

**NATO UNCLASSIFIED**

22 September 2020

**DOCUMENT**  
C-M(2020)0036-AS1

**IBAN AUDITOR'S REPORT ON THE AUDIT OF THE 2018 FINANCIAL STATEMENTS  
OF NCIO**

**ACTION SHEET**

On 21 September 2020, under the silence procedure, the Council noted the RPPB report, agreed its conclusions and recommendations, and agreed to the public disclosure of the report, the IBAN Auditor's Report and associated 2018 financial statements of NCIO, attached to C-M(2020)0036.

(Signed) Jens Stoltenberg  
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2020)0036

**NATO UNCLASSIFIED**



**NATO UNCLASSIFIED**

7 September 2018

**DOCUMENT**  
C-M(2020)0036  
**Silence Procedure ends:**  
**21 Sep 2020 17:30**

## **IBAN Auditor's Report on the audit of the 2018 Financial Statements of NCIO**

### **Note by the Secretary General**

1. I attach the International Board of Auditors for NATO (IBAN) Auditor's Report on the 2018 financial statements of NATO Communication and Information Organisation (NCIO). The IBAN Auditor's Report set out qualified opinions on both the 2018 financial statements and on compliance for NCIO.
2. The IBAN report has been reviewed by the Resource Policy and Planning Board (RPPB) (see Annex 1).
3. I do not believe this issue requires further discussion. Therefore, **unless I hear to the contrary by 17:30 hours on Monday, 21 September 2020**, I shall assume the Council noted the RPPB report, agreed its conclusions and recommendations, and agreed to the public disclosure of this report, the IBAN Auditor's Report and associated 2018 financial statements of NCIO.

(Signed) Jens Stoltenberg

Annex 1: RPPB report  
Enclosure 1: IBAN audit report + financial statements

1 Annex  
1 Enclosure

Original: English

**NATO UNCLASSIFIED**

-1-



**IBAN AUDITOR'S REPORT ON THE 2018 FINANCIAL STATEMENTS OF NATO  
COMMUNICATIONS AND INFORMATION ORGANISATION (NCIO)**

**Report by the Resource Policy and Planning Board**

References:

- |                               |                                                                          |
|-------------------------------|--------------------------------------------------------------------------|
| A. IBA-A(2019)0118            | - IBAN Audit on the 2018 Financial Statements of NCIO                    |
| B. CM(2015)0025               | - NATO Financial Regulations (NFRs)                                      |
| C. AC/337(FC)D(2015)0003-REV6 | - NCIO Financial Rules and Procedures (FRPs)                             |
| D. PO(2015)0052               | - Wales Summit tasker on transparency and accountability                 |
| E. NCIO/CH/2020/006 (INV)     | - Updated plan against the IBAN Auditor's Report (Feb 2020)              |
| F. BC-D(2020)0077-REV1        | - BC Report on the IBAN Audit on the 2018 Financial<br>Statements of ACO |

**INTRODUCTION**

1. This report by the RPPB addresses the IBAN Auditor's Report on the 2018 financial statements of the NATO Communications and Information Organisation (NCIO). The IBAN audit set out qualified opinions on the financial statements and on compliance of NCIO in 2018 (Reference A).

**AIM**

2. This report summarises the IBAN Auditor's Report to enable 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.

3. The RPPB is mandated under Article 15 of the NFRs (reference B) to provide Council with comments and recommendations on the IBAN Auditor's Report. The RPPB acknowledges the issues highlighted in the IBAN audit report have already been considered and dealt with by the appropriate governing bodies of NCIO (the Audit Committee and the Agency Supervisory Board (ASB)). In this regard the RPPB notes this report is based on comments provided by the NCIO in the IBAN report (References A and E) and the discussion at the RPPB meeting on 30 June 2020.

**OBSERVATIONS**

4. The IBAN raised three observations during the audit in 2018 for which the first two observations superseded those raised in prior years. The first observation impacts the audit opinion on both the financial statements and on compliance and was first raised in respect of the 2013 financial statements. The second observation only affects the audit opinion on the financial statements and was first raised in respect of the 2016 financial statements. The remaining observation is new and did not impact the audit opinion.

The IBAN also followed up on the status of observations from previous years' audits and notes five were closed, seven were in progress, and three were open.

5. Observation 1: The IBAN issued a qualified opinion on the financial statements and on compliance because of a lack of integrated systems to support the management and financial reporting of property, plant and equipment (PP&E) and intangible assets. This observation has also been the basis for qualified audit opinions since 2013. To partly mitigate the risk of further qualified opinions, the Agency has continued with the phased implementation of its planned integrated solution, Enterprise Business Applications (EBA), which completed phase 1 in January 2019 after several delays. The Agency has since reported a delay to full compliance because the data supporting assets under construction and intangible assets are still to be fully validated. The Agency is seeking a major improvement in the 2020 financial statements through validating the data supporting both assets under construction and separately, intangible assets by December 2021.

6. Observation 2: The IBAN found an understatement of inventory and equivalent overstatement of deferred revenue plus advances approximated at EUR 32.3 million, this has been the cause for a qualified opinion on the financial statements since 2016. The IBAN found that the Agency deducted the amount of inventory purchased prior to 2013 as an accounting adjustment from the inventory stated in 2018 financial statements. The IBAN believe the assumption made by the Agency is not accurate because much of the 2013 inventory should have been consumed or impaired.

6.1. The NCIO noted that the Agency has complete accounting records for the physical inventory balances, which were confirmed by the IBAN. Whilst the Agency intend to disclose a more reliable closing inventory balance for 2019 financial statements, the current setup in EBA is hampering efficient and detailed reporting of inventory balances. Ad-hoc reports were in place to secure the publication of the 2019 financial statements and with a view to reduce the risk of material errors.

7. Observation 3: The IBAN found that for the service expenses, the full amount of the accrual was the same as the full value of open purchase orders at year end. IBAN highlighted that it is unlikely that all open purchase orders would have been delivered before the end of the financial year, therefore the accrual value of EUR 43 million is likely to be overstated. This observation did not impact the opinion on the financial statements or on compliance because the overstatements are not considered material. In future IBAN recommends that NCIA complete a review of all open purchase orders to make the best estimate of the value of accruals at year end.

7.1. The Agency commented that the compressed timelines to implement EBA did not give sufficient time to calculate the accrual and in the absence of further evidence the Agency took a prudent approach to calculating the accrual value. To provide further checks an additional assessment of the accruals value has taken place during 2019 and in the opinion of the Agency this should resolve this observation in respect of the 2019 financial statements.

8. Prior year observations: In their consolidated action plan NCIO offer that seven prior year observations are candidates for closure for the 2019 audit with four likely to remain in-

progress or open. This will be detailed in the subsequent IBAN Auditor's Report which is currently planned to be submitted to Council in October 2020.

Further progress is required in the area of internal audit where IBAN observe that the internal control and risk management framework are not sufficiently mature to be evaluated. NCIO has taken steps to improve the areas of risk management, internal control and fraud prevention and has noted this implementation will take time so a precise resolution date is difficult to estimate. Both IBAN and NCIO highlight that the 2020 review of the NFRs and FRPs should clarify the need for an independent reporting line for internal auditing. NCIO offer the estimated target date for resolution is December 2022.

8.1. The IBAN noted some improvements in the quality of data within the Time Accounting System however it was still open to retrospective corrections and significant weaknesses were noted in data quality, management oversight and incomplete and ineffective control frameworks. The Agency note this is a continual improvement process and is linked to the expected implementation of Portfolio, Programme, Project and Service Management system which they have included as part of their 2020-2022 business plan. They note that this implementation is dependent on the support of an appropriate funding mechanism and associated sustainment package to be decided at ASB level.

## **DISCUSSION**

9. The Board raised its concerns with the results of this audit qualification and that the resultant action of the audit findings are getting the appropriate attention they deserve. The Agency reassured the Board that they have already taken significant measures to close most of the observations, but some outstanding observations will not be resolved without further improvements to EBA.

10. Furthermore in 2019, the NCIO ASB in its role as the governing body of the Agency, setup the Audit Committee to oversee the Agency's action plan and timeline for remediation of outstanding IBAN observations. The Board recognises the NCIO is best placed to deal with the overall response and closely track progress against all IBAN observations and recommendations through their consolidated action plan (reference E).

11. The Board query the feasibility of the action plan especially in light of the IBAN observation in relation to the Time Accounting System, which is part of EBA Release 4 and in 2018 remains open with a lack of demonstrable progress. NCIO and the Agency highlight that a system implementation will not resolve these issues alone. In terms of implementation of EBA further work is required to adjust underlying processes and behaviours and in terms of the Time Accounting System further discussions are required to agree the internal funding mechanisms to enable this activity to continue. The Board recognises that this considerable undertaking has been in development for the past couple of years and expects that the adjustment in processes will also be ready by full system implementation.

12. The Board welcome the potential resolution of the observation in relation to understatement of inventory and in this regard look forward to the 2019 Auditor's Report to provide a confirmation.

13. The Board notes that an observation related to NCIO has been highlighted in the IBAN audit of the 2018 financial statements for Allied Command Operations (ACO) (reference F). The Board notes from the observations raised in this report that deficiencies in the Agency's financial management have a direct impact on other common funded NATO entities. The Board reinforce the need for the Agency to work with its customers to provide improvements.

## **CONCLUSIONS**

14. The IBAN raised three observations during the audit in 2018 for which the first two observations superseded those raised in prior years. The first observation impacts the audit opinion on both the financial statements and on compliance and was first raised in respect of the 2013 financial statements. The second observation only affects the audit opinion on the financial statements and was first raised in respect of the 2016 financial statements. The remaining observation is new and did not impact the audit opinion. The IBAN also followed up on the status of observations from previous years' audits and notes five were closed, seven were in progress, and three were open.

15. The Agency offered the Board that seven prior year observations are candidates for closure for the 2019 audit with four likely to remain in-progress or open. This will be detailed in the subsequent IBAN Auditor's Report which is currently planned to be submitted to Council in October 2020.

16. Full implementation of EBA aims to resolve the first IBAN qualification and enable NCIO to fully comply with the NATO Accounting Framework and the Agency accounting policy with respect to fixed assets. The Agency has since reported a delay to full compliance and is now seeking a major improvement in the 2020 financial statements. NCIO and the Agency highlight that further work is required to adjust underlying processes and behaviours to fully implement the EBA solution and resolve the IBAN observation. In this respect the Board expects that the adjustment in processes will also be ready by full system implementation.

17. The Board welcome the resolution of the remaining audit observation in relation to understatement of inventory and in this regard look forward to reviewing the results of the 2019 audit available in late 2020.

18. On a related matter to the NCIO audit activity the Board notes that deficiencies in the Agency's financial management have a direct impact on other common funded NATO entities. The Board reinforces the need for the Agency to work with its customers to provide improvements.

19. The Board recognise that NCIO is best placed to deal with the overall response to the audit findings and closely track progress against all IBAN observations and recommendations through their consolidated action plan.

**RECOMMENDATIONS**

- 20. The Resource Policy and Planning Board recommends that the Council:
  - 20.1. note this report and the IBAN report at reference A;
  - 20.2. agree the conclusions at paragraphs 14 to 19; and
  - 20.3. agree to the public disclosure of the 2018 financial statements, the associated IBAN Auditor's Report and this report in line with agreed policy at Reference D.



NORTH ATLANTIC TREATY ORGANIZATION  
ORGANISATION DU TRAITÉ DE L'ATLANTIQUE NORD

INTERNATIONAL BOARD OF AUDITORS FOR NATO  
COLLÈGE INTERNATIONAL DES AUDITEURS EXTERNES DE L'OTAN

**NATO UNCLASSIFIED**

Enclosure to  
C-M(2020)0036



IBA-A(2019)0118  
27 September 2019

To: Secretary General  
(Attn: Director of the Private Office)

Cc: Chairman, Agency Supervisory Board, NATO Communications & Information Organisation (NCIO)  
General Manager, NATO Communications & Information Agency (NCIA)  
Financial Controller, NCIA  
Chairman, Resource Policy and Planning Board (RPPB)  
Branch Head, Secretariat and Finance Branch, NATO Office of Resources (NOR)  
Private Office Registry

Subject: ***International Board of Auditors for NATO (IBAN) Auditor's Report and Letter of Observations and Recommendations on the audit of the NATO Communications and Information Organisation (NCIO) Financial Statements for the year ended 31 December 2018 – IBA-AR(2019)0019***

IBAN submits herewith its approved Auditor's Report (Annex 2) and Letter of Observations and Recommendations (Annex 3) with a Summary Note for distribution to the Council (Annex 1).

The IBAN report sets out a qualified opinion on the Financial Statements and on compliance for the financial year 2018.

Yours sincerely,

Dr. Hans Leijtens  
Chairman

Attachments: As stated above.





**NATO UNCLASSIFIED**

**ANNEX 1**

**Summary Note for Council  
by the International Board of Auditors for NATO (IBAN)  
on the audit of the Financial Statements of the  
NATO Communications and Information Organisation (NCIO)  
for the year ended 31 December 2018**

NCIO consists of the NCI Agency and its governance structure. The mission of the NCI Agency is to deliver to NATO secure, coherent, cost effective and interoperable communications and information systems and services in support of consultation, command and control (C3) and enabling intelligence, surveillance and reconnaissance capabilities. It includes information technology support to NATO Headquarters, the Command Structure and NATO Agencies. In 2018, NCIO generated revenues of EUR 862.591 million and incurred expenses of EUR 863.067 million, resulting in a deficit of EUR 0.476 million.

IBAN issued a qualified opinion on the financial statements and on compliance for the year ended 31 December 2018.

During the audit, IBAN made three observations and recommendations. These findings are in the Letter of Observations and Recommendations (Annex 3).

The main findings are listed below. Observation one and two impact the audit opinion on the financial statements. Observation one also impacts the opinion on compliance:

1. Lack of integrated systems to support the management and financial reporting of property plant and equipment (PP&E) and intangible assets.
2. Understatement of inventory.
3. Methodology for calculating the service delivery accrual.

IBAN also followed up on the status of observations from its previous years' audit and noted that five were closed, seven were in-progress and three were open.

The Auditor's Report (Annex 2) and the Letter of Observations and Recommendations (Annex 3) were issued to the NCIO whose comments have been included, with the IBAN's position on those comments where necessary (Appendix to Annex 3).

**NATO UNCLASSIFIED**

**ANNEX 2**  
**IBA-AR(2019)0019**

27 September 2019

**INTERNATIONAL BOARD OF AUDITORS FOR NATO**

**LETTER OF OBSERVATIONS AND RECOMMENDATIONS**

**FOR THE NATO COMMUNICATIONS AND INFORMATION ORGANISATION**

**(NCIO)**

**FOR THE YEAR ENDED 31 DECEMBER 2018**

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

ANNEX 2  
IBA-AR(2019)0019

**INDEPENDENT AUDITOR'S REPORT  
TO THE NORTH ATLANTIC COUNCIL**

**Report on the Audit of the Financial Statements**

**Qualified Opinion on the Financial Statements**

The International Board of Auditors for NATO (IBAN) has audited the Financial Statements of the NATO Communications and Information Organisation (NCIO), for the 12 month period ended 31 December 2018, issued under document reference NCIA/FC/2019/03123, and submitted to IBAN on 31 March 2019. These Financial Statements comprise the Statement of Financial Position as at 31 December 2018, the Statement of Financial Performance, the Statement of Changes in Net Assets/Equity and the Statement of Cash Flow, for the 12 month period ended 31 December 2018, including a summary of significant accounting policies and other explanatory notes. In addition, the Financial Statements include a budget execution report for the 12 month period ended 31 December 2018.

In our opinion, except for the effects of the matter described in the Basis for Opinion section of our report, the Financial Statements give a true and fair view of the financial position of NCIO as at 31 December 2018, and of its financial performance, its cash flows and budget execution for the 12 month period ended 31 December 2018, in accordance with accounting requirements and reporting standards consistent with the NATO Accounting Framework.

**Basis for Opinion on the Financial Statements**

We were not able to obtain sufficient evidence in respect to the completeness of Property, Plant and Equipment, Intangible Assets, Computer Information Systems under construction and Automated Information Systems under construction disclosed on the Statement of Financial Position. This is because NCIO's two legacy accounting systems and separate logistic systems do not adequately support the financial reporting of these assets.

In addition, IBAN found that inventory disclosed in the Statement of Financial Position was understated by around EUR 32.3 million. This was because NCIA erroneously continued to remove from inventory an amount identified as purchased prior to 2013 as allowed by the NATO Accounting Framework. At the end of 2018, this adjustment was no longer valid as the vast majority of pre 2013 inventory was consumed and replaced. Deferred Revenue and Advances, liabilities, are also understated by around EUR 32.3 million.

In accordance with the NATO Financial Regulations (NFRs), external audit of the NATO bodies pursuant to the North Atlantic Treaty shall be performed by IBAN.

**NATO UNCLASSIFIED**

ANNEX 2  
IBA-AR(2019)0019

We have conducted our audit in accordance with the International Standards of Supreme Audit Institutions (ISSAIs 1000-1810) developed by the International Organisation of Supreme Audit Institutions (INTOSAI) and in accordance with the additional terms of reference defined in our Charter.

We are independent in accordance with the INTOSAI Code of Ethics and we have fulfilled our other ethical responsibilities in accordance with these requirements. The responsibilities of the members of IBAN are more extensively described in the section «Auditor's Responsibilities for the Audit of the Financial Statements» and in our Charter. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Management's Responsibility for the Financial Statements**

Management's responsibility for the financial statements is laid down in the NFRs. The Financial Statements of NCIO are drawn up in accordance with accounting requirements and reporting standards consistent with the NATO Accounting Framework as approved by the Council. The Financial Controller is responsible for submitting the Financial Statements for audit to IBAN not later than 31st March following the end of the financial year.

The Financial Statements are signed by the Head of the NATO body and the Financial Controller. In signing the Financial Statements, the Head of NATO body 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.

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.

**Auditor's Responsibilities for the Audit of the Financial Statements**

The objectives of the audit are 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 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.

**NATO UNCLASSIFIED**

**ANNEX 2**  
**IBA-AR(2019)0019**

As part of an audit in accordance with ISSAIs, we exercise professional judgement and maintain professional scepticism throughout the planning and performance of the audit. This involves taking into account Considerations Specific to Public Sector Entities. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 the entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of the use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We are required to communicate with the bodies charged with governance, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our Independent External Auditor's Report is prepared to assist North Atlantic Council in carrying out its role. We are therefore responsible solely to the North Atlantic Council for our work and the opinion we have formed.

**NATO UNCLASSIFIED**

ANNEX 2  
IBA-AR(2019)0019

**Report on Compliance**

**Qualified Opinion on Compliance**

Based on the procedures we performed, except for the matter described in the basis of qualification paragraph nothing has come to our attention, as part of our audit of the Financial Statements 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 NATO Financial Regulations and the NATO Civilian Personnel Regulations.

**Basis for Opinion on Compliance**

We did not obtain sufficient evidence that comprehensive records of all property controlled by NCIO have been established as required by Article 12 of the NATO Financial Regulations. This is because the two legacy accounting systems and the various logistic tools in use still do not mitigate the risk that property is not recorded.

We have conducted our compliance audit in accordance with the International Standards of Supreme Audit Institutions (ISSAI 4000) developed by the International Organisation of Supreme Audit Institutions (INTOSAI) and in accordance with the additional terms of reference defined in our Charter.

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

**Management's Responsibility for Compliance**

All NATO staff, military and civilian, are obligated to comply with the NATO Financial Regulations, associated Financial Rules and Procedures and internal implementing directives. These include the NATO Civilian Personnel Regulations.

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

**NATO UNCLASSIFIED**

ANNEX 2  
IBA-AR(2019)0019

### **Auditor's Responsibilities for Compliance**

In addition to the responsibility to provide reasonable assurance about whether the financial statements as a whole are free from material misstatement, the IBAN Charter requires IBAN to provide independent assurance and report annually to the North Atlantic Council about whether funds have been properly used for the settlement of authorised expenditure (propriety) and are in compliance with the regulations in force (regularity). Propriety relates to the observance of the general principles governing sound financial management and the conduct of public officials. Regularity concerns the adherence to formal criteria such as relevant regulations, rules and procedures.

This responsibility includes performing procedures to obtain independent assurance about whether funds have been properly used for the settlement of authorized expenditure and whether they have been used in compliance with the regulations in force. Such procedures include consideration of the risks of material non-compliance.

Brussels, 27 September 2019



Dr. Hans Leijtens  
Chairman

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

**ANNEX 3**  
**IBA-AR(2019)0019**

27 September 2019

**INTERNATIONAL BOARD OF AUDITORS FOR NATO**

**LETTER OF OBSERVATIONS AND RECOMMENDATIONS**

**FOR THE NATO COMMUNICATIONS AND INFORMATION ORGANISATION**

**(NCIO)**

**FOR THE YEAR ENDED 31 DECEMBER 2018**

**NATO UNCLASSIFIED**



**NATO UNCLASSIFIED**

**ANNEX 3**  
**IBA-AR(2019)0019**

## **Introduction**

The International Board of Auditors for NATO (IBAN) audited the NATO Communications and Information Organisation (NCIO) Financial Statements for the year ended 31 December 2018, and issued a qualified opinion on both the financial statements and on compliance. The reasons for the qualification, as well as other observations and recommendations, are summarised in the Observations and Recommendations section below.

## **Observations and Recommendations**

During the audit, IBAN made three observations and recommendations.

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

1. Lack of an integrated system to support the management and financial reporting of Property, Plant and Equipment (PP&E) and Intangible Assets.

One observation impacts the audit opinion on the financial statements:

2. Understatement of Inventory.

The final audit observation does not impact the audit opinion:

3. Service delivery expense accrual valuation.

IBAN also followed up on the status of observations from previous years' audits and noted that five were closed, seven were in-progress and three were open.

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

ANNEX 3  
IBA-AR(2019)0019

**OBSERVATIONS AND RECOMMENDATIONS**

**1. LACK OF AN INTEGRATED SYSTEM TO SUPPORT THE MANAGEMENT AND FINANCIAL REPORTING OF PROPERTY, PLANT AND EQUIPMENT (PP&E) AND INTANGIBLE ASSETS**

**Reasoning**

1.1. Article 12 of the NATO Financial Regulations (NFRs) requires NATO bodies to establish and maintain comprehensive accounting records of all assets and liabilities. Furthermore, the NATO Accounting Framework requires that NATO bodies shall capitalise in their Statement of Financial Position all controlled Property, Plant and Equipment (PP&E) and Intangible assets purchased after 1 January 2013 above certain capitalisation thresholds.

1.2. The NATO Accounting Framework also states that if NCIO is acting as a service provider to NATO Commands for Computer Information Systems (CIS) or Automated Information Systems (AIS) assets, then NCIO has control over those assets. It also states that such CIS and AIS assets that are under construction should be capitalised from 1 January 2018.

**Observation**

1.3. IBAN found that, as in prior years, NCIO's two legacy accounting systems and separate logistic systems do not provide an effective and efficient control over NCIO's PP&E and Intangible assets. The accounting systems and various asset registers and logistics tools in place still do not mitigate the risks that assets are not recorded or disclosed on the statement of financial position.

