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4 September 2020

DOCUMENT
C-M(2020)0030-AS1

**IBAN REPORT TO COUNCIL - MAIN FINDINGS FROM THE 2018 FINANCIAL
STATEMENTS AUDITS**

ACTION SHEET

On 3 September 2020, under the silence procedure, the Council noted the RPPB report attached to C-M(2020)0030, agreed its recommendations and agreed to the public disclosure of the RPPB report and the IBAN report.

(Signed) Jens Stoltenberg
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2020)0030

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13 August 2020

DOCUMENT
C-M(2020)0030
Silence Procedure ends:
03 Sep 2020 17:30

IBAN REPORT TO COUNCIL - MAIN FINDINGS FROM THE 2018 FINANCIAL STATEMENTS AUDITS

Note by the Secretary General

1. The Resource Policy and Planning Board (RPPB) have agreed with the report at Annex 1 that covers the International Board of Auditors for NATO (IBAN) report to Council on the main findings from the 2018 financial statements audits (see enclosure).
2. I do not believe this issue requires further discussion. Therefore, **unless I hear to the contrary by 17:30 hours on Thursday, 3 September 2020**, I shall assume the Council noted the RPPB report, agreed its recommendations and agreed to the public disclosure of this report and the IBAN report.

(Signed) Jens Stoltenberg

Annex: RPPB report
Enclosure: IBAN report to Council on the main findings from the 2018 financial statements audits

1 Annex
1 Enclosure

Original: English

IBAN REPORT TO COUNCIL – MAIN FINDINGS FROM THE 2018 FINANCIAL STATEMENTS

Report by the Resource Policy and Planning Board

References:

- A. IBA-M(2020)0001 – IBAN Report to Council on Main Findings from the 2018 Financial Statements Audits
- B. C-M(2015)0025 – NATO Financial Regulations (NFR)
- C. C-M(2016)0023 – NATO Accounting Framework (NAF)
- D. PO(2015)0052 – Wales Summit tasker on transparency and accountability

INTRODUCTION

1. This report by the RPPB addresses the IBAN report to Council on the main findings from the 2018 financial statements audits (reference A). The IBAN report provides an overview to Council on the main findings of the 2018 financial statements audits to further enhance Council's ability to oversee and account for the organisation's limited resources.
2. To best serve the interests of the organisation IBAN will continue to report, on an annual basis, the main findings of the annual financial statement audits.

AIM

3. This IBAN report enables the Board to reflect on strategic issues or concerns emanating from the audit of financial statements of NATO entities and to recommend courses of action to Council as applicable, which have the potential to improve transparency, accountability and consistency.

DISCUSSION

4. The financial statement audits provide independent assurance and advice to Council that the financial statements of the NATO bodies and Reporting Entities present fairly their financial position, financial performance and cash flows; and funds have been properly used for the settlement of authorised expenditure and are in compliance with the regulations (reference B).

5. Size and scale of Reporting Entities. In 2018 NATO Reporting Entities had annual expenses ranging from approximately EUR 1 million to EUR 2,982 million and therefore experienced varying degrees of complexity in financial reporting and accountabilities depending on their size and mandate.

- 5.1. The Board welcomes the IBAN analysis of NATO Reporting Entities and notes the variety in the scale of annual expenses reported by these entities. The Board notes the

clarification in the IBAN report that the total expenses include those between NATO Reporting Entities so there may be an element of double counting.

6. Trend of IBAN opinions and grouping of observations and recommendations. IBAN notes the increasing trend from 2016 to 2018 in the number of unqualified opinions on financial statements (from 16 in 2016 to 23 in 2018) and on compliance (from 11 in 2016 to 22 in 2018). This trend reflects, in overall terms, the progress made over implementing the NATO Accounting Framework (reference C) and complying with the NATO Financial Regulations (NFR) (reference B). The IBAN has been gradually reducing the number of separate recommendations from 2016 to 2018 and has grouped these into 5 distinct themes for their report:

- Theme 1. Financial and budgetary accounting and reporting;
- Theme 2. Property, plant, equipment, inventories and intangible assets;
- Theme 3. Procurement, contracting and other arrangements;
- Theme 4. Funding, revenue and cash management; and
- Theme 5. Compliance with other NATO regulations, rules and sound financial management principles.

6.1. The themes are of equal importance however themes 1 and 2 cover issues that present the highest risk of audit qualification, either because they impact financial statement disclosures or because of the amounts involved. The first theme shows a general improvement in financial reporting with the number of IBAN recommendations impacting the audit opinion reducing from 73 in 2016 to 40 in 2018. However the second theme with 8 recommendations in 2018 has remained stable since 2016 and means more progress is required to address these recommendations. Given the amounts involved, the second theme may lead to qualified opinions in the future. This theme includes weaknesses such as inaccurate and incomplete asset registers, lack of an integrated system to manage and account for assets and understatement of inventories.

