent balances, NFO's financial assets and liabilities do not have associated interest rates. NFO is restricted from entering into borrowings and investments, and, therefore, there is an insignificant interest rate risk. Interest earned is not a budgetary resource but contributes to the surplus owed to Nations.

Current Assets

a. Cash and cash equivalents

Cash and cash equivalents are defined as short-term assets. They include cash in hand, deposits held with banks, and other short term highly liquid investments.

b. Funds managed for third parties

Funds managed on behalf of third parties are held in cash and are presented as a liability. They are accounted for when cash is effectively received. They are represented as a separate item in the cash flow statement of the entity in order to avoid any confusion.

c. Receivables

Receivables are stated at net realisable value, after provision for doubtful and uncollectible debts.

Contributions receivable are recognised when a call for contribution has been issued to the funding nations. No allowance for loss is recorded with respect to Member countries' assessed contributions receivable.

d. Prepayments

A prepayment is a payment in advance of the period to which it pertains and is mainly in respect of an advance payment made to a third party.

e. Inventories

As mentioned above, NATO's adaptations of IPSAS were spelled out in C-M(2013)0039 of July 2013, which included IPSAS 12 Inventories. It is described as follows:

Control of NATO Inventories was refined with a set of 10 criteria to be used in assessing the level of control of an asset. A positive response on six of the criteria will lead to the asset being capitalised in the Financial Statements if it is above the capitalisation threshold. This is applied from January, 2013.

Criteria that may indicate control of an asset
The act of purchasing the asset carried out (or resulted from instructions given) by the NATO Reporting Entity.
The legal title is in the name of the NATO Reporting Entity.
The asset is physically located on the premises or locations used by the NATO Reporting Entity.
The asset is physically used by staff employed by the NATO Reporting Entity or staff working under the NATO Reporting Entity's instructions.
The fact that the NATO Reporting Entity can decide on an alternative use of the asset.
The fact that the NATO Reporting Entity can decide to sell or to dispose the asset.
The fact that the NATO Reporting Entity, if it has to remove or destroy the asset, can take the decision to replace it.
The fact that a representative of the NATO Reporting Entity regularly inspects the asset to determine its current condition.
The fact that the asset is used in achieving the objectives of the NATO Reporting Entity.
The fact that the asset will be retained by the NATO Reporting Entity at the end of the activity.

Capitalisation thresholds relevant to the financial statement are as follow:

Category	Threshold	Basis
Consumables	€50,000	Per location/warehouse
Spare Parts	€50,000	Per location/warehouse
Ammunition	€50,000	Per location/warehouse
Strategic stocks	€50,000	Per location/warehouse

Slow moving inventory – Assuming turnover of stock is over a 12 month period, any items not used over a 36 month period will be deemed to be slow moving.

Strategic stock – Some complex elements of slow moving stock can be identified as strategic if they are deemed essential to the effective operation of an asset and cannot be readily replaced by commercial off the shelf items or cannot be purchased due to market decisions to close production lines of key inventory items due to the advanced age of the strategic asset to which the stock relates

NFO will capitalise inventory which it controls in its financial statements. Where there is a conflict between more than one NATO Reporting Entity as to the control of inventory, only the end-user entity will report the inventory in its financial statements, based on reliable information provided by the NATO services provider entity as defined in individual agreements between the two entities.

NFO will include transportation costs involved in bringing the inventories to their present location and condition in the initial valuation of inventory. These costs will be measured on the actual cost of transportation per item of inventory or by using an apportionment of the global transportation costs of bringing the inventories to their present location and condition across all inventory items in the period. Transportation costs involved in the subsequent movement of inventory which brings them into operational use will not be included in the value of inventory. The method of measuring these costs will be disclosed.

NFO may consider inventory acquired prior to 1 January 2013 as fully expensed.

For inventory held prior to 1 January 2013, and not previously recognized as an asset, NFO will provide a brief description of inventory held within their inventory recording systems in the notes to the financial statements. Such disclosure will include as a minimum the types of inventories held, locations where inventories are held and the approximate number of items held per asset category.

Where this adaptation conflicts with another requirement of IPSAS this adaptation shall apply. For the remainder, IPSAS 12 shall apply.

NFO assesses inventories under IPSAS 12. The outcome of this assessment is that the value of the inventories is immaterial both in value and in terms of the nature of the items held. Consequently, inventory is fully expensed on receipt. The materiality will be assessed each year.

In consideration of the above thresholds, the NFO currently has no inventory.

Non-Current Assets - Fixed Assets (Property, Plant & Equipment)

a. Property, Plant & Equipment

In February of 2013 Council decided to adapt a number of IPSAS standards to better suit the specific requirements of the Alliance (C-M(2013)0006). The adaptations were spelled out in C-M(2013)0039 of July 2013, among which were specific items addressing IPSAS 17 PPE.

Control of NATO PPE was refined with a set of 10 criteria to be used in assessing the level of control of an asset. A positive response on six of the criteria will lead to the asset being capitalised in the Financial Statements if it is above the capitalisation threshold. This is applied from January, 2013.

Capitalisation thresholds relevant to the financial statement are as follow:

Category	Threshold	Depreciation life	Method
Land	€200,000	N/A	N/A
Buildings	€200,000	40 years	Straight line
Other infrastructure	€200,000	40 years	Straight line
Installed equipment	€ 30,000	10 years	Straight line
Machinery	€ 30,000	10 years	Straight line
Vehicles	€ 10,000	5 years	Straight line
Aircraft	€200,000	Dependent on type	Straight line
Vessels	€200,000	Dependent on type	Straight line
Mission equipment	€ 50,000	3 years	Straight line
Furniture	€ 30,000	10 years	Straight line
Communications	€ 50,000	3 years	Straight line
Automated information systems	€ 50,000	3 years	Straight line

NATO FORACS considers PPE acquired prior to 1 January 2013 as fully expensed. However, existing accounting policies will continue to be applied for any PPE assets already capitalized prior to 1 January 2013. For PPE upgraded after 1 January 2013, only the portion related to the modification will be capitalized.

In consideration of the above thresholds, the NFO currently has no PPE.

b. Intangible assets

As mentioned above, NATO's adaptations of IPSAS were spelled out in C-M(2013)0039 of July 2013, which included IPSAS 31 Intangible Assets. It is described as follows:

Control of NATO Intangible Assets was refined with a set of 10 criteria to be used in assessing the level of control of an asset – they are the same as mentioned above under Inventory. A positive response on six of the criteria will lead to the asset being capitalised in the Financial Statements if it is above the capitalisation threshold. This is applied from January, 2013.

NATO Intangible Assets Capitalisation Thresholds - the NATO FORACS will capitalise each intangible asset item above the following agreed NATO thresholds:

Category	Threshold	Depreciation life	Method
Computer software (commercial off the shelf)	€50,000	4 years	Straight line
Computer software (bespoke)	€50,000	10 years	Straight line
Computer database	€50,000	4 years	Straight line
Integrated system	€50,000	4 years	Straight line

FORACS will capitalise all controlled intangible assets above the NATO Intangible Asset Capitalisation Threshold. For anything below the threshold, the NATO FORACS will have the flexibility to expense specific items.

FORACS will capitalise integrated systems and include research, development, implementation and can include both software and hardware elements. But FORACS will not capitalise the following types of intangible assets in their financial statements:

- rights of use (air, land and water);
- landing rights;
- airport gates and slots;
- historical documents; and,
- publications

FORACS will capitalise other types of intangible assets acquired after 1 January 2013 including:

- Copyright
- Intellectual Property Rights
- Software development

FORACS may consider Intangible Assets acquired prior to 1 January 2013 as fully expensed.

FORACS will report controlled Intangible assets in its financial statements. Where there is a conflict between more than one NATO Reporting Entity as to the control of intangible assets, only the end-use entity will capitalise the intangible asset in its financial statements based on reliable information provided by the NATO services provider entity as defined in individual agreements between the two entities.

For intangible assets held prior to the 1 January 2013, and not previously recognized as an asset, FORACS will provide a brief description of intangible assets held in its intangible asset recording systems in the notes to the financial statements. Such disclosure will include as a minimum the types of intangible held, locations where intangible assets are held and the approximate number of items held per asset category.

If an intangible asset is upgraded after 1 January 2013, only the portion related to the modification will be capitalised.

Where this adaptation conflicts with another requirement of IPSAS this adaptation will apply. For the remainder, IPSAS 31 shall apply. This adaptation is effective for financial reporting periods beginning on 1 January 2013.

In 2015, the NFO has initiated a replacement of a software required for its operations.

Current Liabilities

a. Payables

Payables are amounts due to third parties, based on goods received or services provided that remain unpaid. These include estimates of accrued obligations to third parties for goods and services received but not yet invoiced.

b. Advances and unearned revenue

Advances are contributions received related to future year's budgets. Funds are called in advance of their need because NFO has no capital that would allow it to pre-finance any of its activities.

Unearned revenue represents participating nations contributions which have been called for current budgets but that have not yet been recognised as revenue in the absence of any related budgetary expenditure.

Non-Current Liabilities

The NFO has no non-current liabilities.

Revenue Recognition

Revenue comprises contributions from Member Nations and amounts due by beneficiaries of services provided by the FORACS ranges.

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. The balance of unspent contributions and other revenues that relate to future periods are deferred accordingly.

Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the entity recognises a liability until the condition is fulfilled.

Contributions to be called from Member nations, based on the budget they approved, are initially recorded as unearned revenue liabilities. They are recognised as revenue in the statement of financial performance when such contributions are used for their intended purpose as envisioned in the approved Budget.

Transformational adjustments were made in calculating earned revenue and expenses in the Statement of Financial Performance.

Segment Reporting

A segment is a distinguishable activity or group of activities for which it is appropriate to separately report financial information. There is no segment in NFO.

Statement of Financial Position**NOTE 3: CASH AND CASH EQUIVALENTS**

The current bank accounts are held in EUR. Deposits are held in interest-bearing bank accounts, immediately available.

Considering the various interest rates paid on the various types of bank accounts, all funds were placed in current accounts as of 31 December 2015.

NOTE 4: FUNDS MANAGED FOR THIRD PARTIES

The NATO-IS Office of Financial Control holds funds, in cash, contributed to the NFG, NFA and, since 2013, NFN budgets. These bank accounts are controlled by NFO, thus the closing balances are reported in the NFO's financial statements. Upon request of the Range Managers, funds are transferred to the Greek, US and Norwegian officials respectively, under the supervision of the Range Managers to execute their budget following their national rules. The breakdown is as follows.

in EUR	2015	2014
NFG	666,265.99	569,446.39
NFA	1,702,569.04	1,004,121.65
NFN	1,891,150.86	914,341.63
TOTAL	4,259,985.89	2,487,909.67

NOTE 5: ACCOUNTS RECEIVABLE

Contributions receivable are funds requested from the nations to finance the 2015 and 2016 Budgets. The call for contribution was issued on 14 July 2015. As directed by the Steering Committee, the call includes approximately 20% of the current year's budget credits and an advance of approximately 80% for next financial year.

No outstanding receivables relating to previous financial years on budget contribution calls are reported. All outstanding receivables related to budgetary contributions from NFO member Nations were collected at the time of issuance of these financial statements.

This item also includes amounts to be regularised in relation to the process by which excess budgetary funds of the other ranges are transferred to NFO.

NOTE 6: PREPAYMENTS

Correspond to services to be delivered in the following year.