1.4. Specifically, we found that NCIA had not assured the completeness of records (compliance) and financial reporting of the following assets:

- CIS and AIS PP&E acquired before and after 1 January 2013, not under construction, and which were acquired through the Core Financial System (CFS). Such assets are considered as controlled by NCIO according to the NATO Accounting Framework;
- CIS and AIS intangible assets acquired before and after 1 January 2013, not under construction, such as Information Technology (IT) Programmes built in-house;
- CIS and AIS assets that were under construction from 1 January 2018.

**NATO UNCLASSIFIED**

ANNEX 3  
IBA-AR(2019)0019

**Recommendation**

1.5 IBAN recommends that, with the implementation of the Enterprise Business Application (EBA) in 2019, all the above assets should be disclosed as PPE, Intangible Assets and CIS and AIS work in progress as appropriate in the NCIO 2019 Financial Statements.

**2. UNDERSTATEMENT OF INVENTORY**

**Reasoning**

2.1. The NATO Accounting Framework (Paragraph 6.3) requires that NATO bodies capitalise in their Statement of Financial Position all controlled inventory purchased after 1 January 2013 above certain capitalisation thresholds.

**Observation**

2.2. IBAN audited the inventory controlled at NCIA's CIS Sustainment Support Centre (CSSC) and found that the improvements found in the previous two years had been maintained. We noted that the CSSC had performed a major physical control and clean-up exercise of all inventory held at the CSSC during 2018. Our testing revealed no errors regarding the quantities that form the listings of inventory supporting the financial statements and the amounts physically controlled by the CSSC.

2.3. In terms of disclosure of inventory in the financial statements, we found that the total value of inventory reported in the Statement of Financial Position was EUR 8.1 million. On the other hand, the total value of actual inventory from the detailed listings provided by the CSSC was EUR 40.4 million. NCIA has assumed that the EUR 32.3 million difference is the value of inventory purchased prior to 1 January 2013. The NATO Accounting Framework allowed the EUR 32.3 million to be expensed. However, we found, as in previous years, the accounting adjustment for inventory purchased prior to 2013 was incorrect. In our opinion, it is a false assumption to deduct the amount of inventory purchased prior to 2013. This is because this inventory would have been consumed or become obsolete by the end of 2018 and replaced by new inventory. As a result, inventory held at 31 December 2018 is understated by around EUR 32.3 million. However, this figure may be affected by adjustments to unit prices and for slow moving and obsolete stocks (see paragraph 2.4 below). Deferred Revenue and Advances in the Statement of Financial Position were also understated by the same amount.

2.4. NCIA disclosed to IBAN that it has concerns over the unit prices migrated from the legacy system NATO Depot and Support System (NDSS). In addition, we noted that the NATO Accounting Framework states that the Agency may choose to write down to the net realisable value items which are considered slow moving over the last

**NATO UNCLASSIFIED**

**ANNEX 3**  
**IBA-AR(2019)0019**

36 months.

## **Recommendation**

2.5. IBAN recommends that, with the implementation of the new EBA in 2019, the Agency disclose the full value of inventory held in its 2019 Financial Statements. In addition, the Agency needs to complete its clean up exercise on unit prices migrated from NDSS. Further, the agency should identify slow moving and obsolete inventory and write them down to net realizable value in the 2019 Financial Statements.

## **3. SERVICE DELIVERY EXPENSE ACCRUAL VALUATION**

### **Reasoning**

3.1 NCIA's financial statements are prepared in accordance with the NATO Accounting Framework on an accrual basis and transactions and events are recorded and recognised in the financial statements in the period to which they relate. At year end, NCIA estimates the value of goods and services rendered during the year but not yet invoiced.

### **Observation**

3.2 For the service expenses (excluding the agency's internal cost accrual), the accrual estimate is based on an analysis of the amount of NCIA's open purchase orders (POs) expensed i.e. goods or services delivered but not yet invoiced at year end. Due to resources involved in implementing EBA and the objective to produce financial statements by 31 March, a less detailed analysis of open POs was carried out compared to previous years. A limited analysis was carried out by service line management of open POs and little feedback received by finance staff as to the amount that should be accrued. NCIA management took the decision to assume, unless receiving evidence to the contrary, that the value of all open POs should be accrued. This resulted in an amount of EUR 44 million of open purchase orders being accrued at year end. In effect, all open POs relating to billable activities (direct expenses) were accrued at year end 2018. This contrasts to 2017, when EUR 35.3 million was accrued from a total of EUR 43.1 million open purchase orders which is around 82%.

3.3 In IBAN's opinion, it is unlikely that the value of all open POs at year end would have been delivered before the end of the financial year. We believe a key control in estimating an accrual is to get detailed feedback from those staff responsible for delivering services as to the amounts delivered but not invoiced at year end. As this did not occur, in IBAN's opinion, it is likely that accruals and expenses are overstated. Revenue is also overstated as it is based on expenses/accruals. As a detailed analysis

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

**ANNEX 3**  
**IBA-AR(2019)0019**

was not done to estimate the accrual at year end, IBAN is not in a position to quantify the overstatement.

3.4 However, in our opinion, the overstatements are not material due to a number of mitigating factors. Firstly, POs and their related deliverables for 2018 were more aligned to the financial year than in 2017. Secondly NCIA track POs in the accounting system that identifies costs to a specific financial year to mitigate risk of future year costs being recognised in the current period. Finally, quarterly reviews are carried out on Service Level Agreements with customers to monitor performance and take action on any issues that might arise. These factors mitigate the risk of material misstatement but, in IBAN's opinion, the key control is always to analyse in detail open POs.

### **Recommendation**

3.5 IBAN recommends that NCIA ensure, in future, that a complete review of all open purchase orders be undertaken by service line management in order to make the best estimate of the value of external service accruals at year end.

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

ANNEX 3  
IBA-AR(2019)0019

**FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS**

IBAN followed up on the status of observations from the previous years' audit. The observations, actions taken by the auditee as reviewed by IBAN, and their status are summarised in the table below.

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p><b>(1) NCIO FY 2017</b> <b>IBA-AR(2018)11, paragraph 1</b></p> <p><b>LACK OF INTEGRATED SYSTEMS TO SUPPORT THE EFFECTIVE AND EFFICIENT MANAGEMENT AND FINANCIAL REPORTING OF PROPERTY, PLANT AND EQUIPMENT (PP&amp;E) AND INTANGIBLE ASSETS</b></p> <p><b>Board's recommendation</b> The Board recommends that NCIO reduces the inefficiencies and risks involved with the use of multiple accounting systems and logistic tools for the recording of PP&amp;E and Intangible Assets and this be accomplished within timelines that have been established i.e. end of 2018.</p>	<p>The Agency intends to achieve this by the end of the 2019 Financial Year when EBA has been fully implemented. <b>This Observation is superseded by Observation 1 in the Letter of Observations and Recommendations and its status is therefore treated as Closed.</b></p>	<p>Observation <b>Closed.</b></p>
<p><b>(2) NCIO FY 2017</b> <b>IBA-AR(2018)11, paragraph 2</b></p> <p><b>EUR 33.4 MILLION UNDERSTATEMENT OF INVENTORY</b></p> <p><b>Board's recommendation</b> The Board recommends that the Agency disclose the full value of inventory held in its 2018 Financial Statements. In addition, the Agency needs to complete its clean up exercise on unit prices migrated from NDSS. Further, the agency needs to identify slow moving and obsolete inventory and write them down to net realizable value in the 2018 Financial Statements. Finally, the agency should ensure that physical inspections and clean up exercises on the inventory held are carried out regularly and preferably on an annual basis.</p>	<p>The Agency intends to achieve this by the end of the 2019 Financial Year when EBA has been fully implemented. <b>This Observation is superseded by Observation 2 in the Letter of Observations and Recommendations and its status is therefore treated as Closed.</b></p>	<p>Observation <b>Closed.</b></p>

**NATO UNCLASSIFIED**

**ANNEX 3**  
**IBA-AR(2019)0019**

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p><b>(3) NCIO FY 2017</b> <b>IBA-AR(2018)11, paragraph 3</b></p> <p><b>NCIA PERSONNEL ESTABLISHMENT POLICY NOT FULLY COMPLIED WITH</b></p> <p><b>Board's recommendation</b> The Board recommends that the Agency:</p> <p>a) Comply strictly with its Personnel Establishment Policy in respect to the ceilings.</p> <p>b) Finalise clarification on the IWC ceiling in the Financial Plan.</p> <p>Further, the Board invites the ASB, as responsible for approving the overall Personnel Establishment, to be more proactive in its oversight role to ensure proper visibility into the Agency personnel management.</p>	<p>a) In 2018, the number of posts for both NATO Civilians and the interim work force capacity (IWC) were within the ceiling in the Financial Plan as approved by the ASB. The ceiling was 2310 and the actual number of posts 2303. <b>Observation Closed.</b></p> <p>b) The Financial Plan 2019 - 2021 clarifies the issue of the overall manpower ceilings for all categories of staff, including the IWC ceiling. In addition, The Financial plan details the ceilings both in terms of posts and Full Time Equivalents (FTEs). <b>Observation Closed.</b></p> <p>Regarding the role of the ASB, the following actions have been taken:</p> <ul style="list-style-type: none"> <li>- With AC/337(FC)N(2018)0016, the Nations have defined the format and content of the Agency's Personnel Establishment submission, including a description of its evolution, trend and projections. Paragraphs 15-18 provide for the inclusion of the total number of civilian and military posts, along with their respective ceilings agreed by the Nations, an analysis of the number of posts compared to the</li> </ul>	<p>Observation <b>In-Progress.</b></p>

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

**ANNEX 3**  
**IBA-AR(2019)0019**

OBSERVATION / RECOMMENDATION	ACTION	STATUS
	<p>previous year, per location and grade, and the distinction of posts between direct and overhead, per directorate, including any potential upgrades or downgrades. Finally, an organisational chart complements the deliverable, while in the future the Agency will indicate the source of revenue for each civilian position. The deliverable shall be released in time for the Finance Committee meeting on 13 Sep 2019.</p> <ul style="list-style-type: none"> <li>- Further to the above, with AC/337(FC)N(2018)0016, paragraph 28, the Nations have demanded an Organisational Directive setting out the applicability, scope, governing principles, roles and responsibilities, as well as a description of the business processes and control mechanisms, regulating the employment of Interim Workforce Capacity. The deliverable shall be issued ahead of the Finance Committee meeting on 13 Sep 2019.</li> <li>- With AC/337-N(2018)0020 and AC/337-D(2019)0020, the Nations have obtained visibility of personnel trends from 2015 onwards, including the evolution of the Personnel Establishment' structure, composition, grades, and diversity. The next deliverable will focus on the "to be", and will be</li> </ul>	

**NATO UNCLASSIFIED**



NATO UNCLASSIFIED

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
	<p>embedded in the 2020-2022 Business Plan, with ceilings agreed upon in the context of the 2020-22 Financial Plan.</p> <ul style="list-style-type: none"> <li>- With AC/337-N(2019)0011, page 8, the Nations have monitored the military and civilian manning per quarter, against the agreed ceiling. This type of deliverable is released on a quarterly basis.</li> <li>- With AC/337-N(2018)0023 + COR, The ASB delegated the oversight of the Agency's Personnel Establishment to the Finance Committee.</li> </ul> <p><b>Observation In-Progress.</b></p>	
<p><b>(4) NCIO FY 2017</b> <b>IBA-AR(2018)11, paragraph 4</b></p> <p><b>FURTHER IMPROVEMENTS REQUIRED IN THE AREA OF RISK MANAGEMENT, INTERNAL CONTROL AND INTERNAL AUDIT</b></p> <p><b>Board's recommendation</b> While continuing the effort of maintain corporate Enterprise Risk, the Board recommends that:</p> <ul style="list-style-type: none"> <li>a) NCIO perform a systematic and detailed assessment and documentation of its internal control and risk management procedures to support compliance with its approved internal control framework.</li> <li>b) NCIO issues clear directions on appropriate mechanisms for fraud</li> </ul>	<ul style="list-style-type: none"> <li>a) In 2018, the Agency continued to develop risk registers with related mitigating controls in accordance with the COSO framework adopted by the ASB. Additional work was done in the area of recruitment. In addition, a high level self-assessment of internal controls was completed by Senior Management and the Chairman of the ASB.</li> </ul> <p><b>Observation In-progress.</b></p> <ul style="list-style-type: none"> <li>b) The Internal Control Framework as described in a) above is regarded by the</li> </ul>	<p><b>Observation In-progress.</b></p>

NATO UNCLASSIFIED

NATO UNCLASSIFIED

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p>prevention and detection related to financial activities.</p> <p>c) Internal Audit</p> <ul style="list-style-type: none"> <li>- fully evaluate, once the system is in place, the internal control and risk management throughout NCIA, and that this work be clearly documented, so as to be able to conclude as to NCIA's compliance against COSO;</li> <li>- modifies its Charter to ensure independence in compliance with internationally accepted Internal Auditing Standards as mentioned in Article 13.2 of the NFRs.</li> </ul>	<p>agency as the appropriate mechanism for the detection and prevention of fraud. To date, Internal Audit has assisted finance, acquisitions and the recruitment process in the identification of appropriate mitigating controls. <b>Observation In-progress.</b></p> <p>c) The Internal control and risk management framework is not yet sufficiently developed in NCIA to be evaluated. <b>Observation Open.</b></p> <p>Regarding the Charter, internationally accepted internal audit standards and reporting lines, this is a NATO wide issue that will be part of the review of the NFRs and FRPs. <b>Observation In-Progress.</b></p>	
<p><b>(5) NCIO FY 2017</b> <b>IBA-AR(2018)11, paragraph 5</b></p> <p><b>NO CLEAR CONFIRMATION OF THE SYSTEM OF INTERNAL CONTROL</b></p> <p><b>Board's recommendation</b> The Board recommends that NCIO's Statement of Internal Control contain the confirmations required by FRP XII including the confirmation by the Director of Acquisition on the content for procurement and contracting of the Statement of Internal Control.</p>	<p>The Statement of internal control still does not comply with the wording of FRP XII. Specifically, the following elements are not included:</p> <ul style="list-style-type: none"> <li>- confirmation that an effective system of internal control is operated by the entity.</li> <li>- confirmation with regard to safeguarding of assets.</li> <li>- areas of improvement of the System of Internal Control and an assessment of the possible impact of these weaknesses.</li> </ul>	<p>Observation <b>Open.</b></p>

NATO UNCLASSIFIED

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p><b>(6) NCIO FY 2017</b> <b>IBA-AR(2018)11, paragraph 6</b></p> <p><b>WEAKNESSES IN THE SOURCE SELECTION PLANNING PROCESS</b></p> <p><b>Board's recommendation</b> The Board recommends that the Agency comply with its 2017 Acquisition SOP ensuring that sufficient resources are planned for the evaluation and selection phases and that Source Selection Plans are approved prior to the issuance of the solicitation document.</p>	<p>A revised SOP 16.1 has been implemented in 2019. NCIA believe that implementation of the SOP should ensure that sufficient resources are available for the evaluation and selection phases. The Board will follow up this issue as part of its 2019 audit.</p>	<p>Observation <b>Open.</b></p>
<p><b>(7) NCIO FY 2016</b> <b>IBA-AR(2017)15, paragraph 3</b></p> <p><b>LACK OF CONSISTENT AND ROBUST PROCESS FOR DETERMINING CAPABILITY DEVELOPMENT PROJECT REVENUE FOR THE PERIOD</b></p> <p><b>Board's recommendation</b> The Board recommends NCIA to improve the Cost-to-Complete estimate by:</p> <p>Incorporating project investment costs into an integrated system in order to consolidate the assessment of future costs of a project. Standardising the "cost-to-complete" estimation processes among the Project Managers, ensuring thorough reviews by management and Finance are strengthened again, and documenting these and the results of the estimation process. Ensuring the year-end instructions to Project Managers are more descriptive on how "cost-to-complete" should be estimated.</p>	<p>NCIA over time has significantly improved the quality of the CTC process and IBAN notes the increased accuracy of the Cost to Complete estimates. With the introduction of EBA, a new more integrated approach (less reliance on spreadsheets) is planned to be implemented by the end of 2019. We will evaluate these processes as part of our audit of the NCIO 2019 financial Statements.</p>	<p>Observation <b>In-progress.</b></p>

NATO UNCLASSIFIED

NATO UNCLASSIFIED

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p><b>(8) NCIO FY 2016</b> <b>IBA-AR(2017)15, paragraph 6</b></p> <p><b>CONTRACTOR CLAIM RESULTING FROM CHANGING AND DELAYED CONTRACT REQUIREMENT DEFINITION AND WEAK COORDINATION BETWEEN NCIA AND THE INVESTMENT COMMITTEE</b></p> <p><b>Board's recommendation</b> The Board reminds NCIO and the funding committees of the recommendations of the IBAN Special Performance Audit Reports to Council on the need to improve NATO's capability package process, including:</p> <ul style="list-style-type: none"> <li>- For the Agency, improving information management and transparency by rationalizing and modernizing the processes and information technology used to manage Capability Package work.</li> <li>- For the funding committees, unifying, strengthening and clarifying governance roles to ensure capability requirements reflect needs and enable capability delivery as closely as possible to agreed plans.</li> </ul>	<ul style="list-style-type: none"> <li>- A proposed new format of quarterly reports on NSIP implementation to the investment committee which focuses on broader capabilities and highlights achievements has yet to be developed. <b>Observation Open.</b></li> <li>- The Deputy Permanent Representative Committee (DPRC) is monitoring the ongoing implementation of the newly agreed approach on common funded capability delivery governance structure. <b>Observation In-progress.</b></li> </ul>	<p>Observation <b>In-progress.</b></p>
<p><b>(9) NCIO FY 2016</b> <b>IBA-AR(2017)15, paragraph 10</b></p> <p><b>WEAKNESSES IN THE TIME ACCOUNTING SYSTEM (TAS)</b></p> <p><b>Board's recommendation</b> The Board has seen improvement in the quality of the TAS data since its full implementation with Service Delivery in 2014. Nevertheless, as EBA has been delayed and the Agency is not yet working with its integrated management system, the Board recommends NCIO to continue its efforts in mitigating risks and internal controls specifically for "internal service providers" and for the CIS delivery to Alliance Operation Missions.</p>	<p>IBAN has noted improvements over time in the quality of the TAS data. However, IBAN found that the TAS in practice is still open to retrospective corrections. In addition, a performance audit was carried out by IBAN in 2018 (IBA-A (2019)0019. Whilst noting improvements in the TAS, the</p>	<p>Observation <b>Open.</b></p>

NATO UNCLASSIFIED

NATO UNCLASSIFIED

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
	report also outlined significant weaknesses in data quality, management oversight of TAS data and an incomplete and ineffective control framework. As a result, IBAN regards this recommendation as still open.	
<p><b>(10) NCIO FY 2016</b> <b>IBA-AR(2017)15, paragraph 3</b></p> <p><b>INCOMPLETE INFORMATION IN THE DISCLOSURE NOTES ON THE TRANSITION PROGRAMME</b></p> <p><b>Board's recommendation</b> The Board recommends that, in future, the note related to the Transition Programme include full disclosure of IC funding provided during the year for transition activities.</p>	<p>Note 32 of the NCIO 2018 financial statements contains considerable and adequate information on the Transition Funding and Expenditure.</p>	<p>Observation <b>Closed.</b></p>
<p><b>(11) NCIO FY 2014</b> <b>IBA-AR(2015)20, paragraph 7</b></p> <p><b>LACK OF A FORMAL AND DOCUMENTED PROCESS TO IDENTIFY AND DISCLOSE CONTINGENT LIABILITIES</b></p> <p><b>Board's recommendation</b> The Board recommends that NCIO improve the way that information on contingent liabilities is requested, collected and assessed. Such a process is necessary to ensure that contingent liabilities disclosures in the Financial Statements are accurate and complete. The process should be also fully documented as well.</p>	<p>Agency Instructions on reporting of provisions, contingent liabilities/assets and events after the reporting period came into effect on 12 July 2018 (INSTR 04.03.02.07). In addition, the agency provided IBAN with a summary of the inputs provided by the key members of staff involved through the agency's Tasker Tracking System.</p>	<p>Observation <b>Closed.</b></p>

NATO UNCLASSIFIED

NATO UNCLASSIFIED

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p><b>(12) NCIO FY 2014</b> <b>IBA-AR92015)20, paragraph 8</b></p> <p><b>INCOMPLETE CONFIRMATION OF YEAR - END ASSETS AND LIABILITIES OUTSTANDING BETWEEN NATO BODIES</b></p> <p><b>Board's recommendation</b> The Board recommends that NCIO improve its process to prepare, send and receive confirmation of the outstanding asset and liabilities balances from other NATO Bodies as part of the preparation of the Financial statements.</p>	<p>Material Assets and Liabilities were confirmed with most significant NATO bodies i.e. ACO, IS and IMS. However, further progress needs to be made regarding transactions with ACT.</p>	<p>Observation <b>In-progress.</b></p>
<p><b>(13) NCIO FY 2013</b> <b>IBA-AR(2014) 22, paragraph 4</b></p> <p><b>NCIO's FINANCIAL REPORTING PROCESSES DO NOT YET FULLY MITIGATE THE RISK OF ERRORS IN THE FINANCIAL STATEMENTS</b></p> <p><b>Board's recommendation</b> The Board recommends NCIO to improve its financial reporting control procedures, including management reviews, in order to ensure that they adequately mitigate the risk of errors in the financial statements.</p>	<p>Due to the implementation of EBA by end of 2019, new procedures and controls will be put in place by the Agency. These will be assessed as part of IBAN's audit of the 2019 financial statements.</p>	<p>Observation <b>In-progress.</b></p>
<p><b>(14) NCIO FY 2012</b> <b>IBA-AR92013)23, paragraph 6</b></p> <p><b>NCIA SD SEGMENT FINANCIAL STATEMENTS ( former NCSA)</b></p> <p><b>Board's Recommendation</b> The Board Recommends that now that an adapted IPSAS framework has been approved with different requirements for PP&amp;E compared to IPSAS 17, NCIA should develop a detailed accounting policy on PP&amp;E and ensure sufficient note disclosures on PP&amp;E in future financial statements.</p>	<p>Please see Observation 1 in the letter of observations and recommendations. The Agency intends to achieve this by the end of the 2019 Financial Year when EBA has been fully implemented.</p>	<p>Observation <b>In-progress.</b></p>

**NATO UNCLASSIFIED**

ANNEX 3  
IBA-AR(2019)0019

OBSERVATION / RECOMMENDATION	ACTION	STATUS
<p><b>(15) NCSA FY 2012</b> <b>IBA-AR92012)10, paragraph 5.2</b></p> <p><b>NO CONSOLIDATION OF MORALE AND WELFARE ACTIVITIES (MWA)</b></p> <p><b>Board's Recommendation</b> The Board recommends that NCSA consolidates the MWA activities into the NCSA Financial Statements in order to present fairly the total revenue, expenditures, assets and liabilities.</p>	<p>The NATO Accounting Framework C-M(2016) 0023 does not require that MWA activities be consolidated in NATO financial statements since 2016.</p>	<p>Observation <b>Closed.</b></p>

The Open status is used for recommendations that are open and for which no notable progress has been achieved to date. The In-progress status is used for open recommendations when the NATO Body has started to implement the recommendation or when some (but not all) sub-recommendations are closed. The Closed status is used for recommendations that are closed because they have been implemented, are superseded, or have lapsed.