6.2. The number of recommendations in theme 3 has shown a slight improvement, while more significant progress was achieved in theme 4. Of note, the number of recommendations in the fifth theme have remained stable since 2016. Out of a total of 35 recommendations in 2018, 18 were related to compliance with the NFR on risk management, internal control, the statement of internal control and internal audit. These requirements cover all parts of NATO's operations, with a much broader scope than only financial and budgetary matters. The delay in achieving compliance is partly due to a lack of clarity to who in practice is responsible and accountable for their implementation.

6.3. The Board is encouraged with the decreasing number of qualified opinions and new recommendations which show the positive trend in financial reporting. However the Board notes that the substance of audit recommendations are more important than the number. In this regard the Board acknowledges that continued efforts are needed in particular on Property, Plant and Equipment, inventories and intangible assets which was in 2018, the main cause of audit qualification. The Board also notes the need for improvements in the areas of risk management, internal controls and internal audit, which the Board recalls has been a continual concern for a number of years, dating back to 2015. In this regard the

Board, while encouraging NATO Bodies and Reporting Entities to make progress in these areas, notes the ongoing review of the NFR will assess the options to address some of these concerns on the lack of clarity.

7. IBAN qualifications in 2018. The IBAN notes only MSIAC and NCIO received qualified audit opinions in 2018, these are both related to observations raised in prior years. Two observations impacted the audit opinion for NCIO and one observation impacted the audit opinion for MSIAC. The MSIAC observation, initially raised in 2015, related to holding a reserve which does not comply with the NFR¹. The observations for NCIO, initially raised in 2013, relate to an understatement of inventory and completeness of property disclosed in the financial statements and the establishment of comprehensive records of property controlled by NCIO².

8. The Board is pleased with the content of the IBAN report, the strategic focus by grouping the recommendations into themes and commend IBAN for their clear presentation of the facts.

CONCLUSIONS

9. The Board welcomes the analysis undertaken by IBAN on the audit findings on the 2018 Financial Statements of NATO Reporting Entities.

10. The Board is pleased by the reduced number of qualified opinions and new recommendations which show an improving trend in financial reporting. The Board acknowledges continued efforts are required on Property, Plant and Equipment, inventories and intangible assets which was in 2018, the main cause of audit qualification. Implementation of risk management, internal controls and internal audit continues to be an area of concern. In this regard the Board, while encouraging NATO Bodies and Reporting Entities to make progress in these areas, notes the ongoing review of the NFR will assess the options to address some concerns on the lack of clarity.

11. The Board welcomes the content of the IBAN report and the grouping of recommendations into themes. Moreover, the Board are content that this report will allow Council to focus on strategic issues and provide an overall assessment on the progress made by NATO Reporting Entities in connection with improving financial management, transparency, accountability and consistency.

¹ A proposal to resolve the qualification on compliance for MSIAC is addressed in the report on the IBAN audit of the MSIAC Financial Statements for 2018 (AC/335-N(2020)0024).

² The RPPB are planning to address the IBAN observations on NCIO in a separate report.

RECOMMENDATIONS

12. The Resource Policy and Planning Board recommends that the Council:
 - 12.1. notes this report and the IBAN report at reference A;
 - 12.2. agrees the conclusions at paragraphs 9 to 11; and
 - 12.3. agrees to the public disclosure of the IBAN report and this report in line with agreed policy at Reference D.



INTERNATIONAL
BOARD OF AUDITORS
FOR NATO

**Report to Council on Main Findings
from the 2018 Financial Statements Audits**

FOREWORD BY THE CHAIRMAN

On behalf of the International Board of Auditors for NATO, it is my pleasure to share with you the first Report to Council on Main Findings from the Financial Statements Audits.

The purpose of this Report is to provide an overview to Council on the main findings of the 2018 financial statements audits covering NATO Bodies and other NATO Reporting Entities.

In the view of strengthening transparency and accountability over the use of NATO's resources, the Board believes that the complexity of the Organisation and the technical nature of the individual audit reports need to be complemented by aggregated information. Through this more innovative and informative way of reporting, our goal is to further enhance Council's ability to oversee and account for the Organisation's limited resources.

With the aim to best serve the interests of the Organisation and the Nations, we will continue to report our Main Findings on Financial Statements Audits on an annual basis, in accordance with our independent status set out in our Charter and International Standards of Supreme Audit Institutions.