NOTE 7: INVENTORIES

Nothing to report, inventories are not considered material.

NOTE 8: NON CURRENT ASSETS

End 2015, a contract was signed with the NATO Communications and Information Agency in order to replace, by end 2018, the IT system used by FORACS for its operations in a total amount of EUR 1,558,500. The value of service received by end 2015 was estimated at EUR 25,884.17.

NOTE 9: ACCOUNTS PAYABLES

Payables and accrued expenses may be to commercial suppliers, staff, other NATO bodies, FORACS member Nations or other FORACS entities.

Payable to suppliers relates to goods and services for which an invoice has been received, checked, and queued for payment but for which payment was still pending at year-end.

Accrued expenses correspond to the estimated accrual obligation to third parties for goods and services received but not yet invoiced.

Payable to Nations

A payable of EUR 174,028.42 is in relation to reimbursable salaries and represents the amount due to the United States (US) for a civilian staff member who was previously employed by FORACS but paid directly by the US government. This amount payable is usually applied by the US against the US' annual contribution to NFO.

An amount of EUR 2,023,231.96 corresponding to 2015 lapsed credits (EUR 796,916.61 end 2014) were payables to FORACS member Nations. Up to now, the standard practice of the FORACS Steering Committee has been to use these amounts to fund the NFO supplementary budget or to add them to the Project Accumulated Surplus (see note on Net Assets). High level amounts lapsed in 2015 in relation to the impact of the new NATO financial regulations (see Note on Budget Execution).

Payable to other FORACS entities

Payables to NFG, NFA and NFN are amounts called by the NATO-IS Office of Financial Control to finance the related ranges.

NOTE 10: DEFERRED REVENUE**Unearned Revenue**

Unearned revenue corresponds to contributions called for the current year budget (received or receivable) but for which corresponding expenditures will be incurred after the reporting date of 31 December 2015. They include principally those amounts of contributions which will be spent in subsequent years on the NFO Budget. If the funds are not spent by the end of the second year following the year in which they have been approved, these funds may be kept and used an additional year.

NOTE 11: ADVANCES

Advances called amounting to EUR 760,577.60 relate to funding the NFO 2016 budget (FC(CC)(2015)0009(FOR-01)).

NOTE 12: SHORT TERM PROVISIONS

There are no short term provisions.

NOTE 13: OTHER CURRENT LIABILITIES

For 2015, these consist essentially of transactions relating to NFO and funded and allocated in accordance with its budget but which were executed in the NATO International Staff accounts during 2015. Therefore they were treated as inter entity transactions, as both these NATO entities are controlled by the OFC accounting system (automatically picked-up by the ERP). These transactions are pending regularisation.

NOTE 14: NON CURRENT LIABILITIES AND LONG TERM UNEARNED REVENUE

The long term unearned revenue is unearned revenue in relation to net carrying amounts of Property, Plant and Equipment and intangible assets. Revenue is recognised over the estimated life cycle of the Property, plant and equipment and the intangible assets.

NOTE 15: NET ASSETS

Net Assets correspond to FORACS' Project Accumulated Surplus.

Project Accumulated Surplus relates to funds held at the direction of the Steering Committee essentially in the case of emergency funding needs for the Project and also for reallocation among NATO FORACS entities when the Steering Committee approves their supplementary budgets. It originates from previous years' budgetary and financial operations of the various NATO FORACS entities. A substantial proportion of the Project Accumulated Surplus will be used to fund the upgrade of the IT system used by FORACS for its operations.

Statement of Financial Performance

NOTE 16: REVENUE

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. The non-exchange revenue is matched with the expenses stemming from budget execution. The revenue related to the NFO Budget that has been recognised in 2014 relates directly to the expenses: the total revenue is matched with the total expenses recognised in 2014.

Contributions, when called, are booked as an Unearned Revenue and subsequently recognized as Revenue when it is earned.

NOTE 17: EXPENSES

Wages, Salaries and Employee Benefits

The personnel costs include all civilian personnel expenses as well as other non salary related expenses, in support of funded activities. They also include expenses for salaries and emoluments for approved NATO permanent civilian positions and temporary personnel, for other salary related and non related allowances including overtime, medical examinations, recruitment, installation and removal, and for contracted consultants and training.

Supplies and Consumables Used

This item also includes expenses attributed to Capital Expenses from a budget perspective, if they do not meet the criteria of PPE or Intangible Assets.

NOTE 18: BUDGET INFORMATION**NATO FORACS Budget**

Presently, the NATO FORACS Budgets are not publicly available.

The actual amounts referred to by IPSAS 24 ("amounts that result from execution of the budget") are considered to be the commitment of credits.

Presentation of budget information in the financial statements

The NFO budget classification is based on the economic nature of the expenses broken down into three chapters as follows:

Chapter I : Personnel Expenses
Chapter II: Operating Expenses
Chapter III : Capital Costs

The NFO Budget is prepared for the same period (1 January to 31 December) and encompasses the same entity as these financial statements.

Changes to the budgetary regulations were introduced by the North Atlantic Council in 2015 in approving a new set of NATO Financial Regulations. The new NATO Financial Regulations were made applicable to the 2015 budget year as from 1 May 2015. They have in particular instilled an accruals based approach to budget preparation and budget execution, whereas before the approach was largely commitment and cash based. As a consequence, it is not possible to compare the budget executions of 2014 and 2015, since the underlying concepts differ. It has not been possible to restate the 2014 budget execution in order to make it comparable.

The budget execution for 2015 may contain flaws since (a) the budget was prepared and approved in 2014 before the new Financial Regulations were formally approved and (b) two sets of regulations were in force during 2015, with the new ones as from 1 May 2015. In addition, commitments that were carried-forward from previous years into 2015 had been approved and were executed in accordance with the old rules.

Up until 2014, the budget and accounting bases differed. The 2015 NFO Budget was prepared and executed on a commitment basis; it was not fully prepared on an accrual basis. As from 2016, these differences should become smaller, with 2015 being a transition year.

The NFO budget is prepared and executed as follows:

- 1) The commitment of credits is the advance acceptance and recording of the financial consequence resulting from a legal obligation incurred during the financial year. As a consequence credits are allocated, and commitments are approved, for goods, services and works to be delivered at a later stage. Up until 2014, commitments have been settled when an invoice is presented for payment, and not when the service is rendered or goods delivered as is the case for expenses under accrual accounting and with the new NATO Financial Regulations. Commitments of appropriations are now supposed to correspond to services or goods to be received in the course of the year.
- 2) Unliquidated commitments are carried forward and added to the budget of the following financial year in relation to an existing legal commitment or if a special agreement is given

by the Steering Committee. Under the previous financial rules, unliquidated commitments would correspond to the amounts remaining to be paid. Under the new regulations they would correspond to services not received or goods not delivered, at year-end, for specific circumstances, and should therefore normally be equal to zero. Outstanding commitments can be carried forward for two years. As a consequence, the services or goods received may relate to a commitment of credits from previous years' budgets. Whereas the previous Financial Regulations allowed for an almost automatic carry-forward of credits provided a contract was signed, with the new Regulations the carry-forward should be justified by a reason for which the services or goods could not be received in the course of the year. As a consequence, carried-forward credits herein follow two different rules.

- 3) Commitments, because they are an advance acceptance, and because payments cannot be made above approved credit levels, typically include an estimation factor and are (if only slightly) higher than the actual amount eventually paid. This results in commitments being higher than the actual expenses and in credits eventually lapsing.
- 4) Commitments are only made in respect of future payments (old rules) or expenses (new rules) relating to the initial purpose of the commitment. Commitments for capital expenditures are normally made in the year during which the purchase order is issued. In accrual accounting, the related costs would not appear in the Statement of Financial Performance but in the Balance Sheet and only upon reception of the works, goods or services. Conversely, there is no budgetary commitment of credits for non-cash flow transactions such as capital depreciation or provisions which would normally appear in the Statement of Financial Performance under accrual accounting.
- 5) On an exceptional basis, the FORACS Steering Committee may approve the carry-forward of credits without any prior legal commitment, for instance for projects at their initiation stage or planned expenditures. In accrual accounting there would be no expense recorded.
- 6) The balance of unused budgetary credits (not committed) lapses and is returned to Member Nations at year-end. Lapses may include cases where a project was eventually not completed or started, and therefore lead to no expense.

Outstanding commitments can be carried forward during two years.

Budget approval

The way in which NFO deals with budget approvals is as follows. Every year, a basic budget is requested in order to provide contributors with a stable level of contribution and a significant amount is planned for under the supplementary budget.

The 2015 NFO Budget authorization was initially approved at 977,029.00 (BA1 in the Table at Annex 5). A supplementary budget was approved in the amount of EUR 1,998,256.00, bringing the total 2015 NFO budget to EUR 2,975,285.00 (BA2 in the Table at Annex 5). In 2015, the supplementary budget usage was projected to cover mainly the development of specific software.

Budget execution

The NFO 2015 and 2014 budget execution is shown at Annex 5 and Annex 6 respectively, which compares the budget's authorized credits and the actual amounts committed and expended.

As a consequence of the new Financial Regulations a high amount of credits lapsed because the budget included the full estimated cost of the IT software update, which is a several years project. Related funds could not be carried forward in accordance with the principle of the new financial regulations according to which commitments should correspond to services or goods received (economic benefits) by the NATO entity in the course of the budget year.

Credits are transferred under the authority delegated to the NATO-IS Financial Controller by the NATO Financial Regulations and Financial Rules and Procedures.

No transfers were required during the execution of the 2015 NFO budget. The changes that appear concerning the credits carried forward from 2014 are due to a change in the chart of accounts which resulted in different breakdown of credits across chapters and is a matter of classification.

Reconciliation between Budget and Calls for Contributions

The funding of the budget is made of an advance call and a call for contributions, carried over credits, the previous year's surplus, and on occasion a contribution from the Project's Accumulated Surplus and/or a transfer from another FORACS entity.

One call for contributions is issued every year which includes an advance concerning the budget of the following year and the remainder concerning the current year's budget (i.e. current year budget minus advance called during the previous year and any other adjustments among the FORACS entities).

On 19 August 2014, an advance on the 2015 budget was called in an amount of EUR 781,623.20 (FC(CC)(2014)0009(FOR-01)). The 2015 call for contribution was issued on 14 July 2015 (FC(CC)(2015)0009(FOR-01)). As directed by the Steering Committee, this call included EUR 195,405.80 to provide the complement to the advance call issued in 2014, in order to fund the 2015 initial budget approved at EUR 977,029.00, and an advance on the 2016 budget in the amount of EUR 760,577.60.

The remainder of total budget for the 2015 annual budget was financed by the refundable surplus reported from 2014 (EUR 802,511.00), from the Project's Accumulated Surplus (EUR 1,053,186.00) and from a transfer from among the other FORACS entities (EUR 142,559.00).

The table below reconciles the approved budget and the sources of funding.

amounts in EUR	2015
Initial Budget	977,029.00
Supplementary Budget	1,998,256.00
Total Annual Budget	2,975,285.00
Advance called previous year	781,623.20
Call in current year	195,405.80
Total Cash Calls	977,029.00
Use of Previous Year's Surplus	802,511.00
Use of Project Accumulated Surplus	1,053,186.00
Transfer from other FORACS entities	142,559.00
Other Funding Sources	1,998,256.00
Total Funding	2,975,285.00

NOTE 19: WRITE-OFFS

Nothing to report.

NOTE 20: LEASES

NFO does not have any financial leases.