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

**NATO COMMUNICATIONS AND INFORMATION AGENCY (NCIA) FORMAL  
COMMENTS ON THE LETTER OF OBSERVATIONS AND RECOMMENDATIONS  
AND THE INTERNATIONAL BOARD OF AUDITORS (IBAN) POSITIONS**

**OBSERVATION 1:**

**LACK OF AN INTEGRATED SYSTEM TO SUPPORT THE MANAGEMENT AND  
FINANCIAL REPORTING OF PROPERTY, PLANT AND EQUIPMENT (PP&E) AND  
INTANGIBLE ASSETS**

***NCIA's Formal Comments***

*The Agency agrees to the need for an integrated solution, this will be provided by the EBA at the time when full system functionality is enabled. Meanwhile the Board has recognised the significant efforts by NCI Agency to mitigate some of the asset management issues. Importantly, the migration of PP&E and inventory recorded in NATO Depot and Support System (NDSS) to its former CNAFS accounting system was completed at the CIS Service Support Centre (CSSC) and at the CIS Support Units. The NCI Agency has further undertaken continuous efforts in order to ensure that EBA will adequately handle the PPE and intangible assets accounting requirements and specifically the assets under construction for which the EBA implementation is a pre-requisite for the Agency.*

**OBSERVATION 2:**

**UNDERSTATEMENT OF INVENTORY**

***NCIA's Formal Comments***

*As a result of the Hand Over / Take Over of Inventory from the NATO Commands in 2014, the NCI Agency applied the accounting treatment for inventories prescribed in the NATO Accounting Framework<sup>1</sup> for inventory acquired prior to 1 January 2013 and considered it as fully expensed.*

*The IBAN's audit at the NCIA's CIS Sustainment Support Centre confirmed that the NCI Agency has complete accounting records for the physical inventory balances. The Agency notes the improvements found by the IBAN were maintained in 2018 and that testing revealed no errors regarding the quantities that form the listings of inventory supporting the financial statements and the amounts physically controlled by the CSSC.*

*The Agency agrees that the adjusting accounting entry (consistent with the NATO Accounting Framework) from 2014 that decreased the asset for the value of the*

**NATO UNCLASSIFIED**



**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

*prior 2013 acquired inventory items must be reviewed, in order to disclose the full value of inventory in stock on its statement of financial position. In addition we will make the effort in identifying slow moving and obsolete inventory and will validate the unit prices that were migrated from NDSS.*

*It intends to clean this data with the objective of disclosing a more reliable figure for inventory balances by the end of 2019.*

**OBSERVATION 3:  
SCOPE LIMITATION ON COMPLIANCE WITH PROCUREMENT RULES  
[Observation 3 now deleted in this Letter of Observations and Recommendations]**

***NCIA's Formal Comments***

*As per IBA-A(2019)0078 cover letter where IBAN indicates that the Agency need to formally request in writing to IBAN to complete the procurement work subsequent to the issuance of the attached draft audit report this request/letter has been send by NCI Agency on 29 July 2019- NCIA/ACQ/2019/123688.*

*In the meantime IBAN auditors are conducting their field audit on procurement hence the Agency is not in a position to respond to this observation.*

*Formal comments from the Agency will be provided to IBAN as soon we will receive the final observation/recommendation resulting from this IBAN field audit.*

**IBAN's Position**

**IBAN completed its work on procurement and found no issues to report. As a result, the scope limitation on compliance with procurement rules and the associated observation and recommendation have been removed from this final report.**

**OBSERVATION 4:  
SERVICE DELIVERY EXPENSE ACCRUAL VALUATION  
[Now observation 3 in this Letter of Observations and Recommendations]**

***NCIA's Formal Comments***

*The transition phase of EBA that occurred from mid December 2018 till end of February 2019 resulted in a compressed timeframe to obtain feedback from the service lines management to calculate the service delivery expense accruals. As*

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

*a consequence the Agency has taken a prudent approach to calculate best estimate of the accruals whenever feedback was not available from the service line management.*

*Within EBA, the accrual process is based on the recorded receipt of goods and/or services entered by the service line management (task managers/project managers). Such shift of the process enables accruals to be reflected in the financial records immediately after goods are delivered or services rendered directly by the respective requestors, which in the Agency's opinion provides more accurate estimates and ensures better accountability and transparency.*

## **FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS**

### **(4) NCIO FY 2017**

**IBA-AR(2018)11, paragraph 4**

### **FURTHER IMPROVEMENTS REQUIRED IN THE AREA OF RISK MANAGEMENT, INTERNAL CONTROL AND INTERNAL AUDIT**

#### **NCIA's Formal Comments**

*a) In 2018, the Agency continued to develop risk registers with related mitigating controls in accordance with the COSO framework adopted by the ASB. For all identified risks, controls have been developed and documented by management, considering the risk appetite of the Agency. The internal control section of each risk register describes and documents each control, how it is implemented, who owns/co-owns it and how it is to be treated. The development of the controls is based on the 17 principles of the COSO framework as well as the relevant point of focus. In addition, a high level self-assessment of internal controls was completed by Senior Management and the Chairman of the ASB. IA will continue to support management in the implementation of the NCIO Internal Control Framework.*

*b) The Internal Control Framework as described in point a) above as well as the provisions of the Agency Directive on Enhancing Transparency and Accountability in the NCI Agency - Fraud Prevention (AD 05.04), are regarded by the Agency as the appropriate mechanism for the detection and prevention of fraud. To date, Internal Audit and the Fraud Prevention and Detection Manager have assisted Finance, Acquisition and HR for the recruitment process, in the identification of risks of fraud and in the development of appropriate mitigating controls. The significant progress made by the Agency was also recognised by the IBAN with the performance audit on Fraud Prevention and Detection.*

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

*c) While a system of internal controls is already in place within NCIA, the implementation of the NCIO Internal Control Framework is currently ongoing, as mentioned above. Therefore, compliance against this framework cannot be conducted by IA at this stage. As mitigation measures, IA is performing assessment of internal controls by audited process. In addition, IA supported management in conducting a NCIO wide annual Control Self-Assessment which was completed by the EMS members of the Agency as well as by the ASB Chairman.*

*Regarding the amendment of the IA Charter to change the reporting lines for the IA function, in the Board's opinion, this is a NATO wide issue that needs to be discussed further. The upcoming review of the NATO Financial Regulations will provide the opportunity to review the existing reporting lines for IA, in line with the recommendations provided by the internationally accepted internal audit standards while considering the NATO context.*

**(5) NCIO FY 2017**

**IBA-AR(2018)11, paragraph 5**

**NO CLEAR CONFIRMATION OF THE SYSTEM OF INTERNAL CONTROL**

***NCIA's Formal Comments***

*The NCIO agrees with the recommendation and will implement accordingly.*

**(6) NCIO FY 2017**

**IBA-AR(2018)11, paragraph 6**

**WEAKNESSES IN THE SOURCE SELECTION PLANNING PROCESS**

***NCIA's Formal Comments***

*The Agency considers that the recommendation has been implemented by Acquisition to the maximum extent possible through actions and documents described below.*

*The Procurement SOP has been amended in 2018 and approved in January 2019 to enforce and secure timely participation of staff in the evaluation process when appointed/ designated by the Source Selection Authority (SSA). Paragraph 4.1.5.4 clearly specifies that participation to the evaluation process takes precedence on other activities and that the evaluation team members will either process evaluation in specific physical places/rooms dedicated to this or virtually isolate themselves from business as usual activities to entirely focus on the*

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

*evaluation. The actual prioritization of work for the members of evaluation teams is the responsibility of their organizational element.*

*It has to be noted that the Procurement SOP is not a resource planning tool to ensure that sufficient resources have been properly planned to deliver timely evaluation of bids.*

*With respect to the Source Selection Plan (SSP) approval process - it is not recommended to have the SSP approved prior to bid issuance. The reason for this is that the SSP will normally have to be amended during the bidding process to update evaluation planning which cannot be anticipated at the time of issuance of the solicitation documents, like schedule changes or team composition.*

*The Procurement SOP (paragraph 3.6.2) clearly indicates that a draft SSP shall be developed during the IFB package development and that final SSP will be submitted to the SSA 2 weeks prior the bid closing date to ensure the latest information resulting from the bidding process has been properly reflected (essentially final schedule of event and team composition) (paragraph 3.7.5.6). The Procurement SOP clearly mandates in its paragraph 3.7.5 (disposition of the source selection plan) that the SSP has to be approved prior to bid opening.*

*In order to strengthen the evaluation process, in February 2019 the DACQ has instituted Standing Project Evaluation Board Chairs who will oversee and monitor the procurement from issuance of the Invitation For Bid (IFB) until completion of bid evaluation.*

**(7) NCIO FY 2016**

**IBA-AR(2017)15, paragraph 3**

**LACK OF CONSISTENT AND ROBUST PROCESS FOR DETERMINING CAPABILITY DEVELOPMENT PROJECT REVENUE FOR THE PERIOD**

**NCIA's Formal Comments**

*The Agency notes the Board's appreciation for the progress made throughout 2018. Furthermore, the implementation of EBA includes an adapted CTC process to integrate the different aspects of NSIP authorisations and Non-NSIP Acquisition type projects and thus improve further standardisation. The Agency agrees that further evaluation is required on the CTC process for the year ended 2019 and will continue to pursue full compliance with the Board's recommendation.*

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

**(8) NCIO FY 2016**

**IBA-AR(2017)15, paragraph 6**

**CONTRACTOR CLAIM RESULTING FROM CHANGING AND DELAYED CONTRACT REQUIREMENT DEFINITION AND WEAK COORDINATION BETWEEN NCIA AND THE INVESTMENT COMMITTEE**

***NCIA's Formal Comments***

*A new format of quarterly reports to Investment Committee on NSIP implementation started in 2018 with a broader capability view and highlight capability development achievement. The Agency, via its Board, remains engaged with the currently ongoing NATO institutional and Customer Funding Regulatory Framework reviews. In addition, the General Manager has included in his Strategic Plan for the Agency specific objectives aimed at improving the Agency's capability development and delivery performance.*

*Furthermore, following the approval by Defense Ministers of the Common Funded Capability Delivery Governance model at their 7-8 June meeting, endorsed by Heads of State and Government at the 2018 NATO Summit, its implementation started in August 2018. The new capability delivery process will be detailed in an Overarching Directive, to be signed by Capability Management Authorities (ACT, ACT, NCIA, NSPA) by Quarter 4, 2019. This process will reduce the number of required consensus decisions to four mandatory and two optional decision gates, operationalize a programmatic approach including a single project- level authorization, improving delivery of required capabilities that meet commanders' performance expectations within expected timelines and agreed cost.*

*In addition, the establishment of a Capability Management Function (with ToR signed by SACEUR, SACT, GM NCI Agency and GM NSPA in April 2018) were all management Products are coordinated prior to bringing them to Governance, not only allow to engage with the MC and RPPB with one voice, but improve performance and provides better transparency across DOTMLPFI lines of development.*

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

**(9) NCIO FY 2016**  
**IBA-AR(2017)15, paragraph 10**  
**WEAKNESSES IN THE TIME ACCOUNTING SYSTEM (TAS)**

***NCIA's Formal Comments***

*Following the successful implementation of EBA Work Package (WP) 2, including full support for the Enterprise Service Delivery Model (ESDM) and for internal Operational Level Agreements (OLAs), the agency now has the tools in place to enable tracking and monitoring of service costs, including accurate Time Accounting (TAS) data, thus enabling the agency to effectively manage "internal service providers" and the delivery of CIS Services to our customers. Quality and accuracy of TAS is also much improved due to the implementation of the ESDM, however the EBA WP 4, for implementation of a new, best practice, P3SM system in replacement of MS-EPM, is delayed by concerns within the IC on eligibility. The TBCE for WP 4 was delivered in December 2018, but still remains unauthorised, therefore the expected implementation date for this new functionality is now not before the end of 2020. Many additional benefits for both project management and service delivery are envisaged once the WP has been authorised and implemented, but cannot be realised until then.*

**(12) NCIO FY 2014**  
**IBA-AR(2015)20, paragraph 8**  
**INCOMPLETE CONFIRMATION OF YEAR - END ASSETS AND LIABILITIES**  
**OUTSTANDING BETWEEN NATO BODIES**

***NCIA's Formal Comments***

*The Board found that considerable progress was made by the Agency. NCIA material asset balances was either confirmed and/or differences investigated with IS, IMS, ACO. The Agency agrees that further improvement is required and will comply with the Board's recommendation.*

**NATO UNCLASSIFIED**

**NATO UNCLASSIFIED**

APPENDIX  
ANNEX 3  
IBA-AR(2019)0019

**(13) NCIO FY 2013**

**IBA-AR(2014)22, paragraph 4**

**NCIO'S FINANCIAL REPORTING PROCESSES DO NOT YET FULLY MITIGATE THE  
RISK OF ERRORS IN THE FINANCIAL STATEMENTS**

***NCIA's Formal Comments***

*Following EBA implementation new processes and procedures have been designed and are being implemented. The Agency welcomes the Boards comment to fully assess those new controls by the end of 2019.*

**(14) NCIO FY 2012**

**IBA-AR(2013)23, paragraph 6**

**NCIA SD SEGMENT FINANCIAL STATEMENTS (FORMER NCSA)**

***NCIA's Formal Comments***

*PP&E accounting policy was issued in 2017. An intangible asset accounting policy is also expected. These policies will form the basis for more detailed NCIA implementing instructions on the subject that need to be aligned with newly implemented EBA.*

**NATO UNCLASSIFIED**



NATO UNCLASSIFIED



**General Manager**

Boulevard Leopold III  
1140 Brussels, Belgium

Telephone: +32 (0)2 707 8200  
+32 (0)2 707 8474

NCIA/FC/2019/03123  
31 March 2019

To: Distribution

Subject: **NATO Communications and Information Organisation  
Financial Statements for the period 01 January to 31 December 2018**

1. This letter forwards the Financial Statements for the NCI Organization for the period 01 January to 31 December 2018. The statements also include the financial information for the NCIO Secretariat.
2. The Statements submitted herein are unaudited. In accordance with the NCI Organisation Charter, once the IBAN audit results are received, the Financial Statements will be forwarded to the Agency Supervisory Board for approval taking into account the IBAN report and the advice of the Finance Committee.
3. The NCI Agency Financial Statements for the period 01 January to 31 December 2018 can be publicly disclosed.
4. The NCI Agency is already working with the IBAN on audit fieldwork, and stands ready to provide all necessary further support to the audit team including reports, documents and associated reconciliations and explanations.

Kevin Scheid  
General Manager

Rui Silva  
Acting Financial Controller

Enclosure:

NCIO Financial Statements for the period 01 January to 31 December 2018

Distribution:

External

Chairman Board of Auditors for NATO  
Chairman NCIO Agency Supervisory Board

Internal

Members Executive Management Board



NATO Communications  
and Information Agency  
Agence OTAN d'information  
et de communication

Avenue du Bourget 140  
1140 Brussels, Belgium

[www.ncia.nato.int](http://www.ncia.nato.int)

NATO UNCLASSIFIED





**NATO Communications and Information Agency**  
**Agence OTAN d'Information et de Communication**



NCIA/FC/2019/03123

## **NCIO Financial Statements 2018**

NATO UNCLASSIFIED

Contents	Page
Foreword NCI Agency GM	2
Overview	3
NCIO Statement of Financial Position	9
NCIO Statement of Financial Performance	10
NCIO Statement of Cash Flows	11
NCIO Statement of Changes in Net Assets	12
NCIO Budget Execution Statement	13
Accounting Policies	14
Notes to the Financial Statements	19
NAF impact prior 1/1/13	50
Statement on Internal Control	51
Financial Controller Certification	53
List of Acronyms	54

## Foreword by General Manager NATO Communication and Information (NCI) Agency

These are the second set of Financial Statements to be issued since I became General Manager and the first using the Enterprise Business Application (EBA) functionality. This constitutes a major achievement and provides the Agency with a critical tool to become more agile and responsive in terms of the financial management of its services and projects.

Financially and operationally, 2018 has been a challenging but equally rewarding year. Overall, total revenue amounts to 862.6 MEUR, an increase of 12% compared to the previous year and the net operating result shows a small deficit of 0.5 MEUR, or 0.06% of total revenue.

The improved financial result compared to the 2.5 MEUR planned deficit included in the 2018-2020 Financial Plan is part of the overall Agency achievements for 2018 and was achieved thanks to a combination of extra business and prudent financial management.

### Other internal Agency accomplishments include:

- Increasing the Agency's civilian staff capacity to better deliver on projects and services with the Commands, NATO Headquarters and Nations;
- Building-up full-time Chief Operating Officer (COO) function, which has brought renewed focus on delivering project, programs and services;
- Acting on the lessons learned from the new NATO Headquarters project and employing programme management processes and methodologies;
- Implementing IBAN and NCI Agency Internal Audit recommendations to take a holistic, programmatic approach to major change initiatives, such as Polaris, FGFS, and EBA;
- Continuing our highly effective outreach and partnering with NATO member's National industries and over EUR 567.7M in 2018 alone;
- Introducing Costed Customer Service Catalogue that constitutes the cornerstone of the Service Oriented Model;
- Reducing layers of management, streamlining internal decision-making and empowering program and service line leaders as part of the implementation of a matrix-management structure for the Agency;
- Updating our implementation of the contract policy to remove one of the central impediments to higher workforce morale and effectiveness;
- EBA release 1 brought into use;

- Den Haag building addition completed, renovation continues, staff/labs moved to temporary quarters, although Active IT urgently requires funding;
- Over 90 staff moved from Glons; 50 more to go.

### Some specific Capability and Service Delivery accomplishments:

- Network services remained at 99.8% availability;
- Supported 27 Major Military Exercises, Trident Juncture a Success;
- Increased fidelity of NSIP cost forecast;
- Delivered the BMD Review, improving software delivery approach for improved results;
- ACCS Transition to Operations (TtO) and Addendum #3 initiated and being implemented;

Satellite Ground Stations, delayed, but managed and Contractor addressing concerns.

### Future Challenges

Looking forward to 2019, just some of the strategic challenges include: reaching IOC for the NCI Academy in Oeiras; continuing The Hague building renovations without loss of productivity; ACCS and BMD lessons learned implementation to address National Experts recommendations; Polaris/ITM Programme Wave 1 and 2; NATO Iraq Mission; re-competition of some major contracts; and the new Governance Model for Common Funded Capability Delivery.

In addition, I remain focused on a balanced financial performance consistent with the financial objective to breakeven over the three year planning cycle.

Kevin J. Scheid  
General Manager, NATO Communications and  
Information Agency

## Overview of the NATO Communication and Information Organisation (NCIO) and Agency (NCIA)

### Vision

NATO is in the midst of a fundamental transformation in the way it performs its mission by more effectively exploiting information technology and reforming its business processes. Today, NATO's consultation (Article IV) and collective military operations (Article V) are dependent on a secure, resilient IT infrastructure and an array of software applications. These capabilities are critical to NATO's success and we invest in them through projects like the new NATO Headquarters active network, IT modernisation across the NATO Enterprise, the NATO communications infrastructure and the development or acquisition of thousands of applications, all accounting to billions of euros of investments. The benefits of these investments need to be fully realised. Threats to this infrastructure are as dangerous to the Alliance as a conventional military attack, and have been recognised by the North Atlantic Council at the Warsaw Summit as a threat rising to the level for collective defence.

The NATO Communications and Information Organisation (NCIO) is at the centre of this digital transformation and the NCI Agency is positioned to lead the way. We acquire, deploy and defend communications systems for NATO's political decision-makers and Commands; and we are on the frontlines against cyber-attacks, monitoring thousands of them daily, diagnosing threats, working closely with governments and industry to prevent future debilitating attacks. We have a 63-year legacy to build upon, from the Cold War, the Balkans, and Afghanistan to the rapid deployment of IT to the Force Integration Units on NATO's eastern flank. We have decades of experience of working side-by-side with NATO soldiers, sailors and airmen and women. We are uniquely qualified to lead this endeavour.

To lead this endeavour, we need to shake off past practices, bureaucratic processes and the lack of agility that has been undermining our effectiveness. We need to tap the technical expertise of our military staff, their leadership training, their dedication to mission; we need to tap the expertise of our civilian staff who have learned both in the civil services and industry the value of delivering on cost, on schedule and with the performance required by the customer. We need to harness the skills of our leaders to help in turning around our declining customer satisfaction ratings and low staff morale by managing well and delivering on our promises, thereby earning the trust of the Nations.

Ultimately, working together as an effective team, the NCI Organisation has the potential to become one of the top 10 international organisations to work for in Europe within five years.

### Mission

Our mission defined in our Charter<sup>1</sup> is a solid foundation for the Agency and we will build upon this foundation.

The digital transformation of NATO is a necessity; all large organisations are facing this challenge. The NCI Organisation is uniquely positioned to lead the way forward in this digital endeavour, given that we are well-positioned with our unique technical expertise.

Working with NATO Nations, their technology industries and with the support of our Supervisory Board, we will lift NATO's technological prowess and deliver it as an additional arrow in NATO's quiver against those who would challenge or undermine the Alliance.

Accordingly, we will:

- Provide, maintain and defend a NATO enterprise-wide secure, resilient, cloud-based information technology infrastructure required for NATO's consultation (Article IV) and collective defence (Article V);
- Provide the tools and know-how for communicating, managing and exploiting NATO's business and operational data; bring artificial intelligence and machine learning to the business of securing and managing NATO's information assets;
- Advise, counsel and implement the business transformation techniques and practices NATO requires to take full advantage of its information technology investments.

In order to lead NATO's digital endeavour over the next five years, we need to turn around the declining performance of the Agency, get back to basics, and improve our project, programme, portfolio management (P3M) and service delivery, improve our human resource support and work better as a team. We also need to resolve our long-standing facilities challenges so that we can provide a secure and resilient digital and physical workplace for our staff.

To accomplish all this, we need to achieve a variety of near-term strategic goals in the coming months and years.

The first five, immediate goals are focused on a Turnaround of the Agency's performance and are necessary in order to regain trust with our staff and customers:

1. Hire, train, and retain a diverse world-class, tech-savvy workforce;
2. Provide and maintain the physical and digital workplace for the NCI Agency's workforce;
3. Reform, rebuild and strengthen the Agency's project, programme and portfolio management and service delivery capabilities;
4. Champion customer funding, tailor it for the digital endeavor endeavour; strengthen our financial management model;
5. Organise as a flexible matrixed organisation that can take on new programmes and lines of services as it completes others. Organise as a flexible matrixed organisation that can take on new programs and lines of services as it completes others.

