NORTH ATLANTIC COUNCIL

CONSEIL DE L'ATLANTIQUE NORD



2 November 2017

**DOCUMENT**
C-M(2017)0053-AS1

# IBAN AUDIT ON THE 2015 FINANCIAL STATEMENTS OF THE INTERNATIONAL STAFF

## ACTION SHEET

On 31 October 2017, under the silence procedure, the Council noted the IBAN report attached to C-M(2017)0053 and agreed the RPPB recommendation regarding disclosure of the financial statements and the associated audit report.

(Signed) Jens Stoltenberg
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2017)0053

24 October 2017

**DOCUMENT**
C-M(2017)0053
**Silence Procedure ends:**
**31 Oct 2017 17:30**

# IBAN AUDIT ON THE 2015 FINANCIAL STATEMENTS OF THE INTERNATIONAL STAFF

## Note by the Secretary General

1. I attach the International Board of Auditors for NATO (IBAN) report on the audit of the 2015 financial statements of the International Staff. The IBAN have issued a disclaimer of opinion on the financial statements and on compliance for the year 2015.

2. The IBAN report has been reviewed by the Resource Policy and Planning Board (RPPB) (see Annex). The issues behind the disclaimer of opinion are well known and were highlighted in advice from the RPPB to Council in July 2016 (PO(2016)0542(INV)). A lessons learned report is currently being prepared by the International Staff Financial Controller and further advice will be submitted with the audit of the 2016 financial statements of the International Staff.

3. I do not believe that this matter requires discussion in the Council. Consequently, **unless I hear to the contrary by 17:30 hours on Tuesday, 31 October 2017**, I shall assume that the Council has noted the IBAN report on the 2015 financial statements of the International Staff and agreed the RPPB recommendation regarding disclosure of the financial statements and the associated audit report.

(Signed) Jens Stoltenberg

1 Annex
2 Enclosures
2 Appendices

Original: English

# IBAN AUDIT ON THE 2015 FINANCIAL STATEMENTS OF THE INTERNATIONAL STAFF

## Report by the Resource Policy and Planning Board (RPPB)

References:
A. IBA-AR(2017)04
B. PO(2016)0542(INV)

## INTRODUCTION

1. This report covers the audit of the 2015 financial statements of the International Staff (IS) (reference A). It is based on the report by the Budget Committee (BC) which was approved on Monday 10 July 2017 (reference: BC-D(2017)0100-FINAL).

## BACKGROUND

2. Council is already aware of the background to the delays in the production and submission of the 2015 financial statements of the IS (reference B). Competing priorities and critical staff shortfalls in the Office of the Financial Controller (FC) were significant contributory factors in the problems encountered in the production and submission of the IS financial statements. In October 2016, the FC updated the BC and the RPPB about further difficulties and delays in issuing the 2015 financial statements, specifically highlighting that serious concerns about the quality and auditability of the data and information. The RPPB instructed[1] the FC to issue the financial statements before the end of 2016 as the only option to provide the required level of transparency and be closest to the provisions of the NATO Financial Regulations (NFRs).

## OBSERVATIONS

3. The IBAN have issued a Disclaimer of Opinion on the financial statements and on compliance for the year 2015. The IBAN found fundamental control and structural weaknesses resulting from the implementation of the new Enterprise Resource Planning (ERP) system by the IS which led to a high risk that the possible effects on the financial statements of undetected misstatements could be both material and pervasive. The IBAN's findings revealed a number of significant weaknesses related to controls over the ERP system and transactional and accounting controls. As a result the IBAN was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Based on the audit carried out, the IBAN did not believe that the IS were in a position to issue the 2015 financial statements as cleaning of the accounting data was still on-going.

[1] OC/RPPB(2016)0101 (INV)

4. In addition to the many technical accounting observations and recommendations the IBAN concluded that the IS did not implement the most efficient and effective ERP structure to meet the financial reporting requirements of the IS. The IBAN believes that the IS configuration and implementation of the ERP significantly contributed to the inability to produce timely and accurate financial statements and will likely continue to present challenges in the future. The IBAN recommends that an independent external assessment of the IS ERP implementation be undertaken at the latest by the end of 2017.

## DISCUSSION

5. The majority of the observations and recommendations made by the IBAN related to weaknesses in transactional and technical accounting controls have been agreed by the IS FC. Almost all of them are directly linked with problems encountered during implementation of the ERP system.

6. As for the IBAN observations and recommendations on ERP configuration and implementation, the Board notes that the IS FC does not agree with all of the observations. In particular, the IS FC disagrees with the use of the high level comparison with how other NATO bodies have implemented their ERP systems to infer that the set-up implemented by the IS was not appropriate or that lessons learned from others were not considered. The IS FC points out that the set-up of the system was the result of a thorough requirement validation and design process conducted by a reputed, world-class audit and accounting firm that was responsible for system implementation.

7. While it is too early to say if all of the observations associated with ERP implementation and the weaknesses in transactional and accounting controls have been addressed by the IS FC, the 2016 financial statements for the IS have already been submitted to the IBAN for audit. A number of change requests were implemented during 2016 in the area of ERP controls (concerning travel invoices and purchase orders, tolerance limits, control over the payment file sent to the bank, competency centre job descriptions, change control board minutes, reduction of the risk of paying from the wrong bank account). The audit report on the 2016 financial statements should be submitted by the end of August and the BC will pay close attention to its findings.

8. As for the IBAN recommendation that an independent external assessment of the IS ERP implementation be undertaken, a lessons learned report by the IS FC has already been commissioned with the involvement of independent internal audit staff (reference B). For the moment further action should await the outcome of this lessons learned report. The IS FC should complete this report as a matter of urgency and by not later than the end of September 2017 so that further advice can be considered alongside the audit of the 2016 financial statements of the IS.

**Public Disclosure**

9. The FC has confirmed that the 2015 financial statements can be publicly disclosed[2].

**CONCLUSIONS**

10. The challenges involved in ERP implementation and the problems encountered by the IS are not new. Nations have been kept well informed and while a disclaimer of opinion is obviously regrettable, the nature of the IBAN report on the 2015 financial statements of the IS was foreseeable. This is not the first time that the IBAN have had to issue a disclaimer of opinion on the financial statements of the IS[3]. The Board is disappointed that the IBAN have again had to issue a disclaimer of opinion but it acknowledges the underlying reasons; these are not excuses but mitigating factors. Council has already noted (reference B) the need for the FC function to be provided with the appropriate resources (human and financial) as well as systems and practices to ensure that auditable financial statements are presented in accordance with the NFRs.

11. The RPPB is concerned by the scale of the issues identified by the IBAN; 19 separate issues[4] in four broad areas including basic errors in the financial statements; weaknesses in accounting and transactional controls and in ERP controls. The Board notes the action taken by the IS FC in response to the audit findings, although it is too early to say if all of the observations associated with ERP implementation and the weaknesses in transactional and accounting controls have been fully addressed such that they will not affect the audit opinion on the 2016 financial statements which have at least been submitted to the IBAN on time.

12. There was no consensus during discussions in the BC to support, at this stage, the IBAN recommendation that an independent external assessment of the IS ERP implementation be undertaken. The RPPB believes that the lessons learned report by the IS FC should be complete as a matter of urgency and by not later than the end of September 2017 so that further advice on the need for an external review can be considered alongside the audit of the 2016 financial statements of the IS.

[2] FC(2016)191

[3] The IBAN issued a disclaimer of opinion on the financial statements of the International Staff (IS) between 2007 and 2012 due to limitations in the accounting system used by the IS.

[4] An overview is at appendix 1

## RECOMMENDATIONS

13. The RPPB recommends that the Council:

a) note the IBAN report IBA-AR(2017)04;
b) agree the conclusions at paragraphs 10-12;
c) note that the IS FC will prepare the lessons learned report into ERP implementation with the involvement of independent internal audit staff and submit it to the BC not later than the end of September 2017;
d) note that the issues identified in the IBAN report will be kept under review and further advice will be submitted with the audit of the 2016 financial statements of the IS; and,
e) approve the public disclosure of this report, the IBAN audit (reference A)) and the associated 2015 financial statements of the IS.

## IBAN AUDIT ON THE 2015 FINANCIAL STATEMENTS OF THE INTERNATIONAL STAFF

The table below represents a summary of the findings and recommendations made by the IBAN in their audit on the 2015 financial statements of the International Staff and the action taken in response. More details can be found in annexes 3 (IBAN findings) and 5 (comments by IS FC) of the audit report (IBA-AR(2017)04).

| | **IBAN Observation and Recommendations** | **Action taken by IS Financial Controller** |
|---|---|---|
| | **Errors identified in 2015 financial statements** | |
| 1. | Over-statement of cash balances | Manual errors are being identified and corrected |
| 2. | Errors in cash flow statement | Errors corrected in the 2016 financial statements |
| 3. | Reconciliation of transactions in future financial statements | Action implemented in the 2016 financial statements |
| 4. | Inconsistent disclosure of accumulated surplus | Changes were introduced in the 2016 financial statements so as to limit surpluses to the segments related to Partners accommodation |
| 5. | Identification of accrued liabilities in 2015 and 2016 | Process has been put in place to better identify accruals from 2016. Restatement of accruals at end of 2015 would be extremely difficult, costly to attain and of limited value for money |
| 6. | Assets and liabilities held in foreign currencies should in future be revalued at year-end | Action implemented in the 2016 financial statements |
| 7. | Consistency of notes to support main financial statements | Action to be implemented in the 2017 financial statements |

| | | |
|---|---|---|
| | **ERP implementation and effect on financial statements** | |
| 8. | Independent external assessment of ERP implementation | Pending decision by BC. Internal review with support from independent internal auditors already commissioned |
| | **Weaknesses in accounting and transactional controls** | |
| 9. | Lack of basic accounting reconciliations | Action are gradually being put in place since end 2016 with a view to periodic closures and reconciliations |
| 10. | Insufficient level of controls over budget execution | FC will address the issue with stakeholders with a view to streamlining the exchange of information between the budgeting and the accounting software components |
| 11. | Improved management of carry forward of commitments | The way programme commitments are treated in the ERP will be re-examined with IS Divisions concerned in order to limit the cases in which PRs are used for commitment purposes |
| 12. | Matching invoices to purchase orders and the delivery of goods and services | The situation will be re-examined with IS Divisions concerned in order to assess the possibility to extend the use of the 3-way matching where relevant |
| 12. | Process configuration for travel invoices is changed | Changes implemented in July and December 2016 |
| 13. | Tolerance limits for travel too high | Tolerance level has been reduced in 2016 |
| 14. | Need to strengthen controls over bank payment files | Change introduced in December 2016 |

| | | |
|---|---|---|
| | **Weaknesses in ERP controls** | |
| 15. | Develop and document clear procedures for ERP user access | Job descriptions updated and approved by HR to clarify roles and responsibilities |
| 16. | Periodic review of user access rights | FC is considering the best approach in terms of access end date for staff who are on indefinite duration contracts |
| 17. | Monitoring of switch user function | Control checks on the switch user function among NATO bodies will be harmonised |
| 18. | Access rights to IT consultants | IS has put time limitations on consultants ‘ access |
| 19. | Formal documentation of decisions made by Change Control Board | Formal meeting minutes will now be kept |

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

The Board was required to audit the Financial Statements of the International Staff as at 31 December 2015. The total budgetary spend disclosed in the 2015 Financial Statements was EUR 194 million.

The Board issued a Disclaimer of Opinion on the Financial Statements and on compliance for the year ended 31 December 2015 (Annex 2).

The Board found fundamental control and structural weaknesses resulting from implementation of the International Staff's new Enterprise Resource Planning (ERP) system. The Board found that these weaknesses led to errors in the 2015 financial statements. The Board concluded from the errors and control weaknesses identified that there was a high risk that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

Because of the significance of the errors and weaknesses found, the Board has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, the Board does not express an opinion on the financial statements or on compliance.

Annex 3 outlines the Board's detailed observations and recommendations under four main headings as follows:

- Errors identified in the 2015 financial statements.
- Implementation of the new ERP system and its effects on the financial statements.
- Weaknesses in accounting and transactional controls.
- Weaknesses in controls related to the new ERP system.

Annex 4 outlines in more detail the Board's findings on the ERP implementation.

The International Staff's formal comments are contained in Annex 5 and 6. The detailed formal comments provide further information to the reader, but do not change the Board's observations or recommendations. The Board notes that the IS agrees with most of its observations on the financial statements and controls but disagrees with some of the Board's findings on Enterprise Resource Planning system implementation. Where deemed appropriate, the Board has provided its position on some of the recommendations that were not accepted by the IS.

03 May 2017

# INTERNATIONAL BOARD OF AUDITORS FOR NATO

# AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF

# THE INTERNATIONAL STAFF (IS)

# FOR THE YEAR ENDED 31 DECEMBER 2015

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

## Report on the Financial Statements

The International Board of Auditors for NATO (Board) was engaged to audit the Financial Statements of the International Staff which comprised the Statement of Financial Position as at 31 December 2015, the Statement of Financial Performance, Statement of Changes in Equity and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. The Board was also engaged to audit the Statement of Budget Execution for the year ended 31 December 2015.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these Financial Statements in accordance with the NATO Accounting Framework and the requirements of the NATO Financial Regulations as authorised by the North Atlantic Council, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these Financial Statements based on our audit, which is conducted in accordance with our Charter and international standards on auditing. Because of the matters described in the Basis for Disclaimer of Opinion on the Financial Statements paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for our audit opinion.

*Basis for Disclaimer of Opinion on the Financial Statements*

The Board found fundamental control and structural weaknesses resulting from implementation of the IS' new Enterprise Resource Planning (ERP) system. The Board found that these weaknesses led to errors in the 2015 financial statements. The Board concluded from the errors and control weaknesses identified that there was a high risk that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

*Disclaimer of Opinion on the Financial Statements*

Because of the significance of the matters described in the Basis for Disclaimer of Opinion on the Financial Statements paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

**Report on Compliance**

*Management's Responsibility for Compliance*

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

*Auditor's Responsibility*

In addition to the responsibility to express an opinion on the Financial Statements described above, our responsibility includes expressing an opinion on whether the financial transactions and information reflected in the Financial Statements are, in all material respects, in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations. Because of the matters described in the Basis for Disclaimer of Opinion on Compliance paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for our audit opinion.