NOTE 21: RESTRICTIONS ON FIXED ASSETS

There are no restrictions on fixed assets.

NOTE 22: CONTINGENT LIABILITIES

There have been no contingent liabilities identified that would be expected to result in a material obligation.

NOTE 23: CONTINGENT ASSETS

Nothing to report.

NOTE 24: EMPLOYEE DISCLOSURE

Accounting for employee benefits is accounting for any liability in relation to all forms of consideration given by an entity in exchange of service rendered by employees.

It should be noted that the NATO-IS is managing centrally three pension programs, namely the Defined Benefit Pension Scheme (DBS), the Provident Fund and the Defined Contribution Pension Scheme (DCPS) as well as the Retiree Medical Claims Fund (RMCF), covering staff employed by all NATO bodies. NATO wide financial statements are issued by NATO-IS Office of Financial Control for the three Pension Schemes and the RMCF, therefore, no related assets or liabilities are recognised in these financial statements.

At December 31, 2015, NFO had an approved Personnel Establishment of 4 positions funded by the FORACS budget (4 at year-end 2014).

At December 31, 2015 two staff members participated in the Defined Contribution Pension Scheme (DCPS) administered by NATO. The DCPS provides that the NFO budget makes a 12 percent monthly matching contribution to the staff members' contributions for current service. Two other employees participated in NATO's Defined Benefit Pension Scheme (DBPS): a deduction of 9.5% of their salaries is made and contributed to the annual financing of this Plan. In addition, the NFO budget makes a monthly matching contribution of 19% to the DBPS. Consequently, the NFO has neither DBPS nor DCPS liabilities for its staff members. These contributions are expensed during the year in which the services are rendered and represent the total pension obligation of the entity.

Contributions to the NATO pension schemes:

amounts in EUR	2015		
	Staff	Employer	Total
Co-ordinated Pension Scheme	16,225.08	32,450.16	48,675.24
Defined Contribution Pension Scheme	20,681.34	23,411.97	44,093.31
TOTAL	36,906.42	55,862.13	92,768.55

Untaken leave by NFO staff is not considered material.

NOTE 25: KEY MANAGEMENT PERSONNEL AND RELATED PARTIES

The NATO FORACS Steering Committee (one representative per member nation) is the governing body of the NFO and of the NFG, NFN and NFA. Therefore for the purpose of IPSAS 20 the latter are considered related parties. Steering Committee members are nominated by their respective National Authorities. They are paid on the basis of applicable National pay scales. The Steering Committee members do not receive from NATO any additional remuneration for Steering Committee responsibilities or access to benefits.

The key management personnel of the NFO consists of the Project Manager. The Project Manager is responsible for the overall operational management of FORACS. The Project Manager reviews the three range's budgets, proposed by the range managers, and proposes all four budgets to the Steering Committee for approval. The three sites are managed operationally by range managers, each nominated by the participating nation where the site is located.

During part of 2014, the NFO Project Manager's salary was paid by the US using national salary scales under reimbursable procedures agreed at the NATO wide level, by which the US is reimbursed the costs corresponding to the grade of Project Manager established post (A5)

There are no other remuneration or benefits to key management personnel or their family members.

NOTE 26: RELATED PARTIES

In reviewing the four budgets on an annual basis, the Steering Committee determines the budgetary credits for the initial and the supplementary budgets. It is in this context that funds are called and held in cash or cash equivalents by the NATO-IS Office of Financial Control to finance three other NATO FORACS budgets, namely NATO FORACS Greece, NATO FORACS AUTEK and NATO FORACS Norway. For more effective cash management purposes, the Steering Committee approved the call procedure whereby funds pertaining to NFG, NFA and NFN are transferred into accounts at NATO Headquarters. These bank accounts are controlled by NFO, thus the closing balances are reported in the NFO's financial statements. Upon request of the Range Managers, funds are transferred to the Greek, US and Norwegian officials respectively, under the supervision of the Range Managers to execute their budget following their national rules.

The surplus of the various NATO FORACS entities is held at NATO HQ on NFO bank account and used by the Steering Committee for reallocation when their supplementary budgets are approved. These funds are not controlled by the NFO Project Manager. This information is provided to the Steering Committee to enable it to implement its supplementary budget authorisations.

Key management personnel have no significant party relationships that could affect the operation of the NATO FORACS Office.

In 2015, NATO International Staff charged NFO an amount of EUR 43,031 for administrative support costs (EUR 42,219.50 in 2014) and EUR 10,432.05 for common operating costs (EUR 10,579.64 in 2014). In addition, the International Staff charges annual rent for office space occupied in Building Z (EUR 12,969.07 in 2015 and 2014).

* * * * *

List of acronyms:

AUTEC	Atlantic Underwater Test and Evaluation Center
BC	Budget Committee
DI	Defence Investment Division (NATO International Staff)
FORACS	Naval Forces Sensor and Weapon Accuracy Check Sites
IPSAS	International Public Sector Accounting Standards
IS	International Staff
MOU	Memorandum of Understanding
NCIA	NATO Communication and Information Agency
NSPA	NATO Support Agency
NNAG	NATO Naval Armaments Group
NFA	NATO FORACS AUTEC
NFG	NATO FORACS Greece
NFN	NATO FORACS Norway
NFO	NATO FORACS Office
NFSC	NATO FORACS Steering Committee
PPE	Property, Plant and Equipment

**Summary Note for Council
by the International Board of Auditors for NATO (Board)
on the audit of the Financial Statements of the NATO FORACS Office
for the year ended 31 December 2016**

The NATO Naval Forces Sensors and Weapon Accuracy Check Sites (NATO FORACS) provide a comprehensive calibration of sensors associated with the weapon systems of NATO naval units such as surface ships, submarines and anti-submarines helicopters. These tests are conducted at three FORACS ranges under the jurisdiction of Norway (NFN), Greece (NFG), and the United States (NFA).

The overall management of the programme is the responsibility of the FORACS Steering Committee. The NATO FORACS Office is located at the NATO Headquarters in Brussels and serves as the executive staff of the Steering Committee. The NATO FORACS Office budget for 2016 (including brought forward) amounted to EUR 3.08 million while budget expenses amounted to EUR 1.78 million.

During the audit, the Board identified three observations. The main findings are listed below.

Two observations impact the audit opinion on the financial statements and on compliance:

1. Commitment of 2016 budgetary credits for a service to be rendered in 2017.
2. Material weaknesses in internal control over financial reporting.

One observation does not impact the audit opinions:

3. Carry-forward of credits for the services rendered before the end of the financial year.

The Board also followed up on the status of eleven outstanding observations from its previous years' audits and noted that two were settled, one was partially settled, five were superseded by current year observations and three are still outstanding which result in current year audit qualifications on compliance.

For the NATO FORACS Steering Committee's formal comments, see the Appendix to Annex 3.

15 December 2017

INTERNATIONAL BOARD OF AUDITORS FOR NATO

**AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF
NATO FORACS OFFICE (NFO)
FOR THE YEAR ENDED 31 DECEMBER 2016**

**REPORT OF THE INTERNATIONAL BOARD OF AUDITORS
FOR NATO TO THE NORTH ATLANTIC COUNCIL**

Report on the Financial Statements

The International Board of Auditors for NATO (Board) audited the accompanying financial statements of NATO FORACS Office (NFO), which comprised the Statement of Financial Position as at 31 December 2016, the Statement of Financial Performance, Statement of Changes in Net Assets and Cash Flow Statement for the year then ended and a summary of significant accounting policies and other explanatory notes. The Board also audited the Statement of Budgetary Operations for the year ended 31 December 2016.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the NATO Accounting Framework and the requirements of the NATO Financial Regulations as authorised by the North Atlantic Council. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit, which is conducted in accordance with our Charter and international standards on auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, due to fraud or error. In making those risk assessments, internal control relevant to the entity's preparation and presentation of financial statements is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion on the Financial Statements

We found the receivables in the Statement of Financial Position is overstated by EUR 361,263. We also did not obtain sufficient evidence that the balance of payables in the Statement of Financial Position are fairly presented as a detailed list reconciling to the balance in the Statement of Financial Position could not be obtained. In addition, a prepayment for which the related services was partly to be received in 2017 was fully recorded as an expense, resulting in an undetermined overstatement of expenses in the Statement of Financial Performance and understatement of prepayments (asset) in the Statement of Financial Position. Lastly, amounts that had previously been reported as payables in the Statement of Financial Position were now being recorded as Advances. No disclosures of this change in accounting policy were disclosed as required by the NATO Accounting Framework.

Qualified Opinion on the Financial Statements

In our opinion, except for the effects and possible effects of the matters described in the section Basis for Qualified Opinion on the Financial Statements, the financial statements present fairly, in all material respects, the financial position of NFO as of 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with the NATO Accounting Framework.

Report on Compliance*Management's Responsibility for Compliance*

In addition to the responsibility for the preparation and presentation of the financial statements described above, management is also responsible for ensuring that the financial transactions and information reflected in the financial statements are in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations as authorised by the North Atlantic Council.

Auditor's Responsibility

In addition to the responsibility to express an opinion on the financial statements described above, our responsibility includes expressing an opinion on whether the financial transactions and information reflected in the financial statements are, in all material respects, in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations. This responsibility includes performing procedures to obtain reasonable assurance about whether the funds have been used for the settlement of authorised expenditure and whether their operations have been carried out in compliance with the financial and personnel regulations in force. Such procedures include the assessment of the risks of material non-compliance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion on Compliance

We found that NFO at 31 December 2016 held EUR 547,000 of Project Accumulated Surpluses. These Project Accumulated Surpluses are to be used in cases of emergency funding needs, and are a management reserve. Such a management reserve does not comply with Articles 24.2 and 29.3 of the NATO Financial Regulations, which require, respectively, that appropriations which have not been committed shall lapse at the end of the financial year, and that each contribution instalment shall be calculated to restrict total currency holdings to the minimum to meet forecast payments prior to receipt of the following contribution instalment.

The NATO Financial Regulations allow NATO bodies to commit budgetary appropriations for goods and services to be rendered during the financial year. However, NFO committed EUR 96,622 of 2016 budgetary appropriations to fund a service to partly be received in 2017.

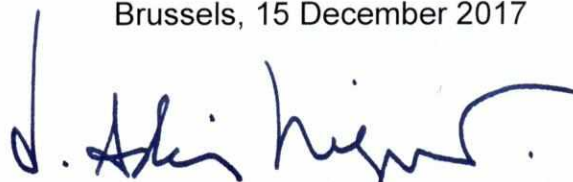
The NATO Financial Regulations required the establishment of a system of internal control. We found material weaknesses in internal control over financial reporting at NFO. Material misstatements and other errors were identified by us during the audit which had not been prevented or detected by internal controls over financial reporting.

We found that bank balances were not being reconciled during 2016. This represents a material weakness in internal control over financial reporting.

Qualified Opinion on Compliance

In our opinion, except for the matters described above in the *Basis for Qualified Opinion on Compliance* paragraph, in all material respects the financial transactions and information reflected in the financial statements of NFO are in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations.

Brussels, 15 December 2017

A handwritten signature in blue ink, appearing to read 'H. Metzger', is written over a horizontal line.