Seven subsequent goals will drive the way for sustained high quality delivery of services and programmes: Seven subsequent goals will drive the way for sustained high quality delivery of services and programs:

6. Streamline internal business processes and ensure timely decision-making while assuring proper internal controls and safeguards;
7. Increase NCI Agency customers' satisfaction;
8. Strengthen NATO decision-making through better use of information, the exploration of 'big data', artificial intelligence and machine learning tools and techniques to the advantage of the Alliance;
9. Prepare for timely and sustainable delivery of Communication and Information Systems (CIS) support for crisis response and / or business continuity requirements;
10. In the spirit of 'One NATO', champion and maintain a coherent, harmonised enterprise architecture as NATO's Consultation, Command and Control (C3) technical design authority;
11. Develop and deliver world-class Command, Control, Communications, and Computers, Intelligence, Surveillance, and Reconnaissance (C4ISR) education and training services, including cyber, across the NATO enterprise; and

12. Optimise the NCI Agency's acquisition business practices and work with governing bodies to reform acquisition policies for smarter procurement including software intensive capabilities.

### Business Model

As established by the NCIO Charter in mid-2012, the NCI Agency is customer funded in delivering NATO Information and Communication Technology (ICT). Principles of Customer Funding based on the Charter include:

- Customers shall be charged the direct costs plus an overhead to cover general administrative expenditures, recuperation of capital investments, and Agency operating and running costs;
- Charges to customers shall be subject to customer agreement prior to being incurred;
- Customer Rates are set in such a way to ensure balance between planned income (revenue) and expenditure (expenses) to achieve breakeven over the planning period; and are submitted, after review by the ASB Finance Committee, to the ASB for endorsement and finally to the BC for approval on behalf of all Customers.

Since 2014 the NCIA been operating with a Bridging Model, with customers charged on the basis of Customer Funding except for the NATO CIS School, Latina. The School will migrate to the Customer Funding model used elsewhere in the Agency once the facility is moved to Oeiras, Portugal and the revised cost structure is established. The Agency continues to evolve from an asset based to a service based provider and mature Customer Funding through use of the Costed Customer Service Catalogue approach. Two catalogues have been produced including one specifically for the new NATO HQ (NNHQ) in 2018 and one for non-NNHQ (NATO Command Structure entities or internal customers) for use starting in the 2019 budget cycle.

At Reference H, the NAC approved the Customer Funding Regulatory Framework which forms the basis of the Agency financial operations. Key aspects of this framework cover the issues of overarching principles, eligibility; the definition of customers, internal and external, their roles and responsibilities; the coordination with existing programming and planning mechanisms; the recapitalization of ICT assets and equipment; the roles of the ASB, RPPB, NATO Budget Committee (BC), and Investment Committee (IC); service demand and requirements validation;

pricing of Agency services; the provision of independent advice to the NATO resource community; the roles of other stakeholders in the governance of the NCI Agency; the requirement for ICT Services and Capabilities; and procedures governing use of the Operating Fund. The use of the Operating Fund, which in this context performs the function of a repository for Accumulated Surpluses or Deficits, is determined by Nations. The overall level of the Operating Fund (excluding the depreciation) is currently set by a Nations at 10MEUR, with any increases based on a risk assessment and justification.

One of the aims of the Customer Funding is to empower the customer to secure the best value for money in obtaining the services it requires. The concept also aims to ensure that the beneficiaries of the goods and services are the ones who pay the full costs of the benefits they receive. The customer states their requirements, generally in the context of the draft SLA, capability package or by submitting a task order or customer request form. The Agency confirms its ability to fulfil the requirements, and following internal staffing and coordination, proposes a cost for each service or capability requested based on approved Customer Rates and/or Costed Customer Service Catalogue. Operating as an integral part of NATO, the Agency must remain attentive to the NATO's funding constraints and in close coordination with its customers tailor its service levels to the requirements and priorities set by its customers.

Being Customer Funded, the Agency must recover all of its costs from the work and services it provides its customers. In line with the Budget Committee's guidance the Customer Rates or professional labor fees the Agency charges its customers, termed respectively Project Service Costs (PSCs) for capability development and Service Support Costs (SSCs) for ICT services, aim to achieve financial breakeven over time. The Customer Rates are based on the actual costs as disclosed in the most recent published but still to be audited Annual Financial Statements<sup>1</sup>. Since the 2017 Customer Rates, following Nations' approval, a single set of rates structure has been in use as this is considered to offer better transparency and traceability of the Agency's cost structure as well as allowing a more stable calculation methodology and facilitating comparability over the years.

Consistent with the Customer Funding Regulatory Framework, the Agency predominantly contracts with customers for the provision of CIS services on the basis of Firm Fixed Price (FFP) agreements whereby NCI Agency delivers a specified

set of goods or services for a fixed price. The use of FFP reduces administration costs and provides customers with more stability and less risk as the Agency manages all associated risks with delivering the goods or services within the agreed price, unless otherwise agreed with the customer (e.g. exchange rate fluctuations for agreements not priced in Euros). The Agency's obligation is the delivery in accordance with the agreed specifications, and the customer's obligation is payment of the agreed amount. Given the constraints on the use of the Operating Fund and its limited level, the NCI Agency relies on the customer provided funding via advance payments and timely payment of invoices to provide the cash flow for daily operations.

---

<sup>1</sup> The unaudited Annual Financial Statements are used since the NCIO Financial Rules and Procedures require both these and the proposed Customer Rates to be issued by 31 March

## Financial Statements Overview

### Basis of Preparation

The NCIO Financial Statements are a formal record of the financial activities and position of the NCI Agency and the ASB Secretariat. These include an extensive set of notes to the financial statements describing each item on the statement of financial position, performance, cash flow and budget execution statement in further detail.

The NCIO Financial Statements are a standalone document and undergo a specific approval process as well as an audit by the International Board of Auditors for NATO (IBAN). For full visibility of the Agency's operating performance and strategic alignment to the NATO mission, readers should also consult the NCIO Annual Report.

In respect to the 2018 NCIO Financial Statements, these were prepared:

- for public disclosure
- on a going-concern principle
- on the basis of a single entity using multiple legacy accounting and operating systems
- on an accrual basis and a historical cost convention, except as disclosed in the accounting policies and detailed notes

Amounts in the financial statements are stated in euros.

### Compliance with Financial Regulations

The NCIO Financial Statements are submitted to the Agency Supervisory Board (ASB) and the International Board for Auditors of NATO (IBAN) in accordance with NAC approved standards, including the International Public Accounting Standards (IPSAS) as adopted through the NATO Accounting Framework and the NATO Financial Regulations (NFR). This is consistent with Article 53 of the Charter: "The General Manager shall submit to the ASB and the International Board of Auditors for NATO annual financial statements in accordance with NAC approved standards, including the International Public Sector Accounting Standards (IPSAS) as adopted by NATO, and the provisions of the NATO Financial Regulations".

The Financial Regulations that are applicable to NCIO are described in the Charter under Article 50: "The NCIO shall be governed by the provisions of the NATO Financial Regulations, subject to such derogations as may be approved by the NAC upon recommendation by the Resource Policy and Planning Board".

Article 27 of the NATO Financial Regulations specifically relates to the Agency as a Customer Funded entity: *"Customer-Funded bodies make agreements with customers to provide goods and services in accordance with Customer requirements. Customers' agreement will describe the requirements for how funds are to be made available to the Customer-Funded bodies and how the funds will be committed and carried forward; these requirements may be different from common-funded NATO bodies"*.

The NATO Communications & Information Agency Customer Funding Regulatory Framework is a fundamental part of the governance of the Agency, along with the NCIO Charter provisions. It's designed to deliver effective and efficient C&I service provision by NCIA by establishing mechanisms for validating Agency costs and for validation of all requirements, including ICT services, while future C&I capability requirements will continue to be provided through the Capability Package process with greater emphasis on ICT asset renewal which will be on a biennial schedule to ensure that technology upgrades and replacement of obsolescent equipment keeps up with the military requirement.

With effect from 1 April 2016 and thus applicable to the 2018 NCIO Financial Statements, the ASB concluded a two-year effort to update NATO's Financial Regulations (NFRs) and Financial Rules and Procedures (FRPs) by approving the new FRPs specifically applicable to the NCIO and the NCIA.

### Financial Performance and Position Highlights

Total revenues for 2018 amount to 862.6 MEUR, an increase of 92.2 MEUR or 12% from 2017, and include:

- 331 MEUR of acquisition revenue earned as Host Nation and procurement principal for NSIP, NATO Entities and Nations, an increase of 47.8 MEUR or 16.9% from previous year;
- 288.3 MEUR of operating, services and project support revenue contracted, using BC approved Customer Rates, for the provision and acquisition of CIS capabilities and services, an increase of 30.1 MEUR or 6.4% from previous year;
- 236.8 MEUR of operating and external CIS revenue earned in direct support of the delivery of services, an increase of 14.1 MEUR or 6.4% from previous year;
- 4.2 MEUR of other operating revenue earned in the provision of other support services provided to hosted entities (e.g. NAGSMA) as well as contribution revenue from the execution of the BC funded portion of the Transition Programme and NCIO Independent Secretariat core funding from Nations;

- 2.3 MEUR earned from favourable foreign exchange rate variances and, to a minor extent, interest earned from short-term deposits, typically one to three months (same as previous year).

Totalling 863.1 MEUR the 2018 Agency costs and expenses are 93.8 MEUR or 12.2% higher compared to 2017 and include:

- 329.6 MEUR of acquisition costs incurred in the procurement, on behalf of the Investment Committee (IC), other NATO entities and Nations, of CIS capabilities and services from industry, increase of 49.9 MEUR or 17.8 % from previous year;
- 260.8 MEUR of costs related with the civilian personnel employed during the year (in compliance with NATO Personnel Regulations, NAC approved salary scales and allowances), and interim workforce - contractors, temporary staff and consultants, up 33.2 MEUR or 14.6% from previous year;
- 260.1 MEUR of costs for Contractual Supplies and Services, an increase of 2.9 MEUR or 1.1% from previous year, which include operating and external CIS costs in direct support of the delivery of services, costs related to the execution of capabilities' projects as well as running costs of the Agency facilities and equipment.
- 7.7 MEUR cost from an in-year increase of provisions mainly on active projects and services the agency is delivering and loss of job indemnity of serving staff.
- 3.7 MEUR of depreciation expense for fixed assets capitalised in line with the accounting policies as adopted by NATO, decrease of 0.4 MEUR from previous year;
- 1.1 MEUR of expenses from unfavourable foreign exchange rate variances, including bank transaction fees related to conversion of currencies, decrease of 2.8 MEUR from previous year; and,

Net result for the year, is a deficit of 0.5 MEUR compared to a surplus of 1.1 M Eur previous year which is close to a break even.

Total assets amount to 438.7 MEUR an increase of 59.5 MEUR or 15.7% from previous year, largely made up of Cash holdings and Receivables. Total Liabilities amount to 414.1 MEUR an increase of 60 MEUR or 16.9% from previous year, mostly reflecting an increase in the balances of Deferred Revenue and Advances and Accounts Payable and additions into provisions.

#### **Total Net Equity and Operating Fund**

In line with the NFRs applicable to the Agency Customer Funding regime and the Customer Funding Regulatory Framework, the Agency maintains, as part of its Total Net Equity, an Operating Fund. This serves as a limited source of working capital

and acts as buffer to absorb the surpluses or deficits from Agency's operating results. The use and level of the Agency Operating Fund is fully governed by Nations.

At 31 December 2018, the Agency Total Net Equity amounts to 24.6 MEUR broken-down as follows:

- 6.1 MEUR of Reserved Earnings, composed of (1) the remaining Transition Reserve of 2.9 MEUR, as per RPPB decision, for purposes of funding transition activities of the Agency, and (2) the Depreciation Reserve, amounting to 3.2 MEUR, related to assets not yet fully depreciated.
- 18.5 MEUR of Retained Earnings, which equal the Operating Fund (as per the IBAN guidance and ASB Finance Committee decision, depreciation reserve is no longer considered as part of the Operating Fund).

In October 2017, Nations at the ASB Finance Committee: (1) confirmed the continued need for an Operating Fund as a risk management tool, (2) agreed to no longer include the depreciation reserve as part of the Operating Fund, (3) confirmed to the target level being 10.0 MEUR with increases based on risk assessment to be justified (4) agreed on the pro rata distribution of potential surplus from the Operating Fund based upon the Military Budget and the NATO Security Investment Programme share in the Agency revenue via the call for contributions mechanism (previously any surplus was applied as a rebate/reduction to the customer rates i.e. 5.6 MEUR for 2017 Customer Rates and 2.8 MEUR for 2018 Customer Rates).

#### **Internal Control Framework**

Internal control helps entities to achieve objectives and sustain and improve performance. NCIO has an Internal Control Framework (ICF), approved by the ASB in 2016, that has been designed considering the components and associated principles of the COSO's Internal Control - Integrated Framework'. It is expected it will enable NCIO to effectively and efficiently develop a system of internal control that adapts to changing business and operating environment, mitigate risks to acceptable levels, and support sound decision making and governance of the organisation. The NCIO ICF is under implementation and continues to be matured, and as part of this, an NCI Agency Internal Control Panel has been established which meets regularly to: oversee the implementation of the ICF across the Agency, oversee development & deployment of related policies and procedures, recommend priorities and objectives to the GM and identify opportunities, risks, control weaknesses, and correcting measures to the GM.

#### **Risk Management**



The Agency operates an Enterprise Risk Management (ERM) system with Corporate and also Directorate Risk Registers. The Agency's top risk landscape is dynamic and is made up of risks that can be Agency-wide and/or corporate in nature. The Agency regularly reviews its top risks at an Executive level taking account of the environment in which the Agency operates and its risk appetite, as well as the probability of the risk occurring and its impact. Such an Executive level review takes place a minimum of once or twice per year with regular monitoring through the Monthly Operating Report (MOR). All Agency top risks are assigned to an individually accountable Risk Owner (usually an Executive) to manage. Other lower level (in terms of probability and impact) risks are within Directorate Risk Registers.

Of the top ten risks the Agency has identified some other risk that have given rise to Provisions and are captured in the Financial Statements (note 27).

The Agency continues to mature its ERM, through a documented process, trainings, workshops, presentations and communications to staff as well as reinforcing the activities to review, mitigate and regularly report on risks. The Agency also separately tracks the issues it faces.

#### **External and Internal Audit**

As a chartered NATO Organisation, the Agency financial statements, performance and underlying transactions are audited by the IBAN upon mandate from the NAC. The Agency also has its own body of Internal Auditors, whom, under the direct authority of the General Manager, perform internal reviews of control and compliance.

#### External Audit

The International Board of Auditors (IBAN) led in 2018 the audit of the 2017 NCIO FS resulting in a number of observations, of which four were considered critical:

- Lack of integrated systems to support the effective and efficient management and financial reporting of property, plant and equipment and intangible assets.
- Lack of a consistent and robust process in determining capability development project revenue for the period.
- Understatement of inventory which is linked to the implementation of the NATO Accounting Framework.
- No formal request submitted to the Agency Supervisory Board for the increase in its authorised NATO International (NIC) personnel ceiling in accordance with the NCIA Personnel Establishment Policy and the approved ceilings of the 2017-2019 Financial Plan.

The Agency, under the remit of its supervisory board, is undertaking the necessary actions to remediate and resolve all outstanding observations.

IBAN has already initiated the audit of the 2018 Financial Statements. As per the NFR the NCIO Financial Statements are submitted to IBAN and ASB by 31 March. In accordance with the NCIO Charter, the ASB will approve the Financial Statements once IBAN audit results are published, taking in consideration the advice of the ASB Finance Committee.

#### Internal Audit

The Internal Audit activities were a significant part of the Agency's overall control structure and exercised a positive influence on the overall Agency performance.

During the reporting period, Internal Audit completed 18 reports - 10 advisory and 8 compliance engagements. The completed engagements spanned several thematic areas and covered reviews of project management activities, operational processes, corporate and administrative processes and information technology areas. Management continues to enhance the existing follow-up process with the aim to follow-up even more closely on the progress of outstanding observations identified in the Internal Audit reports.

Internal Audit will continue performing follow up missions and will report on the status of the implementation of the recommended actions during 2019 to Agency management and the ASB Finance Committee. Finally, IA continued to support the implementation of the NATO Financial Regulations and the NCIO Financial Rules and Procedures and also contributed to the development and implementation of the NCIO Internal Control Framework.

**NCIO Statement of Financial Position***As of 31 December 2018**(all figures are in Euro)**(Prior Year restated)*

		NCIO	
	Note	2018	2017
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and Cash Equivalents	1	148,294,384	160,827,986
Receivables	2	272,827,470	207,166,505
Prepayments and Miscellaneous Assets	3	3,107,687	3,121,046
Inventory	4	8,069,523	3,566,455
Work in Progress	5	3,145,258	879,313
Other Current Assets	6	15,415	40,436
<b>Total Current Assets</b>		<b>435,459,737</b>	<b>375,601,740</b>
<b>Non-Current Assets</b>			
Financial Assets		0	0
Non-current Receivables	7	1,925	1,904
Property, Plant and Equipment	8	3,183,617	3,458,587
Intangible Assets	8	16,617	71,697
Other Non-Current Assets		0	0
<b>Total Non-Current Assets</b>		<b>3,202,159</b>	<b>3,532,188</b>
<b>TOTAL ASSETS</b>		<b>438,661,896</b>	<b>379,133,928</b>

**NCIO Statement of Financial Position***As of 31 December 2018**(all figures are in Euro)**(Prior Year restated)*

		NCIO	
	Note	2018	2017
<b>LIABILITIES</b>			
<b>Current Liabilities</b>			
Payables	9	157,965,846	137,116,806
Deferred Revenue and Advances	10	238,571,180	207,528,805
Borrowings		0	0
Other Current Liabilities	11	1,901,240	1,522,745
<b>Total Current Liabilities</b>		<b>398,438,266</b>	<b>346,168,356</b>
<b>Non-Current Liabilities</b>			
Non-Current Payables		0	0
Non-Current Deferred Revenue and Advances		0	0
Non-Current Borrowings		0	0
Provisions	12	15,666,610	7,932,079
Other Non-Current Liabilities		0	0
<b>Total Non-Current Liabilities</b>		<b>15,666,610</b>	<b>7,932,079</b>
<b>TOTAL LIABILITIES</b>		<b>414,104,876</b>	<b>354,100,435</b>
<b>NET ASSETS/EQUITY</b>			
Retained Earnings	13	18,482,932	17,316,377
Reserved Earnings	32	6,074,088	7,717,116
<b>TOTAL NET ASSETS/EQUITY</b>		<b>24,557,020</b>	<b>25,033,493</b>
<b>TOTAL LIABILITIES AND NET ASSETS/EQUITY</b>		<b>438,661,896</b>	<b>379,133,928</b>

**NCIO Statement of Financial Performance***For the year ended 31 December 2018**(all figures are in Euro)**(Prior Year restated)*

		NCIO	
	Note	2018	2017
<b>REVENUE</b>			
Project and Support Services Revenue	14	288,260,703	258,152,164
External Services Revenue	15	236,769,744	222,620,080
Acquisition Revenue	16	330,985,358	283,184,550
Other Operating Revenue	17	4,238,758	4,224,401
<b>TOTAL OPERATING REVENUE</b>	<b>19</b>	<b>860,254,563</b>	<b>768,181,194</b>
Financial Revenue	28	2,336,200	2,152,762
Other Revenue	18	0	11,850
<b>TOTAL REVENUE</b>	<b>19</b>	<b>862,590,763</b>	<b>770,345,806</b>
<b>EXPENSES</b>			
Cost of Acquisition	20	(329,592,123)	(279,706,085)
Personnel Costs	21	(260,825,316)	(227,616,964)
Contractual Supplies and Services	24	(260,053,734)	(257,110,914)
Depreciation and Amortisation	25	(3,687,789)	(4,134,860)
Provisions	26	(7,734,531)	3,280,666
Financial Expenses	28	(1,129,660)	(3,953,914)
Other Expenses	29	(44,083)	(16,199)
<b>TOTAL EXPENSES</b>		<b>(863,067,236)</b>	<b>(769,258,271)</b>
<b>SURPLUS/(DEFICIT)</b>			
Retainable Earnings	33	(476,473)	1,087,535
Refundable Earnings		0	0
<b>SURPLUS/(DEFICIT) FOR THE PERIOD</b>		<b>(476,473)</b>	<b>1,087,535</b>
Revaluation of Assets		0	0

**NCIO Statement of Cash Flows***For the year ended 31 December 2018**(all figures are in Euro)**(Prior Year restated)*

	Note	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Surplus/(Deficit) for the Period		(476,473)	1,087,535
Depreciation and Amortisation		3,679,467	4,116,698
Revaluation of Assets		0	0
Decr./ (Incr.) Receivables		(65,660,965)	(33,086,827)
Decr./ (Incr.) Prepayments and Miscellaneous Assets		13,359	1,795,186
Decr./ (Incr.) Inventory		(4,503,068)	7,754,953
Decr./ (Incr.) Work in Progress		(2,265,945)	(508,745)
Decr./ (Incr.) Other Current Assets		25,021	17,029
Incr./ (Decr.) Payables		20,849,039	(4,063,884)
Incr./ (Decr.) Deferred Revenue and Advances		31,042,374	24,685,076
Incr./ (Decr.) Borrowings		0	0
Incr./ (Decr.) Other Current Liabilities		378,495	(2,534,098)
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>		<b>(16,918,696)</b>	<b>(737,076)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Decr./ (Incr.) Financial Assets		0	105
Decr./ (Incr.) Non-current Receivables		(21)	0
Decr./ (incr.) PP&E and Intangible Assets		(3,349,416)	(3,382,431)
Decr./ (Incr.) Other Non-Current Assets		0	0
<b>NET CASH FLOWS FROM INVESTING ACTIVITIES</b>		<b>(3,349,437)</b>	<b>(3,382,326)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Incr./ (Decr.) Non-Current Payables		0	0
Incr./ (Decr.) Non-Current Deferred Revenue and Advances		0	0
Incr./ (Decr.) Non-Current Borrowings		0	0
Incr./ (Decr.) Provisions		7,734,531	(3,280,666)
Incr./ (Decr.) Other Non-Current Liabilities		0	0
<b>NET CASH FLOWS FROM FINANCING ACTIVITIES</b>		<b>7,734,531</b>	<b>(3,280,666)</b>
<b>NET INCR./ (DECR.) CASH AND CASH EQUIVALENTS</b>		<b>(12,533,602)</b>	<b>(7,400,068)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>			
Incr./ (Decr.) Cash and Cash Equivalents		(12,533,602)	(7,400,068)
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>		<b>148,294,384</b>	<b>160,827,986</b>

**NCIO Statement of Change in Net Assets/Equity (Operating Fund)***For the year ended 31 December 2018**(all figures are in Euro)**(Prior Year restated)*

	Note	NCIO	
		2018	2017
<b>BALANCE AT BEGINNING OF PERIOD</b>		25,033,493	23,945,958
Variations due to restatement		0	0
<b>Restated balance</b>		25,033,493	23,945,958
Net gains/(losses) not recognised in the Statement of Financial Performance			0
Net surplus/(deficit) for the period		(476,473)	1,087,535
<b>BALANCE AT END OF PERIOD</b>		24,557,020	25,033,493
<b>RESERVES AT BEGINNING OF PERIOD</b>		7,717,116	9,796,881
Net increase/(decrease) of book value of property, plant and equipment		(329,476)	(734,262)
Net increase/(decrease) of reserves		(1,313,552)	(1,345,502)
Net increase/(decrease) of currency translation differences		0	0
<b>RESERVES AT END OF PERIOD</b>		6,074,088	7,717,116
<b>SURPLUSES/(DEFICITS) CARRIED FORWARD</b>		18,482,932	17,316,377
<b>NET ASSETS/EQUITY AT END OF PERIOD</b>		24,557,020	25,033,493

**NCIO Budget Execution  
Statement**

For the year ended 31 December 2018  
(all figures are in Euro)

NCIO

Note	Initial Budget	Transfers	BA2	Transfers	Final Budget	Net Commitment	Expenses	Total Spent	Carry Forward	Lapsed
<b>BUDGET</b>										
Chapter 1	2,403,080	0	0	0	2,403,080	2,845	2,378,693	2,381,538	2,845	21,542
Chapter 2	95,091	0	0	0	95,091	376	62,321	62,697	376	32,394
Chapter 3	0	0	0	0	0	0	0	0	0	0
<b>Total current year</b>	2,498,171	0	0	0	2,498,171	3,221	2,441,014	2,444,235	3,221	53,936
Chapter 1	0	0	0	0	0	0	0	0	0	0
Chapter 2	5,759	0	0	0	5,759	0	5,759	5,759	0	0
Chapter 3	0	0	0	0	0	0	0	0	0	0
<b>Total prior year</b>	5,759	0	0	0	5,759	0	5,759	5,759	0	0
Chapter 1	0	0	0	0	0	0	0	0	0	0
Chapter 2	11,063	0	0	0	11,063	0	7,465	7,465	0	3,598
Chapter 3	0	0	0	0	0	0	0	0	0	0
<b>Total 2 years ago</b>	11,063	0	0	0	11,063	0	7,465	7,465	0	3,598
<b>TOTAL</b>	2,514,993	0	0	0	2,514,993	3,221	2,454,238	2,457,459	3,221	57,534

## Accounting Policies

### Basis of preparation

These financial statements have been prepared in accordance with the NATO Accounting Framework (NAF) which is based upon International Public Sector Accounting Standards (IPSAS). IPSAS relating to *IPSAS 6 – Consolidated financial statements and accounting for controlled entities*, *IPSAS 12 – Inventories*, *IPSAS 17 – Property, Plant and Equipment* and *IPSAS 31 – Intangible Assets* were adapted by the NAC in August 2013 for reporting periods beginning on 1 January 2013. In addition, where certain financial reporting requirements are required by the NATO Financial Regulations (NFR), these are also met.