*Basis for Disclaimer of Opinion on Compliance*

The Board found fundamental control and structural weaknesses resulting from the implementation of the IS' new ERP system. The Board found that these led to instances of non-compliance with rules and regulations. These weaknesses have led the Board to conclude that there is a high risk that the transactions presented in the financial statements are not, in all material respects, in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations.

*Disclaimer of Opinion on Compliance*

Because of the significance of the matters described in the Basis for Disclaimer of Opinion on Compliance paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Brussels, 03 May 2017

Lyn Sachs
Chairman

# INTERNATIONAL BOARD OF AUDITORS FOR NATO

## LETTER OF OBSERVATIONS AND RECOMMENDATIONS

## FOR THE INTERNATIONAL STAFF (IS)

## FOR THE YEAR ENDED 31 DECEMBER 2015

## 1. INTRODUCTION AND DISCLAIMER OF AUDIT OPINION

1.1 The Board attempted to audit the 2015 International Staff (IS) Financial Statements that were issued late on 30 December 2016. The late issuing of the Financial Statements is not in compliance with the NATO Financial Regulations (NFRs), which required the financial statements to be issued by 31 March 2016.

1.2 Prior to the financial statements being issued, the Board carried out a number of interim audit procedures. The Board examined the way the new Enterprise Resource Planning (ERP) system was implemented by the IS. In addition, the Board assessed the controls in place over the ERP system and the controls over transactions and accounting that were in place during 2015. The Board's observations and recommendations are shown under four main headings as follows:

- Errors identified in the 2015 Financial Statements.
- Implementation of the new ERP system and its effects on the financial statements.
- Weaknesses in accounting and transactional controls.
- Weaknesses in controls related to the new ERP system.

1.3 The Board previously reported to the IS in April 2016 on its interim control findings (ref: IBA-A (2016)45). The Board's findings revealed a number of significant weaknesses related to controls over the ERP system and transactional and accounting controls. The Board identified weaknesses in controlling access and accountability within the ERP. The Board found weaknesses in accounting controls, including the lack of a documented control to ensure that all data from the old system was correctly loaded into the new ERP to form the basis of the opening 2015 balances. In addition, a number of weaknesses were also identified related to the budgetary reporting and controls over commitments carried forward. Further, the Board also found weaknesses in the system settings and authorisation procedures related to payments, especially relating to travel invoices.

1.4 The Board concluded from its interim findings that the risks related to the financial statements and compliance were high and that the possible effects of undetected misstatements and instances of non-compliance resulting from control weaknesses and a lack of reconciliations could be both material and pervasive. Specifically, the weaknesses outlined above could lead to misstatements in the financial statements, transactions that do not comply with the NATO Financial Regulations and budgetary authorities and incorrect payments. There is also an increased risk of potential misuse and fraud in this situation.

1.5 Following its interim audit work, the Board's audit of the 2015 IS Financial Statements revealed material errors in financial reporting and unreconciled transactions. The Board also found that payments had been made from incorrect bank accounts and that these transactions had not yet been fully identified and corrected.

1.6 The Board's findings on fundamental weaknesses in the ERP implementation and the controls in place during 2015 are supported by the Statement of Internal Control that was issued by the IS with the 2015 financial statements and that outlines a number of problem areas. The Statement of Internal Control states that the problems were due to the implementation of the new ERP system. They related to difficulties in making payments, accounting problems and limitations in financial reporting. As a result, a high number of accounting corrections and other adjustments (over 8,000 line items) needed to be made prior to producing the 2015 financial statements. In addition, the accounting data supporting the financial statements contained around EUR 23 billion of both debits and credits confirming that many accounting corrections needed to be made during 2015. Some of the corrections related to 2015 were made in 2016 and some are still being made in 2017. These were not reflected in the 2015 financial statements.

1.7 Furthermore, the ERP structure implemented did not properly prevent the booking in 2015 and 2016 of a very high number of incorrect cross-financial statement postings between the financial statements for which the IS is responsible. The Statement of Internal Control outlined the main areas for concern as accruals, cut-off, reconciliations and reporting. The Board's audit of the financial statements confirmed that these factors had, indeed, led to accounting errors in the 2015 IS Financial Statements, most significantly the cash presented did not agree to the cash in the bank by EUR 5,650,615.41.

1.8 Based on the audit carried out on the 2015 IS Financial Statements, the Board does not believe the IS were in a position to issue the 2015 Financial Statements as cleaning of the accounting data was still ongoing. In addition, the IS was not able to provide the Board with fully reconciled accounting data to conduct its audit. As a result, the Board could not obtain sufficient appropriate audit evidence on which to base an opinion. The Board concludes that the possible effects on the financial statements of undetected misstatements and instances of non-compliance with rules and regulations could be both material and pervasive. These audit findings have led the Board to issue a disclaimer of opinion on the financial statements and on compliance. Accordingly, it does not express an opinion on the financial statements or on compliance.

1.9 The Board received factual and formal comments from the IS. Where deemed necessary, the Board amended its draft report to take account of the factual comments. The IS's formal comments are contained in Annex 5 and 6. The detailed formal comments provide further information to the reader, but do not change the Board's observations or recommendations. The Board notes that the IS agrees with most of its observations on the financial statements and controls but disagrees with some of the Board's findings on ERP implementation. Where deemed appropriate, the Board has provided its position on some of the recommendations that were not accepted by the IS.

## OBSERVATIONS AND RECOMMENDATIONS

## 2. ERRORS IDENTIFIED IN THE 2015 FINANCIAL STATEMENTS

### 2.1 OVERSTATEMENT OF CASH BALANCES

#### Reasoning

2.1.1 It is a fundamental requirement that all bank accounts are effectively controlled throughout the reporting period and correctly presented in the financial statements.

#### Findings

2.1.2 The Board found that cash presented in the 2015 IS Financial Statements was overstated by EUR 5,650,615.41. The amount in the year-end bank balances was EUR 79,023,251. The amount in the financial statements was EUR 84,673,866.41. The difference is mainly in two areas. Firstly, the bank balance in the main EURO IS bank account was EUR 51,954,700.99. However, the amount in the 2015 financial statements was EUR 56,218,101.78, which is EUR 4,263,400.79 more. Secondly, an accounting correction was made prior to producing the financial statements that increased the cash disclosed further by EUR 1,387,214.62.

2.1.3 From discussions with the IS, the Board understands that EUR 3,928,616.46 of the differences appear to result from payments made from the main IS bank accounts that relate to other financial reporting entities also controlled by the IS. These payments resulted in cash being cleared in the main IS bank account not being reflected in the general ledger balances of the IS financial statement. Specifically, these payments related to FORACS, MSIAC, the New Headquarters and the pension schemes. The Board understands that some of the necessary corrections to regulate this situation were done in 2016 and 2017, but were not reflected in the amounts disclosed in the 2015 financial statements.

2.1.4 The use of incorrect bank accounts resulted from problems relating to the ERP implementation as outlined in the Statement of Internal Control. The control of reconciling the bank accounts to the accounting system was not carried out periodically during or at the end of 2015. The IS provided the Board with details of transactions that related to separate IS entities. These totaled EUR 3,928,616.46. This leaves a residual unexplained amount in the main bank account of EUR 334,784.33 and an unexplained amount in overall cash disclosed of EUR 1,721,998.95.

#### Recommendation

2.1.5 The Board recommends, as a matter of urgency, that the IS identify the cause of the discrepancy in cash and ensure that cash is effectively controlled and correctly disclosed in future.

## 2.2 ERRORS IN THE CASH FLOW STATEMENT

**Reasoning**

2.2.1 The Cash Flow Statement presented in the financial statements needs to fully reconcile opening and closing cash balances to all movements in assets, liabilities and relevant transactions.

**Finding**

2.2.2 Given that cash was misstated in the 2015 IS Financial Statements, the Cash Flow Statement cannot be relied upon. In addition, the Board found that the bank balances disclosed in the Cash Flow Statement at the beginning and end of 2015 do not agree to the amounts disclosed as cash in the Statement of Financial Position. In addition, the calculated net increase in cash from the beginning to end of year does not agree to the movement in the disclosed cash balance. As it is calculated from movements in the Statement of Financial Position, this is an indication of accounting errors.

**Recommendation**

2.2.3 The Board recommends that the IS identify the reasons for the errors in the Cash Flow Statement and ensure that it is correctly stated in future financial statements.

## 2.3 INABILITY TO RECONCILE EXPENSES IN THE BUDGET EXECUTION STATEMENT TO EXPENSES IN THE STATEMENT OF FINANCIAL PERFORMANCE

**Reasoning**

2.3.1 Expenses recorded in the Budget Execution Statements are recorded on the same basis as transactions recorded in the Statements of Financial Performance and Position. To ensure the completeness and accuracy of the expenses disclosed, it is a fundamental control that these expenses can be reconciled to each other.

**Finding**

2.3.2 The IS were unable to provide the Board with the reconciliation of transactions disclosed in the Statements of Financial Performance and Position to the expenditure recorded in the Budget Execution Statements. Without this reconciliation, uncertainty exists as to whether expenses are complete and accurate and in compliance with rules and regulations. Also, see observation 4.2 relating to insufficient levels of controls over budget execution.

**Recommendation**

2.3.3 The Board recommends that the IS ensure, in future financial statements, that a detailed reconciliation of transactions in the Statements of Financial Performance and

Position to the expenses in the Budget Execution Statement be provided at the time of the issuance of the financial statements.

## 2.4 INCONSISTENT DISCLOSURE OF AN ACCUMULATED SURPLUS

### Reasoning

2.4.1 Accumulated surpluses in financial statements need to be justified and fully reconciled within the financial statements.

### Finding

2.4.2 The Board found that the Statement of Financial Position disclosed an accumulated surplus of EUR 2,635,200.04 at 31 December 2015. The prior year surpluses as of 31 December 2014 were disclosed as zero. The surplus (equivalent to overall assets being greater than liabilities) are explained in Note 23 to the 2015 IS Financial Statements as corresponding 'to miscellaneous surpluses generated outside the budget execution context'. However no breakdown explaining their nature is disclosed e.g. miscellaneous income, foreign exchange gains etc. or how they occurred. Furthermore, as the balance was zero at the beginning of the year, the surplus should have been reflected in the activities of the year and presented as a surplus in the Statement of Financial Performance. However, no surplus was presented in the Statement of Financial Performance. This is a further indication of accounting errors.

### Recommendation

2.4.3 The Board recommends that the IS justify the reasons for the accumulated surplus disclosed and ensure that, in future, they are correctly disclosed on the Statement of Financial Performance.

## 2.5 LACK OF ASSURANCE ON PROPER CUT-OFF OF EXPENSES

### Reasoning

2.5.1 Prior to issuing financial statements, all accrued liabilities at year-end should be identified and disclosed within the financial statements.

### Findings

2.5.2 A total of EUR 9,752,346.10 is disclosed under liabilities as Payables. This amount includes invoices received but not yet paid at year-end. It also includes accrued liabilities where a service or good had been received from a supplier but no invoice had been received at year-end.

2.5.3 The IS stated to the Board that the exercise to identify all accrued liabilities was not completed before the 2015 financial statements were issued, and that if the exercise is completed before the 2016 financial statements are issued, some of the 2015 accruals will be recognised in the 2016 statements. This is supported by the statements made in the Statement of Internal Control. As a result, it is likely that payables and expenses are misstated in the 2015 financial statements, including expenses in the Budget Execution Statement.

**Recommendation**

2.5.4 The Board recommends that the IS identify all accruals related to 2015 in its 2016 financial statements.

## 2.6 NO FOREIGN EXCHANGE RATE REVALUATION OF MONETARY ASSETS AND LIABILITIES AT YEAR-END

**Reasoning**

2.6.1 The NATO Accounting Framework requires monetary assets and liabilities in foreign currencies be revalued at the year-end rate.

**Finding**

2.6.2 The Board found that no foreign exchange rate revaluation was done relating to assets and liabilities presented in the 2015 IS Financial Statements. As a result, all the monetary assets and liabilities are presented using rates at the date of the relevant transaction e.g. when funds were received into the bank. This means that monetary assets and liabilities are misstated in the 2015 financial statements by an unknown amount.

**Recommendation**

2.6.3 The Board recommends that, for all future IS financial statements, the IS ensure that all assets and liabilities, as required by the NATO Accounting Framework, held in foreign currencies are revalued at year-end.

## 2.7 DISCREPANCY BETWEEN INVENTORY PRESENTED IN FINANCIAL STATEMENTS AND DISCLOSED IN NOTES

**Reasoning**

2.7.1 The notes to financial statements should be consistent to the main financial statements (Statements of Financial Performance, Position, etc.)

**Finding**

2.7.2 The Board found that the Statement of Financial Position disclosed the balance of inventory at 31 December 2015 as EUR 10,645. However, Note 8 of the financial statements supporting the balance discloses inventory as EUR 791,014.

**Recommendation**

2.7.3 The Board recommends that the IS ensure, in future, that all note discloses support and are consistent with the main financial statements.

## 3. IMPLEMENTATION OF THE NEW ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM AND ITS EFFECT ON THE FINANCIAL STATEMENTS

**Reasoning**

3.1 The new ERP system should be implemented in the most efficient and effective manner to ensure it meets the control and reporting requirements of the entity.

**Findings**

3.2 The Board concluded that the IS did not implement the most efficient and effective ERP structure given the financial reporting requirement to prepare 9 separate financial statements. The financial statements, in addition to the IS, are the New NATO Headquarters, the NATO Staff Centre, MSIAC, FORACS, and four NATO retirement benefit plans. BICES also uses the new ERP system, but does not rely on the IS to produce its financial statements.