Hervé-Adrien Metzger
Chairman

15 December 2017

INTERNATIONAL BOARD OF AUDITORS FOR NATO

LETTER OF OBSERVATIONS AND RECOMMENDATIONS

FOR THE NATO FORACS OFFICE (NFO)

FOR THE YEAR ENDED 31 DECEMBER 2016

Introduction

The International Board of Auditors for NATO (Board) audited the NATO FORACS Office (NFO) Financial Statements for the year ended 31 December 2016 and issued a qualified opinion on the financial statements and on compliance.

Observations and Recommendations

During the audit, the Board identified three observations.

Two observations impact the audit opinion on the financial statements and on compliance:

1. Commitment of 2016 budgetary credits for a service to be rendered in 2017.
2. Material weaknesses in internal control over financial reporting.

One observation does not impact the audit opinions:

3. Carry-forward of credits for the services rendered before the end of the financial year.

The Board also followed up on the status of eleven outstanding observations from its previous years' audits and noted that two were settled, one was partially settled, five were superseded by current year observations and three are still outstanding which result in current year audit qualifications on compliance.

This Letter of Observations and Recommendations was formally cleared with the NATO FORACS Steering Committee, and the formal comments are included (Appendix, Annex 3).

OBSERVATIONS AND RECOMMENDATIONS

1. COMMITMENT OF 2016 BUDGETARY CREDITS FOR A SERVICE TO BE RENDERED IN 2017

Reasoning

1.1 Appropriations shall be available for commitment only during the financial year for which they have been approved (NATO Financial Regulations (NFRs) Article 24.1).

1.2 An entity's financial statements shall give a true and fair view of its financial position and performance. In order to achieve this, the events and transactions shall be recorded in the correct accounting period.

Observation

1.3 The NFO signed an agreement with a contractor for the review of the precision of NATO FORACS measurements. The work started in 2016 and the estimated completion date for the review is December 2017. The NFO made an advance payment of EUR 96,622 (which was the estimated cost of the review) in August 2016, and a final cost settlement will be done when the review is completed.

1.4 The Board found that even though the service was yet to be completed as at 31 December 2016, the advance amount paid was fully reported as an expense in the 2016 NFO Budget Execution Statement and the Statement of Financial Performance. As a result, 2016 budgetary credits were used to fund a service which was to be completed in 2017, and the expenses in the Statement of Financial Performance were overstated and prepayments (asset) were understated by an amount which the Board was not able to quantify.

Recommendation

1.5 The Board recommends that NFO recognise expenses when related services or goods are received to ensure that its financial statements give a true and fair view of its Financial Position and Performance.

2. MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Reasoning

2.1 The NFRs require the Financial Controller to exercise the responsibility of budgeting, accounting and reporting activities of the NATO entity. This includes being responsible for the financial internal control system established, and for the preparation of the financial statements in accordance with the NATO Accounting Framework.

Observations

2.2 The Board found the following misstatements or errors in the financial statements:

- a) The NFO had a EUR 361,263 outstanding receivable from one of the ranges since 2014. This amount was finally settled in 2016. However, the settlement was incorrectly recorded in the accounting records, and this resulted in this open item remaining in the sub-ledger and continuing to be reported as a receivable at the end of 2016. Therefore, both assets and liabilities of the NFO were overstated by this amount in the Statement of Financial Position.
- b) The detailed listing for accounts payable did not reconcile with the balance reported in the Statement of Financial Position. This was made up of a number of differences which net to EUR 23,962. This was material for NFO. The Board made inquiries about these differences but the NFO was still working to identify the reason for this as at the date of this report.
- c) The advance contributions from Nations for the ranges (EUR 1,354,281) were reported under Advances in the 2016 Statement of Financial Position whereas they were presented as Payables in 2015. The nature and the reasons for this change of accounting policy were not disclosed in the notes to the financial statements, even though it is required by the NATO Accounting Framework.
- d) There was an error on the revaluation of cash held in foreign currencies other than Euro and this resulted in an overstatement of the cash balance by EUR 6,945.
- e) According to the 2016 Budget Execution Statement, EUR 4,602 of credits were brought forward from the 2014 budget to 2016 for Chapter 2 expenses and there was no amount brought forward in Chapter 1. However, the 2016 Budget Execution Statement reported no expenses in Chapter 2, whereas an expense of EUR 5,512 was reported in Chapter 1 for the 2014 budget.
- f) The figures in the Cash Flow Statement did not reconcile with the balances in the Statement of Financial Position, as should be the case. For instance, the decrease in payables was reported as EUR 4,439,741 in the Cash Flow Statement, whereas it was EUR 6,936,577 according to the Statement of Financial Position.
- g) Under Other Current Liabilities, the NFO reported an amount of EUR 111,017 for the NFO transactions executed in other NATO International Staff bank accounts instead of the NFO bank accounts. The Board found that two items reported under Payables had the same nature and should have been included in Other Current Liabilities. The total value of these two items amounted to EUR 4,721.

Recommendations

2.3. The Board recommends that NFO:

- a) Establish robust internal procedures which would define responsibilities, requirements and controls for the preparation of the financial statements in order to ensure that they are free of material misstatements and other errors or omissions.
- b) Report in the Statement of Financial Position only the assets and liabilities which are supported by appropriate evidence and to retain supporting documentation for audit purposes.

3. CARRY-FORWARD OF CREDITS FOR THE SERVICES RENDERED BEFORE THE END OF THE FINANCIAL YEAR

Reasoning

3.1 Appropriated funds which have been committed and for which goods and services have been rendered, but the invoice has not been received by the end of the financial year, shall be recorded as an accrued liability and the commitment shall be reduced (NFRs, Article 25.2).

Observation

3.2 The Board found that for some of the services received in 2016, but not billed by the supplier before year-end, the NFO did not reduce the commitments and carried them forward to 2017. The result of this mistreatment is an overstatement of credits carried forward by EUR 5,206, and an understatement of 2016 expenses by the same amount in the Budget Execution Statement and the Statement of Financial Performance.

Recommendation

3.3 The Board recommends that NFO review open commitments at year-end in order to determine whether the related good or service has been received within the year, and if so, to reduce the commitment and book the expense accordingly.

FOLLOW-UP OF PREVIOUS YEAR'S OBSERVATIONS

The Board reviewed the status of the observations and recommendations arising from the previous audit. The observations and their status are summarised in the table below.

OBSERVATION / RECOMMENDATION	ACTION TAKEN	STATUS
Audit Report FY 2015 IBA-AR(2017)22 paragraph 1.3 Use of a Management Reserve Fund not in compliance with the NFRs Board's recommendation The Board recommends that NFO comply with Article 29.3 of the NFRs and restrict currency holdings to the minimum to meet forecast payments prior to receipt of the following contribution instalment. Alternatively, if the NFO Steering Committee strongly believes that such a management reserve is necessary, a request for deviation from Articles 24.2 and 29.3 of the NFRs should be made to Council.	This continues to be a basis for qualification on compliance.	Observation Outstanding.
Audit Report FY 2015 IBA-AR(2017)22 paragraph 2.3 Late Issuance of Financial Statements Board's recommendation The Board recommends that NFO submit future financial statements by 31 March, the deadline defined in the NFRs.	The 2016 financial statements were issued on time.	Observation Settled.
Audit Report FY 2015 IBA-AR(2017)22 paragraph 3.3 No Issuance of Statement of Internal Control Board's recommendation The Board recommends that NFO provide the Board with the signed Statement of Internal Control at the time of the issuance of the financial statements.	The NFO provided the Board with the signed Statement of Internal Control at the time of the issuance of the 2016 financial statements.	Observation Settled.
Audit Report FY 2015 IBA-AR(2017)22 paragraph 4.3 Unsupported Budgetary Credits Carried Forward Board's recommendation The Board recommends that NFO review open commitments at year-end in order to determine whether to carry them forward to the next year or to lapse them.	At the end of 2016, the NFO reviewed open commitments and they were lapsed or carried forward taking the rules set in the NFRs into consideration. However, the Board found an overstatement of carry-forwards in the 2016 audit.	Observation Superseded by Observation 3.

OBSERVATION / RECOMMENDATION	ACTION TAKEN	STATUS
<p>Audit Report FY 2015 IBA-AR(2017)22 paragraph 5.4</p> <p>Material Weaknesses in Internal Control Over Financial Reporting</p> <p>Board's recommendation The Board recommends that NFO:</p> <p>a) Establish robust internal procedures which would define responsibilities, requirements and controls for the preparation of the financial statements in order to ensure that they are free of material misstatements and other errors or omissions.</p> <p>b) Present monetary assets and liabilities in currencies other than Euro in the financial statements after revaluation with official NATO exchange rates applicable at year-end.</p> <p>c) Report in the Statement of Financial Position only the assets and liabilities which are supported by appropriate evidence and to retain supporting documentation for audit purposes.</p> <p>d) Improve internal controls over financial reporting to ensure that all expenses are being recorded in the financial statements</p>	<p>a) No changes in internal procedures for 2016. This continues to be a basis for qualification on compliance.</p> <p>b) Foreign exchange revaluation was done for the 2016 financial statements. However, it was not fully accurate - see current year observation 2.</p> <p>c) See current year observations 1 and 2.</p> <p>d) See current year observation 2.</p>	<p>Observation Superseded by current year observation 2.</p> <p>Observation Superseded by current year observation 2.</p> <p>Observation Superseded by current year observation 2.</p> <p>Observation Superseded by current year observation 2.</p>
<p>Audit Report FY 2015 IBA-AR(2017)22 paragraph 6.3</p> <p>Significant Delays in Providing Information Required for the Audit</p> <p>Board's recommendation The Board recommends that the IS Office of Financial Control provide required information to the Board in a timely basis. In order to meet the Board's deadlines, less flexibility will be provided in future audits.</p>	<p>For the 2016 audit, there were not significant delays in receiving information, except for Payables as noted in observation 2.</p>	<p>Observation Partially settled.</p>
<p>Audit Report FY 2015 IBA-AR(2017)22 paragraph 7.8</p> <p>Effort to Achieve Compliance With The Revised NATO Financial Regulations, Particularly Those Articles On Internal Control, Risk Management And Internal Audit</p> <p>Board's recommendation a) Ensure its risk management policy and risk registers include financial reporting and</p>	<p>For the 2016 audit, there were no changes in procedures with regards</p>	<p>Observation Outstanding.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN	STATUS
<p>compliance risks.</p> <p>b) As required by FRP XII 3) (e), choose a specific internal control framework that it will use to assess its system of internal control. The assessment is required by Article 12 of the NFRs. Since other NATO entities have already adopted COSO as their internal control framework, and it is a framework that can be used by entities of all sizes, the NFO should consider adopting COSO as their internal control framework.</p> <p>c) In coordination with the IS where applicable, begin the work of assessing and documenting the system of internal control and risk management procedures to support compliance with NFR Articles 11 and 12, FRPs XI and XII, and the internal control framework that it chooses.</p> <p>d) Through outsourcing if considered to be more cost effective, ensure internal audit activities are evaluating NFO risk management and internal control.</p> <p>e) Ensure that the supplementary budget credits are only used to enter into commitments for goods and services to be rendered during the financial year. Contract authority should be used for goods and services to be received in future years.</p>	<p>to internal control, risk management and internal audit.</p>	
<p>Audit Report FY 2014 IBA-AR(2015)18 paragraph 2.3</p> <p>Segregation of Duties – Bank Reconciliations</p> <p>Board's recommendation The Board recommends that a bank reconciliation report is prepared regularly, and not only at year-end. In addition, the NATO FORACS Office should ensure that the segregation of duties is adequate: bank reconciliations should be signed both by the preparer and the Head of Treasury (or deputy) as reviewer.</p>	<p>No monthly bank reconciliations were done during 2016. This continues to be a basis for qualification on compliance.</p>	<p>Observation Outstanding.</p>

**NATO FORACS STEERING COMMITTEE FORMAL COMMENTS ON THE
LETTER OF OBSERVATIONS AND RECOMMENDATIONS**

**OBSERVATION 1: PARA 1.5
COMMITMENT OF 2016 BUDGETARY CREDITS FOR A SERVICE TO BE RENDERED
IN 2017**

NATO FORACS Steering Committee's Formal Comment:

Agreed in principle. The relationship was between FORACS and an entity who was acting as FORACS' agent and who let the contract on behalf of NATO FORACS. They required transfer of full funds at the outset before they would enter into the contract, in order to ensure that they were not exposed to any financial risk.