The Financial Statements are prepared on the going-concern basis which means that those charged with governance of NCIO consider that they believe NCIO will continue in existence for at least a year from the date the financial statements are issued.

The preparation of financial statements in compliance with the NAF requires the use of certain critical accounting estimates and requires that those responsible for preparing and presenting the financial statements of NCIO use judgement in applying these accounting policies. The areas where significant judgements and estimates have been made in preparing the financial statements and their effect are disclosed in the notes to the financial statements.

The policies have been consistently applied to all the years presented.

### Changes in Accounting Standards

The following IPSAS have become effective as of 1 January 2018:

- IPSAS 39 - Employee Benefits (replaces IPSAS 25)

The following IPSAS will become effective as of 1 January 2019:

- IPSAS 40 - Public Sector Combinations

NCIO has not yet made an assessment of whether these standards will impact NCIO Financial Reporting.

### Revenue Recognition

#### Revenue from exchange transactions

Under its third year of Customer Funding under a Bridging Model the vast majority of NCIO's revenue is Customer Funded revenue which is subdivided into:

- Operations and service revenue (e.g. Scientific Programme of Work (POW) and IC project service costs, SLA External CIS and service support costs).

- Acquisition revenue, for which NCIO considers it is the procurement principal on behalf of sponsors, NATO entities or Member Nations.
- Other revenue represents shared services associated with the hosting and support the Agency provides to other NATO entities such as NAGSMA.

NCIO also still has some contributions income from budgets:

- NCIO's Independent Secretariat: revenue associated with the running of the Independent Executive Secretariat which is to support the ASB Chairman. This budget is core funded and the ASB approves the structure and its annual budget, which is based on the Military Budget cost share model.
- Transition: specific budgets, authorised by the BC, created in 2013 and onwards to cover for expenses related to the NATO Command Structure reform and Agency Transition Programme workforce adjustments.

#### Revenue measurement and timing

Provided the amount of revenue can be measured reliably and it is probable that NCIO will receive payment, revenue for goods and services delivered is recognised when NCIO has transferred the significant risks and rewards of ownership and it is probable that NCIO will receive payment for delivering goods and services. These criteria are considered to be met when the goods or services are delivered to the customers' satisfaction. For all Customer Funded revenue, revenue is recognised by reference to the stage of completion or the cost burn rate, depending on the type of funding agreement; firm fixed price or cost reimbursable. For the budget revenue, income is recognised at the moment an expense is incurred as the revenue is guaranteed to be funded by member Nations.

### Expenses Recognition

NCIO has the following main categories of costs:

- Acquisition: costs relating to goods and services procured as a principal on behalf of sponsors, NATO entities or Member Nations.
- Personnel: costs derived from the employment of civilian personnel, as per NATO regulations, including salaries, allowances, pension contributions, recruitment and moving costs, but also training, medical and interim workforce (contractors, temporary staff and consultants).
- Contractual supplies and services: costs pertaining to goods and services procured from industry either directly in support of the delivery of services and capabilities or required for the normal functioning of the Agency's facilities and equipment.

- Depreciation, amortisation and provisions: costs related to usage of Agency assets, spread on a straight-line over their economic life, and costs related to the variance of Agency reserves (e.g. reserve for future losses, reserve for untaken leave).
- Foreign currency exchange and financial gains/losses: payments by NATO Bodies and Host Nations may be made in a variety of currencies. Gains/losses on foreign currency exchanges occasionally occur between the time of assessment and the time of payment. These differences are assessed and either refunded, charged or absorbed by the NCI Agency, depending on the agreement with the Customers. Gains or losses are recognised in the accounts in the period in which they occur.

Expenses are recognised when an invoice is posted or accrued, which reflects the point at which a good or service is received to the NCIO's satisfaction.

#### **Financial Plan Execution**

*IPSAS 24 - Presentation of Budget Information in Financial Statements* applies to public sector entities which are required or elect to make their approved budgets publically available.

NCIO, under full Customer Funding, has no budget but an Annual Financial Plan which is authorised by the ASB under the NCIO Charter, and which includes a statement of planned income (revenue) and expenditure (expenses).

Per above however, NCIO still has some budget elements for which specific individual budget execution statements have been prepared.

#### **Cash Flow Statements**

IPSAS 2 – Cash Flow Statements allows the choice between presenting the cash flow based on the direct method or indirect method. NCIO has elected to use the indirect method of presentation in these financial statements.

#### **Foreign Currency**

Transactions entered into by NCIO in a currency other than the currency of the primary economic environment in which they operate (their "functional currency"; which is Euro for NCIO) are recorded at the exchange rates in effect when the transactions occur. The use of exchange rates does not materially impact the financial statements.

Foreign currency transactions are recorded by converting the foreign currency amount at the BC conversion rates valid at the date of the transaction. NSIP and Third Party acquisition transactions are converted using the quarterly exchange rates

issued by the IC. This rate is imposed by the IC and allows the NCI Agency to get reimbursed for all exchange, bank and miscellaneous financial results.

NCIO applied the following principles for reporting foreign currency items at each reporting date: foreign currency monetary items have been translated using the closing rate. Items that are measured in terms of historical cost in a foreign currency have been translated using the exchange rate at the date of the transaction.

The Agency recognises all exchange differences as revenues or as expenses in the Statement of Financial Performance in the period in which they arise.

#### **Financial Assets**

The financial assets of NCIO are cash and cash equivalents, accounts receivable and prepayments. They are measured at fair value. Changes in fair value are recognised in the Statement of Financial Performance.

#### **Financial Liabilities**

The financial liabilities of NCIO are accounts payable, accruals, customer advances, unearned revenues, provisions for costs and contingencies and miscellaneous items. They are measured at fair value. Changes in fair value are recognised in the Statement of Financial Performance.

#### **Receivables**

Amounts receivable are reported at fair value in the Statement of Financial Position. Provisions for doubtful debts are only made once a legal process is started against a debtor and this is limited to only private sector entities; no provisions are made against Nations' debts as they are deemed to be collectable.

#### **Accounts Payable**

Accounts Payable represent amounts for which goods and services, supported by a vendor invoice, have been received at the year-end but which remain unpaid. Accounts payable includes, services and goods received supported by an unpaid invoice and estimates of accrued obligations for goods and services received but not yet invoiced by the vendors.



**Advances and/or Unearned Revenue**

In order to ensure that Customer and budget requirements can be met, NCIO can call for money in advance of need to provide adequate cash flow. The advance is shown as an asset but is matched by a liability because until the funds are used, they are owed back to the Customer who provided the funding.

**Prepayments**

When NCIO makes advance payments to vendors these are reflected as prepayments in the Statement of Financial Position.

**Retirement Benefits: Provident Fund and Defined Contribution Pension Scheme**

Contributions to Provident Fund and DCPS are charged to the Statement of Financial Performance in the year to which they relate. NCIO is not exposed directly to any liabilities that may arise on the scheme and have no control over the assets of the scheme which is accounted for centrally at NATO Headquarters.

**Retirement Benefits: Defined Benefit Pension Scheme** Contributions to the NATO Defined Benefit Pension Scheme are charged to the Statement of Financial Performance in the year to which they relate. NCIO is not exposed directly to any liabilities that may arise on the scheme and has no control over the assets of the scheme which is accounted for centrally at NATO Headquarters.

**Other Long-Term Service Benefits**

Employment of NATO civilian staff is governed by the NATO Civilian Personnel Regulations. Different rules apply depending on the circumstances of employment. Where there is a liability for potential long-term service benefits at the year-end, they are described and disclosed in the notes to the Financial Statements.

**Leased Assets**

Where substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred to NCIO (a "finance lease"), the asset is treated as if it had been purchased outright. NCIO has no finance leases.

Where substantially all of the risks and rewards incidental to ownership are not transferred to NCIO (an "operating lease"), the total rentals payable under the lease are charged to the Statement of Financial Performance on a straight-line basis over the lease term. Examples of operating leases can include photocopiers and cars.

**Externally Acquired Intangible Assets**

Externally acquired intangible assets are recognised at cost and subsequently amortised on a straight-line basis over their useful economic lives. The useful economic lives are deemed to be 3 years and all assets are capitalised above €5,000.

**Property, Plant and Equipment (PPE)**

PPE is recognised when it is an asset controlled by NCI Agency. Assets, of which PPE is a type, are defined by IPSAS as "Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity". Control of an asset is defined by IPSAS as arising "when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit." In addition, the NATO Accounting Framework has established criteria as to assist in assessing the level of control that any NATO Reporting Entity has for reporting assets in its financial statements. Even so, for CIS assets, NCIO's Charter stipulates that NCIO is considered the owner of these assets and thus NCIO is to report them in their financial statements. In some cases this is linked to the Handover/Takeover process - see below.

Per the NATO Accounting Framework (NAF) – adapted IPSAS 17, NCIO has adapted its accounting for 2012 and 2013 in considering all PPE acquired prior to 1 Jan 2013 as fully expensed. Per the NAF, a brief description of such PPE is presented as an Annex to this document with available information on the types, location and approximate number of items held per Asset category.

**NCIO Charter and related Handover/Takeover (HO/TO) process**

Per the NCIO Charter, NCIO is to assume ownership of all IT assets and IT infrastructure from the NATO commands. For those assets taken over, NCIO has considered those acquired prior to 2013 as fully expensed per the NATO Accounting Framework - adapted IPSAS 17 standard.

**Property, Plant and Equipment (PPE)**

NCIO controlled PPE is recognised at cost. Cost includes the purchase price, (including import duties, non-refundable purchase taxes, and deducting trade discounts and rebates) and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating, such as costs of site preparation, initial delivery and handling costs and installation costs. For each category of PPE capitalisation threshold values per item are defined. Items with a value below the applicable threshold will be expensed.

Depreciation is provided on all items of PPE so as to reduce its carrying value over the expected useful economic lives. The expected lives of PPE and their associated capitalisation thresholds per item are:

	<i>Sub-categories</i>	<i>PP&amp;E Thresholds</i>	<i>Economic Life Time</i>	<i>Annual Deprec. %</i>
<b>1.</b>	<b>CLASS 1.: INFRASTRUCTURE, PLANT AND EQUIPMENT</b>			
1.1.	CATEGORY 1.1.: AUTOMATIC DATA PROCESSING EQUIPMENT	5,000	3	33.33%
1.2.	CATEGORY 1.2.: COMMUNICATION SYSTEMS	5,000	3	33.33%
1.3.	CATEGORY 1.3.: MACHINERY	5,000	4	25.00%
1.4.	CATEGORY 1.4.: INSTALLED EQUIPMENT	5,000	4	25.00%
1.5.	CATEGORY 1.5.: FURNITURE	5,000	10	10.00%
1.6.	CATEGORY 1.6.: TRANSPORT EQUIPMENT	10,000	4	25.00%
1.7.	CATEGORY 1.7.: MISSION EQUIPMENT	5,000	4	25.00%
<b>2.</b>	<b>CLASS 2.: LAND AND BUILDINGS</b>			
2.1.	CATEGORY 2.1.: LAND	0	NA	
2.2.	CATEGORY 2.2.: BUILDINGS	25,000	40	2.50%
2.3.	CATEGORY 2.3.: INFRASTRUCTURE	25,000	40	2.50%
2.4.	CATEGORY 2.4.: BUILDING ENHANCEMENTS	10,000	10	10.00%
<b>3.</b>	<b>CLASS 3.: INTANGIBLE ASSETS</b>			
3.1.	CATEGORY 3.1.: SOFTWARE	5,000	3	33.33%
3.2.	CATEGORY 3.2.: RIGHTS OF WAY, INTELLECTUAL PROPERTY RIGHTS (IPR's), ADMINISTRATIVE CONCESSION RIGHTS	0	NA	
3.3.	CATEGORY 3.3.: INVESTMENTS IN RESEARCH AND DEVELOPMENT (R&D)	0	NA	

#### Land and Buildings

The NCIO occupies buildings and facilities at various locations NATO wide (and in the locations of NATO operations) and all provided for free by the Host Nation or the hosting Organisation. As of 2013, even though some buildings were previously valued and recognised as assets, under the NAF the NCIO elected to show these as now expensed when acquired prior to 1 Jan 2013.

#### Depreciation and Amortisation

Assets are depreciated or amortised in the year of purchase but not the year of disposal. Depreciation is also calculated on a full year basis, i.e. regardless of whether an item was available for use at the beginning of the year or at the end.

#### **Inventories**

Inventories are assets in the form of materials or supplies to be consumed or distributed in the production process or in the rendering of services or held for sale or distribution in the ordinary course of operations or in the process of production for sale or distribution. Inventories are measured at the lower of cost or current

replacement cost. The cost of standard items of inventories is measured by using the weighted average cost formula.

As per the 2013 NCIO Financial Statements (Annex B, items 90-92, page 42) NCIO legacy entities did not report inventories other than those held in NPC Glons and NCISS (minor value), as under the procurement agent principle all assets/inventories acquired for Customers (mainly ACT and ACO) were excluded from the Statement of Financial Position.

Under the full Customer Funding regime as of 2014, and per its Charter, NCIO is now considered as procurement principal for the inventories and as a result, now accounts for all inventories. Nevertheless and as already reported in its 2013 Financial Statements, NCIO is applying the NAF – adapted IPSAS 12 – by which it considers all inventory acquired prior to 1 Jan 2013 as expensed.

As per the NAF, based on the information available, the NCIO has produced an Annex to these Statements which provides a summary of such expensed inventory - types, locations and approximate number of items held per inventory category.

NCIO has no capitalisation thresholds for Inventory.

#### **Provisions**

NCIO recognises provisions for liabilities of uncertain timing or amount including those for legal disputes. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

#### **Contingent Liabilities**

NCIO discloses in the notes to the Financial Statements contingent liabilities where:

- the NCIO is exposed to possible financial liabilities that arose from events which occurred before the year-end, and where the confirmation of the existence of the liability will only be known through the occurrence or non-occurrence of one or more uncertain future events not wholly within the organisations control, or,
- the NCIO is exposed to a current financial liability which arose from events which occurred before the year-end where NCIO does not believe it will be required to pay for the financial liability, or, the amount of the financial liability cannot be measured with sufficient reliability.

#### **Net Equity and Operating Fund**

Net Equity is, per the NAF/IPSAS, reflected in the Agency's Annual Financial Statements under the Statement of Financial Position, equalling the balance between total Assets and total Liabilities.

Net Equity are subdivided into:

- Retained Earnings, considered as accumulated surplus and deficit available for distribution
- Reserved Earnings, considered as accumulated surplus and deficit that are reserved for a specific purpose, and thus not available for distribution

As of 2014 the NCI Agency works under a Customer Funding bridging model. The approved policies and procedures of this Customer Funding financial regime that authorise and regulate the use of the NCI Agency Operating Fund during this reporting period are the NFRs (C-M(2015)0025 dated 4 May 2015) and the FRPs (AC/337-D(2016)0014-AS1 dated 29 March 2016), and the Customer Funding Regulatory Framework approved by the Council in 2015 (PO(2015)0394-AS1 dated 16 July 2015).

Oversight of the performance and use of the Fund is the responsibility of the Nations.

End of 2016, the Agency Supervisory Board (ASB) Finance Committee tasked the Agency to develop a paper on the Operating Fund for discussion. During its meeting on 12 and 13 October 2017, the Agency Supervisory Board (ASB) Finance Committee decided<sup>2</sup> as follows:

- The need for an Operating Fund as a risk management tool.
- The definition of Operating Fund as the accumulated surplus or deficit fund equalling the sum of retained earnings, but no longer comprising of depreciation reserve.
- The target level of the Operating Fund at 10 M EUR, excluding depreciation reserve.
- Tasked the Agency to conduct a risk assessment to justify any increase to the Operating Fund above 10 M EUR.
- Agreed on the pro rata distribution of potential surplus Operating Fund based upon the Military Budget and the NATO Security Investment Programme share in the Agency revenue via the call for contributions mechanism, with the understanding that the adjustment mechanism be revised within a year (up until then any surplus was returned through a reduction in Customer Rates).

Per the above and as of the 2018 Financial Statements the Operating Fund, per Nations guidance, is considered equal to the Retained Earnings.

---

<sup>2</sup> AC/337(FC)DS(2017)0004

## NOTES TO THE FINANCIAL STATEMENTS

### **Critical Accounting Estimates and Judgements**

NCIO makes certain estimates and assumptions regarding the future. Estimates and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions. Some balances such as accruals and unbilled sales need to be assessed at the year-end to estimate the value of work and services delivered at the year-end. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

### **Legal proceedings both real and possible**

In accordance with IPSAS, NCIO recognises a provision where there is a present obligation from a past event, a transfer of economic benefits is probable and the amount of costs of the transfer can be estimated reliably. In instances where the criteria are not met, a contingent liability may be disclosed in the notes to the financial statements. Obligations arising in respect of contingent liabilities that have been disclosed, or those which are not currently recognised or disclosed in the financial statements could have a material effect on NCIO's financial position.

Application of these accounting principles to legal cases requires NCI Agency's management to make determinations about various factual and legal matters beyond its control. The Agency reviews outstanding legal cases following developments in the legal proceedings and at each reporting date, in order to assess the need for provisions and disclosures in its financial statements. Among the factors considered in making decisions on provisions are the nature of litigation, claim or assessment, the legal process and potential level of damages in the jurisdiction in which the litigation, claim or assessment has been brought, the progress of the case (including the progress after the date of the financial statements but before those statements are issued), the opinions or views of legal advisers, experience on similar cases and any decision of the ASB to how it will respond to the litigation, claim or assessment.

**A. Notes to the NCIO Statement of Financial Position****1. Cash and Cash Equivalents**

Cash available on demand is considered to be cash that can accessed at very short notice (e.g. 1 working day) while a short-term deposit is invested from typically one to three months. Cash and cash equivalents includes amounts advanced by Customers for future usage. Cash balances are restricted to the use for which Customers have provided the cash.

Given the limitations on the size and use of the Operating Fund, the NCI Agency relies on the Customer provided funding via advance payments and timely payment of invoices to provide the cash flow for daily operations.

(All amounts in 1 Euro)

		NCIO	
		Note	
		Unit	
		2018	2017
<b>Cash and Cash Equivalents</b>			
100	Cash in hand	35,784	35,380
101	Current bank clearing accounts and internal transfers	(3,081)	488
102	Current bank accounts - Euro	118,872,586	96,631,995
104	Current bank accounts - Non-Euro	29,299,143	41,700,870
106	Current investments accounts - Euro	0	0
108	Current investments accounts - Non-Euro	89,952	22,459,253
		<b>148,294,384</b>	<b>160,827,986</b>

**2. Accounts Receivable**

Receivables total 272.8 MEUR. Trade receivables are impacted by the NSIP Quarterly Accounting Financial Report (QAFR) bookings. The NCI Agency has adapted its accounting treatment per the IBAN observation in the past, so that advances received from the NSIP Programme are netted against the amounts to be received from the same programme. This more clearly and accurately represents the position of the NCI Agency against the programme at year-end. Without these impacted QAFR bookings trade receivables total 127.1 MEUR which include billed but not yet received amounts from Customers.

Trade receivables from accrued revenue amounts to 244 MEUR.

		Note	2018	2017
		Unit		
<b>Receivables</b>				
11001	Customer receivables (A/R) - Common funded - NATO and NATO entities		99,589,453	128,403,858
11002	Customer receivables (A/R) - Not common funded		75,322,047	66,261,479
1107	Customer receivables - Bad debts		(336,812)	(345,130)
11000	Customer receivables (A/R) - Common funded - NSIP		(149,362,386)	(137,662,008)
111	Customer receivables - Consolidated entities		0	0
113	Customer receivables - Recoverable expenses		431,197	386,977
115	Current receivables - Tax or personnel related		2,949,042	2,478,846
116	Current receivables - Accrued, unbilled revenue		244,238,196	147,604,939
119	Current receivables - Other		(3,267)	37,544
			<b>272,827,470</b>	<b>207,166,505</b>

NSIP related trade receivables from nations are 55.8 MEUR and trade receivables from accrued revenue amounts to 71.3 MEUR, resulting in a total 127.1 MEUR, that is netted against the balance of advances through the QAFR pay sheets of 149.4 MEUR leading to a net position of liability towards the NSIP at 31/12/2018 of 22.3 MEUR as per the below table.