3.3 The implemented structure did not properly prevent the booking in 2015 and 2016 of a very high number of incorrect cross-financial statement postings between the different financial statements. The Board believes that the IS implementation of the ERP significantly contributed to the inability to produce timely and accurate financial statements and will likely continue to present challenges in the future. Further, it required additional IT programming and the implementation of additional internal controls.

3.4 Annex 4 provides more detail relating to the Board's understanding of the IS ERP implementation.

**Recommendation**

3.5 The Board recommends that an independent external assessment of the IS ERP implementation be undertaken focusing on the requirement of the IS to produce 9 separate Financial Statements. Such an assessment should also consider the lessons to be learned for future ERP system implementations in NATO. The Board recommends that this assessment be performed at the latest by the end of 2017.

## 4. WEAKNESSES IN ACCOUNTING AND TRANSACTIONAL CONTROLS

The interim work carried out by the Board on accounting and transactional controls (section 4) and controls in the new ERP system (section 5) was completed in April 2016. As a result, the observations in these two sections below relate to findings at that time and reflect the situation that existed during 2015. It is possible that changes may have occurred since April 2016. These will be taken into account during the Board's audit of the 2016 IS Financial Statements.

### 4.1 LACK OF BASIC ACCOUNTING RECONCILIATIONS, INCLUDING CASH

**Reasoning**

4.1.1 According to paragraph VI 4) (c) of the NATO Financial Rules and Procedures, the Financial Controller shall ensure that all accounts are reconciled and verified on a regular basis, and all activities with financial implications, including multinational and non-appropriated fund activities, controlled by periodic inspection.

4.1.2 Accounting controls such as closure of periods, bank reconciliations and regular reconciliations of sub ledgers are vital to ensure that accounting errors are picked up in a timely fashion so that the necessary corrective action can be taken. In addition, the introduction of a new ERP system requires a control to ensure that all data from the old system is correctly loaded into the new ERP. This is to ensure that opening balances are correctly stated. Such controls mitigate the risk of transaction errors and misstatements.

**Findings**

4.1.3 The Board found that the IS had not carried out basic accounting controls during 2015. Firstly, accounting periods had not been closed on a regular basis so that accounting data could be reconciled and cleaned as necessary. Secondly, reconciliations between the General Ledger (GL) and sub ledgers (accounts payable and receivable) were not carried out. Thirdly, a reconciliation of expenses recorded against the budget to expenses reported in the GL has not been done.

4.1.4 Finally, the Board found that the IS did not perform monthly reconciliations of cash balances between the accounting system and bank statements for 2015 and through 2016. Monthly reconciliations can only be performed after all bank transactions have been recorded and reconciled in the ERP. This did not happen because there were a significant amount of unreconciled and unprocessed bank transactions in the ERP in 2015.

4.1.5 The Board also found that the necessary work to ensure opening balances and open items had been fully loaded in the new system had not been completed. These need to be fully matched/reconciled to the old system with a clear audit trail.

**Recommendation**

4.1.6 The Board recommends that, as soon as possible, the IS introduce regular accounting controls to ensure accounting periods are closed promptly, regular reconciliations to sub ledgers are carried out, budget expenses are reconciled to GL expenses and cash is reconciled between the bank and the accounting system. In addition, the Board recommends that the OFC complete its work on data transfer from the old system and that this is documented with a clear audit trail.

## 4.2 INSUFFICIENT LEVEL OF CONTROLS OVER BUDGET EXECUTION

**Reasoning**

4.2.1 It is vital that controls are put in place to ensure that the budget is expensed for the purpose approved and that payments do not exceed the limits approved. A lack of such controls leads to the risk of non-compliance with the budgetary authorities.

**Findings**

4.2.2 The Board found that the IS common funded budget was loaded into the ERP system in 2015 at a summarised level only for some of the budgetary credits. The budget credits were loaded based on the budget structure from the budget system (different to the ERP) which, in some cases, differed from the accounting string in the ERP GL. As a result, the ERP system could only check funds against summarised budgetary ceilings rather than be controlled on a line by line basis. The Board understands that, in 2015, it was not possible for all budget holders to check expenses against fund ceilings within the ERP system.

4.2.3 In order to ensure effective and efficient budgetary control, budgetary credits should ideally be loaded into an ERP system with the same accounting string as in the GL. This allows funds to be matched to detailed committed credits and expenses. In addition, it allows staff to closely monitor their detailed budget throughout the year and facilitates the reconciliation of budgetary expenses to those recorded in the GL. At the time of the interim audit (February 2016) it was not possible to get 2015 budget execution reports from the system.

**Recommendation**

4.2.4 The Board recommends that, in future, the IS load its common funded budget into the ERP system by using the same accounting string as in the GL to ensure the budget can be executed and controlled effectively.

### 4.3 CARRY FORWARD OF COMMITMENTS BASED ON PURCHASE REQUISITIONS INCREASES THE RISK OF NON-COMPLIANCE AND OF MISSTATEMENT

**Reasoning**

4.3.1 In order to comply with the NATO Financial Regulations, controls are necessary to ensure committed credits are only carried forward into the next financial year where a legal liability exists.

**Findings**

4.3.2 The Board found that, for programme expenses, purchase requisitions (PRs), which are internal requests to authorise future expenses and to reserve funds, were being carried forward at year-end as committed funds (i.e., a legal liability to pay once a good or service is received). This should only be possible when the Purchase Order (PO) (contract with the supplier) is created.

4.3.3 The IS took a decision to authorise the carry forward of PRs due to the nature of programme expenses. Programme expenses cover grants, studies, surveys, seminars etc. These do not easily fit into the normal PO process followed with commercial purchases. However, PRs, by their nature, are not recognised as commitments within an ERP system. In addition, their use poses a risk as changes can be made to PRs within the ERP system without being authorised by management. Once a PO is created, no changes can be made without specific authorisation by management. In addition, the recognition of PRs as commitments creates accounting difficulties in terms of reconciling and controlling the carry forward of commitments. The Board understands the reasons why PRs are used in this way by the programmes. However, it is a practice that should be avoided. A specific and better controlled procedure should be set for instances where the need to commit fund without a legal supporting contract exists.

**Recommendation**

4.3.4 The Board recommends that the OFC examine, with the programmes, the implementation of future work flows that ensure that the norm is to use POs to create liabilities and form the basis of carry forwards so that the use of PRs is strictly limited to cases where there is an operational necessity. In cases where PRs are carried forward, controls, including monitoring, should be put in place and clearly documented.

## 4.4 MATCHING INVOICES TO PURCHASE ORDERS AND THE DELIVERY OF GOODS AND SERVICES

### Reasoning

4.4.1 Controls over the authorisation of payments are necessary to ensure that the invoice matches the PO and that the goods/services have been received in accordance with the PO/contract. This control mitigates the risk of erroneous payments.

### Findings

4.4.2 For commercial invoices, the three-way matching control (invoice, receipt, and PO are matched) is the default setting in the ERP. Divisions do the input of the receipt in the system and the system automatically does the three-way match. However, it is possible for authorised staff to change the setting. In addition, when an invoice is on hold as a result of three-way matching, it can be released without registering the receipt by switching to two-way matching. The Board understands that when the setting is changed to two-way matching, the PO must be reapproved by Procurement.

4.4.3 For programme expenses, two-way matching has been set up in the ERP (PO and invoice matching with no receipt in the system). Commitments are based on the PRs. Invoices go to Divisions which validate them and create a PO in the system. The payment is then controlled and authorised by Finance. As a result, the legal liabilities are effectively being created by the approved PR. As outlined in observation 4.3, there are risks in using PRs to create liabilities. In addition, the use of POs and three-way matching is the ideal. The PO creates a clear liability and the recording of the receipt in the system evidences that, and when, the good/service has been received.

### Recommendation

4.4.4 The Board recommends, similar to the recommendation on PR approval, that the IS examine with the programmes, the implementation of future work flows that ensure that the norm is to use POs to create liabilities and to restrict the use of PRs to those cases where it is absolutely necessary. In addition, OFC should use three-way matching wherever possible and practical, and the situations where two-way matching is permissible should be identified and documented, and subsequently monitored.

## 4.5 TRAVEL INVOICES AND POs CAN BE MODIFIED AND PROCESSED WITHOUT AUTHORISATION

**Reasoning**

4.5.1 It should never be possible for an invoice to be processed and paid without formal authorisation. This increases the risk of fraud, irregularity, errors and misstatements.

**Finding**

4.5.2 The Board found that travel invoices imported from the legacy system were not subject to invoice approval since they had already been approved in the legacy travel system. However, the Board found that, within the test environment, manually input invoices did not need to be approved. The system does not distinguish between legacy invoices (already approved in the old system) and those manually booked in the new ERP. The Board found that it is possible to modify a PO for travel in the ERP directly and this PO by default will be processed, regardless of the amount, without an approval.

**Recommendation**

4.5.3 The Board recommends that the IS ensure that the travel invoices process configuration is changed to prevent manually entered travel POs and invoices being processed without an approval

## 4.6 INCOMPLETE TOLERANCE LIMITS AND LIMITS SET TOO HIGH

**Reasoning**

4.6.1 It is standard within an ERP system to set up tolerance limits on unit price and quantity. This is the allowable difference between the PO and the invoice to allow payment to be authorised. However, these limits need to be set at an appropriate level. If not set at the appropriate level, there is a risk of payment errors.

**Finding**

4.6.2 The Board found that the tolerance limit for travel had been set at 30%. In addition, there were no limits relating to unit price variance between the invoice and the PO for goods and services. This represents a risk as invoices can be processed regardless of the difference between the price of goods and services ordered and the price invoiced.

**Recommendation**

4.6.3 The Board recommends that the OFC lower the tolerance limit related to travel. In addition, an appropriate tolerance limit relating to price variations should be implemented to ensure that only invoices that match the PO price are processed and approved.

## 4.7 CONTROLS OVER PAYMENT FILES SENT TO THE BANK NEED STRENGTHENING

**Reasoning**

4.7.1 It is a standard control within an ERP system to ensure that the payment file created in the system is exactly the same as the payment file paid by the bank and that no changes are possible. A lack of such a control heightens the risk of fraud and error.

**Finding**

4.7.2 The Board found that the IS did not have a control in place to ensure that the payment file generated by the ERP could not be altered prior to being sent to the bank. There exists a risk that the bank processes a different file. However, such an eventuality should be picked up by bank reconciliation performed by the IS's Treasury Service. However, as shown in observation 4.1, bank reconciliations were not performed during 2015.

**Recommendation**

4.7.3 The Board recommends that the IS establish a control to ensure that an ERP generated payment file is not manipulated between its creation and being uploaded to the bank.

# 5. WEAKNESSES IN CONTROLS RELATED TO THE NEW ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM

## 5.1 LACK OF PROCESS DOCUMENTATION RELATING TO ACCESS MANAGEMENT AND JOB DESCRIPTIONS

**Reasoning**

5.1.1 Formal controls over user access are required to ensure that the segregation of duties principles are respected. In addition, controls are needed to ensure that the appropriate staff member has the required roles and responsibilities assigned. Further, staff need to clearly understand their roles and responsibilities, especially those tasked with controlling access, security and system control settings. This is required to ensure that staff are accountable for carrying out their responsibilities effectively. A lack of access control heightens the potential risk of error, fraud and accounting misstatements.

**Findings**

5.1.2 There was no formal documentation on the process of granting and modifying user access to the ERP. The Office of the Financial Controller (OFC) has a Competency Centre (CC) that has responsibility for controlling access rights, roles and responsibilities and control settings. Each division of the IS has a staff member who is responsible for authorising their staff's roles and responsibilities within the ERP. However, the CC does not monitor how these roles and responsibilities are assigned in order to ensure security and segregation of duties.

5.1.3 There is a documented segregation of duties matrix. However, it has assigned work that conflicts with the segregation of duties principles. For example, the general ledger clerk is also authorised to make payments. Further, staff has been assigned the responsibility to both amend supplier details (e.g. bank accounts) and also to make payments by credit card. In addition, the CC staffs' job descriptions had not been updated since the introduction of the ERP. Their exact roles and responsibilities had not been clarified.

### Recommendation

5.1.4 The Board recommends that the IS develop and document clear procedures for granting, modifying, and monitoring user access to the ERP. In addition, the IS should develop a segregation of duties matrix that correctly identifies the segregations required. Further, the Board recommends that the IS create job descriptions for staff working in the CC clarifying their roles and responsibilities.

## 5.2 LACK OF PERIODIC REVIEW OF USER ACCESS RIGHTS

### Reasoning

5.2.1 Controls are required to ensure that, when a member of staff leaves or changes job, user rights are amended to control the risk of inappropriate access. Inappropriate access heightens the risk of errors and misuse.

### Finding

5.2.2 Since February 2016, Human Resources sent CC a list of departing staff so the CC can take action to remove them from the system. However, no information is provided on staff when they change IS Divisions. If the Division coordinators do not ask for new responsibilities to be assigned to a user, the old responsibility assignments will not be deactivated. The Board found cases where staff who moved departments still had access to their old responsibilities together with the new ones. The Board also found that only 286 responsibility assignments out of 2,140 had been assigned an end date.

### Recommendation

5.2.3 The Board recommends that the IS develop documented procedures that set up formal channels of communication to ensure the CC is aware of staff members who have transferred between departments. In addition, a periodic review of users and their responsibilities should be set up to ensure the appropriate roles and responsibilities are assigned to the correct staff. Further, users should have access end dates assigned according to the duration of their contract.

## 5.3 THE USE OF THE 'SWITCH USER' FUNCTION NEEDS TO BE MONITORED

### Reasoning

5.3.1 It is a vital control in an ERP system that delegation of roles and responsibilities is monitored and controlled to ensure segregation of duties are respected and there is a clear audit trail showing the actions of the delegated staff member.

### Findings

5.3.2 In the ERP system there is the possibility for staff to delegate their work list. This is a standard functionality. There is also a 'switch user' function that allows users to use each other's user account. The Board found that this function is authorised to be used by finance staff when someone is sick. It is necessary to ensure that payments can still be approved during unscheduled absences. It is not known whether other IS Divisions also use this function.