*Daniela Morgante
Chairman
International Board of Auditors for NATO*

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1. IBAN'S RESPONSIBILITIES REGARDING FINANCIAL STATEMENTS AUDITS

1.1 IBAN's Mandate Regarding Financial Statements Audits

1.1.1 In accordance with Article 1 of its Charter, the International Board of Auditors for NATO (IBAN) has a mandate to audit NATO Bodies on behalf of the North Atlantic Council (hereinafter referred to as Council) and other NATO Reporting Entities in accordance with Council decisions. For the purposes of this audit mandate, the terms:

- **NATO Body** denotes civilian or military headquarters and other organisations established pursuant to the North Atlantic Treaty, subject to the provisions of either the 1951 Ottawa Agreement or the 1952 Paris Protocol.
- **NATO Reporting Entity** refers to a NATO body or an identifiable budget or area of activity that prepares financial statements. A NATO Reporting Entity may comprise one or more NATO civilian and military bodies, entities, budgets, or activities.

1.1.2 IBAN's mandate regarding financial statements audit covers NATO Bodies and other NATO Reporting Entities that operate under one of the three juridical personalities created by the NATO member States. These three personalities are either possessed by the North Atlantic Treaty Organisation (NATO) by virtue of the Ottawa Agreement, or possessed by the two Supreme Headquarters (SHAPE and HQ SACT) by virtue of the Paris Protocol. This mandate also covers the financial audit of non-appropriated funds, in so far as they are included in the financial statements of a NATO Reporting Entity.

1.1.3 22 NATO Reporting Entities operate under the juridical personality possessed by the North Atlantic Treaty Organisation by virtue of the Ottawa Agreement. These NATO Reporting Entities constitute an integral part of the Organisation.

1.1.4 Two Allied Commands (ACO, ACT) exercise the juridical personalities possessed by the Supreme Headquarters SHAPE and HQ SACT by virtue of the Paris Protocol. These two NATO Reporting Entities include the Supreme Headquarters and their subordinate NATO military bodies authorised to act on their behalf.

1.1.5 IBAN's mandate regarding the audit of the 2018 financial statements therefore included 24 NATO Reporting Entities. The following table presents total expenses for each NATO Reporting Entity. These totals include expenses between NATO Reporting Entities.

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Table 1: Total Expenses in 2018 per NATO Reporting Entity

Legal Framework	Juridical Personality	NATO Reporting Entity	Total Expenses 2018 (1)
Ottawa Agreement (1951)	NATO	BGX	Classified
		DCPS (3)	29
		IMS	26
		IS	267
		MSIAC Office (5)	2
		NAGSMO (2)	9
		NAHEMO (2)	12
		NAMEADSMO (2)	1
		NAMMO	413
		NAPMA	52
		NATO CPS (3)	192
		NATO Provident Fund (3)	0
		NATO Staff Centre (4)	1
		NCIO	863
		NDC	10
		NEFMO	2,174
		NETMA	44
		NATO FORACS Office (5)	1
		NHQ (4)	28
		NSPO	2,982
RMCF (3)	25		
STO	35		
Paris Protocol (1952)	SHAPE	ACO	1,022
	HQ SACT	ACT	144

Source: IBAN data

Notes

- (1) All expenses are expressed in EUR million except for NAMEADSMO and NAPMA, which are expressed in USD million.
- (2) The expenses as per financial statements only contain costs incurred in connection to the administrative budget. IBAN also audits the operational expenditure of NAGSMO, NAHEMO and NAMEADSMO, which amounted respectively to EUR 178 million, EUR 1,049 million and USD 0.6 million for 2018.
- (3) The four benefit schemes operate under the legal personality possessed by the North Atlantic Treaty Organisation (NATO) by virtue of the Ottawa Agreement. The benefits provided by these schemes apply to NATO international civilians employed in accordance with the Civilian Personnel Regulations under the Ottawa Agreement and Paris Protocol.

In compliance with International Accounting Standards 26, financial statements of NATO benefit plans do not contain a statement of financial performance with expenses. Therefore the total decrease in net assets available for benefits are shown for all NATO benefit plans.

- (4) *The NATO Staff Centre and NHQ are activities of the International Staff.*
- (5) *MSIAC Office and NATO FORACS Office are NATO Reporting Entities only in respect of activities carried out by the International Staff in relation to MSIAC and FORACS.*

1.1.6 As shown in the above table, NATO Reporting Entities have different levels of annual expenses ranging from approximately EUR 1 million to EUR 2,982 million in 2018. NATO Reporting Entities therefore experience varying degrees of complexity in financial reporting and accountabilities depending on their size and mandate.