**OBSERVATION 2: PARA 2.3
MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

NATO FORACS Steering Committee's Formal Comment:

Agreed.

**OBSERVATION 3: PARA 3.3
CARRY-FORWARD OF CREDITS FOR THE SERVICES RENDERED BEFORE THE
END OF THE FINANCIAL YEAR**

NATO FORACS Steering Committee's Formal Comment:

OFC and NFO did a review of all open commitments. However, due to human error, this transaction was omitted.

PREVIOUS YEAR'S OBSERVATIONS AND RECOMMENDATIONS

**PARA 1.3 USE OF A MANAGEMENT RESERVE FUND NOT IN COMPLIANCE WITH
THE NFRS**

NATO FORACS Steering Committee's Formal Comment:

At the NATO FORACS Steering Committee Meeting on 3 November 2017, the Committee reaffirmed that they consider the continued provision of an Operational Reserve to be essential to the operation of the FORACS Project, as

they have for the past ten years. Application for a deviation from the revised NFRs will be sought.

PARA 2.3 SEGREGATION OF DUTIES – BANK RECONCILIATIONS

NATO FORACS Steering Committee's Formal Comment:

Agreed. The ERP automatically reconciles, on a daily basis, most cash transactions and provides an up-to-date report of unreconciled cash movements and their dates. IS staff conduct reconciliations between bank statements and the accounting system's cash management module. In addition, it is putting in place reconciliations at the level of General Ledger.

NATO FORACS OFFICE

**FINANCIAL STATEMENTS
Financial Year 2016**

Annexes:

- 1 Statement of financial position
- 2 Statement of financial performance
- 3 Statement of cash flow
- 4 Statement of changes in net assets/equity
- 5 Statement of budget execution
- 6 Explanatory notes to the financial statements



M. PAGE
Project Manager FORACS



S. CHAGNOT
Financial Controller NATO-IS

NATO FORACS OFFICE
Statement of Financial Position

As at 31 December 2016

(in EUR currency)

Notes	Current Year	Prior Year	Variance
	2016	2015	CY - PY
Assets			
Current assets			
Cash and cash equivalents	4,825,084.38	7,324,293.54	-2,499,209.16
Short term investments			0.00
Receivables	847,905.43	1,134,199.98	-286,294.55
Prepayments	1,700.00	11,969.58	-10,269.58
Other current assets			0.00
Inventories			0.00
	5,674,689.81	8,470,463.10	-2,795,773.29
Non-current assets			
Receivables			0.00
Property, plant & equipment			0.00
Intangible assets	796,959.14	25,844.17	771,114.97
	796,959.14	25,844.17	771,114.97
Total assets	6,471,648.95	8,496,307.27	-2,024,658.32
Liabilities			
Current liabilities			
Payables	-244,934.22	-7,181,511.47	6,936,577.25
Deferred revenue	0.00	0.00	0.00
Advances	-2,258,462.00	-760,577.60	-1,497,884.40
Provisions			0.00
Other current liabilities	-2,623,669.80	-47,205.09	-2,576,464.71
	-5,127,066.02	-7,989,294.16	2,862,228.14
Non-current liabilities			
Provisions	0.00	0.00	0.00
Deferred revenue	-796,959.14	-25,844.17	-771,114.97
Other non-current liabilities			0.00
	-796,959.14	-25,844.17	-771,114.97
Total liabilities	-5,924,025.16	-8,015,138.33	2,091,113.17
Surplus/Deficit	0.00		0.00
Retained earnings	-547,623.79	-481,169.24	-66,454.55
Reserves			
Total net assets	-547,623.79	-481,169.24	-66,454.55

NATO FORACS OFFICE
Statement of Financial Performance

As at 31 December 2016

(in EUR currency)

Notes	Current Year	Prior Year	
	2016	2015	Variance
Revenue			
Revenue	-1,001,075.10	-884,893.59	-116,181.51
Financial revenue	-68,714.54	0.00	-68,714.54
Other revenue			0.00
Total revenue	-1,069,789.64	-884,893.59	-184,896.05
Expenses			
Personnel	567,850.86	580,659.09	-12,808.23
Contractual supplies and services	416,747.66	304,234.50	112,513.16
Depreciation and amortization			0.00
Impairment			0.00
Provisions			0.00
Other expenses	0.00	0.00	0.00
Finance costs	85,191.12	0.00	85,191.12
Total expenses	1,069,789.64	884,893.59	184,896.05
Surplus/(Deficit) for the period	0.00	0.00	0.00

NATO FORACS OFFICE Statement of Cash Flow

As at 31 December 2016

(in EUR currency)

Notes	Current Year	Prior Year
	2016	2015
Cash flow from operating activities	2,499,209.46	1,961,153.30
Surplus/(Deficit)		
Non-cash movements	0.00	0.00
Depreciation/ Amortisation		
Impairment		
Increase/(decrease) in payables	4,439,741.29	4,390,377.46
Increase/ (decrease) in other current liabilities	-1,533,316.28	-1,664,441.57
Increase/ (decrease) in provisions		
(Gains)/losses on sale of property, plant and equipment		
Increase/ (decrease) in other current assets	760,845.39	-24,089.69
Decrease/ (Increase) in receivables	-290,216.16	-766,599.79
Increase/ (decrease) in other NON current liabilities	-877,844.78	25,906.89
Net cash flow from operating activities	2,499,209.46	1,961,153.30
Cash flow from investing activities		
Purchase of property plant and equipment / Intangible assets	0.00	0.00
Proceeds from sale of property plant and equipment	0.00	0.00
Net cash flow from investing activities	0.00	0.00
Cash flow from financing activities	0.00	0.00
Net cash flow from financing activities	0.00	0.00
Net increase/(decrease) in cash and cash equivalents	2,499,209.46	1,961,153.30
Cash and cash equivalent at the beginning of the period	7,324,293.54	5,363,140.54
Cash and cash equivalent at the end of the period	4,825,084.38	7,324,293.54

NATO FORACS OFFICE
Statement of Changes in Net Assets/Equity

As at 31 December 2016

(in EUR currency)

	Capital contributions	Reserves	Accumulated surplus/deficit	Total
Balance at the beginning of the period 2014				
Changes in accounting policy				
Restated balance				
Net (gains)/losses recognised directly in net assets/equity			894,978.94	
Exchange difference on translating foreign operations				
Gain on property revaluation				
Surplus/(deficit) for the period				
Change in net assets/equity for the year ended 2015			894,978.94	
Balance at the beginning of the period 2015				-481,168.94
Changes in accounting policy				
Restated balance				
Net (gains)/losses recognised directly in net assets/equity			-66,454.85	
Exchange difference on translating foreign operations				
Gain on property revaluation				
Surplus/(deficit) for the period				
Change in net assets/equity for the year ended 2016			-66,454.85	
Balance at the end of the period 2016				-547,623.79

NATO FORACS OFFICE
Statement of Budget Execution
 As at 31 December 2016

(Amounts in euro)	Initial budget	Transfers	BA2	Transfers	BA3	Transfers	Final budget	Commitments	Expenses	Total spent	Carry forward	Lapsed
Budget 2016												
Chapter 1	549,432	1,993,577	2,543,009	-	2,543,009	-	2,543,009		1,529,414	1,529,414		1,013,595
Chapter 2	401,290	-	401,290	-	401,290	-	401,290	28,200	180,633	208,833		192,457
Chapter 3	-	-	-	-	-	-	-		-	-		-
Chapter 4	-	-	-	-	-	-	-		-	-		-
Total	950,722	1,993,577	2,944,299	-	2,944,299	-	2,944,299	28,200	1,710,047	1,738,247	-	1,206,052
Total FY 2016	950,722	1,993,577	2,944,299	-	2,944,299	-	2,944,299	28,200	1,710,047	1,738,247	-	1,206,052
Budget 2015												
Chapter 1	123,067		123,067	-	123,067	-	123,067	9,894	60,281	70,176		52,892
Chapter 2	5,785		5,785	-	5,785	-	5,785	-	5,718	5,718		67
Chapter 3	-		-	-	-	-	-		-	-		-
Total	128,853	-	128,853	-	128,853	-	128,853	9,894	65,999	75,893	-	52,959
Total FY 2015	128,853	-	128,853	-	128,853	-	128,853	9,894	65,999	75,893	-	52,959
Budget 2014												
Chapter 1			-	-	-	-	-		5,512	5,512		(5,512)
Chapter 2	4,602		4,602	-	4,602	-	4,602			-		4,602
Chapter 3			-	-	-	-	-			-		-
Total	4,602	-	4,602	-	4,602	-	4,602	-	5,512	5,512	-	(911)
Total FY 2014	4,602	-	4,602	-	4,602	-	4,602	-	5,512	5,512	-	(911)
Total all budgets	1,084,176	1,993,577	3,077,753	-	3,077,753	-	3,077,753	38,095	1,781,558	1,819,653	-	1,258,100

**EXPLANATORY NOTES TO NATO FORACS OFFICE
2016 FINANCIAL STATEMENTS****NOTE 1: GENERAL INFORMATION**

FORACS' mission is to measure the bearing, range, position and heading accuracy of sensors and navigation systems and to provide communications systems and interoperability testing in surface ships, submarines and maritime aircraft to satisfy national requirements and to meet NATO material readiness standards.

The NATO FORACS Memorandum of Understanding was signed in 1974 by seven NATO nations: Denmark, Germany, Greece, Italy, Norway, the United Kingdom and the United States. In September 1994, Canada became the eighth signatory.

Three NATO FORACS (Naval Forces Sensor and Weapons Accuracy Check Sites) test ranges were authorized under the management of a NATO FORACS Steering Committee (NFSC).

NATO FORACS Office (NFO) was established at NATO Headquarters in January 1977. This office provides technical direction for the project, quality control over test procedures, and maintains a data bank of test results for national summary reports.

NATO FORACS Norway (NFN) began routine testing in 1978.

NATO FORACS Greece (NFG) was opened for routine operation in 1985.

In 1994 the US FORACS range at AUTECH (Atlantic Underwater Test and Evaluation Center) became an affiliated NATO FORACS test range called NATO FORACS AUTECH (NFA).

Nations maintain oversight of the project through the NATO FORACS Steering Committee. The Steering Committee executes its responsibility through an executive Project Manager at the NFO in Brussels.

Normal operations and maintenance of NATO FORACS activities are funded by the member nations on a cost-sharing basis. Non-member nations utilize the resources and capabilities based on a calculated 'day rate' for services. Fixed facilities and capital costs are commonly funded through the NATO Security Investment Programme (NSIP). NATO International Staff Financial Control provides accounting and budgeting for the NATO FORACS Office and handles annual calls to nations to fund operations for the Project.