5.3.3 In the case of the 'switch user' function, there is no audit trail indicating that the work was carried out by delegated staff. The system records it as if it were carried out by the staff who delegated. The Board did not find evidence as to how the use of this function was controlled and monitored, increasing the risk of it being used without the proper authorisation. In addition, there is no end date to the 'switch user' function. In the Board's opinion, although the use of 'switch user' function appears unavoidable for certain limited operational reasons, it needs to be carefully monitored and controlled.

### Recommendation

5.3.4 The Board recommends that the IS put controls in place to ensure that the use of the 'switch user' function is strictly controlled and monitored to ensure that it is only ever used in the appropriate circumstances. This could take the form of a periodic report that shows clearly who has used it, when it was used and for what purpose. The limitations on the use of the 'switch user' function, and the related controls, should be clearly documented.

## 5.4 ACCESS TO THE NEW NEW ENTERPRISE RESOURCE PLANNING (ERP) PRODUCTION ENVIRONMENT GIVEN TO AN IT CONSULTANT

### Reasoning

5.4.1 Access to the real-time operating ERP production environment should only be granted to staff responsible for the processing and approval of transactions and accounting entries. Staff without these responsibilities, such as system developers, should not be granted access to an environment other than the testing one. Such access increases the risk to data integrity if changes are made without being tested first.

**Finding**

5.4.2 The Board found that an IT consultant had been granted access to the production environment in order to perform configuration changes without a time limit being set on the access.

**Recommendation**

5.4.3 The Board recommends that the IS ensure that access rights given to consultants normally only cover the test environment and that access should only be granted to production to implement agreed changes. In addition, the access should be time limited.

## 5.5 NO FORMAL DOCUMENTATION OF CHANGE CONTROL BOARD DECISIONS

**Reasoning**

5.5.1 The Change Control Procedures outline the management of system change requests and the roles and responsibilities of the Change Control Board (CCB). It also states that the ERP CC should document the decisions made at the CCB meeting and send the approved list of changes to the Application Support Group for approval and execution. This mitigates the risk of inappropriate system changes.

**Finding**

5.5.2 The Board found that there is a spreadsheet where the ERP changes are recorded together with comments showing whether the CCB agreed or disagreed to the change requests. However, there are no minutes of the CCB meetings documenting the participants, the discussion and decisions made.

**Recommendation**

5.5.3 The Board recommends that the IS ensure that minutes of the CCB decisions are recorded and develop an approval form signed by the CCB to ensure that only approved change requests are implemented.

## IMPLEMENTATION OF THE ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM IN THE INTERNATIONAL STAFF

### 1. INTRODUCTION

1.1 In July 2016, the Board advised the Council in a Special Report that it could not audit the 2015 IS Financial Statements because they had not been issued (IBA-A(2016)60, dated 5 July 2016) on time. In paragraph 2.2 of that report, it was stated that the Board had already reported to the IS in April 2016 (IBA-A (2016)45) that there were significant internal control weaknesses and potentially structural weaknesses identified in respect to the new Enterprise Resource Planning (ERP) system with serious implications for the financial reporting, including an increased risk of fraud and misuse. The IS Financial Controller (FC) briefed the Resource Policy and Planning Board in October 2016 and stated that ‘there is no indication of there being any systemic issue with the ERP as implemented’ (FC (2016)128). The 2015 IS Financial Statements were finally issued on 30 December 2016, or 9 months late.

1.2 In line with applicable auditing standards[1], the Board obtained an understanding of the new information system. The Board concentrated on how the ERP system had been set up given the requirement for the IS to produce 9 financial statements and the delays encountered in producing those statements. The financial statements, in addition to the IS, are the New NATO Headquarters, the NATO Staff Centre, MSIAC, FORACS, and four NATO retirement benefit plans. BICES also uses the new ERP system, but does not rely on the IS to produce its financial statements. Specifically, the Board:

1) Considered whether problems exist resulting from how the system was implemented;
2) Compared the IS implementation to similar ERP systems implemented in other NATO bodies; and
3) Examined the remedial actions being taken by the IS to produce the 2015 financial statements.

### 2. STANDARD STRUCTURES FOR PRODUCING MULTIPLE FINANCIAL STATEMENTS

2.1 The ERP system provides several ways in which it can be structured to provide sufficient control and segregation of data to effectively and efficiently support the production of multiple financial statements. Below is a summary of the various elements of the ERP organisational structure:

> **‘Legal entity’:** Information about an entity is stored in the ERP in the ‘legal entity’. The ‘legal entity’ administers transaction rules to comply with legislation and regulatory requirements.

[1] International Standard of Auditing 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*.

**‘Ledger’:** A ledger provides ledger accounting for the accounting entity and stores the financial information. Ledgers can be grouped into ‘Ledger Sets’. An example provided in the ERP documentation is the following: ‘A group has 26 registered companies in one country. National regulations require that each company maintains a distinct book of accounts. The correct set up is a ledger for each company which are grouped into a Ledger Set. Finance staff can treat the collection as if they were one for all accounting activities, while the data remains distinct for each company’. Separate ledgers ensure data integrity and segregation.

**‘Operating units’:** An operating unit is used to keep the data of one entity distinct from the data of another entity and to keep data of an operation private from management of another operation. Separate ‘operating units’ ensure data integrity and segregation. The minimum number of operating units suggested by the database provider is one per entity.

**‘Balancing segments’:** Within a ledger, part of the chart of accounts must be nominated as a ‘balancing segment’. The ERP customers use balancing segments to identify different entities that are accounted for together in a single ledger. This provides the least level of data integrity and segregation within the ERP and often requires additional programming and internal controls to be successful.

## 3. THE IMPLEMENTED STRUCTURE IN THE IS

3.1 The new IS ERP system was implemented using two legal entities (IS and BICES),[2] one ledger, one operating unit and 71 balancing segments. Risks to such a set-up include accounting problems relating to one accounting entity misposting transactions to another accounting entity and delays in closing the financial period of one entity result in delays for all entities.[3]

3.2 The IS did not choose to implement separate operating units to ensure the segregation and integrity of accounting data. Furthermore, the ‘balancing segments’ chosen by the IS were not at the financial statement level (9 balancing segments for the 9 financial statements), but rather, at a level not facilitating the production of 9 separate financial statements (71 balancing segments at the fund level).[4] The Board believes that using so many balancing segments complicates the ERP system, further increasing the risks and reducing the efficiencies to be gained from the system.

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[2] BICES insisted that it be set up as a separate ‘legal entity’ within the ERP system to avoid cross-bookings between its balances and transactions and those of the 9 other financial reporting entities.

[3] For example, the 2015 FORACS and MSIAC financial statements were issued in July 2016, but the accounting for these entities in the ERP system could not be finally closed until January 2017, after the issuance of the 2015 IS Financial Statements on 30 December 2016. Transactions were booked to these segments in the meantime.

[4] The Board could not find evidence in the ERP implementation bidding/offering documents referring to the requirement for the ERP system to support the production of separate financial statements.

3.3 The Board found that the IS common funded budget was loaded into the ERP system in 2015 based on the budget structure from the budget system (different to the ERP) which, in some cases, had a different accounting string to that in the ERP GL. In order to ensure effective and efficient budgetary control, budgetary credits are normally loaded into an ERP system with the same accounting string as in the GL. This allows funds to be matched to detailed committed credits and expenses. In addition, it allows staff to closely monitor their detailed budget throughout the year and facilitates the reconciliation of budgetary expenses to those recorded in the GL.

## 4. IMPLEMENTATION OF SIMILAR SYSTEMS AT OTHER NATO ENTITIES

4.1 The Board examined how the same software package had been implemented in other NATO bodies, namely the International Military Staff (IMS), Allied Command Operations (ACO) and NATO EF2000 and Tornado Development, Production & Logistics Management Agency (NETMA). These entities have not experienced significant problems with data segregation due to the way their ERP systems had been set-up. The Board found that the IS did not appear to have made use of the lessons learned by these bodies.

### IMS

4.2 The IMS FC is the Financial Controller not only for the IMS, but also the NATO Defence College (NDC) and the Science & Technology Organisation (STO). The IMS FC is responsible for producing separate financial statements for each of these entities. The IMS chose to implement separate 'ledgers' and separate 'operating units', which correspond to the separate financial statements required to be produced.

### ACO

4.3 There is no requirement for ACO to produce separate financial statements by ACO Command. As a result, the ACO system has only one 'ledger'. However, each ACO Command is a separate 'operating unit' in the system (some of them with more than one 'balancing segment'). Some of the 'operating units' are also used for non-ACO transactions managed by ACO (e.g. for the European Union). Different profile/responsibilities are in place to manage local access/hierarchy/workflow and corporate access/hierarchy/workflow. This kind of configuration/set-up allows ACO to manage the accounting data at controlled entity (the dedicated 'operating unit') and at controlling entity (ACO with one 'ledger' and with the responsibility of the full reconciliation and reporting).

### NETMA

4.4 NETMA is required to produce three separate financial statements for NETMA, the NATO European Fighter Aircraft Development, Production and Logistics Management Organisation (NEFMO) and the NATO Multi-Role Combat Aircraft Development, Production and In Service Support Management Organisation (NAMMO).

The system structure implemented is one ‘legal entity’, one ‘ledger’ and two ‘operating units’ (the two operating organisations, NEFMO and NAMMO, are one and the administrative agency, NETMA, is the other). Three ‘balancing segments’ matching to the requirement to produce three separate financial statements (NAMMA, NEFMA, and NETMA) were implemented.

4.5 In conclusion, there are different ways that the ERP system purchased by the IS can be set up to support the requirement to produce multiple financial statements. Separate ‘ledgers’ are used by the IMS and separate ‘operating units’ and ‘balancing segments’ (same number of ‘balancing segments’ as financial statements) are used by NETMA. ACO, which is only required to present one consolidated set of financial statements and has a central treasury, implemented separate ‘operating units’ for each of its sub-commands to ensure the proper segregation of data.

## 5. IS REMEDIAL ACTIONS TAKEN

5.1 Since August 2016, the IS has performed certain remedial actions. Related to payments, it has grouped the 71 funds into 24 pay groups with the intention to prevent users from performing erroneous cross-financial statement bookings. A similar grouping has recently been put in place for revenues and receivables. However, there is still no similar control for other account areas.

5.2 In addition, the IS has employed consultants to research and recommend accounting corrections and to help produce the 2015 and 2016 financial statements.

## 6. CONCLUSION

6.1 In the Board’s opinion the IS did not implement an efficient and effective ERP structure given the financial reporting requirement to prepare 9 separate financial statements. The IS uses 71 different funds as the ‘balancing segment’ in the chart of accounts and not separate operating units. In the Board’s view, this is not an appropriate solution to support the preparation of the 9 separate financial statements.

6.2 The appropriate solution, in the Board’s view, would have been to have either separate ‘ledgers’ or ‘operating units’ for each separate financial statement. The use of 71 balancing segments increases risk and reduces the effectiveness to be gained from the system.

6.3 The implemented structure did not properly prevent the booking in 2015 and 2016 of a very high number of incorrect cross-financial statement postings between the different financial statements.[5] The Board believes that the IS's implementation of the ERP significantly contributed to the inability to produce timely and accurate financial statements and will likely continue to present challenges in the future. In addition, the ERP required additional IT programming and the implementation of additional internal controls. Significant weaknesses in internal control, identified and communicated to the IS (IBA-A(2016)45) during the Board's interim audit, further increases the challenges to produce timely and accurate financial statements.

6.4 The implementing consultants were not significantly involved once the system went live, which was a further complication. In addition, the Board found that the IS did not appear to have made use of the lessons learned by other NATO bodies that had successfully implemented similar ERP systems from the same software provider. These factors played a role in coming to a solution that, in the Board's view, does not best support the production of multiple financial statements in a timely and efficient manner and that minimises the risks of misstatements.

[5] For example, it is possible to book an MSIAC payment against an IS bank account and vice versa. This leads to under and overstatements of cash balances in different financial statements. In addition, there were 8,720 instances of intercompany postings in 2015 and for 2016 until mid-October there were 3,890 lines. Furthermore, such a large number of accounting journals, and the subsequent corrective actions, pose significant risks. The risks relate to the integrity of the data and transparency i.e. whether all the corrections are capable of being traced and understood. This poses a significant risk to the accuracy of the financial statements. Risks also exist that the data could be manipulated without detection when so many corrections need to be made.