		Note	2018	2017
		Unit		
110021	Customer receivables (A/R) - NATO Nations (BS 60)	CD - NSIP	55,819,724	49,179,998
110002	Customer receivables (A/R) - NSIP - QFR Advances on approved forecast (BS 10)	CD - NSIP	(149,362,386)	(137,662,008)
116020	Accrued, unbilled - License revenue (Accum.)	CD - NSIP	71,301,928	97,127,980
			<b>(22,240,735)</b>	<b>8,645,970</b>

**3. Prepayments and Miscellaneous Assets**

		Note	2018	2017
		Unit		
<b>Prepayments and Miscellaneous Assets</b>				
130	Prepayments		3,107,687	3,121,046
			<b>3,107,687</b>	<b>3,121,046</b>

This amount represents advances and prepayments made to vendors.

**4. Inventories**

		Note	2018	2017
		Unit		
<b>Inventory</b>				
14000	Inventory - Consumables		1,338,729	1,682,302
14001	Inventory - Spare parts		6,730,794	1,884,151
			<b>8,069,523</b>	<b>3,566,455</b>

The inventory ending balance is for a total of 8.1 MEUR which is an increase of 4.5 MEUR when compared to 2017.

Since 2014 NCI Agency is considered the principal for procurement of CIS assets for NSIP and Third Parties and is therefore taking the primary responsibility and risk for the related inventory items. Inventories reported are those inventories held at NCI Agency's depots such as CSSC Brunssum, NPC Glons and NCISS Latina; they are valued with the weighted average cost method. Prior to 2014 inventories, other than NPC and NCISS, were not reported as being the service provider to the NATO Command Structure (NCS), the NCI Agency operated under delegated budget agreements as a procurement agent for the NCS. Since the NCI Agency became fully Customer Funded as of 1 Jan 2014 inventories are fully disclosed, as the NCI Agency is no longer acting as an agent on behalf of a third party but rather as a principal in rendering services to its Customers.

However, the first time recognition of inventory was impacted by the introduction of the NAF applicable as of 1 January 2013 that allows for the adaption of IPSAS 12 - inventory items acquired prior to 1 January 2013 can be considered as fully expensed.

For the first time recognition of the CSSC Brunssum, the initial amount of 32.3 MEUR was booked as a beginning balance. As a result of the application of the NAF, a correction to the balance for the prior 2013 acquired items of 30.1 MEUR was made for all NCI Agency inventories. In 2015, inventory was also taken on from CSUs as a beginning balance and amounting to 2.2 MEUR. This beginning balance has also been considered as acquired prior to 1 January 2013 resulting in a total amount of 32.3 MEUR expensed per the NAF. In accordance with the stipulations of the NAF, a brief description on inventories held prior to 1 JAN 2013, is provided later in this document.

The Agency has agreed with IBAN to assess the legacy NDSS converted data/NAF adjustment with the objective to have a more reliable value to bring into the statement of position by the end of 2019.

**5. Work In Progress**

		<b>Note</b>		
		<b>Unit</b>	<b>2018</b>	<b>2017</b>
<b>Work in Progress</b>				
145	Work in progress		3,145,258	879,313
			<b>3,145,258</b>	<b>879,313</b>

The work in progress consists of capitalised expenses for pre-financed projects, for cost overruns on Advance Planning Funds (APF) and for recoverable exceptions.

Pre-financed projects totalling €2,970,540 are governed by existing binding arrangements (overarching framework agreements such as Memorandum of Understanding – MOU) between the Agency and its main sponsors. All existing pre-finance authorisations are granted as per the terms and conditions prescribed in the FRPs specifically developed for the Agency operating under its Customer Funding Regime. The decision to pre-finance projects is assessed by the Chief Operating Officer (COO), Production Directors and the Financial Controller prior to being approved on a case-by-case basis by the Financial Controller. Accordingly we do not view this as a technical contingent asset.

For projects sponsored by NSIP, APFs may be authorised to cover the initial cost for writing the full project price proposal (TBCE). In some cases the APFs are insufficient to cover this initial effort in which case the NCI Agency capitalises the shortfall pending approval of the Project Service Cost (PSC). Funds expended during this stage are capitalised as work in progress for a total amount of €97,878.

In the course of executing projects, sometimes the Customer requests changes in specifications, scope, or duration that results in the costs exceeding the contracted revenue. Similarly to APF over-runs, for these recoverable exceptions, costs are capitalised until the exceptions are contractually regularised. The total capitalised amount of recoverable exceptions is €132,619.

**6. Other Current Assets**

		<b>Note</b>		
		<b>Unit</b>	<b>2018</b>	<b>2017</b>
<b>Other Current Assets</b>				
1559	Transitory asset accounts - Clearing accounts		15,415	40,436
			<b>15,415</b>	<b>40,436</b>

This amount concerns different transactions that are pending a resolution/final booking in 2019.



**7. Non-current Receivables**

		Note	2018	2017
		Unit		
<b>Non-current Receivables</b>				
160	Non-current financial assets		1,925	1,904
			1,925	1,904

**8. Property, Plant and Equipment (PPE) and Intangible Assets**

The NCI Agency capitalises all PPE which it controls. The NCI Agency has applied the NAF, adapting IPSAS 17 on PPE, in that all PPE acquired prior to 1 Jan 2013 are considered expensed. As per the stipulations of the NAF, a brief description of these PPE held prior to 1 JAN 2013, can be found further in this document.

## NCIO Statement of Property, Plant and Equipment and Intangible Assets

As of 31 December 2018

(all figures are in Euro)

NCIO											
		ACQUISITION				DEPRECIATION				BOOK VALUE	
31-Dec-2017	Current Year	Disposals / Adjustm.	Transfers / Reversals	Revaluation	31-Dec-2018	31-Dec-2017	Current Year	Disposals / Adjustm.	31-Dec-2018	31-Dec-2018	
7,719,906	2,540,269	(62,897)	0	0	10,197,278	(5,776,770)	(2,331,512)	30,570	(8,077,711)	2,119,567	
2,902,675	750,646	0	0	0	3,653,320	(2,025,910)	(966,266)	0	(2,992,176)	661,144	
422,467	171,818	(11,757)	0	0	582,529	(232,720)	(150,187)	0	(382,907)	199,622	
197,590	34,334	0	0	0	231,924	(145,440)	(41,127)	0	(186,567)	45,357	
670,596	34,566	(5,948)	0	0	699,214	(575,168)	(67,830)	5,948	(637,049)	62,165	
0	0	0	0	0	0	0	0	0	0	0	
379,608	0	0	0	0	379,608	(299,711)	(41,314)	0	(341,024)	38,583	
12,292,842	3,531,633	(80,602)	0	0	15,743,873	(9,055,719)	(3,598,235)	36,519	(12,617,435)	3,126,438	
15,436	0	(15,436)	0	0	0	(6,175)	(1,544)	7,718	0	0	
142,950	0	0	0	0	142,950	(71,475)	(14,295)	0	(85,770)	57,180	
0	0	0	0	0	0	0	0	0	0	0	
158,386	0	(15,436)	0	0	142,950	(77,650)	(15,839)	7,718	(85,770)	57,180	
277,829	10,312	0	0	0	288,141	(206,132)	(65,393)	0	(271,525)	16,617	
277,829	10,312	0	0	0	288,141	(206,132)	(65,393)	0	(271,525)	16,617	
12,729,058	3,541,945	(96,038)	0	0	16,174,964	(9,339,500)	(3,679,466)	44,237	(12,974,730)	3,200,234	
140,727	0	(140,727)	0	0	0	0	0	0	0	0	
12,869,784	3,541,945	(236,765)	0	0	16,174,964	(9,339,500)	(3,679,466)	44,237	(12,974,730)	3,200,234	
12,869,784	3,541,945	(236,765)	0	0	16,174,964	(9,339,500)	(3,679,466)	44,237	(12,974,730)	3,200,234	
	3,541,945	(236,765)	0	0	3,305,179		(3,679,466)	44,237	(3,635,230)	(330,050)	
9,463,197	3,135,602	(236,765)	(10,506)	0	12,351,528	(6,474,046)	(1,183,083)	44,237	(7,612,893)	4,738,636	
	3,135,602	(236,765)	(10,506)	0	2,888,331	0	(1,183,083)	44,237	(1,138,847)	1,749,485	

3,200,234 Eur Total Plant, property and Equipment as published in the detail table consist of 3,183,617 Eur Property Plant and Equipment and 16,617 Eur of Intangible assets as published in the statement of financial position.

**9. Payables**

		<b>Note</b>		
		<b>Unit</b>	<b>2018</b>	<b>2017</b>
<b>Payables</b>				
2000	Supplier payables - Accounts payable		2,768,441	16,686,514
2004	Supplier payables - Accrued supplier invoices		154,257,277	120,055,102
2010	Supplier payables - Consolidated entities - Accounts payable		0	0
2014	Supplier payables - Consolidated entities - Accrued expenses		0	0
2006	Supplier payables - Warranties received		940,128	375,190
			<b>157,965,846</b>	<b>137,116,806</b>

Trade payables are short-term (less than 1 year) liabilities to Vendors; directly related to the activities and operations of the Agency.

**10. Deferred Revenue and Advances**

		<b>Note</b>		
		<b>Unit</b>	<b>2018</b>	<b>2017</b>
211	Current deferred revenue		181,310,587	156,331,383
215	Current advances and prepayments received		57,260,593	51,197,422
			<b>238,571,180</b>	<b>207,528,805</b>

The Deferred/Unearned Revenue and Advances of 238.6 MEUR are composed of:

- Revenue is billed for ongoing projects and services, however revenue earned is determined through the stage of completion resulting in 181.3 MEUR of revenue billed but not yet recognised as earned.
- Advances and prepayments of 57.3 MEUR refer to deposits from customers and IC nations for projects and services that will be delivered by the agency.

**11. Other Current Liabilities**

		Note	2018	2017
		Unit		
<b>Other Current Liabilities</b>				
250	Current tax and personnel related liabilities		260,770	76,052
251	Current retirement and pensions related liabilities		0	0
254	Current other liabilities		1,640,470	1,472,936
255	Transitory liability accounts		0	(26,243)
			<b>1,901,240</b>	<b>1,522,745</b>

Other current liabilities include:

- Refundable surpluses amount to 1.6 MEUR and represent mostly funds to be returned to the IC from acquisition projects and to the BC for results (lapses/financial/miscellaneous) on budgets - mostly prior year budgets - since the Agency is Customer Funded as of 2014.
- Other liabilities related to personnel amount to 260.8 KEUR.

**12. Provisions**

		Note	2018	2017
		Unit		
<b>Provisions</b>				
2901	Provisions - Major risks and costs		6,864,531	950,317
2902	Provisions - Personnel related risks and costs		8,802,079	6,981,762
			<b>15,666,610</b>	<b>7,932,079</b>

Provisions are liabilities and obligations, which are known to exist but for which the amount is not certain yet and the probability of occurrence is not fully known at the time of the disclosure. Amounts include:

- Projects are constantly monitored and deviations from the original cost estimates and authorised budgets are reported and analysed. At year-end closing a thorough cost-to-complete exercise is carried out to determine what the current status is in terms of costs and revenue to date, and to estimate what the cost-to-complete will be for multiple year projects. If, as a result of this process, the project management together with the NCI Agency Capability Development's financial management come to the conclusion that the project is likely to generate a loss at completion, then a provision will be made to cover that potential future loss. Analysis conducted at a later stage may result in a change of estimates which translates in an increase or decrease of the provision built up in prior years. The total provision for the Customer Funded projects amounts to 4.1 MEUR.

- The NCI Agency provision for the untaken leave days outstanding at year end, in accordance with IPSAS 25 Employee benefits, constitutes a liability towards the future for 7 MEUR. This provision is calculated on a rolling basis, i.e. the prior year provision is reversed at the beginning of the year and a new provision calculated, thus charging the change for the year to the Statement of Financial Performance.
- Provision made for 342 KEUR for JFC Naples for “Trattamento di Fine Rapporto (TFR)” in application of the Italian Law and of IPSAS 19. TFR is a vested benefit payable to the employee for a part of his / her salary deferred in time to the moment when termination of the contract takes place. The calculation of the value of this liability takes place annually and includes interests for the loan forcedly made by the employee to the employer given the fact that payment is deferred to a later time. In view of the foregoing, TFR has to be considered as one extra monthly instalment of the annual pay.

### 13. Net Assets/Equity

Under its Customer Funding model, the NCI Agency is allowed to have an Operating Fund (OF) which represents its retained earnings accumulated over the years. The use of this OF is regulated, as detailed earlier in this report, by the Customer Funding Regulatory Framework approved by Council in 2015. Further information is presented under the note related to the Statement of Change/Equity (OF).

## B. Notes to the NCIO Statement of Financial Performance

### 14. Projects and Service Support Revenue

		Note	2018	2017
		Unit		
<b>Project and Support Services Revenue</b>				
500	Project services revenue	CD - Ops	107,567,591	104,549,622
501	Support services revenue	CD - Ops	0	0
501	Support services revenue	SD	180,693,112	153,602,542
			<b>288,260,703</b>	<b>258,152,164</b>

With the introduction of full Customer Funding as of 1 Jan 2014, the 2018 operations revenue can be categorised as either Project Support Revenue for 107.6 MEUR stemming from Capability Development (Project Services Costs) or Services Revenue for 180.7 MEUR, coming from signed Service Level Agreements (Service Support Costs) and other Service Agreements, all agreed and calculated at approved Customer Rates.

For all Customer Funded revenue, revenue is recognised, in accordance with IPSAS 9 and 11, by reference to the stage of completion or the cost burn rate, depending on the type of funding agreement; firm fixed price or cost reimbursable. This revenue recognition was already in place in 2013 for that part of the NCI Agency's business Customer Funded at that time but has now been expanded to nearly all its revenues. In applying this revenue recognition a “cost to complete” is calculated based on either inputs from the project manager as to the resources required to complete the project/deliverables or either based on information from the financial system as to the legal liabilities incurred per the end of 2018, but not yet accrued or expended, and which nevertheless form part of the 2018 services signed with the Customers through the Service Level Agreements.

**15. External CIS Revenue**

The total revenue per service as specified in the Service Level agreements have two revenue components. There is the Service Support Revenue element that is based on effort charged at approved customer rates (see the note above) and the External CIS Revenue of 219.5 MEUR in 2018 that represents the revenue charged to customers to cover the contractual supplies and services delivered by industry required by the NCI Agency to provide its CIS services.

		Note	2018	2017
		Unit		
<b>External Services Revenue</b>				
5100	External CIS revenue – Billed		219,527,482	202,616,329
5105	External CIS revenue - Accrued, unbilled (CY)		14,606,837	17,282,308
5106	External CIS revenue - Deferred revenue reversal (CY)		0	0
5109	External CIS revenue - Deferred (CY) (-)		2,635,425	2,721,442
			<b>236,769,744</b>	<b>222,620,080</b>

**16. Acquisition Revenue**

		Note	2018	2017
		Unit		
<b>Acquisition Revenue</b>				
5110	Acquisition revenue – Billed	CD - NSIP	201,579,752	226,150,714
5115	Acquisition revenue - Accrued, unbilled (CY)	CD - NSIP	38,877,391	(38,629,519)
5110	Acquisition revenue – Billed	CD - TP	79,533,484	115,176,768
5115	Acquisition revenue - Accrued, unbilled (CY)	CD - TP	(748,311)	(4,589,919)
5119	Acquisition revenue - Deferred (CY) (-)	CD - TP	11,743,042	(14,923,494)
533	External CIS and acquisition revenue - Acquisition - Intra-company	CD - TP	0	0
			<b>330,985,358</b>	<b>283,184,550</b>

Acquisition Revenue is earned as Host Nation for the NSIP, and for other NATO entities and Nations. Included here are the Acquisition Revenues for the AirC2 and BMD programmes.

Revenue is recognised by reference to the stage of completion or the cost burn rate, depending on the type of funding agreement; firm fixed price or cost reimbursable. All of NSIP and, most other agreements as well, are through cost reimbursable funding agreements, and thus at cost burn rate.

**17. Other Operating Revenue**

Note	2018	2017
------	------	------

		Unit	
<b>Other Operating Revenue</b>			
529	Other operations revenue	4,067,977	3,859,999
541	Inventory variation - (Increase)/Decrease	0	0
545	Other revenue	170,781	364,402
		<b>4,238,758</b>	<b>4,224,401</b>

Other Operating Revenue consists of elements such as:

- Revenue from the support to and hosting of Agencies such as NAGSMA and BGX;
- Revenue from 2018 budgets for the ASB Independent Secretariat and the BC877 NCI Agency Implementation Budget for a total of 2.5 MEUR. Details and their Budget Execution Statements can be found under section D of the Notes to the Financial Statements.

## 18. Other Revenue

		Note	2018	2017
		Unit		
<b>Other Revenue</b>				
560	Fixed assets sales – Surpluses		0	11,850
			<b>0</b>	<b>11,850</b>

This amount represents a surplus from sales of depreciated fixed assets.

## 19. Revenue Details

In summary the NCI Agency total operating revenue, excluding financial and other revenue for the period ending 31 December 2018 was 860.3 MEUR broken-down as:

- 860.3 MEUR of Operating revenue excluding other operating revenue is:
  - 331 MEUR Acquisition Revenue earned in the execution of procurements for NSIP and Third Parties;
  - 236.8 MEUR External CIS Revenue earned in the execution of CIS Service Level Agreements for goods and services procured from industry;
  - 288.3 MEUR Operating Revenue earned through the rendering of capability development and delivery of CIS services by Agency resources; and
- 4.2 MEUR Other operating revenue

Financial and other (non-operating) revenue results in an amount of 2.3 MEUR

## 20. Cost of Acquisitions

		Note	2018	2017
		Unit		
<b>Cost of Acquisition</b>				
727	Contractors, general services and supplies	CD - NSIP	240,431,600	186,641,195
727	Contractors, general services and supplies	CD - TP	89,160,523	93,064,891
			<b>329,592,123</b>	<b>279,706,085</b>

The NCI Agency procures significant amounts of goods and services using funds provided by all its sponsors but principally the IC. Expense recognition is based upon actual payments made together with accrued expenses which are based on the value of work completed by contractors where invoices are not yet received.

As for the revenue, the cost of acquisitions does not include the Project Service Costs (PSCs) of the NCI Agency to enact the procurements on behalf of sponsors. These professional fees are accounted for through the Project and Support Services Revenue as they relate to the NCI Agency work across the C4ISR lifecycle. It must be noted that there is not a direct relationship for any financial year between the PSCs with the specific acquisition payments and costs associated with major acquisitions. This is due to the fact that PSCs are recognisable when the service is provided and not when the actual acquisition transactions occur, particularly as the subsequent receipt of goods and payment to Vendors can occur over many years when downstream activity is minimal.

## 21. Personnel Costs

		Note	2018	2017
		Unit		
<b>Personnel Costs</b>				
710	Salaries, allowances and other remunerations		152,927,879	141,958,138
711	Interim Workforce Capacity (IWC)		74,879,323	55,413,718
712	Recruitment costs and installation and separation allowances		2,721,407	2,638,767
713	Clothing costs and allowances		148,240	56,548
715	Medical examinations and general personnel related insurances		15,075,625	14,677,059
716	Education and training		3,467,587	2,103,065
717	Employer contributions to pensions; loss of job and other personnel contracts related indemnities		2,027,400	2,310,533
718	NATO Pensions (Pension funds)		9,577,855	8,459,137
			<b>260,825,316</b>	<b>227,616,964</b>

Personnel costs in this category are for staff members hired under the NATO Civilian Personnel Regulations (CPRs) and contractors. The figures represent the costs of personnel working on activities required to operate the NCI Agency and deliver services to Customers. This category also includes cost incurred with recruitment activity, learning and development, and personnel related costs due to reorganisation (loss of job indemnity) charged against the BC 877 Budget for 2 MEUR.



## 22. Employee Disclosures

### Staff Numbers

At 31 December 2018 - 909 (2017: 966) military posts and 1536 (2017: 1470) NATO civilian posts were filled.

### Retirement benefits

NCI Agency NICs and temporary personnel (not contractors), past and present, are enrolled in various NATO pension schemes. The NCI Agency contributes to the schemes for existing employees at amounts laid out in the CPR.

The NCI Agency does not control or manage any of the schemes or scheme assets and is not exposed to the risks and rewards of the schemes and hence does not record any assets or liabilities of the schemes on its Statement of Financial Position. In 2017 the NCI Agency contributed 9.2 MEUR (2017: 8.4 MEUR) to the various NATO pension schemes.

Further to an analysis covering the last years of the history of death in service risks in relation to premiums paid by the Organisation during 2012-2015, a compensation of EUR 6 million at the NATO-wide level was agreed by the insurance company. End 2018, the NATO Secretary General decided that a fraction of this amount (circa EUR 1,7 million) should be paid to NATO staff who were members of the DCPS during the period 2012-2015 in proportion to the contributions they made to the DCPS. Staff employed by "NATO body" during the period 2012-2015 and affiliated to the DCPS are therefore entitled to a payment to be made from the NATO DCPS accounts. A decision still has to be taken concerning the remaining amount of the compensation, which may result in a proportional payment to the NATO body.

## 23. Related Party Transactions

NCIO has no related party relationships where significant influence or control of the related party exists from a financial reporting perspective. The NCIO is providing CIS support and C3 capabilities and which exists for its Member Nations and partners. Many Member nations and partner countries have financial and operating control, or, significant influence over suppliers based in their territories; as such the NCIO can trade with suppliers which may be controlled or influenced by its Member Nations. However, NCIO trades with such suppliers at "arms-length" and under transparent procurement regulations; while it aims to get the best value for money for its Customers it does not do this through exerting control or significant influence over its suppliers.

The NCIO is an integral part of NATO and it transacts in its normal business activities with other NATO bodies and these transactions occur at cost or under a firm fixed price.

### Related Party Transactions of Members of Boards and Committees

The NCIO reports to a number of Boards and Committees which form part of its governance. With the exception of the ASB, those charged with governance may also have potential related party transactions with NCIO this has not been validated.

### Representative Allowance of the General Manager

The General Manager (GM), in addition to other allowances to which all staff are entitled, receives a representation allowance due to the requirements to represent the NCI Agency.

Since 2013, management of the GM representation allowance moved, per the BC guidance, from a situation where recipients receive the representation allowance as an advance and return the unspent amount to the NATO body, to a situation where all recipients are reimbursed permitted expenses within the limits of their individual representation allowance allocation.

The total entitlement to representation allowance for the NCI Agency GM was 10,691.76 Eur. The actual expenses during 2018: 7,814.15 Eur (2017: 5,361.55 Eur) were as follows:

- Rental supplement: € 0.00
- Functions: € 7,814.15
- Total representation allowance: € 7,814.15

### Key Management Personnel

Key Management Personnel hold positions of responsibility within NCI Agency. They are responsible for implementing the strategic direction and carrying out the operational management of NCI Agency; they are entrusted with significant authority. Procedures are in place to ensure Key Management Personnel carry out their responsibilities impartially and in compliance with the Code of Conduct (applicable to all staff) and the Agency discloses:

- the remuneration of Key Management Personnel,
- related parties,
- loans made, and
- payments provided for services provided to the entity other than as an employee.