These financial statements relate only to the NATO FORACS Office (NFO). The three NATO FORACS ranges (NFA, NFG and NFN) are responsible for executing their own budgets and issuing their own financial statements under their national budgeting and financial rules.

NATO FORACS conducts tests for eight Alliance nations in response to NATO's tasking to provide mission capable platforms. This testing also supports Nation's acquisition and upgrade programmes testing ship, submarine and maritime aircraft. Having systems in ships, submarines and maritime aircraft aligned and calibrated to the same common reference and to clearly defined accuracy standards aligns with the Connected Forces Initiative and improves interoperability of maritime systems within and between nations. In 2013, FORACS adopted a strategic tag line: *Operational Confidence Through Accuracy*

The NATO FORACS Project continues to demonstrate a quality management culture based on ISO 9001:2008 and in 2014 achieved recertification for a further three years. Routine internal and external annual audits took place in 2016.

NOTE 2: ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below.

Declaration of Conformity

The NFO financial statements have been prepared in accordance with NATO Financial Regulations (NFR), the Financial Rules and Procedures (FRP) and the NATO Accounting Framework, which is an adapted version of the International Public Sector Accounting Standards (IPSAS).

Basis of Preparation

These financial statements relate only to the NATO FORACS Office (NFO).

These financial statements have been prepared on a going-concern basis. The assumption is that NFO is a going concern and will continue in operation and meet its objectives and obligations for the foreseeable future.

The financial year is from 1 January to 31 December.

The amounts shown in these financial statements are presented in EUR

FORACS applied IPSAS 9 Revenue from exchange transactions and IPSAS 23 Revenue from non-exchange transactions.

The following IPSAS have no material effect on the 2016 NFO financial statements:

IPSAS 5: Borrowing Costs

IPSAS 6: Consolidated and Separate Financial Statements

IPSAS 7: Investments in Associates.

IPSAS 8: Interests in Joint Ventures

IPSAS 10: Financial Reporting in Hyperinflationary Economies

IPSAS 11: Construction Contracts

IPSAS 16: Investment Property

IPSAS 21: Impairment of non-cash generating assets

IPSAS 26: Impairment of Cash-Generating Assets

IPSAS 27: Agriculture

IPSAS 32: Service Concession Arrangements: Grantor

Changes in accounting policy

None to report.

Reclassification of Financial Statements of Previous Years

None to report.

Use of Estimates

In accordance with generally accepted accounting principles, the financial statements include amounts based on estimates and assumptions by management, according to the most reliable information available, judgement and assumptions. Estimates include accrued revenue and expenses. Actual results could differ from those estimates. Changes in estimates are reflected in the period in which they become known.

Foreign Currency Transactions

The NFO's budget is authorized and managed in EUR so the contribution calls are made in EUR. Foreign currency transactions as required are accounted for at the NATO exchange rates prevailing on the date of the transactions. Monetary assets and liabilities at year-end which were denominated in foreign currencies were converted into EUR using the NATO rates of exchange that were applicable at 31 December 2016.

Realised and unrealised gains and losses resulting from the settlement of such transactions and from the revaluation at the reporting dates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Financial Performance.

NFO does not have any unrealised gains or losses resulting from the translation of statements.

Financial Risks

NFO uses only non-derivative financial instruments as part of its normal operations. These financial instruments include cash, bank accounts and deposit accounts.

All the financial instruments are recognised in the statement of financial position at their fair value.

The organisation is exposed to a variety of financial risks, including foreign exchange risk, credit risk, currency risk, liquidity risk and interest rate risk.

a. Foreign currency exchange risk

The exposure to foreign currency risk is limited as the vast majority of NFO's expenditures are made in EUR, the currency of its budget. The current bank accounts are held in EUR.

b. Credit risk

NFO incurs credit risks from cash and cash equivalent held with banks and from receivables.

The maximum exposure as at 31 December 2016 is equal to the total amount of bank balances, short term deposits and receivables. There is very limited credit risk associated with the realization of these elements.

Concerning cash and cash equivalent NFO credit risk is managed by holding current bank accounts and short term highly liquid deposits that are readily convertible to a known amount of cash held with ING Bank (Belgium) which has the following short term credit ratings:

ING Bank Credit Ratings as at 07/02/2017

	Fitch	Moody's	S&P
Short term	F1	NA	A2

The NFO outstanding accounts receivable are managed by maintaining control procedures over receivables. Most cash receivables are due from NATO member nations, which are considered credit worthy.

c. Liquidity risk

The liquidity risk, also referred to as funding risk, is based on the assessment as to whether the Organisation will encounter difficulties in meeting its obligations associated with financial liabilities. A liquidity risk could arise from a short term liquidity requirement. There is a very limited exposure to liquidity risk because of the funding mechanism which guarantees contributions in relation to the approved budgets. Some limited risk could be due to the inaccuracy of budget forecasts. However, past history shows that this process results in surpluses and the budgetary rules provide for revised budgets.

d. Interest rate risk

Except for certain cash and cash equivalent balances, NFO's financial assets and liabilities do not have associated interest rates. NFO is restricted from entering into borrowings and investments, and, therefore, there is an insignificant interest rate risk. Interest earned is not a budgetary resource but contributes to the surplus owed to Nations.

Current Assets

a. Cash and cash equivalents

Cash and cash equivalents are defined as short-term assets. They include cash in hand, deposits held with banks, and other short term highly liquid investments.

b. Funds managed for third parties

Funds managed on behalf of third parties are held in cash and are presented as a liability. They are accounted for when cash is effectively received. They are represented as a separate item in the cash flow statement of the entity in order to avoid any confusion.

c. Receivables

Receivables are stated at net realisable value, after provision for doubtful and uncollectible debts.

Contributions receivable are recognised when a call for contribution has been issued to the funding nations. No allowance for loss is recorded with respect to Member countries' assessed contributions receivable.

d. Prepayments

A prepayment is a payment in advance of the period to which it pertains and is mainly in respect of an advance payment made to a third party.

e. Inventories

As mentioned above, NATO's adaptations of IPSAS were spelled out in C-M(2013)0039 of July 2013, which included IPSAS 12 Inventories. It is described as follows:

Control of NATO Inventories was refined with a set of 10 criteria to be used in assessing the level of control of an asset. A positive response on six of the criteria will lead to the asset being capitalised in the Financial Statements if it is above the capitalisation threshold. This is applied from January, 2013.

Criteria that may indicate control of an asset
The act of purchasing the asset carried out (or resulted from instructions given) by the NATO Reporting Entity.
The legal title is in the name of the NATO Reporting Entity.
The asset is physically located on the premises or locations used by the NATO Reporting Entity.
The asset is physically used by staff employed by the NATO Reporting Entity or staff working under the NATO Reporting Entity's instructions.
The fact that the NATO Reporting Entity can decide on an alternative use of the asset.
The fact that the NATO Reporting Entity can decide to sell or to dispose the asset.
The fact that the NATO Reporting Entity, if it has to remove or destroy the asset, can take the decision to replace it.
The fact that a representative of the NATO Reporting Entity regularly inspects the asset to determine its current condition.
The fact that the asset is used in achieving the objectives of the NATO Reporting Entity.
The fact that the asset will be retained by the NATO Reporting Entity at the end of the activity.

Capitalisation thresholds relevant to the financial statement are as follow:

Category	Threshold	Basis
Consumables	€50,000	Per location/warehouse
Spare Parts	€50,000	Per location/warehouse
Ammunition	€50,000	Per location/warehouse
Strategic stocks	€50,000	Per location/warehouse

Slow moving inventory – Assuming turnover of stock is over a 12 month period, any items not used over a 36 month period will be deemed to be slow moving.

Strategic stock – Some complex elements of slow moving stock can be identified as strategic if they are deemed essential to the effective operation of an asset and cannot be readily replaced by commercial off the shelf items or cannot be purchased due to market decisions to close production lines of key inventory items due to the advanced age of the strategic asset to which the stock relates

NFO will capitalise inventory which it controls in its financial statements. Where there is a conflict between more than one NATO Reporting Entity as to the control of inventory, only the end-user entity will report the inventory in its financial statements, based on reliable information provided by the NATO services provider entity as defined in individual agreements between the two entities.

NFO will include transportation costs involved in bringing the inventories to their present location and condition in the initial valuation of inventory. These costs will be measured on the actual cost of transportation per item of inventory or by using an apportionment of the global transportation costs of bringing the inventories to their present location and condition across all inventory items in the period. Transportation costs involved in the subsequent movement of inventory which brings them into operational use will not be included in the value of inventory. The method of measuring these costs will be disclosed.

NFO may consider inventory acquired prior to 1 January 2013 as fully expensed.

For inventory held prior to 1 January 2013, and not previously recognized as an asset, NFO will provide a brief description of inventory held within their inventory recording systems in the notes to the financial statements. Such disclosure will include as a minimum the types of inventories held, locations where inventories are held and the approximate number of items held per asset category. Where this adaptation conflicts with another requirement of IPSAS this adaptation shall apply. For the remainder, IPSAS 12 shall apply.

NFO assesses inventories under IPSAS 12. The outcome of this assessment is that the value of the inventories is immaterial both in value and in terms of the nature of the items held. Consequently, inventory is fully expensed on receipt. The materiality will be assessed each year.

In consideration of the above thresholds, the NFO currently has no inventory.

Non-Current Assets - Fixed Assets (Property, Plant & Equipment)

a. Property, Plant & Equipment

In February of 2013 Council decided to adapt a number of IPSAS standards to better suit the specific requirements of the Alliance (C-M(2013)0006). The adaptations were spelled out in C-M(2013)0039 of July 2013, among which were specific items addressing IPSAS 17 PPE.

Control of NATO PPE was refined with a set of 10 criteria to be used in assessing the level of control of an asset. A positive response on six of the criteria will lead to the asset being capitalised in the Financial Statements if it is above the capitalisation threshold. This is applied from January, 2013.

Capitalisation thresholds relevant to the financial statement are as follow:

Category	Threshold	Depreciation life	Method
Land	€200,000	N/A	N/A
Buildings	€200,000	40 years	Straight line
Other infrastructure	€200,000	40 years	Straight line
Installed equipment	€ 30,000	10 years	Straight line
Machinery	€ 30,000	10 years	Straight line
Vehicles	€ 10,000	5 years	Straight line
Aircraft	€200,000	Dependent on type	Straight line
Vessels	€200,000	Dependent on type	Straight line
Mission equipment	€ 50,000	3 years	Straight line
Furniture	€ 30,000	10 years	Straight line
Communications	€ 50,000	3 years	Straight line
Automated information systems	€ 50,000	3 years	Straight line

NATO FORACS considers PPE acquired prior to 1 January 2013 as fully expensed. However, existing accounting policies will continue to be applied for any PPE assets already capitalized prior to 1 January 2013. For PPE upgraded after 1 January 2013, only the portion related to the modification will be capitalized.

In consideration of the above thresholds, the NFO currently has no PPE.

b. Intangible assets

As mentioned above, NATO's adaptations of IPSAS were spelled out in C-M(2013)0039 of July 2013, which included IPSAS 31 Intangible Assets. It is described as follows:

Control of NATO Intangible Assets was refined with a set of 10 criteria to be used in assessing the level of control of an asset – they are the same as mentioned above under Inventory. A positive response on six of the criteria will lead to the asset being capitalised in the Financial Statements if it is above the capitalisation threshold. This is applied from January, 2013.