1.1.7 In accordance with Article 1 of the IBAN Charter and based on a specific Council authorisation, IBAN also audits financial statements of non-NATO multi-nationally funded or sponsored entities that are not NATO Reporting Entities, but in which NATO has a particular interest. These entities are not NATO Reporting Entities because they do not operate under one of NATO's three juridical personalities. In addition, IBAN also audits the SHAPE International School, which is not a NATO Reporting Entity although it is an integral element of SHAPE. The results of these audits are not reported to Council, but to their respective governing bodies. These financial audits do not form part of this report.

1.2 Financial Statements Audits and Reporting

1.2.1 The function of IBAN regarding Financial Statements Audit in accordance with Article 2 of the IBAN Charter is:

To provide independent assurance and advice to the Council and, through their Permanent Representatives, the Governments of member countries that:

- *the financial statements of the NATO bodies present fairly their financial position, financial performance, and cash flows and that;*
- *the funds have been properly used for the settlement of authorised expenditure and are in compliance with the regulations in force.*

1.2.2 The function of IBAN regarding Financial Statements Audit in accordance with Article 2 of the IBAN Charter do not provide independent assurance on the following, given that they are covered by IBAN's performance and NATO Security Investment Programme (NSIP) audit mandate :

- *that the activities of the NATO bodies have been carried out with efficiency, effectiveness and economy (performance audit/value for money audit);*

- *that the expenditures incurred by member countries (Host Nations) or NATO bodies in respect of the NSIP have been carried out in compliance with the regulations in force (NSIP audit).*

1.2.3 IBAN's independent assurance is provided for every NATO Reporting Entity in the Independent Auditor's Report to the North Atlantic Council, which contains a Report on the Financial Statements and a Report on Compliance. The Report on the Financial Statements presents IBAN's opinion on whether the financial statements present fairly their financial position, financial performance, and cash flows. The Report on Compliance presents IBAN's opinion on whether the funds have been properly used for the settlement of authorised expenditure and are in compliance with the regulations in force. The IBAN Independent Auditor's Report therefore contains two separate audit opinions.

1.2.4 Each Financial Statements Audit Report also contains a Letter of Observations and Recommendations, in which IBAN reports observations impacting the audit opinions and any other observations that we consider should be brought to the attention of Council. Observations and recommendations raised during the audit, which have not been included in the IBAN's Auditor's Report and in the Letter of Observations and Recommendations addressed to Council are set out in a management letter addressed to the Head of the NATO Reporting Entity.

1.2.5 In accordance with Article 14 of its Charter, IBAN prepares and presents each year reports on the audited annual financial statements relating to NATO bodies and other NATO Reporting Entities. The purpose of this report is to provide an overview of the main findings from the 2018 financial statements audits.

1.3 Audit Standards and Financial Statements Audit Objectives

1.3.1 IBAN undertakes its audits in accordance with the principles of the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI) as per Article 15 of the IBAN Charter. Our financial audits are conducted according to the International Standards of Supreme Audit Institutions (ISSAI), which are officially authorised and endorsed by INTOSAI. We apply ISSAIs 1000-1810 to the financial statements audit and ISSAI 4000 to the compliance audit component.

1.3.2 The objective of the audit of the financial statements is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an independent auditor's report that includes an opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements or the accountability needs of users.

1.3.3 The objective of the audit of compliance is to obtain independent assurance about whether funds have been properly used for the settlement of authorised expenditure and are in compliance with the regulations in force.

1.3.4 In accordance with these standards, audit opinions on financial statements and on compliance can be unqualified, qualified, a disclaimer, or adverse:

- An **unqualified opinion** is when IBAN issues an opinion that the financial statements and budget execution report are stated fairly and that nothing has come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the rules and regulations.
- A **qualified opinion** means that IBAN was generally satisfied with the presentation of the financial statements, but that some key elements of the statements were not fairly stated or affected by a scope limitation, or specific issues have come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the rules and regulations.
- A **disclaimer** is issued when the audit scope is severely limited and IBAN cannot express an opinion, or when there are material uncertainties affecting the financial statements or the use of funds.
- An **adverse opinion** is issued when the effect of an error or disagreement is so pervasive and material to the financial statements that IBAN concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

1.4 **Management's Responsibilities for the Financial Statements and for Compliance**

1.4.1 Management's responsibility for the financial statements is laid down in the NATO Financial Regulations (NFRs) (C-M(2015)0025). The financial statements of NATO Reporting Entities are prepared in accordance with the NATO Accounting Framework (C-M(2016)0023), adapted from International Public Sector Accounting Standards (IPSAS). In addition, budget execution reports are annexed to the financial statements as required by Article 34.4 of the NFRs.