Euro (A7/A6)	2018	2017
Basic salaries	1,038,701	1,072,666
Allowances	172,993	191,432
Post-employment benefits	341,564	0
Employer's contribution to Insurance	115,849	124,323
Employer's contribution to Pension	70,136	86,118
<b>Total</b>	<b>1,739,243</b>	<b>1474,539</b>

  

FTE	2018	2017
General Manager	1	1
Directors (A6/OF6/OF7)	7.66	8.62

<b>Name</b>	<b>Nationality</b>	<b>Role</b>	<b>Grade and step at year-end</b>	<b>Loans received from NCIA</b>	<b>Family members receiving income from NCIA</b>	<b>Other revenue from NCIA or NATO</b>
Kevin Scheid	USA	General Manager	A7 step 4	Nil	Nil	Nil
RADM Thomas Daum	DEU	Chief of Staff	OF-7	Nil	Nil	Nil
Ludwig Decamps	BEL	Chief Operating Officer	A6 Step 7	Nil	Nil	Nil
Peter Scaruppe	DEU	Director Acquisition	A6 Step 7	Nil	Nil	Nil
Anne-Marie Pick (left 31 Oct 18)	USA	Financial Controller	A6 Step 8	Nil	Nil	Nil
Gregory Edwards	USA	Director Infrastructure Services	A6 Step 5	Nil	Nil	Nil
BGEN Luigi Tomaiuolo (left 31 Jul 18)	ITA	Director of Service Operations	OF-6	Nil	Nil	Nil
Murray Davidson	GBR	Director Service Strategy	A6 step 3	Nil	Nil	Nil
Michael Stoltz	DEU	Director Air and Missile Defence Command & Control	A6 Step 6	Nil	Nil	Nil
Simona ROCCHI	ITA	Legal Advisor	A6 Step 6	Nil	Nil	Nil

All Key Management Personnel of the NCI Agency must sign a declaration statement that supports the disclosure requirements of IPSAS 20.

Out of the Key Management, none had family members who were employed as interns and/or in a temporary position with the Agency.

## 24. Contractual Supplies and Services

<b>Note</b>	<b>2018</b>	<b>2017</b>
-------------	-------------	-------------

		Unit	
Contractual Supplies and Services			
720	Rent and operational leasing costs	34,076,875	33,265,433
721	Maintenance and repair (Services)	187,305,609	181,010,823
722	Consumables and spare parts (Supplies)	1,629,504	13,575,220
723	Minor equipment (Investments below threshold)	2,010,898	1,981,059
724	Utilities, postal and courier services, travel and transportation	15,173,441	13,267,975
725	Facilities management, environment, safety and security	3,685,538	1,961,740
726	Public relations, representation, hospitality and moral and welfare	241,638	183,929
727	Contractors, general services and supplies	5,830,117	5,272,439
730	Investment costs	10,100,114	6,592,296
		260,053,734	257,110,914

Contractual supplies and services contain both direct and indirect costs:

- Rent and leasing costs only concern either rental costs or operating leases per IPSAS 13; the NCI Agency does not have any finance leases
- Expenses on External CIS (direct costs), to the amount of 229.3 MEUR, are included throughout the above items of contractual Supplies and Services
- Within the Consumables and spare parts we have an amount of -4.5 MEUR from inventory variation (increase of inventory balance)
- Investments not capitalised concern acquisitions which do not exceed the PPE thresholds (above 5 KEUR per item) per NCI Agency's accounting policy

NCIO also has some Morale and Welfare Activities (MWA) which are not consolidated into the Financial Statements as per the NAF adapted IPSAS 6, even if they are considered to be under the control, from a financial reporting perspective of the NCI Agency.

## 25. Depreciation and Amortisation

Note	2018	2017
Unit		

Depreciation and Amortisation			
740	Amortisation and depreciation	3,679,467	4,116,698
741	Write-offs	8,322	18,162
		3,687,789	4,134,860

For Fixed Assets, the NCI Agency takes into account the current year depreciation as a cost which amounts to 3.7 MEUR. Full detail on the 2018 annual depreciation by asset category can be found in the Table under note 8.

## 26. Provisions

		Note	2018	2017
		Unit		
<b>Provisions</b>				
7461	Provisions - Major risks and costs		5,914,213	-3,444,766
7462	Provisions - Personnel related risks and costs		1,820,318	164,100
			7,734,531	-3,280,666

Details can also be found under note 13. IPSAS defines a provision as “a liability of uncertain timing or amount”

NCIO has made the following provisions:

- Provisions – Major risks and costs
  - In 2018, provisions were made for future losses for active projects/services. The expected loss was recognised as an expense immediately (IPSAS 9 and 11). For reasons of commercial confidentiality, details of which programmes/projects are not disclosed but there four separate items which drive the estimate of a future loss  
Coupled with the other provisions from the respective costs to complete exercise, the net effect is an increase of 5.9 MEUR.
- Provisions – Personnel Related
  - Provision for untaken leave of own personnel of 0.4MEUR increase: personnel leave days untaken at the end of the year can be transferred to the next year and taken before the end of the first quarter. This constitutes a liability towards the next year since staff will not be available for service during this period of time. The provision is calculated on a rolling basis based on actual days of untaken leave outstanding and the average cost of a day of untaken leave per grade level.
  - Provision for Loss Of Job Indemnity (LOJI); the provision balance of LOJI 2018 reported on the statement of financial position was increased by 1.4 MEUR.
  - Provision for “Trattamento di Fine Rapporto (TFR)” in application of the Italian Law and of IPSAS 19 was increased with 6 KEUR compared with prior year.

**27. Contingent Liabilities**

IPSAS defines a contingent liability as “A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, or, a present obligation that arises from past events, but is not recognised because: 1) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or 2) The amount of the obligation cannot be measured with sufficient reliability”. The Agency has a process to capture information on provisions and contingent liabilities at year-end from all the organisational elements, and is implementing a process to capture that information throughout the year.

The execution of some of the transition large programmes the Agency is undertaking carry, due to its complexity and interdependencies, significant risks in terms of scope, schedule and costs.

(1) ITM - mostly for reasons outside the Agency’s control, the Agency has also identified the need to approach this very large and far reaching “project” as a programme as well as the need to expand the scope of the programme to cover for the migration of the applications and dual operations during the transition period;

(2) FGFS in relation to the new building in SHAPE for which Belgium is Host Nation, the risk identified by the Agency pertains to unplanned and out of scope Active Network and other IT related costs in the building currently being refurbished by the Host Nation, The Netherlands in The Hague. The Agency remains attentive and will continue to engage with the relevant governance bodies and entities so to mitigate to the maximum extent possible these risks.

**28. Financial Revenue and Expenses**

		Note	2018	2017
		Unit		
550	Foreign exchange surpluses		2,160,602	2,133,573
555	Other financial surpluses		175,598	19,189
750	Foreign exchange deficits		(1,001,969)	(3,831,738)
7550	Financial costs - Current liabilities		(91,245)	(122,014)
7555	Financial costs – Other		(36,446)	(162)
			<b>1,206,540</b>	<b>(1,801,152)</b>

The total result from financial revenue and expenses is a surplus of 1.2 MEUR. This amount is primarily composed of a net realised foreign exchange gain of 1.2 MEUR. For IC acquisition activity the financial result is borne by NSIP and is thus not included here.

**29. Other Expenses**

		Note	2018	2017
		Unit		
<b>Other Expenses</b>				
760	Fixed assets - Deficits		44,083	16,199
			<b>44,083</b>	<b>16,199</b>

This expense represent some net book value losses on PPE.

**30. Financial Instruments**

NCIO's financial requirements are met from its Customers who are members or partners of NATO. NCIO has no powers to borrow money or to invest surplus funds. Other than financial assets and liabilities which are generated by day-to-day operational activities, no financial instruments are held.

**Liquidity risk**

NCIO's financial requirements and capital expenditure are met by its Customers and are typically funded in advance. NCIO is therefore not exposed to material liquidity risks.

**Credit risk**

NCIO's Customers are member and partner Nations of NATO and hence NCIO is therefore not exposed to material credit risks.

**Foreign currency risk**

NCIO has limited exposure to foreign currency because only a limited amount of its work is denominated in currencies other than the Euro. Most the risk of foreign currency is ultimately born by the NCIO's Customers who are members or partners of NATO.

**31. Write-offs**

Per the applicable NCIO Financial Rules and Procedures (document AC/337-D(2017)0014-AS1);

FRP XVII 1) the amount of the write-off will be based on the net book value.

FRP XVII 5) Write-offs of cash up to a maximum of half Level A of the EFL (€5,000) and write-offs of receivables including anticipatory commitments up to two times Level B of the EFL (€40,000) can be authorised by the General Manager through the Financial Controller.

FRP XVII 6) Write-off of cash losses in excess of half Level A of the EFL (€5,000) need to be authorised by the FinCom. The FinCom needs to authorise the write-off of receivables/anticipatory commitments exceeding two times Level B of the EFL (€40,000).

FRP XVII 8) On write-offs, information will be provided to the NATO budget Committee and the Finance Committee on an aggregated level in the Financial Statements as audited by IBAN.

For the period between 01 January 2018 and 31 December 2018 the NCI Agency has written off:

- CIS assets with total net book value of 36,519 Eur.
- Assets with total net book value of 7,718 Eur.
- Accounts receivable with a total value of 295 Eur.
- Cash losses with a total value of 309 Eur.
- WIP write off with total value of 14,900 Eur.



### ***C. Notes to the NCIO Statement of Change in Net Assets/Equity***

Under its Charter and its Customer Funding model, the NCIO is allowed to have an Operating Fund (OF) which represents its retained earnings accumulated over the years. The use of the OF is regulated by the Customer Funding Regulatory Framework approved by Council in 2015 (PO(2015)0394-AS1) and are part of the NCIO Financial Rules and Procedures (FRP's) that were approved by the Agency Supervisory Board (ASB) in 2017 (AC/337-D(2017)0014-AS1).

The OF is not the NCIA's only source of working capital, because the NCI Agency benefits from significant advance payments from its main customers ACT, ACO and Nations for purposes of the execution of its programmes and services. In addition all the work performed by the Agency in its role as Host Nation under the NSIP and acquisition projects for Third Parties is funded in advance respectively by the Investment Committee and by NATO Nations & Organisations.

The Financial Controller is responsible to recommend the size of the OF and the planned annual action to increase or to reduce it. Any surplus or deficit for 2018 is to be attributed to the OF with Nations deciding on its use.

In October 2017, Nations at the ASB Finance Committee: (1) confirmed the continued need for an Operating Fund as a risk management tool, (2) agreed to no longer include the depreciation reserve as part of the Operating Fund, (3) confirmed to the target level being 10.0 MEUR with increases based on risk assessment to be justified (4) agreed on the pro rata distribution of potential surplus from the Operating Fund based upon the Military Budget and the NATO Security Investment Programme share in the Agency revenue via the call for contributions mechanism (previously any surplus was applied as a rebate/reduction to the customer rates i.e. 5.6 MEUR for 2017 Customer Rates and 2.8 MEUR for 2018 Customer Rates)

In order to fund its transition activities between 2014 and 2018, the Agency requested 18,980 KEUR of common funding and 8,570 KEUR of the OF. The subsequent IC/BC decision sheet (AC/4 (PP) D/27275 – ADD1 and BC-D(2013)0214) authorised 17,009 KEUR of common funding and 7,245 KEUR from the Agency OF. The latter has been reserved to pay for backfill consultancy cost and travel of the NCI Agency personnel involved in activities related to the Transition Programme as per the decision sheet. The difference between the RPPB approved amount (8.6 MEUR) and the detailed amount approved by the IC/BC (7.2 MEUR), has also been reserved for future possible use.

When implementing IPSAS 17, a portion of these earnings were partially encumbered for the value of fixed assets not yet fully depreciated, reported separately as a depreciation reserve. The categories of assets and the breakdown of the remaining book value per category is reported in the Statement of PPE.

The operating surplus for 2018, before adjustment to reserves, is distributed as follows:

#### **32. Reserves at the End of the Period.**

		Note	2018	2017
		Unit		
<b>Reserved Earnings</b>				
310	Reserves - General purpose		3,200,234	3,529,709
311	Reserves - Special programmes		2,873,854	4,187,407
			<b>6,074,088</b>	<b>7,717,116</b>

- 3,200,234 Eur of earnings remain reserved for the assets not yet fully depreciated, thus decreasing the depreciation reserve in 2018 with 339,475 Eur.
- 4,382,593 Eur of accumulated transition expenses are booked against the Special Transition Reserve thus decreasing from a total 8,570,000 Eur at 31 December 2013 to 2,873,854 Eur at 31 December 2018.

		Note Unit	2018	2017
311000	Special programmes reserves - Transition projects - Approved and authorised - Prior years		1,548,578	2,862,131
311001	Special programmes reserves - Transition projects - Approved, not authorised - Prior years		1,325,276	1,325,276
			<b>2,873,854</b>	<b>4,187,407</b>

### Transition Expenses

As per the terms of the RPPB decision on the funding eligibility and modalities of the Agency Transition Programme, the Agency has been authorised to pursue its transition plan with a mix of common funds (from MB and NSIP) and surplus funds from its Operating Fund. This is separate funding provided to the Agency (i.e. not part of the Customer Rates). The table below summarised the transition programme spent against this funding provided (excluding workforce adjustments/overheads).

	Authorised	Spent < 2018	Spent 2018	Total Spent	Remaining
Transition IC funded	52,743,439	27,701,874	3,093,953	30,795,827	21,947,612
Transition OF funded	7,244,724	4,382,593	1,313,553	5,696,146	1,548,578
	<b>59,988,163</b>	<b>32,084,467</b>	<b>4,407,506</b>	<b>36,491,973</b>	<b>23,496,190</b>

The Transition Programme was approved in December 2013, and authorised by the IC with the amount of EUR 15,123,072 to spend on investments and EUR 1,848,928 to spend on project service costs (EUR 7,245,000 approved for backfills). This authorisation was below the amounts requested by the Agency to run the planned Transition Programme. As a consequence, the planned scope of the Transition Programme required an internal assessment, restructuring and re-planning of the funded and unfunded activities. This re-planning effort delayed the formal start-up of execution of the associated Transition Programme project activities.

In addition, the Enterprise Business Application (EBA), previously faced significant delays thereby negatively affecting the implementation schedule for all EBA-related activities. Upon completion of Phase 1 of the project in early 2017, it became apparent the cost estimate for implementing EBA was considerably above the authorised cost, as such an alternative implementation scenario was designed to reduce external implementation cost and maximise efficiencies. Implementation has since started to deliver the Customer Funding Core Capability in early 2018. In 2016, an additional 6,754,436 Eur and 857,940 Eur was approved for EBA. In March 2018, Core HR of Release 1 was delivered and the Initial Operating Capability of the Finance, Project Accounting, Asset Management and Acquisitions part of Release 1 began at the end of 2018. There has been an additional amount of funding for the EBA project during 2018 of 2,622,182 Eur.

Furthermore, the Functional Groupings and Facilities Study (FGFS), addressing the geographical footprint of the Agency, has commenced implementation (14,107,859 Eur approved up until end of 2017), and the FGFS Programme Office stood up during the latter half of 2017. Following the decision sheets an additional amount of 11,392,114 Eur has been foreseen during 2018.

Overall, the Transition Programme projects have all been either completed or are in progress. It is expected that the rate of expenditure is accelerate with the implementation of EBA in 2018. The table on the next pages provide the detailed spending for the NCI Agency Transition Programme in 2014-2018 by activity cluster.

Prior to the Transition Programme being approved in December 2013, the Agency, with full transparency to its ASB, already undertook some transition activities related to the consolidation and rationalisation phases of the Agency reform process. They constituted a set of pre-Transition Programme activities geared to prepare the non-customer funded elements of the agency for the implementation of customer funding and thus ensure the business continuity and the ability of these same elements to deliver within the context of a larger integrated agency. The Transition Programme as approved by nations in December 2013 did not conflict with these activities but rather complemented it by focusing on the next phases of agency reform; rationalisation and optimisation. The amounts spent on these pre-transition activities have been reported in the respective 2012-2014 Financial Statements and are fully accounted for through projects with the required time accounting bookings associated to them.

The amounts associated with transition activities before approval of the Agency transition programme, equate to 7.25 MEUR (this number is however at gross rates, thus including overheads, contrary to the IC/BC Transition Expenses).

It is also important to note that most of this work was done on a best effort basis with long hours by existing agency staff (many of which were indirect staff) operating under hybrid funding models (admin budgets and Customer Funding). Accordingly the majority of this figure was not charged to Agency customers or legacy budgets but serves as a representation of the level of effort undertaken for these activities.

## TRANSITION EXPENDITURES Period 01 JAN'14 - 31 DECEMBER'18 (Actuals+Accruals) - DEC'18 TAS

Against IC approved baselines

Group	Projectcode	Project Description	External baseline Lifecycle	Gross/Net Labor	Consultancy (1)	Other Expenses	Travel	Investments	Total spent	Available (A-G)
Group A - Enabling Services and Enterprise Business Applications	NSP009535	Enterprise Business Application (EBA)	2,848,379.00	2,122,645.07	160,012.63	17,806.11	138,263.07	-	2,438,726.88	409,652.12
	NSI005957	ENABLING SERVICES	1,760,620.00	-	-	-	-	1,429,274.35	1,429,274.35	331,345.65
	NSI005976	EBA - WORK PACKAGE 1	11,507,321.00	-	-	-	-	7,811,450.87	7,811,450.87	3,695,870.13
	NSI005977	EBA - WORK PACKAGE 2	379,738.00	-	-	-	-	379,738.28	379,738.28	0.28
	NSI005978	EBA - SOFTWARE PACKAGE	4,975,707.00	-	-	-	-	4,186,499.60	4,186,499.60	789,207.40
	NCA009223	Enabling Services (ES)	1,180,852.00	124,465.66	948,585.72	4,999.38	8,966.82	-	1,087,017.58	93,834.42
	NCA009224	Enterprise Business Application (EBA)	3,339,706.00	1,503,361.08	1,163,531.33	32,497.06	111,923.72	-	2,811,313.19	528,392.81
	NSE011614	EBA - Internal Engineer Services	1,155,481.00	912,732.07	164,335.75	-	51,283.43	-	1,128,351.25	27,129.75
			27,147,804.00	4,663,203.88	2,436,465.43	55,302.55	310,437.04	13,806,963.10	21,272,372.00	5,875,432.00
Group B - Demand Management, Account Management and Demand Planning										
	NSP009797	DEMAND MANAGEMENT (DM) - CLOSED	160,000.00	137,952.66	14,763.10	14,362.00	-	-	167,077.76	7,077.76
	NSI005979	DEMAND MANAGEMENT (DM) - INACTIVE	762,558.00	-	-	-	-	746,478.28	746,478.28	16,079.72
	NCA009225	DEMAND MANAGEMENT (DM) - CLOSED	666,728.00	-	438,311.48	2,083.95	31,506.47	-	471,901.90	194,826.10
			1,589,286.00	137,952.66	453,074.58	16,445.95	31,506.47	746,478.28	1,385,457.94	203,828.06
Group C - Service Strategy										
	NSP009718	Agency Transition SStrat Cluster - CLOSED	536,000.00	426,597.19	24,820.56	888.05	10,423.31	-	462,729.11	73,270.89
	NSI005980	COO / SERVICE STRATEGY	2,548,862.00	-	-	-	-	2,492,074.04	2,492,074.04	56,787.96
	NCA009226	Service Strategy - CLOSED	1,828,790.00	164,877.92	1,108,735.21	401.02	26,904.24	-	1,300,918.39	527,871.61
			4,913,652.00	591,475.11	1,133,555.77	1,289.07	37,327.55	2,492,074.04	4,255,721.54	657,930.46
Group D - Transition / Education and Training										
	NSP009812	Transition Cultural Amalgamation - CLOSED	44,000.00	-	17,941.88	400.00	-	-	18,341.88	25,658.12
	NSI005981	TRANSITION (TIP12-000.1)	215,000.00	-	-	-	-	-	-	215,000.00
	NCA009229	Transition Management (TIP12-000.2) - CLOSED	228,648.00	8,844.97	-	16,149.54	-	-	24,994.51	203,653.49
			487,648.00	8,844.97	17,941.88	16,549.54	-	-	43,336.39	444,311.61
Group D - Transition / Education and Training										
	NSP009811	Transition Education and Training - CLOSED	60,000.00	35,035.80	14,121.44	6,672.53	1,937.95	-	57,767.72	2,232.28
	NSI005982	NATO IT EDUC. & TRAINING (TIP12-005.1) - INACTIVE	289,800.00	-	-	-	-	287,773.73	287,773.73	2,026.27
			349,800.00	35,035.80	14,121.44	6,672.53	1,937.95	287,773.73	345,541.45	4,258.55
FGFS										
	NSI006153	Functional Groupings and Facilities Study (FGFS)	14,047,563	-	-	-	-	2,644,928.00	2,644,928.00	11,402,635.00
	NSP010991	FGFS	10,852,410	2,672,190	1,565,742	-	187,806	1,741,431.96	6,167,169.71	4,685,240.29
	NSE010972	FGFS - Internal Engineer Services	600,000	-	377,446	-	-	-	377,445.63	222,554.37
			25,499,973	2,672,190	1,943,188	-	187,806	4,386,360	9,189,543	16,310,430
			59,988,163.00	8,108,702.53	5,998,346.84	96,259.64	569,014.54	21,719,649.11	36,491,972.66	23,496,190.34

Against NCI Agency OF Reserve for transition

Group	Projectcode	Project Description	A External baseline Lifecycle	B Net Labor	C Consultancy	D Other Expenses	E Travel	F Investments	G Total spent	H Available (A-G)
Group A - Enabling Services and Enterprise Business Applications	NCA009223	Group A - Enabling Services (ES)	1,180,852.00	124,465.66	948,585.72	4,999.38	8,966.82	-	1,087,017.58	93,834.42
	NCA009224	Group A Enterprise Business Application (EBA)	3,339,706.00	1,503,361.08	1,163,531.33	32,497.06	111,923.72	-	2,811,313.19	528,392.81
			4,520,558.00	1,627,826.74	2,112,117.05	37,496.44	120,890.54	-	3,898,330.77	622,227.23
Group B - Demand Management, Account Management and Demand	NCA009225	DEMAND MANAGEMENT (DM) - CLOSED	666,728.00	-	438,311.48	2,083.95	31,506.47	-	471,901.90	194,826.10
			666,728.00	-	438,311.48	2,083.95	31,506.47	-	471,901.90	194,826.10
Group C - Service Strategy	NCA009226	Service Strategy (SS) - CLOSED	1,828,790.00	164,877.92	1,108,735.21	401.02	26,904.24	-	1,300,918.39	527,871.61
			1,828,790.00	164,877.92	1,108,735.21	401.02	26,904.24	-	1,300,918.39	527,871.61
Group D - Transition / Education and Training	NCA009229	Transition Management (TIP12-000.2) - CLOSED	228,648.00	8,844.97	-	16,149.54	-	-	24,994.51	203,653.49
			228,648.00	8,844.97	-	16,149.54	-	-	24,994.51	203,653.49
			7,244,724.00	1,801,549.63	3,659,163.74	56,130.95	179,301.25	-	5,696,145.57	1,548,578.43