NATO Intangible Assets Capitalisation Thresholds - the NATO FORACS will capitalise each intangible asset item above the following agreed NATO thresholds:

Category	Threshold	Depreciation life	Method
Computer software (commercial off the shelf)	€50,000	4 years	Straight line
Computer software (bespoke)	€50,000	10 years	Straight line
Computer database	€50,000	4 years	Straight line
Integrated system	€50,000	4 years	Straight line

FORACS will capitalise all controlled intangible assets above the NATO Intangible Asset Capitalisation Threshold. For anything below the threshold, the NATO FORACS will have the flexibility to expense specific items.

FORACS will capitalise integrated systems and include research, development, implementation and can include both software and hardware elements. But FORACS will not capitalise the following types of intangible assets in their financial statements:

- rights of use (air, land and water);
- landing rights;
- airport gates and slots;
- historical documents; and,
- publications

FORACS will capitalise other types of intangible assets acquired after 1 January 2013 including:

- Copyright
- Intellectual Property Rights
- Software development

FORACS may consider Intangible Assets acquired prior to 1 January 2013 as fully expensed.

FORACS will report controlled Intangible assets in its financial statements. Where there is a conflict between more than one NATO Reporting Entity as to the control of intangible assets, only the end-use entity will capitalise the intangible asset in its financial statements based on reliable information provided by the NATO services provider entity as defined in individual agreements between the two entities.

For intangible assets held prior to the 1 January 2013, and not previously recognized as an asset, FORACS will provide a brief description of intangible assets held in its intangible asset recording systems in the notes to the financial statements. Such disclosure will include as a minimum the

types of intangible held, locations where intangible assets are held and the approximate number of items held per asset category.

If an intangible asset is upgraded after 1 January 2013, only the portion related to the modification will be capitalised.

Where this adaptation conflicts with another requirement of IPSAS this adaptation will apply. For the remainder, IPSAS 31 shall apply. This adaptation is effective for financial reporting periods beginning on 1 January 2013.

In 2015, the NFO has initiated a replacement of a software required for its operations.

Current Liabilities

a. Payables

Payables are amounts due to third parties, based on goods received or services provided that remain unpaid. These include estimates of accrued obligations to third parties for goods and services received but not yet invoiced.

b. Advances and unearned revenue

Advances are contributions received related to future year's budgets.

Unearned revenue represents participating nations contributions which have been called for current budgets but that have not yet been recognised as revenue in the absence of any related budgetary expenditure.

c. Other Current Liabilities

Amounts corresponding to the current year budgetary surplus (lapsed credits + net interests + miscellaneous income) are considered a liability towards the contributing nations. The settlement does not follow the normal accounts payable process, since the standard approach is to return them to contributing nations via a deduction of the following year's call for budget contributions. This liability is therefore classified under Other Current Liabilities.

This item may include other liabilities that do not result from the standard procure to pay process, such as miscellaneous transactions to be regularized between entities managed by the IS Office of Financial Control.

Non-Current Liabilities

The long term unearned revenue is unearned revenue in relation to net carrying amounts of Property, Plant and Equipment and intangible assets. Revenue is recognised over the estimated life cycle of the Property, plant and equipment and the intangible assets.

NET ASSETS

Net Assets correspond to FORACS' Project Accumulated Surplus. Project Accumulated Surplus relates to funds resulting from past years contributions by FORACS member Nations in excess of budget execution that the Steering Committee decided not to redistribute to the member nations but keep for the needs of FORACS. It is held at the direction of the Steering Committee.

Revenue Recognition

Revenue comprises contributions from Member Nations and amounts due by beneficiaries of services provided by the FORACS ranges.

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. The balance of unspent contributions and other revenues that relate to future periods are deferred accordingly.

Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the entity recognises a liability until the condition is fulfilled.

Contributions to be called from Member nations, based on the budget they approved, are initially recorded as unearned revenue liabilities. They are recognised as revenue in the statement of financial performance when such contributions are used for their intended purpose as envisioned in the approved Budget.

Transformational adjustments were made in calculating earned revenue and expenses in the Statement of Financial Performance.

Segment Reporting

A segment is a distinguishable activity or group of activities for which it is appropriate to separately report financial information. There is no segment in NFO.

Statement of Financial Position**NOTE 3: CASH AND CASH EQUIVALENTS**

The current bank accounts are held in EUR. Deposits are held in interest-bearing bank accounts, immediately available.

in EUR	2016	2015
NFO	3,108,383.36	3,063,956.98
Petty Cash	350.18	350.67
TOTAL	3,108,733.54	3,064,307.65

NOTE 4: FUNDS MANAGED FOR THIRD PARTIES

The NATO-IS Office of Financial Control holds funds, in cash, contributed to the NFG, NFA and, since 2013, NFN budgets. These bank accounts are controlled by IS Office of Financial Control, in the context of the management of FORACS financial operations, thus the closing balances are reported in the NFO's financial statements. Upon request of the Range Managers, funds are transferred to the Greek, US and Norwegian officials respectively, under the supervision of the Range Managers to execute their budget following their national rules.

The breakdown is as follows.

in EUR	2016	2015
NFA	20,370.56	1,702,569.04
NFA short term deposit	815,817.26	0.00
NFG	645,080.73	666,265.99
NFN	235,082.79	1,891,150.86
TOTAL	1,716,350.84	4,259,985.89

NOTE 5: ACCOUNTS RECEIVABLE

Receivables (in EUR)	2016
Budgetary contributions	838,683.82
Advances to staff	9,221.61
Total	847,905.43

Contributions receivable are funds requested from the nations to finance the current and following year budgets of all the FORACS components. There is normally only one call for contribution, issued during the summer period. As directed by the Steering Committee, the call includes approximately 20% of the current year's budget credits and an advance of approximately 80% for next financial year.

Salary advances to staff are governed by the NATO Civilian Personnel Regulations.

NOTE 6: PREPAYMENTS

Corresponds to services to be delivered in the following years (typically advances on education allowances, travel expenses).

NOTE 7: INVENTORIES

Nothing to report, inventories are not considered material.

NOTE 8: NON CURRENT ASSETS

FORACS intends to replace by end 2018 the data recording and analysis software used for its operations. To this effect, end 2015, a contract was signed with the NATO Communications and Information Agency in a total amount of EUR 1,558,500 which constitutes the main commitment related to this project.

(amounts in EUR)	Carrying Amount end 2014	Additions	Disposals	Depreciation	Other Changes	Carrying Amount end 2015
Software	0	25,844				25,844
TOTAL FORACS	0	25,844	0	0	0	25,844

(amounts in EUR)	Carrying Amount end 2015	Additions	Disposals	Depreciation	Other Changes	Carrying Amount end 2016
Software	25,844	771,115				796,959
TOTAL FORACS	25,844	771,115	0	0	0	796,959

NOTE 9: ACCOUNTS PAYABLES

Payables and accrued expenses may be to commercial suppliers, staff, other NATO bodies, FORACS member Nations or other FORACS entities.

Payable to suppliers relates to goods and services for which an invoice has been received, checked, and queued for payment but for which payment was still pending at year-end.

Accrued expenses correspond to the estimated accrual obligation to third parties for goods and services received but not yet invoiced.

Payables (in EUR)	2016
Suppliers	7,849.91
Personnel	3.90
Other FORACS entities	63,012.81
Member Nations	174,028.48
Accruals	39.12
Total	244,934.22

Payable to Nations

A payable of EUR 174,028.42 is in relation to reimbursable salaries and represents the amount due to the United States (US) for a civilian staff member who was previously employed by FORACS but paid directly by the US government. This amount remains to be regularised.

Payables to other FORACS entities

Payables to NFA, NFG and NFN are amounts previously called by the NATO-IS Office of Financial Control and due to the related ranges in order to fund their respective budgets and for which a decision to transfer the funds has been taken and payment is pending.

NOTE 10: DEFERRED REVENUE**Unearned Revenue**

This item is limited to NFO since it is the only FORACS entity over which the IS OFC exercises budget control.

Unearned revenue corresponds to NFO contributions called for the current year budget or before (received or receivable) that NFO intends to use for its initial purpose, but for which corresponding expenditures will be incurred after the reporting period. If the funds are not spent by the end of the second year following the year for which they were approved, these funds will lapse unless a specific decision is taken by member nations for a further carry-forward.

NOTE 11: ADVANCES

The standard call for contribution process includes an advance on the following year's budgets for all FORACS components. The FORACS components may in turn request that part or all of the advances be transferred to them. The amounts called as advances and the net situation of advances at year end was the following.

Advances called (in EUR)	2016
NFO	904,180.80
NFA	1,338,583.76
NFG	896,720.00
NFN	1,647,962.61
TOTAL	4,787,447.17

Advances status (in EUR)	2016
NFO	904,180.80
NFA	793,831.00
NFG	560,450.00
NFN	-
TOTAL	2,258,461.80

NOTE 12: SHORT TERM PROVISIONS

There are no short term provisions.

NOTE 13: OTHER CURRENT LIABILITIES

Amounts corresponding to the current year budgetary surplus of NFO (lapsed credits + net interests + miscellaneous income) are considered a liability towards the contributing nations. The settlement does not follow the normal accounts payable process, since the standard approach is to return them to contributing nations via a deduction of the following year's call for budget contributions. Up to now, the standard practice of the FORACS Steering Committee has been to use these amounts to fund the NFO supplementary budget or to add them to the Project Accumulated Surplus (see note on Net Assets).

Current Year Budget Surplus NFO (in EUR)	2016
Lapsed Appropriations	1,258,100.93
Net Financial Income	- 81,338.55
Miscellaneous Income	203,862.65
Total Surplus Current Year NFO	1,380,625.03

A net amount of EUR 543,795.86 corresponds to amounts previously called by the NATO-IS Office of Financial Control for NFA, NFG and NFN, due to the related ranges in order to fund their respective current and previous budgets, and to funds transferred back from the ranges in relation to their own budget execution.

In addition, for 2016, an amount of EUR 111,017.00 consisted essentially of transactions relating to NFO and funded and allocated in accordance with its budget but which were executed in the NATO International Staff bank accounts during 2015 and 2016. Therefore they were treated as inter entity transactions, as both these NATO entities are controlled by the OFC accounting system (automatically picked-up by the ERP). These transactions are pending regularisation.

NOTE 14: NON CURRENT LIABILITIES AND LONG TERM UNEARNED REVENUE

The long term unearned revenue is unearned revenue in relation to net carrying amounts of Property, Plant and Equipment and intangible assets. Revenue is recognised over the estimated life cycle of the Property, plant and equipment and the intangible assets.

NOTE 15: NET ASSETS

Net Assets correspond to FORACS' Project Accumulated Surplus.

Project Accumulated Surplus relates to funds resulting from past contributions by FORACS member Nations in excess of budget execution that the Steering Committee decided not to redistribute to the member nations but keep for the needs of FORACS. It is held at the direction of the Steering Committee essentially in the case of emergency funding needs for the Project and also for reallocation among NATO FORACS entities when the Steering Committee approves their supplementary budgets. It originates from previous years' budgetary and financial operations of the various NATO FORACS entities. A substantial proportion of the Project Accumulated Surplus will be used to fund the upgrade of the IT system used by FORACS for its operations.

Statement of Financial Performance**NOTE 16: REVENUE**

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. The non-exchange revenue is matched with the expenses stemming from budget execution.