# INTERNATIONAL STAFF FORMAL COMMENTS ON THE LETTER OF OBSERVATIONS AND RECOMMENDATIONS AND THE INTERNATIONAL BOARD OF AUDITORS (BOARD) POSITIONS

## OBSERVATION 2.1: OVERSTATEMENT OF CASH BALANCES

***Comment of the International Staff***

*The recommendation is agreed.*

*The IBAN findings concern the formal disclosure in the financial statements and the reconciliation with bank statements.*

*Concerning disclosure, it must be noted that among the entities/funds included in the scope of the IS Financial Statements, some share the same EUR bank account (Partners' Accommodation, some of the elements grouped under "Trust Fund" and the Refurbishment of Building Z). The "accounting correction" to which IBAN refers in the amount of EUR 1,387,214.62 is an elimination, as presented at Note 32 of the financial statements. The intent was to neutralise, in presentation terms, the effect of these entities "borrowing" cash from the IS. No entry was made in the ERP. We understand that this presentation may have been confusing and the IS will reconsider this presentation.*

*Concerning reconciliation with bank statements, it must be noted that during 2015 and part of 2016, manual errors were made in selecting the bank account from which payments were made, resulting in some payments being made using the IS bank account rather than the one of the entity concerned. These situations were recorded in a specific account (Inter Company Balancing Account). As a consequence, the comparison with the bank statements should be made by taking into account these cross-fund transactions too (EUR 3,928,616.36) and the situation of the consolidated entities using the same bank accounts as the IS (EUR 1,387,214.62). This left a difference of EUR 334,784.33 corresponding to transactions with non-IS entities that remain to be regularised.*

## OBSERVATION 2.2: ERRORS IN THE CASH FLOW STATEMENT

***Comment of the International Staff***

*The recommendation is agreed.*

*The difference appearing in the cash flow statement is due to the fact that the amounts corresponding to the Inter Company Balancing Account (499991) were not taken into consideration. This balancing account represents the transactions made between entities and therefore, end 2015, it accounted, in the IS accounts, for the transactions that were erroneously made by other non-IS entities in using* *the IS bank account. If this account is taken into consideration, the figures match. This presentation has been corrected in the 2016 financial statements in the column concerning 2015.*

**OBSERVATION 2.3:**
**INABILITY TO RECONCILE EXPENSES IN THE BUDGET EXECUTION STATEMENT TO EXPENSES IN THE STATEMENT OF FINANCIAL PERFORMANCE**

***Comment of the International Staff***

*The recommendation is agreed.*

**OBSERVATION 2.4:**
**INCONSISTENT DISCLOSURE OF AN ACCUMULATED SURPLUS**

***Comment of the International Staff***

*The recommendation is agreed. The IS will present in a more consistent manner the surplus which in practice mainly relates to the activities under Partners Accommodation, which are not subject to the standard budget execution context where non-exchange revenue is matched to expenses.*

**OBSERVATION 2.5:**
**LACK OF ASSURANCE ON PROPER CUT-OFF OF EXPENSES**

***Comment of the International Staff***

*The recommendation is noted. The statement of internal control indicated that the cut-off between 2015 and 2016 could not be considered as reliable. This is mainly due to receipting issues where services or goods received in 2015 were erroneously entered as received in 2016 by the budget holders. 2015 was the first year of the ERP and both OFC and line Division staff were confronted with the change linked to the recording of accruals (through either system borne receipts or manual accrual journals). From a budget execution perspective this may have impacted the breakdown between encumbrances and actuals, and as a consequence lapses that would have normally occurred in 2015, occurred in 2016. At the end of 2016 a process was in place to better identify the accruals. But we believe that retrieving the information in order to satisfy IBAN's request to identify which expenses recognized in 2016 should have been in reality accrued in 2015 would be extremely difficult and costly to attain. Restating the accruals as of end 2015 would require a considerable level of time and resources, both in OFC and in front line Divisions (who hold the specific information concerning reception of goods and services) to gather the information needed since it would require going through all PR/PO lines. In the end the benefit may not be worth the effort.*

**OBSERVATION 2.6:**
**NO FOREIGN EXCHANGE RATE REVALUATION OF MONETARY ASSETS AND LIABILITIES AT YEAR-END**

***Comment of the International Staff***

*The recommendation is agreed.*

**OBSERVATION 2.7:**
**DISCREPANCY BETWEEN INVENTORY PRESENTED IN FINANCIAL STATEMENTS AND DISCLOSED IN NOTES**

***Comment of the International Staff***

*The recommendation is agreed.*

**OBSERVATION 3:**
**IMPLEMENTATION OF THE NEW NEW ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM AND ITS EFFECT ON THE FINANCIAL STATEMENTS**

***Comment of the International Staff***

*Choosing the appropriate organization model of this software is a complex and critical matter that requires extensive analysis and multiple design workshops in order to make sure that the functional system architecture will allow the organization meeting its objectives and supporting its mission as intended.*

*The IS agrees that difficulties encountered after go-live and in particular concerning the posting of bank transactions have negatively impacted the production of timely and accurate financial statements. But the "ERP structure" was not the only factor. It should first be noted, that for a variety of reasons, essentially lack of resources, the IS OFC has not been in a position over the last ten years to issue all financial statements in accordance with the NFR deadlines. The ERP went live on 19 January 2015, a date that was fixed in May 2013 and never changed thereafter – delivery met the projected timing. After the go-live of the ERP, other elements played a substantial role in these delays such as staffing levels, vacancy of key positions (e.g. Head Accountant and Head of Competency Centre), important turn-over of staff, simultaneous implementation of other pieces of software (travel liquidations) and change management. Please note that the timelines of the production of the 2016 financial statements have significantly improved. The IS financial statements, for instance, were issued on 11 April 2017. Although this is still not compliant with the new NFR, it is nevertheless the earliest date over the last ten years (the same for the Defined Benefit Pension Scheme issued on 31 March 2017).*

*In implementing the ERP, the IS relied, as explained in the Annex, on the advice of experienced implementers (Diamond Partner status) who recommended the* *structure that was put in place. Whilst, the IS can agree that from a financial reporting perspective, different ERP setups were possible and may have been more reporting oriented (in particular separate Operating Units), it notes that the purposes for having an ERP are not limited to financial reporting which we accept is naturally IBAN's main focus.*

*While it could be claimed that the use of different setup parameters might have facilitated the generation of separate financial statements, this could also have required significant additional implementation and support costs and jeopardised other project and business objectives such as the timely implementation of the system, the use of shared services across the organization, the implementation of uniform and streamlined business processes, and the reduction of the system administration and operation effort.*

*Therefore the IS cannot agree that the ERP software organization model implemented by the IS was not appropriate. The IS believes that the choice was based on sound decisions and professional advice and that it can derive the benefits from the current setup.*

*Therefore, any assessment of the IS ERP implementation should not focus solely on the requirement to produce a given number of separate Financial Statements but should also consider relevant constraints and all the other project objectives and business requirements.*

**Board's position**

This Board position also relates to the more detailed comments made by the IS on ERP implementation that are outlined in Annex 6. In addition, Annex 6 contains further Board positions on the more detailed IS comments.

The Board notes that its recommendation that an external independent assessment be made of the ERP implementation is neither agreed or not by the IS in its formal comments above. However, the IS do comment that any assessment of the ERP implementation should not only focus on the production of financial statements but also consider other project objectives and business requirements.

The Board recognises that the purposes of an ERP system are not limited to financial reporting. However, in the Board's opinion, given the regulatory requirement to produce financial statements, the problems encountered with the IS 2015 financial statements and the weaknesses found, such an assessment should focus specifically on the ERP implementation as regards to the production of multiple financial statements.

## OBSERVATION 4.1: LACK OF BASIC ACCOUNTING RECONCILIATIONS, INCLUDING CASH

***Comment of the International Staff***

*The recommendation is agreed.*

## OBSERVATION 4.2: INSUFFICIENT LEVEL OF CONTROLS OVER BUDGET EXECUTION

***Comment of the International Staff***

*The recommendation is understood.*

*The AFF strings used during budget upload are in certain cases too generic and cannot be used directly for transaction entry in ERP. This indeed requires the OFC Competency Centre to introduce a large volume of AFF combinations from which finance and accounting transactions can effectively be done. The point that IBAN is addressing has to do with the different levels of granularity required on one side, when preparing, submitting, and on the other when executing the budget.*

*The accounting strings used by each software are compatible. The purpose of this approach was to allow funds control at a higher level than that of the level of credit lines (there are several thousand budget lines in the Civil Budget upload) still in compliance with NFR.*

*The IS agrees that some streamlining could be achieved in the exchange of information between both software.*

*It is also to be noted that these facts only apply to the IS budget and not to the other entities managed by the IS OFC.*

**Board's position**

The Board was not able to audit the budget execution statements in the IS 2015 financial statements for the reasons outlined in Annex 3, section 2.3. The Board will revisit the issue of controls over budget execution as part of its audit of the IS 2016 financial statements.

**OBSERVATION 4.3:**
**CARRY FORWARD OF COMMITMENTS BASED ON PURCHASE REQUISITIONS INCREASES THE RISK OF NON-COMPLIANCE AND OF MISSTATEMENT**

***Comment of the International Staff***

*The recommendation is agreed.*

*The new Financial Regulations have reinforced the link between the commitment of appropriations and the existence of a legal obligation. They have also reinforced the principle of annual budgets. OFC believes that these changes in themselves justify revisiting the current set-up for the management of programme related transactions. Lessons have also been learned during the first years of use of the ERP in general and of this specific configuration for Programme transactions in particular. In addition, it must be noted that this specific set up was based on a thorough analysis conducted in 2013 when the situation was different than today: new NFRs have been introduced since then and the practical aspects of the management of key programmes have changed since the design analysis was done. Some of these Programme processes have changed and OFC believes that a large number of programme expenses could follow a process very close to the standard PO process for commercial purchases.*

**OBSERVATION 4.4:**
**MATCHING INVOICES TO PURCHASE ORDERS AND THE DELIVERY OF GOODS AND SERVICES**

***Comment of the International Staff***

*The recommendation is agreed.*

**OBSERVATION 4.5:**
**TRAVEL INVOICES AND POs CAN BE MODIFIED AND PROCESSED WITHOUT AUTHORISATION**

***Comment of the International Staff***

*The recommendation is agreed. Two change requests have been implemented in July and December 2016, one whereby purchase documents with the procurement nature 'Travel' be subject to approval and another for interfaced travel invoices which, if altered in ERP, also be subject to formal approval.*

**OBSERVATION 4.6:**
**INCOMPLETE TOLERANCE LIMITS AND LIMITS SET TOO HIGH**

***Comment of the International Staff***

*The recommendation is agreed. The tolerance for 'NATO Travel' has been set to 0.5%, aligned with amount- and quantity based lines.*

**OBSERVATION 4.7:**
**CONTROLS OVER PAYMENT FILES SENT TO THE BANK NEED STRENGTHENING**

***Comment of the International Staff***

*The recommendation is agreed. A change has been installed on 20 December 2016 to introduce a functionality similar to that used by ACO/NCIA.*

**OBSERVATION 5.1:**
**LACK OF PROCESS DOCUMENTATION RELATING TO ACCESS MANAGEMENT AND JOB DESCRIPTIONS**

***Comment of the International Staff***

*There is and was a process in place to manage user access but we agree that the procedure should be better documented.*

*The job descriptions for staff working in the CC have been updated and approved by HR to clarify their roles and responsibilities.*

**OBSERVATION 5.2:**
**LACK OF PERIODIC REVIEW OF USER ACCESS RIGHTS**

***Comment of the International Staff***

*The Recommendation is agreed and OFC is considering the best approach, in terms of access end date, for staff who are on indefinite duration contracts.*

**OBSERVATION 5.3:**
**THE USE OF THE ‘SWITCH USER’ FUNCTION NEEDS TO BE MONITORED**

***Comment of the International Staff***

*In the current setup, the Worklist Access function (“Switch User”) provides access to the notification in-box only. It does not include the possibility to enter data into the system, neither to modify the data. This is a standard functionality of the ERP system which is only related to the management of approvals and is used only by those approvers who have set up the corresponding delegation rules to other approvers allowing them to process approvals on their behalf in situations of non-*

*availability when the timely approval of an ERP transaction is critical from an operational standpoint, e.g. unexpected absence of the approver, approver inability to access the system to perform the approval of all transactions for legitimate business or operational reasons (heavy workload, participation in meetings, etc.). Accountability remains with the individual who granted the delegation.*

*In the way it has been used by OFC, the Worklist Access function has only been used among people to whom the authority to approve transactions can be delegated in accordance with the NFRs. The approvers in the set-up of the IS ERP can only approve, reject or request information concerning the transactions submitted to them. They cannot modify the latter. Therefore, the risk is that a staff member, with the delegated authority to do so, would approve a transaction that another would have rejected.*

*Staff, when making use of the Worklist Access function have been instructed to put in the "Note Box", that appears with each transaction, that they are the one who has approved/rejected a transaction.*

**Board's position**

The Board notes that a control has been put in place by the use of the 'Note Box' to indicate that approvals have been delegated. The Board reiterates its recommendation that the use of the 'switch user' function be controlled and monitored e.g. by a periodic report that shows who has used it and when it was used.

**OBSERVATION 5.4:**
**PERMANENT ACCESS TO THE NEW NEW ENTERPRISE RESOURCE PLANNING (ERP) PRODUCTION ENVIRONMENT GIVEN TO AN IT CONSULTANT**

***Comment of the International Staff***

*In the future, the IS will indeed put time limitations on access to the production environment*.