## 33. Retained Earnings:

		Note	2018	2017
		Unit		
<b>Retained Earnings</b>				
5	Revenue		862,590,763	770,345,806
7	Expenses		-863,067,236	-769,258,271
300	Surplus (Deficits) carried forward - Prior Years		18,959,405	16,228,842
			<b>18,482,932</b>	<b>17,316,377</b>

Below table reconciles Net Assets/Equity for 2015-2018

### NCIO Reconciliation of Net Assets/Equity (OF - Operating Fund)

For the year ended 31 December 2017

(all figures are in Euro)

(Prior Year restated)

	Property, Plant and Equipment (PP&E) & Intangible Assets		Reserves - Special Purpose	Reserves - Special Progr.	RESERVED EARNINGS	RETAINED EARNINGS	NET ASSETS/EQUITY	
	Acq. Value	Depreciation	Book Value				Surpl./ (Def.) Yr	Yr-end Balance
<b>31-Dec-16</b>	<b>9,493,472</b>	<b>(5,229,501)</b>	<b>4,263,972</b>	<b>5,532,909</b>	<b>9,796,881</b>	<b>14,149,077</b>		<b>23,945,958</b>
2016 - Restat. as Published	3,376,312	(4,110,574)	(734,262)	(1,345,502)	(2,079,764)	3,167,299	1,087,535	1,087,535
<b>31-Dec-17</b>	<b>12,869,784</b>	<b>(9,340,075)</b>	<b>3,529,709</b>	<b>4,187,407</b>	<b>7,717,116</b>	<b>17,316,377</b>		<b>25,033,493</b>
2018 as Published (Unaudited)	16,174,964	(12,974,730)	3,200,234	2,873,854	6,074,088	18,482,932	(476,473)	(476,473)
<b>31-Dec-18</b>	<b>16,174,964</b>	<b>(12,974,730)</b>	<b>3,200,234</b>	<b>2,873,854</b>	<b>6,074,088</b>	<b>18,482,932</b>		<b>24,557,020</b>

Below table shows the evolution of the Net Assets/Equity since 2005:

YEAR-END BALANCES	OF	Destination						NET ASSETS/EQUITY	
	Year-end Balance	Property, Plant and Equipment (PP&E) & Intangible Assets		Reserves - Special Purpose	Reserves - Special Progr.	RESERVED EARNINGS	RETAINED EARNINGS		
		Acq. Value	Acc. Deprec.	Book Value					Yr-end Balance
31-Dec-05	5,064,289	6,352,418	(1,746,915)	4,605,503	0	4,605,503	458,786		5,064,289
31-Dec-06	6,780,419	11,440,622	(3,721,092)	7,719,530	0	7,719,530	(939,111)		6,780,419
31-Dec-07	15,448,855	13,272,399	(6,289,891)	6,982,508	0	6,982,508	8,466,347		15,448,855
31-Dec-08	16,813,862	16,337,520	(9,760,847)	6,576,673	0	6,576,673	10,237,189		16,813,862
31-Dec-09	11,869,058	20,011,958	(13,481,609)	6,530,349	0	6,530,349	5,338,709		11,869,058
31-Dec-10	4,183,086	23,524,061	(18,064,656)	5,459,406	0	5,459,406	(1,276,320)		4,183,086
31-Dec-11	9,913,025	24,356,808	(20,925,008)	3,431,799	0	3,431,799	6,481,225		9,913,025
31-Dec-12	15,770,863	43,368	0	43,368	0	43,368	15,727,495		15,770,863
31-Dec-13	18,350,285	1,043,893	(227,169)	816,725	8,570,000	9,386,725	8,963,561		18,350,285
31-Dec-14	20,280,170	8,276,385	(3,906,195)	4,370,190	7,817,315	12,187,505	8,092,665		20,280,170
31-Dec-15	26,122,091	11,373,573	(7,445,917)	3,927,656	6,217,986	10,145,642	15,976,449		26,122,091
31-Dec-16	23,945,958	9,493,472	(5,229,501)	4,263,972	5,532,909	9,796,881	14,149,077		23,945,958
31-Dec-17	25,033,493	12,869,784	(9,340,075)	3,529,709	4,187,407	7,717,116	17,316,377		25,033,493
31-Dec-18	24,557,020	16,174,964	(12,974,730)	3,200,234	2,873,854	6,074,088	18,482,932		24,557,020

INCR./((DECR.) FOR THE YEAR	OF	Destination						NET ASSETS/EQUITY
	Surplus/((Def.) for the Year	Property, Plant and Equipment (PP&E) & Intangible Assets		Reserves - Special Purpose	Reserves - Special Progr.	RESERVED EARNINGS	RETAINED EARNINGS	
		Acq. Value Yr	Deprec. Yr	Δ Book Value				
31-Dec-05 (*)	5,064,289	6,352,418	(1,746,915)	4,605,503	0	4,605,503	458,786	5,064,289
31-Dec-06	1,716,130	5,088,204	(1,974,177)	3,114,027	0	3,114,027	(1,397,897)	1,716,130
31-Dec-07	8,668,436	1,831,777	(2,568,799)	(737,022)	0	(737,022)	9,405,457	8,668,436
31-Dec-08	1,365,007	3,065,121	(3,470,956)	(405,835)	0	(405,835)	1,770,842	1,365,007
31-Dec-09	(4,944,804)	3,674,438	(3,720,762)	(46,324)	0	(46,324)	(4,898,480)	(4,944,804)
31-Dec-10	(7,685,972)	3,512,104	(4,583,047)	(1,070,943)	0	(1,070,943)	(6,615,029)	(7,685,972)
31-Dec-11	5,729,939	832,746	(2,860,353)	(2,027,606)	0	(2,027,606)	7,757,545	5,729,939
31-Dec-12	5,857,838	(24,313,440)	20,925,008	(3,388,431)	0	(3,388,431)	9,246,270	5,857,838
31-Dec-13	2,579,422	1,000,525	(227,169)	773,357	8,570,000	9,343,357	(6,763,934)	2,579,422
31-Dec-14	1,929,885	7,232,492	(3,679,027)	3,553,465	(752,685)	2,800,780	(870,895)	1,929,885
31-Dec-15	5,841,921	3,097,188	(3,539,722)	(442,534)	(1,599,329)	(2,041,863)	7,883,783	5,841,921
31-Dec-16	(2,176,133)	(1,880,101)	2,216,417	336,316	(685,077)	(348,762)	(1,827,371)	(2,176,133)
31-Dec-17	1,087,535	3,376,312	(4,110,574)	(734,262)	(1,345,502)	(2,079,764)	3,167,299	1,087,535
31-Dec-18	(476,473)	3,305,179	(3,635,230)	(330,050)	(1,313,553)	(1,643,603)	1,167,130	(476,473)

**34. Events after the financial reporting date of 31 December 2018**

NCIO is required to disclose events, both favourable and unfavourable, that occurred between the reporting date of 31 December 2018 and the date when these Financial Statements were authorised for issue by the General Manager. IPSAS requires two types of events which should be identified:

- (a) Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and
- (b) Those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).

No material events occurred which could be categorised as a subsequent event under either (a) or (b).

***D. Notes on the NCIO Budget Execution Statements***

Although NCIO is fully Customer Funded as of 2014, it still has two components that are budget funded in 2018 and for which it thus produces a Budget Execution Statement:

- The NCIO Independent Secretariat Budget, as per the Charter of the NCIO, approved by Council on 19 June 2012 under C-M(2012)0049, the NCIO is composed of an ASB and an executive body composed of a General Manager and his/her staff (the NCI Agency). Per Article 26 (e) of the Charter, the chairperson of the ASB is supported by an Independent Secretariat that is only responsible to the chairperson. Per Article 50 (c) and per AC/337-D(2014)0007-AS1 dated 9 May 2014, the ASB approved core funding (distinct and separate from NATO common funding) for the NCIO Independent Secretariat. The ASB approved the structure and an annual budget based on the Military Budget cost share model.
- The NCI Agency Budget for workforce/reorganisation adjustments as a result of the Transition Programme - BC 877 Budget (NATO common funding)

Expenses amount include accrued expenses as reported in the Statement of Financial Performance; budget execution/financial statement are thus presented on a comparable basis and in compliance with IPSAS24. Lapsed amounts represent budget funds that were not used (unspent) during the course of the financial year. Carry forward amounts are the net Commitments at the end of the financial year that have not been converted into expenses at the end of the financial year. Chapter 1 represents – Personnel cost, Chapter 2 represents Contractual Supplies and Services and Chapter 3 represents Investments.



**NCIO Budget Execution Statement***As of 31 December 2018**(all figures are in Euro)*

NCIO Secretariat

	Note	Initial Budget	Transfers	BA2	Transfers	Final Budget	Net Commitment	Expenses	Total Spent	Carry Forward	Lapsed
<b>BUDGET</b>											
Chapter 1		403,080	0	0	0	403,080	2,845	378,693	381,538	2,845	21,542
Chapter 2		95,091	0	0	0	95,091	376	62,321	62,697	376	32,394
Chapter 3		0	0	0	0	0	0	0	0	0	0
<b>Total current year</b>		498,171	0	0	0	498,171	3,221	441,014	444,235	3,221	53,936
Chapter 1		0	0	0	0	0	0	0	0	0	0
Chapter 2		5,759	0	0	0	5,759	0	5,759	5,759	0	0
Chapter 3		0	0	0	0	0	0	0	0	0	0
<b>Total prior year</b>		5,759	0	0	0	5,759	0	5,759	5,759	0	0
Chapter 1		0	0	0	0	0	0	0	0	0	0
Chapter 2		11,063	0	0	0	11,063	3,315	7,465	10,780	0	3,598
Chapter 3		0	0	0	0	0	0	0	0	0	0
<b>Total 2 years ago</b>		11,063	0	0	0	11,063	3,315	7,465	10,780	0	3,598
<b>TOTAL</b>		514,993	0	0	0	514,993	6,536	454,238	460,774	3,221	57,534

## NCIO Implementation Budget (BC 877)(\*) Budget Execution Statement

As of 31 December  
2018  
(all figures are in  
Euro)

### NCIO Implementation Budget (BC 877)(\*)

Note	Initial Budget	Transfers	BA2	Transfers	Final Budget	Net Commitment	Expenses	Total Spent	Carry Forward	Lapsed
<b>BUDGET</b>										
Chapter 1	2,000,000	0	0	0	2,000,000	0	2,000,000	2,000,000	0	0
Chapter 2	0	0	0	0	0	0	0	0	0	0
Chapter 3	0	0	0	0	0	0	0	0	0	0
<b>Total current year</b>	2,000,000	0	0	0	2,000,000	0	2,000,000	2,000,000	0	0
Chapter 1	0	0	0	0	0	0	0	0	0	0
Chapter 2	0	0	0	0	0	0	0	0	0	0
Chapter 3	0	0	0	0	0	0	0	0	0	0
<b>Total prior year</b>	0	0	0	0	0	0	0	0	0	0
Chapter 1	0	0	0	0	0	0	0	0	0	0
Chapter 2	0	0	0	0	0	0	0	0	0	0
Chapter 3	0	0	0	0	0	0	0	0	0	0
<b>Total 2 years ago</b>	0	0	0	0	0	0	0	0	0	0
<b>TOTAL</b>	2,000,000	0	0	0	2,000,000	0	2,000,000	2,000,000	0	0

**NAF IMPACT PRIOR 1 JAN 2013 EXPENSED PPE AND INVENTORY**

As per the NATO Accounting Framework(NAF), NCIO has chosen per the adapted IPSAS 12 “Inventories”, 17 “Plant, Property and Equipment” and 31 “Intangible Assets”, to consider all inventories, PPE and Intangible Assets acquired prior to 1 January 2013, as fully expensed. Items of PPE acquired prior 1 January 2013 are obsolete from an economic point of view and therefore been cannibalised or disposed of. Inventory items (Consumables and/ or Spare parts) acquired prior 1 January 2013 have been consumed or used during the production/service lifecycle.



NATO UNCLASSIFIED

Office of the Financial Controller  
Boulevard Leopold III  
1140 Brussels, Belgium  
Telephone : +32 (0)2 707 8325



NATO UNCLASSIFIED

NCIA/FC/2019/03122

NCIA/FC/2019/03122  
29 March 2019

Subject: **Statement of Internal Control -  
NATO Communications and Information Organisation (NCIO) Financial  
Statements for the period 01 January 2018 to 31 December 2018**

1. This Statement of Internal Control applies to the NCIO Financial Statements for the year ended 31 December 2018. Internal control is driven by the requirement of the NATO Financial Regulations, the NCIO Financial Rules and Procedures, the NATO Accounting Framework, the NCIO Internal Control Framework and good business practices. Internal control is to ensure that NATO assets are utilized for the purposes intended and that the transactions relating to their usage reflect the highest standards of integrity to justify continued confidence of the NATO Member Nations.
2. The NCIO system of internal control is based on an ongoing process effected by the Board, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance. As part of the process, identified risks to the achievement of NCI Organisation goals and objectives, are managed efficiently, effectively and economically. In detail:
  - a. The ASB has the responsibility to: (1) ensure that effective risk management measures are in place and monitor performance execution on that basis; (2) exercise management control by comparison of the NCIA activities with applicable ASB directives; (3) oversee the delivery of results against targets; (4) evaluate the performance against objectives of the NCIA; (5) benchmark the NCIA against comparable organisations;
  - b. The Chairman of the ASB acknowledges responsibility to maintain a sound system of internal control that supports the ASB Secretariat and ensures it delivers on its mandate;
  - c. The General Manager (GM) acknowledges responsibility to maintain a sound system of internal control that supports the NCI Agency and ensures it delivers on its Chartered mandate;
  - d. The Chief Operating Officer (COO) acknowledges responsibility to maintain a sound system of internal control for business planning together with the related business

intake and capacity management, as well as monitoring programme/project exceptions;

- e. The Director Acquisition acknowledges responsibility to maintain a sound system of internal control that ensures the integrity of all phases of the procurement process;
  - f. The Head of Human Resources acknowledges responsibility to maintain a sound system of internal control relating to the recruitment and departure of staff and associated payment of salaries and allowances;
  - g. The Financial Controller acknowledges responsibility for the correct use and accounting of funds made available to the NCI Agency and the ASB Independent Secretariat for maintaining a sound system of internal financial controls.
3. The main aspects of the NCIO's system of internal control for 2018 are as follows:
    - a. All funds received are recorded, accounted and managed through a set of information systems, which include: enterprise-wide project management; a time accounting system; and two legacy financial systems based on the accounting software from Oracle: the Centralized NATO Automated Financial System (CNAFS); and the Core Financial System (CFS), formerly PeopleSoft. This being migrated, as appropriate, to a new Oracle R12 based tool Enterprise Business Applications (EBA)<sup>1</sup>.
    - b. The Independent Secretariat has its budget approved and funded by ASB Member Nations.
    - c. The NCI Agency annually updates its Customer Rates based on the ASB approved Customer Rates Principles and Methodology<sup>2</sup>. These are endorsed by the ASB, and approved by the NATO Budget Committee on behalf of all Customers.
    - d. The NCI Agency also annually updates its Services Rates (based on Customer Rates for the Agency's professional services element) and these validated by the ASB and NATO Budget Committee.
    - e. The NCI Agency has an integrated planning process comprising the Strategic Plan; Business Plan; and Financial Plan. It prepares annually a Financial Plan (3 year planning horizon) covering revenue and expenses related to Customer Funding which is signed-off by the Executive Management Board, chaired by the GM. The Financial Plan is approved by the ASB.
    - f. All agreements with Customers are in writing and are usually concluded on a Firm Fixed Price and/or Cost Reimbursable basis.
    - g. All procurement is under the responsibility of the Director of Acquisition with the specific involvement of the GM. For some deviations from normal competition

<sup>1</sup> 'Go-Live' is at start 2019 for EBA Release 1

<sup>2</sup> AC/337(FC)D(2018)0003-REV1



NATO UNCLASSIFIED

NCIA/FC/2019/03122



NATO UNCLASSIFIED

NCIA/FC/2019/03122

procedures the Agency has a designated Competition Advocate – Director Service Strategy who advises the GM.

- h. As of 1 August 2018, Service Line Chiefs and the Director AMDC2 are accountable for managing their teams and delivering products and services to the Agency's Sponsors and Customers and will report to the Chief Operating Officer. Through its Service Life Management Board (SLMB) chaired by the COO, the Agency oversees the operational environment with a focus on early identification and quantification of risks which affect services and projects to allow for timely management oversight and/or assistance to mitigate.
- i. The Agency has Enterprise-wide Risk Management and risk registers for Directorates, Service Lines, CIS Support Units and Enabling Offices. However, resources assigned to the Risk Management function are limited compared to the complexity and the size of the Agency.
- j. The Agency has an Internal Audit Function with an approved risk-based annual audit plan which reviews, amongst other areas, internal control and risk mitigation. Internal Audit reports to the General Manager and provides regular updates to the ASB-Audit Committee. However, resources assigned to the function are limited compared to the complexity and the size of the Agency.
- k. The Agency has a Fraud Prevention and Detection function (started in September 2017). It reports to the General Manager and provides regular updates on lessons learned at the Internal Control Panel. One resource is currently assigned to the function. In 2018, one instance of fraud was detected and dealt with by the Agency. The Agency has pursued a proactive and robust investigation. The individual involved has left the Agency and reimbursed the estimated losses, which were immaterial compared to the Agency's overall financial scale.
- l. In order to support the NCI Agency Management and the ASB in undertaking internal control responsibilities, an Internal Control Questionnaire and Assessment (ICQA) is used to serve as a management self-assessment and evaluation tool. This questionnaire is in line with the provisions of the NCIO Internal Control Framework<sup>3</sup> which was developed based on the guidance issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and approved by ASB in November 2016. Management has worked on developing internal controls related to Fraud Prevention within the Finance and Acquisition Directorates as well as the Recruitment process by employing a Control Self-Assessment (CSA) risk based methodology and in line with the COSO guidance.
- m. All new joiners to the Agency participate in an Induction Programme that includes education about Agency procedures and behaviour standards. Moreover, the Agency has a Code of Conduct for all staff, as well as an Anti-Fraud Directive, and staff must undergo training in ethical behaviour and appropriate use of resources. The Agency has also implemented a fraud prevention and detection programme to mitigate the risk of fraud within the organization.

<sup>3</sup> AC/337(FC)N(2016)0036

- 4. During its last financial statements audit<sup>4</sup>, the International Board of Audit for NATO (IBAN) made six observations and recommendations. Observation one and two impacted the audit opinion on the financial statements while observation one also impacted the opinion on compliance. These observations are: 1. Lack of integrated systems to support the effective and efficient management and financial reporting of property plant and equipment (PP&E) and intangible assets. 2. EUR 33 million understatement of inventory. The NCIO remains focused and committed to resolving all IBAN observations and recommendations and the implementation of EBA is a key tool to assist with this.

Kevin J. Scheid  
General Manager

Rui Silva  
Acting Financial Controller

Distribution:

External

Chairman International Board of Auditors for NATO  
Chairman NCIO Agency Supervisory Board

Internal

Members Executive Management Board

<sup>4</sup> IBA-A(2018)0087



NATO UNCLASSIFIED

Office of the Financial Controller

Boulevard Leopold III  
1140 Brussels, BelgiumTelephone : +32 (0)2 707 8325  
Fax :NCIA/FC/2019/03124  
31 March 2019

Subject: **Financial Controller's Certification -  
NATO Communications and Information Organisation (NCIO) Financial  
Statements for the period 01 January 2018 to 31 December 2018**

1. The 2018 Financial Statements for the NCIO are submitted to the International Board of Auditors for NATO (IBAN) and the Agency Supervisory Board (ASB) as required by the NATO Financial Regulations and the NCIO Charter.
2. The Financial Statements were prepared in accordance with the following Reference documents:
  - a. C-M(2012)0049, Charter of the NATO Communications and Information Organisation, approved by Council, dated 14 June 2012.
  - b. C-M(2015)0025), NATO Financial Regulations, approved by Council, dated 4 May 2015;
  - c. PO(2015)0394, NATO Communications & Information Agency Customer Funding Regulatory Framework, approved by Council, dated 16 July 2015;
  - d. C-M(2016)0023, revised NATO Accounting Framework (IPSAS adaptation), approved by Council, dated 29 April 2016;
  - e. AC/337-D(2016)0014-REV1, NCIO Financial Rules and Procedures, approved by the ASB, dated 20 November 2018;
3. I certify that the NCIO 2018 Financial Statements:
  - a. present fairly the NCIO's financial position, financial performance, cash flows and changes in net assets/equity during the period;
  - b. can be publicly disclosed.

A blue ink signature, appearing to be 'Rui Silva', written over a circular stamp.

Rui Silva  
Acting Financial Controller

## ACRONYMS

ACO	ALLIED COMMAND OPERATIONS
ACT	ALLIED COMMAND TRANSFORMATION
AIR C2	AIR COMMAND AND CONTROL
APF	ADVANCE PLANNING FUNDS
ASB	AGENCY SUPERVISORY BOARD
FinCom	AGENCY SUPERVISORY BOARD FINANCE COMMITTEE
BC	NATO BUDGET COMMITTEE
BMD	BALLISTIC MISSILE DEFENCE
CIS	COMMUNICATION INFORMATION SYSTEMS
CPR	NATO CIVILIAN PERSONNEL REGULATIONS
EBA	ENTERPRISE BUSINESS APPLICATIONS
ESPE	END STATE PEACETIME ESTABLISHMENT
FRP	FINANCIAL RULES AND PROCEDURES
GM	GENERAL MANAGER
HO/TO	HANDOVER/TAKEOVER
IBAN	INTERNATIONAL BOARD OF AUDIT FOR NATO
IC	NATO INVESTMENT COMMITTEE
ICTM	INFORMATION COMMUNICATIONS TECHNOLOGY MANAGEMENT
IMS	INTERNATIONAL MILITARY STAFF
IS	INTERNATIONAL STAFF
ISAF	INTERNATIONAL SECURITY ASSISTANCE FORCE
ISPAS	INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS
MC	MILITARY COMMITTEE
MWA	MORALE AND WELFARE ACTIVITIES
IWC	INTERIM WORKFORCE CAPACITY
NAC	NORTH ATLANTIC COUNCIL
NAF	NATO ACCOUNTING FRAMEWORK
NATO	NORTH ATLANTIC TREATY ORGANISATION
NCI Agency	NATO COMMUNICATIONS AND INFORMATION AGENCY
NCIO	NATO COMMUNICATIONS AND INFORMATION ORGANISATION
NCS	NATO COMMAND STRUCTURE
NFR	NATO FINANCIAL REGULATIONS
NIC	NATO INTERNATIONAL CIVILIAN
NSIP	NATO SECURITY INVESTMENT PROGRAMME

OF	OPERATING FUND
PE	PEACETIME ESTABLISHMENT/PERSONNEL ESTABLISHMENT
PPE	PLANT PROPERTY EQUIPMENT
PSC	PROJECT SERVICE COSTS
QAFR	QUARTERLY ACCOUNTING FINANCIAL REPORT
RPPB	NATO RESOURCE POLICY AND PLANNING BOARD
RS	RESOLUTE SUPPORT
SLA	SERVICE LEVEL AGREEMENT
SSC	SERVICE SUPPORT COST