Contributions, when called, are booked as an Unearned Revenue and subsequently recognized as Revenue when it is earned.

NOTE 17: EXPENSES**Wages, Salaries and Employee Benefits**

The personnel costs include all civilian personnel expenses as well as other non-salary related expenses, in support of funded activities. They also include expenses for salaries and emoluments for approved NATO permanent civilian positions and temporary personnel, for other salary related and non-related allowances including overtime, medical examinations, recruitment, installation and removal, and for contracted consultants and training.

Supplies and Consumables Used

This item also includes expenses attributed to Capital Expenses from a budget perspective, if they do not meet the criteria of PPE or Intangible Assets.

NOTE 18: BUDGET INFORMATION**NATO FORACS Office Budget**

Presently, the NATO FORACS Budgets are not publicly available.

The actual amounts referred to by IPSAS 24 ("amounts that result from execution of the budget") are considered to be the commitment of credits.

Presentation of budget information in the financial statements

In the present financial statements budget information is limited to NFO since it is the only entity over which the IS OFC exercises budget control.

The NFO budget classification is based on the economic nature of the expenses broken down into three chapters as follows:

Chapter I : Personnel Expenses
Chapter II: Operating Expenses
Chapter III : Capital Costs

The NFO Budget is prepared for the same period (1 January to 31 December). These financial statements also include non-budgetary transactions related to NFA, NFG and NFN.

Changes to the budgetary regulations were introduced by the North Atlantic Council in 2015 in approving a new set of NATO Financial Regulations. The new NATO Financial Regulations were made applicable to the 2015 budget year as from 1 May 2015. They have in particular instilled an accruals based approach to budget preparation and budget execution, whereas before the approach was largely commitment and cash based.

Despite a stronger emphasis on the principle of annual budgets, the approved and executed budget cannot be considered as accruals-based, since the new regulations allow for a number of exceptions, such as carrying forward commitments for goods and services that were expected to be delivered in the course of the year but for various reasons were not, or authority given to the member Nations to allow for special carry forward of appropriations unused at year-end.

The budget execution for 2015 may contain flaws since (a) the budget was prepared and approved in 2014 before the new Financial Regulations were formally approved and (b) two sets of regulations were in force during 2015, with the new ones as from 1 May 2015. In addition, commitments that were carried-forward from previous years into 2015 had been approved and were executed in accordance with the old rules.

The NFO budget is prepared and executed as follows:

- 1) The commitment of appropriations is the advance acceptance and recording of the financial consequence resulting from a legal obligation incurred during the financial year. As a consequence appropriations are allocated, and commitments are approved, for goods, services and works to be delivered at a later stage. Commitments are settled when the service is rendered or goods delivered as is the case for expenses under accrual accounting.
- 2) Unliquidated commitments are carried forward and added to the budget of the following financial year in relation to an existing legal commitment or if a special agreement is given by the Steering Committee. They correspond to services not received or goods not delivered, at year-end, for specific circumstances. Outstanding commitments can be carried forward for two years. As a consequence, the services or goods received may relate to a commitment of appropriations from previous years' budgets. The carry-forward should be justified by a reason for which the services or goods could not be received in the course of the year. In addition, in accordance with Financial Regulations, member Nations may agree to a further carry-forward of commitments that were already carried forward twice.
- 3) Commitments, because they are an advance acceptance, and because payments cannot be made above approved appropriations levels, typically include an estimation factor and are (if only slightly) higher than the actual amount eventually paid. This results in commitments being higher than the actual expenses and in appropriations eventually lapsing.

- 4) Commitments are only made in respect of expenses relating to the initial purpose of the commitment. Commitments for capital expenditures are normally made in the year during which the purchase order is issued. In accrual accounting, the related costs would not appear in the Statement of Financial Performance but in the Balance Sheet and only upon reception of the works, goods or services. Conversely, there is no budgetary commitment of appropriations for non-cash flow transactions such as capital depreciation or provisions which would normally appear in the Statement of Financial Performance under accrual accounting.
- 5) On an exceptional basis, the Steering Committee may approve the carry-forward of credits without any prior legal commitment, for instance for projects at their initiation stage or planned expenditures. In accrual accounting there would be no expense recorded.
- 6) The balance of unused budgetary appropriations (not committed) lapses and is returned to Contributing Nations at year-end. Lapses may include cases where a project was eventually not completed or started, and therefore lead to no expense.

Budget approval

The way in which NFO deals with budget approvals is as follows. Every year, a basic budget is requested in order to provide contributors with a stable level of contribution and a significant amount is planned for under the supplementary budget.

The 2016 NFO Budget authorization was initially approved at 950,722.00 (BA1 in the Table at Annex 5). A supplementary budget was approved in the amount of EUR 1,993,573.55, bringing the total 2016 NFO budget to EUR 2,944,298.55 (BA2 in the Table at Annex 5). In 2016, the supplementary budget usage was projected to cover mainly the development of specific software.

Budget execution

The NFO budget execution for the current and previous year is shown at Annex 5 and Annex 6 respectively, which compares the budget's authorized appropriations and the actual amounts committed and expended.

Credits are transferred under the authority delegated to the NATO-IS Financial Controller by the NATO Financial Regulations and Financial Rules and Procedures.

amounts in EUR	2016
Total Expenditure Statement of Financial Performance	1,069,789.64
PP&E Acquisition, and Depreciation	796,959.14
Financial Costs	- 85,191.12
Miscellaneous (Income)	-
Budget Execution Total Expenses	1,781,557.66

Reconciliation between NFO Budget and Calls for Contributions

The funding of the NFO budget is made of an advance call and a call for contributions, carried over credits, the previous year's surplus, and on occasion, as directed by the Steering Committee, a contribution from the Project's Accumulated Surplus and/or a transfer from another FORACS entity.

One call for contributions is issued every year which includes an advance concerning the budget of the following year and the remainder concerning the current year's budget (i.e. current year budget

minus advance called during the previous year and any other adjustments among the FORACS entities).

The table below reconciles the approved budget and the sources of funding.

amounts in EUR	2016	2015
Initial Budget	950,722.00	977,029.00
Supplementary Budget	1,993,576.55	1,998,256.00
Total Annual Budget	2,944,298.55	2,975,285.00
Advance called previous year	760,578.00	781,623.20
Call in current year	190,144.00	195,405.80
Total Cash Calls	950,722.00	977,029.00
Use of Previous Year's Surplus	2,054,102.76	802,511.00
Use of Project Accumulated Surplus	-	1,053,186.00
Transfer from (to) other FORACS entities	- 60,526.21	142,559.00
Other Funding Sources	1,993,576.55	1,998,256.00
Total Funding	2,944,298.55	2,975,285.00

NOTE 19: WRITE-OFFS

Nothing to report.

NOTE 20: LEASES

NFO does not have any financial leases.

NOTE 21: RESTRICTIONS ON FIXED ASSETS

There are no restrictions on fixed assets.

NOTE 22: CONTINGENT LIABILITIES

There have been no contingent liabilities identified that would be expected to result in a material obligation.

NOTE 23: CONTINGENT ASSETS

Nothing to report.

NOTE 24: EMPLOYEE DISCLOSURE

Accounting for employee benefits is accounting for any liability in relation to all forms of consideration given by an entity in exchange of service rendered by employees.

It should be noted that the NATO-IS is managing centrally three pension programs, namely the Defined Benefit Pension Scheme (DBS), the Provident Fund and the Defined Contribution Pension Scheme (DCPS) as well as the Retiree Medical Claims Fund (RMCF), covering staff employed by all NATO bodies. NATO wide financial statements are issued by NATO-IS Office of Financial Control for the three Pension Schemes and the RMCF, therefore, no related assets or liabilities are recognised in these financial statements.

At December 31, 2016, NFO had an approved Personnel Establishment of 4 positions funded by the FORACS budget (4 at year-end 2015).

At December 31, 2016 two staff members participated in the Defined Contribution Pension Scheme (DCPS) administered by NATO. The DCPS provides that the NFO budget makes a 12 percent monthly matching contribution to the staff members' contributions for current service. Two other employees participated in NATO's Defined Benefit Pension Scheme (DBPS): a deduction of 9.5% of their salaries is made and contributed to the annual financing of this Plan. In addition, the NFO budget makes a monthly matching contribution of 19% to the DBPS. Consequently, the NFO has neither DBPS nor DCPS liabilities for its staff members. These contributions are expensed during the year in which the services are rendered and represent the total pension obligation of the entity.

Untaken leave by NFO staff is not considered material.

NOTE 25: KEY MANAGEMENT PERSONNEL AND RELATED PARTIES

The NATO FORACS Steering Committee (one representative per member nation) is the governing body of the NFO and of the NFG, NFN and NFA. Therefore for the purpose of IPSAS 20 the latter are considered related parties. Steering Committee members are nominated by their respective National Authorities. They are paid on the basis of applicable National pay scales. The Steering Committee members do not receive from NATO any additional remuneration for Steering Committee responsibilities or access to benefits.

The key management personnel of the NFO consists of the Project Manager. The Project Manager is responsible for the overall operational management of FORACS. The Project Manager reviews the three range's budgets, proposed by the range managers, and proposes all four budgets to the Steering Committee for approval. The three sites are managed operationally by range managers, each nominated by the participating nation where the site is located.

There are no other remuneration or benefits to key management personnel or their family members.

NOTE 26: RELATED PARTIES

In reviewing the four budgets on an annual basis, the Steering Committee determines the budgetary credits for the initial and the supplementary budgets. It is in this context that funds are called and held in cash or cash equivalents by the NATO-IS Office of Financial Control to finance three other NATO FORACS budgets, namely NATO FORACS Greece, NATO FORACS AUTEK and NATO FORACS Norway. For more effective cash management purposes, the Steering Committee approved the call procedure whereby funds pertaining to NFG, NFA and NFN are transferred into accounts at NATO Headquarters. These bank accounts are controlled by NFO, thus the closing balances are reported in the NFO's financial statements. Upon request of the Range Managers, funds are transferred to the Greek, US and Norwegian officials respectively, under the supervision of the Range Managers to execute their budget following their national rules.

The surplus of the various NATO FORACS entities is held at NATO HQ on NFO bank account and used by the Steering Committee for reallocation when their supplementary budgets are approved. These funds are not controlled by the NFO Project Manager. This information is provided to the Steering Committee to enable it to implement its supplementary budget authorisations.

Key management personnel have no significant party relationships that could affect the operation of the NATO FORACS Office.

In 2016, NATO International Staff charged NFO an amount of EUR 43,421.16 for administrative support costs (EUR 43,031 in 2015) and EUR 9,723.20 for common operating costs (EUR 10,432.05 in 2015). In addition, the International Staff charges annual rent for office space occupied in Building Z (EUR 12,969.07 in 2016 and 2015).

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List of acronyms:

AUTEC	Atlantic Underwater Test and Evaluation Center
BC	Budget Committee
DI	Defence Investment Division (NATO International Staff)
FORACS	Naval Forces Sensor and Weapon Accuracy Check Sites
IPSAS	International Public Sector Accounting Standards
IS	International Staff
MOU	Memorandum of Understanding
NCIA	NATO Communication and Information Agency
NSPA	NATO Support Agency
NNAG	NATO Naval Armaments Group
NFA	NATO FORACS AUTEC
NFG	NATO FORACS Greece
NFN	NATO FORACS Norway
NFO	NATO FORACS Office
NFSC	NATO FORACS Steering Committee
PPE	Property, Plant and Equipment