**OBSERVATION 5.5:**
**NO FORMAL DOCUMENTATION OF CHANGE CONTROL BOARD DECISIONS**

***Comment of the International Staff***

*Agreed. The extensive excel chart was considered to provide sufficient information concerning the changes that had been agreed or disagreed, the substance of which will now be also in the Minutes.*

# INTERNATIONAL STAFF FORMAL COMMENTS ON ANNEX 4 OF THE LETTER OF OBSERVATIONS AND RECOMMENDATIONS AND THE INTERNATIONAL BOARD OF AUDITORS (BOARD) POSITIONS

## IMPLEMENTATION OF THE ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM IN THE INTERNATIONAL STAFF

### OBSERVATION 2: STANDARD STRUCTURES FOR PRODUCING MULTIPLE FINANCIAL STATEMENTS

***Comment of the International Staff***

*In its description of Ledgers and Operating Units, the report uses the term "data" in a way that would give the impression that the data is all of one kind, which is incorrect and can lead to confusion. In the ERP software a distinction is made between sub ledger transactions (e.g. Accounts Payable, Accounts Receivable) and general ledger data. Sub ledger transactions are specific to the operating unit while general ledger data is assigned to a ledger. Sub ledger transactions feed the general ledger data. Therefore, different types of data are segregated by Operating Units and Ledgers.*

*The following sentence of the report: "Within a ledger, part of the chart of accounts can be nominated as a 'balancing segment'" gives the impression that the balancing segment is an option. In reality, one segment of the accounting flex field has to be qualified as a balancing segment, since it defines the level at which transactions balance. The balancing segment is therefore critical when it comes to producing financial statements.*

*There is no evidence provided in the report to support the statement that the balancing segment values provide the least level of data segregation. As indicated above defining a balancing segment is not an option. The Balancing Segment and the Organisation Structure components serve relatively different purposes; decisions concerning them cannot be taken independently; therefore we do not understand the comparison that the report. Balancing Segment Values assigned to the balancing segment of the accounting flex field is a possible way to segregate data in ERP software. The IS ERP shares the same ledger for all entities, which demonstrates that the balancing segment is a rather strong element in segregating data in the general ledger. The balancing segment is used not only by IS but also by BICES to produce financial reporting, all based on the same ledger data.*

*The accounting flex field definition and the linked elements, such as the balancing segment values, are part of the standard configuration of the ERP software - no programming is required for those configuration items.*

**OBSERVATION 3:**
**THE IMPLEMENTED STRUCTURE IN THE IS**
**Paragraph 3.1**

***Comment of the International Staff***

*Throughout its report IBAN refers to a number (71) of balancing segments, when in reality the IS decided to select the "fund" segment, and therefore there is only one balancing segment. The report confuses this with the number of values of such balancing segment, which is a different issue.*

*The rationale behind this decision is the following:*

*The IS decided to set the balancing segment at the level of the Fund, i.e. that of entities or activities differentiated from the others because of (a) their degree of financial autonomy, which prevents involuntary budgetary support (e.g. cross funding) or treasury support (e.g. sharing of cash) (for instance, for the New HQ, distinguish between Nationally Funded and Common Funded components), (b) their specific governance (e.g. Budget Committee, Steering Committee for FORACS and MSIAC, Lead Nations for Trust Funds), (c) their specific funding source (Nations contributions vs. prices charged to users), (d) their specific reporting requirements (for instance, the numerous Trust Funds or equivalent which tend to have ad hoc and sometimes evolving requirements), etc.. Hence their transactions need to be separated from the others.*

*This resulted in the number of 71 different fund values, the vast majority (46) being Extra Budgetary Funds such as Trust Funds or equivalents which are eventually consolidated in the IS financial statements. At that time it was considered by the IS that the easiest way to provide specific reporting requirements for each of these entities was to set the balancing level at the Fund level because of the ability to generate financial statements (financial performance and situation statements) for each of them. Similarly, setting the balancing segment at the fund level for entities which share the same bank account as the IS (e.g. Partner's Accommodation) enables one also to see whether or not the entity generates positive cash flows or on the contrary profits from the IS's treasury. In cases such as the Refurbishment of Building Z, where nations agreed that it could be pre-financed using IS's cash, the balancing segment at fund level allows to assess the level of such pre-financing.*

*This approach is linked, with the fact that, historically, the previous accounting system was set up in such a way that each separate entity had its own bank account.*

*Footnote 2 states that having 2 different legal entities defined in the ERP software, is the result of a decision by BICES taken in order to avoid cross-bookings with other non-BICES entities. IS OFC cannot confirm this as a fact since it concerns BICES. However, it has to be noted, as indicated before, that*

*Legal Entities do not administer access to sub ledger data, so the reasoning behind IBAN's statement is unclear. This situation did not prevent issues from arising, as illustrated by the case of a NATO IS invoice paid from a BICES bank account in August 2015. In addition, BICES represents about 2% of the overall volume of transactions, and therefore the issue of putting in place different organisation models in the ERP for such cases can only be accurately assessed if it also encompasses a cost benefit analysis.*

*It has to be noted that with the current setup it is not possible to book in a given entity or fund an expense, revenue, or GL entry belonging to another entity. The ERP Fund value is specific for each of these entities. This is precisely where the choice of the Balancing Segment at Fund level plays a role and prevents these confusions from happening. In this respect the drafting of "Risks to such a set-up include accounting problems relating to one accounting entity misposting transactions to another accounting entity" is not correct and misleading since it refers to all transactions which is not the case. The IS agrees that there is a risk that the wrong bank account might be selected and it has put in place remedial measures to counter that (see below). It does not agree that transaction mispostings, at large (e.g. expenses, revenues, commitments), could happen between separate reporting entities.*

**Board's position**

The Board stated in the conclusion to Annex 4 that the "IS uses 71 different funds as the 'balancing segment'". We know that the balancing segment is one field in the accounting flexfield. This terminology clarification offered by the IS in respect to balancing segments does not impact our analysis or conclusions.

The IS also commented that it does not agree that transaction mispostings at large could happen between the separate reporting entities. The Board cannot comment on this as it was unable to carry out a full audit of the IS 2105 financial statements. This risk will be assessed as part of its audit of the IS 2016 financial statements.

**OBSERVATION 3:**
**THE IMPLEMENTED STRUCTURE IN THE IS**
**Paragraph 3.2**

***Comment of the International Staff***

*IBAN refers to a number (71) of balancing segments, when in reality the IS decided to make use of the "fund" segment, and therefore there is only one balancing segment. The report confuses this with the number of values of the balancing segment, which is a different issue. Therefore the sentence "using so many balancing segments complicates the ERP system" is not accurate.*

*The setup of the system was the result of a thorough requirement validation and design process conducted by the firm responsible for system implementation. This firm is a reputed, world-class audit and accounting firm and one of the few companies in the world that holds a Diamond partner status for this software. As shown in the system documentation, this firm was fully aware of the reporting needs of the Organization and more particularly of the requirement to produce 9 separate financial statements. Considering these and other business needs, the referred firm recommended that the IS put in place only one Operating Unit. The implementing firm's report related to this aspect states that "Multiple Operating Units increase the maintenance of vendors, customers, banks, and other supporting information. They increase complexity as users need to understand where to enter each Operating Unit's information". It also stated that this "can detract from some of the benefits of the ERP" (Document: "Constellation Multi-Org Structure Overview" p.6). The IS followed this advice.*

**OBSERVATION 3:**
**THE IMPLEMENTED STRUCTURE IN THE IS**
**Paragraph 3.3**

***Comment of the International Staff***

*The budget system used by Executive Management is part of the ERP.*

*The accounting strings used by each software are compatible. The purpose of this approach was to allow funds control at a higher level than that of the level of credit lines (there are several thousand budget lines in the Civil Budget upload) still in compliance with NFR.*

*The IS agrees that some streamlining could be achieved in the exchange of information between both software.*

## OBSERVATION 4:
## IMPLEMENTATION OF SIMILAR SYSTEMS AT OTHER NATO ENTITIES

***Comment of the International Staff***

*The comparison made in this section should be taken as a comparison and illustration of different ways of doing, not as a demonstration that the IS should have done differently than it did. The entities to which IBAN refers are in situations that are different from that of the IS and which may have justified the choices they made, or certainly have been taken into consideration, other than the issue of the number of financial statements, such as: multiple geographical location of the business and financial management teams (where the IS is exclusively located in Brussels), hence different chains of command (where the IS has only one Office of Financial Control for all of the entities for which it has to issue financial statements), different master data, if not different reporting currencies.*

*The factors that determine the high-level architecture implemented in the IS ERP software depend not only on the number of financial statements to be produced but also on many other parameters such as organizational and geographical characteristics (e.g., separate operational structure and approval hierarchies vs. fully integrated operation in the same location with the same approval hierarchy), the specific chart of accounts and accounting strategies (e.g., functional currency, use of funds accounting controls, etc.) and the specific business requirements and objectives to be supported by the system (e.g., streamlining of business processes; reduction of administrative, operational, or support effort; consolidation of procurement activities; management reporting requirements; compliance with project constraints; etc.).*

*Choosing the appropriate organization model of this software is a complex and critical matter that requires extensive analysis and multiple design workshops in order to make sure that the functional system architecture will allow the organization meeting its objectives and supporting its mission as intended. This is certainly something that was seriously addressed by the IS during the system design phase with the support of the implementation contractor and involving staff with significant experience in other NATO implementations.*

*Therefore, although the IS agrees with IBAN's statement that "In conclusion, there are different ways that the ERP system purchased by the IS can be set up to support the requirement to produce multiple financial statements." It disagrees with the use of the high-level comparison to infer that the ERP software organization model implemented by the IS was not appropriate (as stated in Section 6 of Annex 1) or that lessons learned from other NATO implementations were not considered in the implementation process (last sentence in paragraph 4.1 of Annex 1).*

## OBSERVATION 5:
## IS REMEDIAL ACTIONS TAKEN

***Comment of the International Staff***

*The "remedial actions" to which IBAN refers are changes put in place to solve the main issues encountered, namely the risk of a human error by which the wrong bank account is used to effect a payment.*

*The change to which the report refers was installed on 23 August 2016 and activated shortly after. This solution comprises the grouping, for payment purposes, of balancing segment values (funds) into fund groups and a redesign of the pay groups. This was done in order to replace the manual controls by automatic controls during payment of Accounts Payable invoices, thereby reducing the number and impact of human errors.*

*Therefore the part of sentence "to prevent users from performing erroneous cross-financial statement bookings" is confusing since it implies that it is possible for the ERP system to mix any kind of transactions: this is not the case and the IBAN report does not give any example or demonstrate that this could be the case. The system did indeed allow for human error concerning bank transactions, and this is the main issue the IS had and has dealt with. But the system has always prevented other kind of transactions, such as expense and revenue, of one entity from being recorded/mixed with those of another entity.*

*Concerning "However, there is still no similar control for other account areas." The drafting implies that in IBAN's view other account areas should have similar controls. However these are not identified in the report. The IS believes that the current automatic controls put in place are adequate and effective.*

**Board's position**

The IS states that the current automatic controls put in place are adequate and effective. The Board cannot comment further as it was unable to carry out a full audit of the IS 2105 financial statements. This risk will be assessed as part of its audit of the IS 2016 financial statements.

**OBSERVATION 6:**
**CONCLUSION**

***Comment of the International Staff***

*We understand that the term “ERP structure” refers to the specific setup of ledgers, accounting flex fields, operating units, legal entities and other significant parameters of the system. This meaning is so broad that it is not possible to properly assess the findings stated in paragraphs 3.2 and 3.3 above since there is no concrete data or information relating to cause-effect relationships between specific setup parameters and the presence of an unspecified number of incorrect postings which might have been caused by other factors or circumstances (e.g. human error or inappropriate accounting processes or practices).*

*It should also be noted that it is precisely because the balancing segment was set at the level it was (i.e. that of the fund segment, in the series of segments that identify the transactions) that it was possible to identify such bank account mispostings. Even creating separate Operating Unit, one for each financial statement, it would still be possible to make such bank mispostings and it would be more difficult to identify them.*

*Choosing the appropriate organization model of this software is a complex and critical matter that requires extensive analysis and multiple design workshops in order to make sure that the functional system architecture will allow the organization meeting its objectives and supporting its mission as intended. This is certainly something that was seriously addressed by the IS during the system design phase with the support of the implementation contractor and involving staff with significant experience in other NATO implementations.*

*The IS agrees that difficulties encountered after go-live and in particular concerning the posting of bank transactions have negatively impacted the production of timely and accurate financial statements. But the IS does not agree that this was the only factor. It should first be noted, that for a variety of reasons, essentially of resources, the IS OFC has not been in a position over the last ten years to issue all financial statements in accordance with the NFR deadlines. The ERP went live on 19 January 2015, a date that was fixed in May 2013 and never changed thereafter - delivery met the projected timing. After the go-live of the ERP, other elements played a substantial role in these delays such as staffing levels, vacancy of key positions (e.g. Head Accountant and Head of Competency Centre), important turn-over of staff, simultaneous implementation of other pieces of software (travel liquidations) and change management. Please note that timelines of the production of the 2016 financial statements have significantly improved. The IS financial statements, for instance, were issued on 11 April 2017. Although this is still not compliant with the new NFR, it is nevertheless the earliest date over the last ten years (the same for the Defined Benefit Pension Scheme issued on 31 March 2017).*

*In implementing the ERP, the IS relied, as explained above, on the advice of experienced implementers (Diamond Partner Status) who recommended the structure that was put in place.*

*Whilst, the IS can agree that from a financial reporting perspective, different ERP setups were possible and may have been more reporting oriented (in particular separate Operating Units), it notes that the purposes for having an ERP are not limited to financial reporting which we accept is naturally IBAN's main focus.*

*Among expected ERP benefits are: standardisation of processes irrespective of the entity served, use of professional best practices, improved segregation of duties and related internal organisation, alignment of the OFC structure with business processes, dismantling of old home-grown software, reduction of paper flows etc. Alternative setups were, of course, possible but would have created their own issues elsewhere. Therefore the IS cannot agree that the ERP software organization model implemented by the IS was not appropriate. The IS believes it can derive the benefits from the current setup.*

**Board's position**

There is a clear regulatory requirement for the separate financial reporting of these 9 financial statements to ensure transparency, accountability and effective governance. As a result, the Board believes that an ERP structure should have been chosen that was more oriented to this reporting requirement. In their formal comment, the IS referred particularly to separate Operating Units as being a structure that may have been more reporting oriented. This is consistent with the Board's view that separate Operating Units ensure data integrity and segregation.