1.4.2 Financial statements are defined by IPSAS as General Purpose Financial Statements, as they are primarily designed to provide to stakeholders external to NATO a transparent and complete view of NATO's assets, liabilities, income, expenses and cash flow. Budget execution reports are Special Purpose Financial Reports, as they are designed to provide Member nations with visibility as to how resources are used in support of agreed objectives and requirements and in compliance with the NFRs.

1.4.3 The Financial Statements of each NATO Reporting Entity are signed by the respective Head and Financial Controller. In signing the Financial Statements, both the Head and the Financial Controller confirm 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.

1.4.4 This confirmation covers the design, implementation and maintenance of internal controls relevant to the preparation and presentation of financial statements that are auditable and free from material misstatement, whether due to fraud or error. This also covers reporting on the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there are plans to liquidate the entity or to cease its operations, or there is no realistic alternative but to do so.

1.4.5 Management's Responsibility for Compliance arise from the fact that all NATO staff, military and civilian, are obligated to comply with the NFRs, associated Financial Rules and Procedures and internal implementing directives. These include the NATO Civilian Personnel Regulations.

1.4.6 The Head of the NATO Body or other NATO Reporting Entity is responsible and accountable for sound financial management. The financial administration of NATO bodies and other NATO Reporting Entities must incorporate the principles of propriety, sound governance, accountability, transparency, risk management and internal control, internal audit, external audit, and fraud prevention and detection.

2. MAIN FINDINGS FROM THE 2018 FINANCIAL STATEMENTS AUDITS

2.1 Summary of Main Findings

2.1.1 The main findings from the 2018 Financial Statements Audits of the 24 NATO Reporting Entities cover the audit opinions issued on the financial statements and on compliance, and the observations and recommendations addressed to Council. In order to place these findings into perspective, the audit results related to the 2018 financial statements are compared with the prior two years.

2.1.2 The following audit opinions were issued on the financial statements and on compliance:

Table 2: Audit Opinions on the financial statements and on compliance

		2018	2017	2016
Financial statements	Unqualified	23	19	16
	Qualified	1	5	7
	Adverse	-	-	-
	Disclaimer	-	-	1
		<u>24</u>	<u>24</u>	<u>24</u>
Compliance	Unqualified	22	14	11
	Qualified	2	10	12
	Adverse	-	-	-
	Disclaimer	-	-	1
		<u>24</u>	<u>24</u>	<u>24</u>

Source: IBAN data

2.1.3 The table above shows a general improvement in the number of unqualified audit opinions issued both on the financial statements and on compliance. An unqualified opinion on the financial statements is when IBAN issues an opinion that the financial statements and budget execution report are stated fairly. An unqualified opinion on compliance is when IBAN issues an opinion that nothing has come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the rules and regulations.

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2.1.4 The table below presents the audit opinions issued by IBAN per NATO Reporting Entity for the 2018 financial statements and two comparative years.

Table 3: Audit Opinions per NATO Reporting Entity

Reporting Entity	2018		2017		2016	
	F/S Opinion	Compliance Opinion	F/S Opinion	Compliance Opinion	F/S Opinion	Compliance Opinion
ACO	Unqualified	Unqualified	Qualified	Qualified	Qualified	Qualified
ACT	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
BGX	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
DCPS	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Qualified
IMS	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
IS	Unqualified	Unqualified	Qualified	Qualified	Disclaimer	Disclaimer
MSIAC	Unqualified	Qualified	Unqualified	Qualified	Qualified	Qualified
NAGSMO	Unqualified	Unqualified	Unqualified	Qualified	Unqualified	Unqualified
NAHEMO	Unqualified	Unqualified	Qualified	Qualified	Qualified	Qualified
NAMEADSMO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NAMMO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NAPMA	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Qualified
NATO CPS	Unqualified	Unqualified	Unqualified	Qualified	Unqualified	Qualified
NATO Provident Fund	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Qualified
NATO Staff Centre	Unqualified	Unqualified	Unqualified	Qualified	Unqualified	Qualified
NCIO	Qualified	Qualified	Qualified	Qualified	Qualified	Qualified
NDC	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NEFMO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NETMA	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NFO	Unqualified	Unqualified	Unqualified	Unqualified	Qualified	Qualified
NHQ	Unqualified	Unqualified	Unqualified	Unqualified	Qualified	Qualified
NSPO	Unqualified	Unqualified	Qualified	Qualified	Qualified	Qualified
RMCF	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
STO	Unqualified	Unqualified	Unqualified	Qualified	Unqualified	Unqualified

Unqualified	23	22	19	14	16	11
Qualified	1	2	5	10	7	12
Disclaimer	-	-	-	-	1	1

Source: IBAN data

2.2 Summary of Unqualified Opinions

2.2.1 Since 2016, the number of unqualified audit opinions on the financial statements increased from 16 to 23 out of a total of 24 NATO Reporting Entities. The number of unqualified audit opinions on compliance increased from 11 to 22 over the same period.