# INTERNATIONAL STAFF

## FINANCIAL STATEMENTS AS AT 31 DECEMBER 2015

**ANNEXES :**

1 Statement of financial position

2 Statement of financial performance

3 Cash flow statement

4 Budgetary Execution Statements

5 Explanatory notes to the financial statements

Jens STOLTENBERG
Secretary General

Stephane CHAGNOT
Financial Controller

ANNEX 1 to
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# INTERNATIONAL STAFF
## Statement of financial position

As at 31 December 2015
(All amounts in EUR)

| | Notes | 2015 | 2014 |
|---|---|---|---|
| **Assets** | | | |
| ***Current assets*** | | | |
| Cash and cash equivalents | 3 | 84,673,866.41 | 77,345,530.70 |
| Short term investments | 4 | 0.00 | |
| Receivables | 5 | 60,960,882.07 | 43,121,081.80 |
| Prepayments | 6 | 2,362,809.48 | 3,908,080.84 |
| Other current assets | 7 | 1,712,598.60 | |
| Inventories | 8 | 10,645.03 | 862,183.77 |
| | | **149,720,801.59** | **125,236,877.11** |
| ***Non-current assets*** | | | |
| Receivables | 9 | 0.00 | |
| Property, plant & equipment | 10 | 833,390.49 | 1,277,583.80 |
| Intangible assets | 11 | 16,072,319.51 | 14,498,137.57 |
| Other non-current assets | 12 | 12,095.75 | |
| | | **16,917,805.75** | **15,775,721.37** |
| **Total assets** | | **166,638,607.34** | **141,012,598.48** |
| **Liabilities** | | | |
| ***Current liabilities*** | | | |
| Payables | 13 | -9,752,346.10 | -28,965,507.32 |
| Deferred revenue | 14 | -73,951,577.45 | -45,530,170.78 |
| Lapsed Credits | 15 | -5,328,722.00 | -5,031,199.01 |
| Advances | 16 | -46,600,000.00 | -45,710,000.00 |
| Voluntary advance Member Nations | 16 | -4,499,794.87 | |
| Short term provisions | 17 | 0.00 | |
| Other current liabilities | 18 | -6,431,569.66 | |
| | | **-146,564,010.08** | **-125,236,877.11** |
| ***Non-current liabilities*** | | | |
| Payables | 19 | 0.00 | |
| Long term provisions | 20 | 0.00 | |
| Deferred revenue | 21 | -16,767,326.32 | -15,775,721.37 |
| Other non-current liabilities | 22 | -675,626.60 | |
| | | **-17,442,952.92** | **-15,775,721.37** |
| **Total liabilities** | | **-164,006,963.00** | **-141,012,598.48** |
| **Net assets** | | | |
| Capital assets | 23 | 0.00 | |
| Reserves | 23 | 0.00 | |
| Accumulated surpluses/ (deficits) | 23 | -2,635,200.04 | |
| **Total net assets/ equity** | | **-2,635,200.04** | **0.00** |

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# INTERNATIONAL STAFF
## Statement of financial performance

for the year ended 31 December 2015
(All amounts in EUR)

| | Notes | 2015 | 2014 |
|---|---|---|---|
| **Revenue** | | | |
| Non exchange revenue | 24 | -200,800,300.88 | -171,489,524.00 |
| Exchange revenue | 25 | -514,469.22 | -14,422,062.52 |
| Other revenue | 26 | -488,843.60 | -648,497.00 |
| Financial revenue | 27 | -144,758.09 | -216,804.01 |
| **Total revenue** | | **-201,948,371.79** | **-186,776,887.53** |
| **Expenses** | | | |
| Personnel | 28 | 112,977,948.23 | 116,350,070.12 |
| Contractual supplies and services | 28 | 86,035,747.87 | 68,684,526.91 |
| Depreciation and amortization | 28 | 754,482.64 | 648,497.00 |
| Impairment | 28 | 0.00 | 0.00 |
| Provisions | 28 | 0.00 | |
| Other expenses | 28 | 2,105,405.39 | 773,663.37 |
| Finance costs | 28 | 74,787.66 | 170,734.09 |
| **Total expenses** | | **201,948,371.79** | **186,627,491.49** |
| **Surplus/(Deficit) for the period** | 29 | **0.00** | **-149,396.04** |

ANNEX 3 to
FC(2016)190

# INTERNATIONAL STAFF
## Statement of cash flow

for the year ended 31 December 2015
(All amounts in EUR)

| | Notes | 2015 |
|---|---|---|
| **Cash flow from operating activities** | **30** | **(7,548,226.78)** |
| Surplus/(Deficit) | | 2,635,200.04 |
| **Non-cash movements** | | **2,635,200.04** |
| Depreciation/ Amortisation | | (902,370.71) |
| Impairment | | |
| Increase /(decrease) in payables | | (19,213,161.22) |
| Increase/ (decrease) in other current liabilities | | 27,549,929.11 |
| Increase/ (decrease) in provisions | | |
| (Gains)/losses on sale of property, plant and equipment | | (345,100.00) |
| Increase/ (decrease) in other current assets | | 567,076.27 |
| Decrease/ (Increase) in receivables | | (17,839,800.27) |
| Increase/ (decrease) in other non-current assets | | |
| **Net cash flow from operating activities** | | **(10,183,426.82)** |
| | | |
| **Cash flow from investing activities** | | |
| Purchase of property plant and equipment / Intangible assets | | 2,229,470.59 |
| Proceeds from sale of property plant and equipment | | |
| **Net cash flow from investing activities** | | **2,229,470.59** |
| | | |
| **Cash flow from financing activities** | | **(69,970.43)** |
| | | |
| **Net cash flow from financing activities** | | |
| | | |
| **Net increase/(decrease) in cash and cash equivalents** | | **(5,388,726.62)** |
| | | |
| **Cash and cash equivalent at the beginning of the period** | | 64,631,098.86 |
| **Cash and cash equivalent at the end of the period** | | 70,016,269.78 |

# INTERNATIONAL STAFF
## Statement of Budget Execution as at 31 December 2015

| (amounts in euro) | Initial budget | Unfreeze | BA2 | Transfers | Revised Budget | Transfers | Final budget | Commitments | Expenses | Total spent | Carry forward | Lapsed |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | 119,743,761.00 | 38,000.00 | 119,781,761.00 | (1,268,944.00) | 118,512,817.00 | 1,400,000.00 | 119,912,817.00 | 2,086,084.90 | 117,745,130.21 | 119,831,215.11 | 2,086,084.90 | 81,601.89 |
| Chapter 2 | 38,207,965.00 | - | 38,207,965.00 | 1,350,491.00 | 39,558,456.00 | (1,000,000.00) | 38,558,456.00 | 4,461,886.26 | 34,044,601.68 | 38,506,487.94 | 4,461,886.26 | 51,968.06 |
| Chapter 3 | 4,845,444.00 | - | 4,845,444.00 | 552,298.00 | 5,397,742.00 | - | 5,397,742.00 | 4,029,685.74 | 1,156,089.85 | 5,185,775.59 | 4,029,685.74 | 211,966.41 |
| Chapter 4 | 24,322,830.00 | - | 24,322,830.00 | (633,845.00) | 23,688,985.00 | (400,000.00) | 23,288,985.00 | 12,176,981.01 | 10,739,682.30 | 22,916,663.31 | 12,176,981.01 | 372,321.69 |
| **Total FY 2015** | **187,120,000.00** | **38,000.00** | **187,158,000.00** | - | **187,158,000.00** | - | **187,158,000.00** | **22,754,637.91** | **163,685,504.04** | **186,440,141.95** | **22,754,637.91** | **717,858.05** |
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | 3,340,084.02 | - | 3,340,084.02 | - | 3,340,084.02 | 110,000.00 | 3,450,084.02 | 1,192,133.18 | 2,252,084.38 | 3,444,217.56 | 1,192,133.18 | 5,866.46 |
| Chapter 2 | 7,751,479.52 | - | 7,751,479.52 | - | 7,751,479.52 | (110,000.00) | 7,641,479.52 | 429,142.52 | 4,608,949.37 | 5,038,091.89 | 429,142.52 | 2,603,387.63 |
| Chapter 3 | 7,680,918.41 | - | 7,680,918.41 | - | 7,680,918.41 | - | 7,680,918.41 | 4,722,890.77 | 2,729,748.52 | 7,452,639.29 | 4,722,890.77 | 228,279.12 |
| Chapter 4 | 14,832,131.57 | - | 14,832,131.57 | - | 14,832,131.57 | - | 14,832,131.57 | 4,252,379.69 | 9,915,389.37 | 14,167,769.06 | 4,252,379.69 | 664,362.51 |
| **Total FY 2014** | **33,604,613.52** | - | **33,604,613.52** | - | **33,604,613.52** | - | **33,604,613.52** | **10,596,546.16** | **19,506,171.64** | **30,102,717.80** | **10,596,546.16** | **3,501,895.72** |
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | 501,738.76 | - | 501,738.76 | - | 501,738.76 | - | 501,738.76 | 165,066.77 | 159,107.98 | 324,174.75 | 165,066.77 | 177,564.01 |
| Chapter 2 | 833,860.73 | - | 833,860.73 | - | 833,860.73 | (100,000.00) | 733,860.73 | 220,000.00 | 407,706.57 | 627,706.57 | 220,000.00 | 106,154.16 |
| Chapter 3 | 2,294,467.05 | - | 2,294,467.05 | - | 2,294,467.05 | 100,000.00 | 2,394,467.05 | 617,394.50 | 1,772,394.47 | 2,389,788.97 | 617,394.50 | 4,678.08 |
| Chapter 4 | 3,742,573.70 | - | 3,742,573.70 | - | 3,742,573.70 | | 3,742,573.70 | 203,611.27 | 3,115,704.81 | 3,319,316.08 | 203,611.27 | 423,257.62 |
| **Total FY 2013** | **7,372,640.24** | - | **7,372,640.24** | - | **7,372,640.24** | - | **7,372,640.24** | **1,206,072.54** | **5,454,913.83** | **6,660,986.37** | **1,206,072.54** | **711,653.87** |
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | 77,124.84 | - | 77,124.84 | - | 77,124.84 | - | 77,124.84 | 940.80 | 76,152.66 | 77,093.46 | 940.80 | 31.38 |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | 1,668,353.80 | - | 1,668,353.80 | - | 1,668,353.80 | - | 1,668,353.80 | 6,100.80 | 1,652,973.00 | 1,659,073.80 | 6,100.80 | 9,280.00 |
| Chapter 4 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2012** | **1,745,478.64** | - | **1,745,478.64** | - | **1,745,478.64** | - | **1,745,478.64** | **7,041.60** | **1,729,125.66** | **1,736,167.26** | **7,041.60** | **9,311.38** |
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | 19,937.28 | - | 19,937.28 | - | 19,937.28 | - | 19,937.28 | - | 18,996.48 | 18,996.48 | - | 940.80 |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | 2,093,038.66 | - | 2,093,038.66 | - | 2,093,038.66 | - | 2,093,038.66 | 1,015.98 | 2,077,656.88 | 2,078,672.86 | 1,015.98 | 14,365.80 |
| Chapter 4 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2011** | **2,112,975.94** | - | **2,112,975.94** | - | **2,112,975.94** | - | **2,112,975.94** | **1,015.98** | **2,096,653.36** | **2,097,669.34** | **1,015.98** | **15,306.60** |
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | 47,579.92 | - | 47,579.92 | - | 47,579.92 | - | 47,579.92 | - | 47,576.35 | 47,576.35 | - | 3.57 |
| Chapter 4 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2010** | **47,579.92** | - | **47,579.92** | - | **47,579.92** | - | **47,579.92** | - | **47,576.35** | **47,576.35** | - | **3.57** |
| | | | | | | | | | | - | | - |
| **CIVIL BUDGET** | | | | | | | | | | | | |
| Chapter 1 | 123,682,645.90 | 38,000.00 | 123,720,645.90 | (1,268,944.00) | 122,451,701.90 | 1,510,000.00 | 123,961,701.90 | 3,444,225.65 | 120,251,471.71 | 123,695,697.36 | 3,444,225.65 | 266,004.54 |
| Chapter 2 | 46,793,305.25 | - | 46,793,305.25 | 1,350,491.00 | 48,143,796.25 | (1,210,000.00) | 46,933,796.25 | 5,111,028.78 | 39,061,257.62 | 44,172,286.40 | 5,111,028.78 | 2,761,509.85 |
| Chapter 3 | 18,629,801.84 | - | 18,629,801.84 | 552,298.00 | 19,182,099.84 | 100,000.00 | 19,282,099.84 | 9,377,087.79 | 9,436,439.07 | 18,813,526.86 | 9,377,087.79 | 468,572.98 |
| Chapter 4 | 42,897,535.27 | - | 42,897,535.27 | (633,845.00) | 42,263,690.27 | (400,000.00) | 41,863,690.27 | 16,632,971.97 | 23,770,776.48 | 40,403,748.45 | 16,632,971.97 | 1,459,941.82 |
| **Total FY 2010** | **232,003,288.26** | **38,000.00** | **232,041,288.26** | - | **232,041,288.26** | - | **232,041,288.26** | **34,565,314.19** | **192,519,944.88** | **227,085,259.07** | **34,565,314.19** | **4,956,029.19** |