2.2.2 These trends of increasing unqualified opinions on the financial statements reflect in overall terms the progress made over the implementation of the NATO Accounting Framework. The increased number of unqualified opinions on compliance reflects improved compliance with regulations in force.

2.2.3 The audit opinions on the financial statements largely relate to the implementation of the NATO Accounting Framework. The NATO Accounting Framework is a complex set of accounting standards adapted from IPSAS. Implementing this framework required considerable changes for NATO Bodies and other NATO Reporting Entities. Leadership within them have now rolled out new Enterprise Resource Programmes (ERPs) and acquired the necessary technical expertise in-house to ensure continued compliance with the NATO Accounting Framework.

2.2.4 The audit opinions on compliance largely relate to compliance with the provisions of the NFRs. The revised NFRs in 2015 introduced a number of new requirements especially around Risk Management, Internal Control, the Statement of Internal Control and Internal Audit. NATO Bodies and other NATO Reporting Entities are in the process of implementing these requirements with various degrees of maturity, depending on the level of complexity and resources constraints.

2.3 Summary of Qualified Audit Opinions

2.3.1 IBAN issued a qualified audit opinion on compliance for 2018 for MSIAC and a qualified audit opinion on the 2018 financial statements and on compliance for NCIO. A qualified opinion on the financial statements means that IBAN was generally satisfied with the presentation of the financial statements, but that some key elements of the statements were not fairly stated or affected by a scope limitation. A qualified opinion on compliance means that specific issues have come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the rules and regulations.

2.3.2 The qualified audit opinion on compliance for MSIAC relates to an open prior year observation related to holding a reserve, which does not comply with the NFRs that do not allow the holding of a reserve without prior approval by Council. MSIAC has not so far requested Council to authorise a deviation from the NFRs on this matter.

2.3.3 The qualified audit opinions on the 2018 financial statements and on compliance for NCIO relate to two observations. The first observation impacted the audit opinion on the financial statements and on compliance as we were not able to obtain sufficient evidence in respect to the completeness of all property disclosed in the Statement of Financial Position and that comprehensive records of all property controlled by NCIO have been established as required by Article 12 of the NFRs. The second observation, which impacted only the audit opinion on the financial statements related to the understatement of inventory disclosed in the Statement of Financial Position.

2.4 Summary of Observations and Recommendations

2.4.1 Each IBAN audit report contains a Letter of Observations and Recommendations in which the observations impacting the audit opinions are reported, and in which other significant observations and recommendations are brought to the attention of Council.

2.4.2 In addition to reporting on observations and recommendations issued for the financial year covered by the report, a follow-up is performed on the status of observations and recommendations from the previous years' audits. During a follow-up, an outstanding recommendation can either receive the status open, in-progress, or closed.

Open: is used for recommendations that are open and for which no notable progress has been achieved to date.

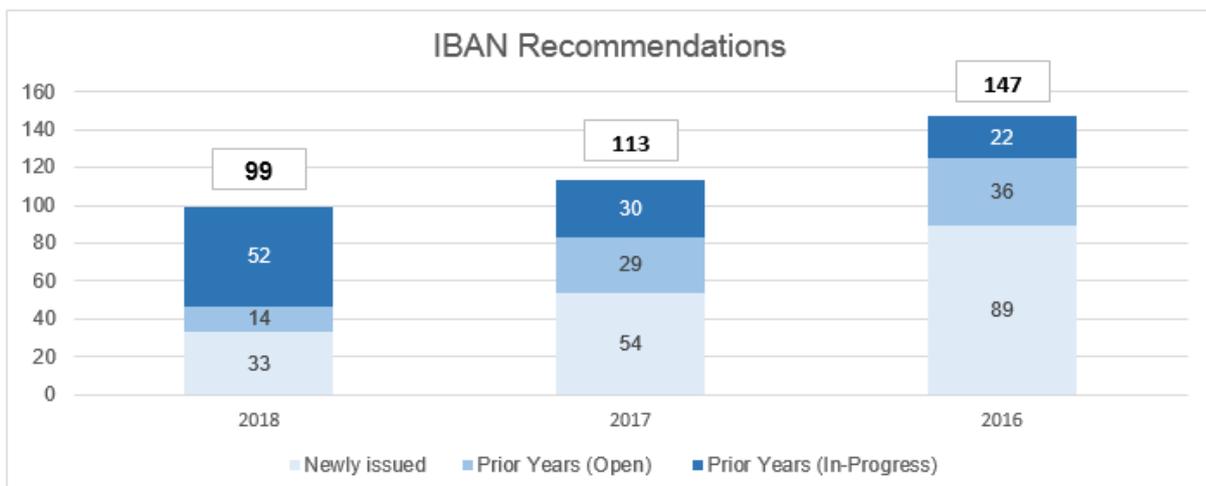
In-progress: is used for open recommendations when the NATO Reporting Entity has started to implement the recommendation or when some (but not all) sub-recommendations are close;

Closed: is for recommendations which were addressed and implemented or superseded by new observations.

Overview of current and prior year recommendations

2.4.3 The chart below contains an overview of all current and prior year recommendations as per IBAN audit reports for the financial years 2018, 2017 and 2016 based on the status of the recommendations described above.

Chart 1: Number of IBAN recommendations



Source: IBAN data

2.4.4 The above chart shows that the number of newly issued observations has decreased while the number of prior year recommendations (open and in-progress) remained stable overall. Among prior year recommendations, the share of recommendations in-progress has increased significantly in the period of observation. In general terms, this can be interpreted as a signal that financial reporting and compliance at NATO is improving and NATO Reporting Entities are currently in the process of addressing our prior year recommendations.

2.4.5 It should however be noted that the substance of audit recommendations is more important than their number. IBAN has gradually been reducing the number of recommendations by grouping these as much as possible and creating sub-recommendations where necessary. Therefore grouping recommendations needs also to be quoted among the reasons of the decrease in the number of newly issued recommendations.

Summary of main findings per theme

2.4.6 In order to present a more explanatory overview of the areas in which audit observations are being made, all audit observations from the 2018, 2017 and 2016 audit reports were categorised on the basis of five themes. This presentation of the observations allows us to identify the areas in which most audit findings occur, and the areas that still show room for improvement. When a recommendation relates to more than one theme, it has been included in the category that we believed carried more weight.

Table 4: Recommendations per theme

IBAN Recommendations per Audit Theme	Total number of IBAN Recommendations			IBAN Recommendations impacting audit opinion on F/S			IBAN Recommendations impacting audit opinion on Compliance		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
1. Financial and budgetary accounting and reporting	40	46	73	-	5	29	-	3	34
2. Property, plant, equipment, inventories and intangible assets	8	9	8	2	3	3	1	2	2
3. Procurement, contracting and other arrangements	8	12	11	-	-	2	-	-	3
4. Funding, revenue and cash management	8	7	18	-	-	4	-	-	5
5. Compliance with other NATO regulations, rules and sound financial management principles	35	39	37	-	-	2	1	7	6
Total number of IBAN Recommendations	99	113	147	2	8	40	2	12	50

Source: IBAN data

Financial and budgetary accounting and reporting

2.4.7 This theme includes recommendations relating to the preparation of the financial statements, budget execution statements, and accounting and associated Information Technology processes. The number of recommendations has reduced

from 73 in 2016 to 40 in 2018. A general improvement in financial reporting across all NATO Reporting Entities can also be noted.

2.4.8 In 2018, recommendations mainly related to the following matters:

- Internal control weaknesses in the financial reporting process, such as lack of segregation of duties and insufficient procedures to review the financial statements prior to their issuance and audit.
- Confirmations of year-end assets and liabilities between NATO Reporting Entities not systematically performed.
- Inaccurate methodology used for calculating accrued liabilities and expenses.
- Weaknesses in the presentation of budget execution statements.
- Post-employment liabilities not recognised by NATO and only disclosed in the notes to the financial statements of the benefit funds.

Property, plant, equipment, inventories and intangible assets

2.4.9 This theme relates to the management, accounting and reporting of property, plant, equipment and inventories, covering both tangible and intangible assets. The number of recommendations have remained stable since 2016 and there were eight recommendations in 2018 for seven NATO Reporting Entities. Improvements are still required in the financial accounting and reporting of Property, plant and equipment, and inventory to address the following weaknesses:

- Inaccurate and incomplete asset registers.
- Lack of an integrated system to manage and account for assets.
- Weaknesses in the capitalisation process.
- Understatement of inventories.

2.4.10 This theme is significant as it may in the future lead to a qualified opinion on the financial statements and on compliance, given the amounts involved.

Procurement, contracting and other arrangements

2.4.11 This theme includes recommendations related to procurement processes and arrangements between NATO Reporting Entities or with Nations. The number of recommendations in this area has reduced and stood at eight in 2018. Some weaknesses in the procurement processes have been noted around source selection planning and monitoring of potential conflicts of interest. They also include the need to have signed technical arrangements for the use of NATO funded equipment and

infrastructure in theatre and a memorandum of agreement and logistic support agreements with customer-funded agencies.

Funding, revenue and cash management

2.4.12 This theme includes recommendations related to the management of funds, revenue and cash. The number of recommendations has reduced from 18 in 2016 to eight in 2018. This decrease is mainly explained by a number of bank reconciliation issues in 2016 that have now been addressed. In 2018, recommendations mainly related to time accounting, unallocated customer credits and the need to restrict the level of cash holdings.

Compliance with other NATO regulations, rules and sound financial management principles

2.4.13 The number of recommendations in this area has remained stable since 2016. Out of a total of 35 recommendations in 2018, 18 were related to compliance with the revised NFRs on Risk Management, Internal Control, the Statement of Internal Control and Internal Audit. These requirements cover all parts of NATO's operations, with a much broader scope than only financial and budgetary matters. The delay in achieving compliance with these rules is partly due to a lack of clarity as to who in practice is responsible and accountable for their implementation. In our view, any new revision to the NFRs should seek to clarify responsibilities related to internal control and risk management.

2.4.14 Two recommendations in 2018 related to the need to strengthen the ability to challenge the validity of information and solutions provided by the NATO customer-funded agencies. There is also a need to mitigate risks that arise with regards to delays, quality, cost overruns and enforceability of agreements.

2.4.15 The other main recommendations in 2018 related to issues of compliance with NATO Civilian Personnel Regulations, the need to obtain related party declarations from key management personnel including if needed from members of supervisory bodies and board of directors, and the use of a management reserve. This last matter impacted the audit opinion on compliance, as mentioned in sub-section 2.3.

2.5 Conclusion

2.5.1 The audits of the financial statements of NATO Reporting Entities show improvement in the number of unqualified opinions issued during the past three years. In addition, the overall decrease in the number of new recommendations made by IBAN is encouraging.

2.5.2 Continued efforts need to be placed in particular on Property, plant, equipment, inventories and intangible assets, which was in 2018 the main cause of audit qualifications by IBAN. Strengthening internal controls over the accounting and financial reporting process may also lead to further significant progress.

2.5.3 In light of the upcoming revision of the NATO Financial Regulations, NATO will have the opportunity to ensure that the regulations, rules and procedures are fully suited to the complexity of the Organisation. Achieving full compliance with NATO regulations, rules and procedures remains a core target going forward.

List of Abbreviations/Acronyms

ACO	Allied Command Operations
ACT	Allied Command Transformation
BGX	NATO Battlefield Information, Collection and Exploitation Systems Group Executive
DCPS	NATO Defined Contribution Pension Scheme
ERP	Enterprise Resource Programme
FORACS	Naval Forces Sensor and Weapons Accuracy Check Sites (FORACS)
F/S	Financial statements
HQ SACT	Headquarters Supreme Allied Commander Transformation
IBAN	International Board of Auditors for NATO
IMS	International Military Staff
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
IS	International Staff
ISSAI	International Standards of Supreme Audit Institutions
MSIAC	Munitions Safety Information Analysis Center
MWA	Morale and Welfare Activities
NAGSMO	NATO Alliance Ground Surveillance Management Agency
NAHEMO	NATO Helicopter Design and Development Production and Logistics Management Agency
NAMEADSMO	NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Agency
NAMMO	NATO Multi-Role Combat Aircraft Development Production and In-Service Support Management Organisation
NAPMA	NATO Airborne Early Warning and Control Programme Management Agency

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NATO	North Atlantic Treaty Organisation
NATO CPS	NATO Coordinated Pension Scheme
NCIO	NATO Communications and Information Organisation
NDC	NATO Defense College
NEFMO	NATO European Fighter Aircraft Development, Production and Logistic Management Organisation
NETMA	NATO Eurofighter 2000 and Tornado Management Agency
NFRs	NATO Financial Regulations
NHQ	NATO New Headquarters
NSIP	NATO Security Investment Programme
NSPO	NATO Support and Procurement Organization
NR	NATO Restricted
Ottawa Agreement	Agreement on the status of the North Atlantic Treaty Organization, National Representatives and International Staff, signed in 1951 in Ottawa
Paris Protocol	Protocol to the SOFA on the Status of International Military Headquarters signed in 1952 in Paris
RMCF	Retirees Medical Claims Fund
SOFA	Agreement between the Parties to the North Atlantic Treaty regarding the Status of their Forces signed in 1951 in London
SHAPE	Supreme Headquarters Allied Power Europe
STO	NATO Science and Technology Organization