# INTERNATIONAL STAFF

## BUDGET EXECUTION STATEMENT: CIVIL BUDGET

(n = 2014) ( in EUR)

| CHAPTER | | BUDGET AUTHORISATIONS | | | COMMITMENTS | EXPENDITURES | BUDGETARY SURPLUS | |
|---|---|---|---|---|---|---|---|---|
| | | BUDGET INITIAL : BC-D(2013)0205-REV3 REV: BC-D(2014)0206 -REV1 | AUTHORIZED TRANSFERS | ADJUSTED CREDITS | | | Credits carried forward to n+1 | Lapsed credits |
| | | (1) | (2) | (3) = (1)+(2) | (4) | (5) | (6) = (4) - (5) | (7) = (3) - (4) |
| 1 | **PERSONNEL COSTS** | | | | | | | |
| | Financial year n | 117,634,626.02 | -5,183.25 | 117,629,442.77 | 116,659,528.62 | 113,572,651.37 | 3,086,877.25 | 969,914.15 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 3,933,428.42 | 0.00 | 3,933,428.42 | 3,553,573.25 | 3,014,536.09 | 539,037.16 | 379,855.17 |
| | Financial year n-2 | 949,904.90 | 0.00 | 949,904.90 | 684,848.26 | 608,664.22 | 76,184.04 | 265,056.64 |
| | Financial year n-3 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 122,517,959.34 | -5,183.25 | 122,512,776.09 | 120,897,950.13 | 117,195,851.68 | 3,702,098.45 | 1,614,825.96 |
| 2 | **OPERATING COSTS** | | | | | | | |
| | Financial year n | 33,004,757.67 | -46,764.94 | 32,957,992.73 | 32,330,091.38 | 26,269,848.04 | 6,060,243.34 | 627,901.35 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 1,801,875.55 | 0.00 | 1,801,875.55 | 1,434,877.16 | 1,329,033.06 | 105,844.10 | 366,998.39 |
| | Financial year n-2 | 100,668.79 | 0.00 | 100,668.79 | 8,953.55 | 6,953.55 | 2,000.00 | 91,715.24 |
| | Financial year n-3 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 34,907,302.01 | -46,764.94 | 34,860,537.07 | 33,773,922.09 | 27,605,834.65 | 6,168,087.44 | 1,086,614.98 |
| 3 | **CAPITAL COSTS** | | | | | | | |
| | Financial year n | 9,894,846.94 | 486,585.19 | 10,381,432.13 | 10,377,103.03 | 2,131,813.70 | 8,245,289.33 | 4,329.10 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 6,365,139.59 | 0.00 | 6,365,139.59 | 6,241,592.16 | 3,880,256.20 | 2,361,335.96 | 123,547.43 |
| | Financial year n-2 | 4,013,705.08 | 0.00 | 4,013,705.08 | 3,828,683.88 | 2,177,710.88 | 1,650,973.00 | 185,021.20 |
| | Financial year n-3 | 3,597,776.65 | 0.00 | 3,597,776.65 | 3,597,776.65 | 1,484,800.71 | 2,112,975.94 | 0.00 |
| | Financial year n-4 | 177,340.00 | 0.00 | 177,340.00 | 177,340.00 | 129,760.08 | 47,579.92 | 0.00 |
| | | 24,048,808.26 | 486,585.19 | 24,535,393.45 | 24,222,495.72 | 9,804,341.57 | 14,418,154.15 | 312,897.73 |
| 4 | **PROGRAMMES TOTAL** | | | | | | | |
| | Financial year n | 28,177,494.00 | -434,637.00 | 27,742,857.00 | 27,411,008.53 | 11,055,839.93 | 16,355,168.60 | 331,848.47 |
| | Carried forward: | | 0.00 | | | | | |
| | Financial year n-1 | 13,506,498.68 | 0.00 | 13,506,498.68 | 12,727,011.68 | 8,487,230.52 | 4,239,781.16 | 779,487.00 |
| | Financial year n-2 | 3,953,724.65 | 0.00 | 3,953,724.65 | 3,304,128.82 | 3,304,128.82 | 0.00 | 649,595.83 |
| | Financial year n-3 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 45,637,717.33 | -434,637.00 | 45,203,080.33 | 43,442,149.03 | 22,847,199.27 | 20,594,949.76 | 1,760,931.30 |
| | **TOTAL CHAPTERS 1 TO 4** | | | | | | | |
| | Financial year n | 188,711,724.63 | 0.00 | 188,711,724.63 | 186,777,731.56 | 153,030,153.04 | 33,747,578.52 | 1,933,993.07 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 25,606,942.24 | 0.00 | 25,606,942.24 | 23,957,054.25 | 16,711,055.87 | 7,245,998.38 | 1,649,887.99 |
| | Financial year n-2 | 9,018,003.42 | 0.00 | 9,018,003.42 | 7,826,614.51 | 6,097,457.47 | 1,729,157.04 | 1,191,388.91 |
| | Financial year n-3 | 3,597,776.65 | 0.00 | 3,597,776.65 | 3,597,776.65 | 1,484,800.71 | 2,112,975.94 | 0.00 |
| | Financial year n-4 | 177,340.00 | 0.00 | 177,340.00 | 177,340.00 | 129,760.08 | 47,579.92 | 0.00 |
| | | 227,111,786.94 | 0.00 | 227,111,786.94 | 222,336,516.97 | 177,453,227.17 | 44,883,289.80 | 4,775,269.97 |

ANNEX 4 to
FC(2016)190

## NATO PMIS
### Statement of Budget Execution as at 31 December 2015

| (amounts in euro) | Initial budget | Transfers | BA2 | Transfers | BA3 | Transfers | Final budget | Commitments | Expenses | Total spent | Carry forward | Lapsed |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **PMIS** | | | | | | | | | | | | |
| Chapter 1 | 122,750.00 | - | 122,750.00 | - | 122,750.00 | - | 122,750.00 | - | 115,379.52 | 115,379.52 | - | 7,370.48 |
| Chapter 2 | 20,000.00 | - | 20,000.00 | - | 20,000.00 | - | 20,000.00 | - | 19,490.57 | 19,490.57 | - | 509.43 |
| Chapter 3 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2015** | **142,750.00** | **-** | **142,750.00** | **-** | **142,750.00** | **-** | **142,750.00** | **-** | **134,870.09** | **134,870.09** | **-** | **7,879.91** |
| **PMIS** | | | | | | | | | | | | |
| Chapter 1 | 1,436.29 | - | 1,436.29 | - | 1,436.29 | - | 1,436.29 | - | - | - | - | 1,436.29 |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2014** | **1,436.29** | **-** | **1,436.29** | **-** | **1,436.29** | **-** | **1,436.29** | **-** | **-** | **-** | **-** | **1,436.29** |
| **PMIS** | | | | | | | | | | | | |
| Chapter 1 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2013** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| | | | | | | | | | | - | | - |
| **Total PMIS** | **144,186.29** | **-** | **144,186.29** | **-** | **144,186.29** | **-** | **144,186.29** | **-** | **134,870.09** | **134,870.09** | **-** | **9,316.20** |

ANNEX 4 to
FC(2016)190

## INTERNATIONAL STAFF

## BUDGET EXECUTION STATEMENT: PMIS

(n = 2014) ( in EUR)

| CHAPTER | | BUDGET AUTHORISATIONS | | | COMMITMENTS | EXPENDITURES | BUDGETARY SURPLUS | |
|---|---|---|---|---|---|---|---|---|
| | | BUDGET | AUTHORIZED TRANSFERS | ADJUSTED CREDITS | | | Credits carried forward to n+1 | Lapsed credits |
| | | (1) | (2) | (3) = (1)+(2) | (4) | (5) | (6) = (4) - (5) | (7) = (3) - (4) |
| 1 | **PERSONNEL COSTS** | | | | | | | |
| | Financial year n | 115,445.00 | 0.00 | 115,445.00 | 115,000.00 | 113,563.71 | 1,436.29 | 445.00 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 115,445.00 | 0.00 | 115,445.00 | 115,000.00 | 113,563.71 | 1,436.29 | 445.00 |
| 2 | **OPERATING COSTS** | | | | | | | |
| | Financial year n | 25,250.00 | 0.00 | 25,250.00 | 19,459.60 | 19,459.60 | 0.00 | 5,790.40 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 25,250.00 | 0.00 | 25,250.00 | 19,459.60 | 19,459.60 | 0.00 | 5,790.40 |
| 3 | **CAPITAL COSTS** | | | | | | | |
| | Financial year n | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 4 | **PROGRAMMES TOTAL** | | | | | | | |
| | Financial year n | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Carried forward: | | 0.00 | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | **TOTAL CHAPTERS 1 TO 4** | | | | | | | |
| | Financial year n | 140,695.00 | 0.00 | 140,695.00 | 134,459.60 | 133,023.31 | 1,436.29 | 6,235.40 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 140,695.00 | 0.00 | 140,695.00 | 134,459.60 | 133,023.31 | 1,436.29 | 6,235.40 |

ANNEX 4 to
FC(2016)190

## NATO OFFICE OF SHARED SERVICES
### Statement of Budget Execution as at 31 December 2015

| (amounts in euro) | Initial budget | Unfreeze | BA2 | Increase | BA3 | Transfers | Final budget | Commitments | Expenses | Total spent | Carry forward | Lapsed |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **OSS** | | | | | | | | | | | | |
| Chapter 1 | 246,900.00 | 246,900.00 | 493,800.00 | - | 493,800.00 | 20,000.00 | 513,800.00 | - | 507,896.14 | 507,896.14 | - | 5,903.86 |
| Chapter 2 | 31,950.00 | 31,950.00 | 63,900.00 | - | 63,900.00 | (20,000.00) | 43,900.00 | - | 36,359.54 | 36,359.54 | - | 7,540.46 |
| Chapter 3 | - | - | - | 1,200,000.00 | 1,200,000.00 | - | 1,200,000.00 | - | 840,742.00 | 840,742.00 | - | 359,258.00 |
| **Total FY 2015** | **278,850.00** | **278,850.00** | **557,700.00** | **1,200,000.00** | **1,757,700.00** | **-** | **1,757,700.00** | **-** | **1,384,997.68** | **1,384,997.68** | **-** | **372,702.32** |
| **OSS** | | | | | | | | | | | | |
| Chapter 1 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2014** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| **OSS** | | | | | | | | | | | | |
| Chapter 1 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 2 | - | - | - | - | - | - | - | - | - | - | - | - |
| Chapter 3 | - | - | - | - | - | - | - | - | - | - | - | - |
| **Total FY 2013** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| | | | | | | | | | | - | | - |
| **Total OSS** | **278,850.00** | **278,850.00** | **557,700.00** | **1,200,000.00** | **1,757,700.00** | **-** | **1,757,700.00** | **-** | **1,384,997.68** | **1,384,997.68** | **-** | **372,702.32** |

## INTERNATIONAL STAFF

## BUDGET EXECUTION STATEMENT: OFFICE OF SHARED SERVICES

(n = 2014) ( in EUR)

| CHAPTER | | BUDGET AUTHORISATIONS | | | COMMITMENTS | EXPENDITURES | BUDGETARY SURPLUS | |
|---|---|---|---|---|---|---|---|---|
| | | BUDGET BC-DS(2013)0069 BD-D(2013)0223-ADD1-AS1 BC-DS(2014)0031 | AUTHORIZED TRANSFERS | ADJUSTED CREDITS | | | Credits carried forward to n+1 | Lapsed credits |
| | | (1) | (2) | (3) = (1)+(2) | (4) | (5) | (6) = (4) - (5) | (7) = (3) - (4) |
| 1 | **PERSONNEL COSTS** | | | | | | | |
| | Financial year n | 582,150.00 | 0.00 | 582,150.00 | 477,530.75 | 477,530.75 | 0.00 | 104,619.25 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 5,170.62 | 0.00 | 5,170.62 | 5,170.62 | 5,170.62 | 0.00 | 0.00 |
| | Financial year n-2 | 77,109.10 | 0.00 | 77,109.10 | 0.00 | 0.00 | 0.00 | 77,109.10 |
| | | 664,429.72 | 0.00 | 664,429.72 | 482,701.37 | 482,701.37 | 0.00 | 181,728.35 |
| 2 | **OPERATING COSTS** | | | | | | | |
| | Financial year n | 127,875.00 | 0.00 | 127,875.00 | 63,522.34 | 63,522.34 | 0.00 | 64,352.66 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 567.30 | 0.00 | 567.30 | 497.30 | 497.30 | 0.00 | 70.00 |
| | Financial year n-2 | 3,542.63 | 0.00 | 3,542.63 | 0.00 | 0.00 | 0.00 | 3,542.63 |
| | | 131,984.93 | 0.00 | 131,984.93 | 64,019.64 | 64,019.64 | 0.00 | 67,965.29 |
| 3 | **CAPITAL COSTS** | | | | | | | |
| | Financial year n | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 4 | **PROGRAMMES TOTAL** | | | | | | | |
| | Financial year n | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Carried forward: | | 0.00 | | | | | |
| | Financial year n-1 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Financial year n-2 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | **TOTAL CHAPTERS 1 TO 4** | | | | | | | |
| | Financial year n | 710,025.00 | 0.00 | 710,025.00 | 541,053.09 | 541,053.09 | 0.00 | 168,971.91 |
| | Carried forward: | | | | | | | |
| | Financial year n-1 | 5,737.92 | 0.00 | 5,737.92 | 5,667.92 | 5,667.92 | 0.00 | 70.00 |
| | Financial year n-2 | 80,651.73 | 0.00 | 80,651.73 | 0.00 | 0.00 | 0.00 | 80,651.73 |
| | | 796,414.65 | 0.00 | 796,414.65 | 546,721.01 | 546,721.01 | 0.00 | 249,693.64 |

# EXPLANATORY NOTES TO NATO INTERNATIONAL STAFF 2015 FINANCIAL STATEMENTS

## NOTE 1: GENERAL INFORMATION

The financial statements cover the budgetary and financial operations relating to the NATO International Staff (IS) budgeted and non-budgeted functions and programs. Funds where the NATO-IS Office of Financial Control (OFC) is the Treasurer for the project (specifically Trust Funds) are also reported.

## NOTE 2: ACCOUNTING POLICIES

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

### Declaration of conformity

The NATO-IS financial statements have been prepared in accordance with the NATO Accounting Framework as approved by nations under C-M(2013)0039 on 26 July, 2013 (which adapts a small number of IPSAS standards to better suit the specific requirements of the Alliance) and with the NATO Financial Regulations (NFR), the Financial Rules and Procedures (FRP).

Due to limitations in the automated accounting system used up until 2014, the IS financial statements could not be made fully IPSAS compliant. The accounting system that was used by NATO-IS for 2014 was a budgetary driven cash accounting system; it did not have an accrual based accounting functionality. As of 2015, a new accounting system has been introduced which will enable accrual accounting. However, due to implementation difficulties encountered during the first months of use of the system, some transactions may have been recorded on a cash basis rather than on an accrual basis.

### Basis of preparation

The financial statements have been prepared on a going-concern basis: NATO-IS will continue in operation for the foreseeable future.

The amounts shown in these financial statements are presented in EUR

The financial year begins on 1 January and ends on 31 December of the same year.

The following IPSAS have no material effect on the 2015 financial statements of the NATO-IS:

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

Concerning IPSAS 6: the transactions concerning the NATO Staff Centre are not consolidated with those of the International Staff, as the IPSAS 6 "Consolidated and Separate Financial Statements" would require, but are reported separately in accordance with a specific decision taken by the NAC.

**Segment Reporting**

A segment is a distinguishable activity or group of activities for which it is appropriate to separately report financial information. For NATO IS the segment information is based on principal activities and different sources of financing for different categories of activities of the organisation. To this end, the following segments have been adopted: Civil Budget, Personnel Management Information System, Office of Shared Services, Trust Funds and Partners' Accommodation. Civil Budget operations can be broken down into Global Objectives.

**Changes in Accounting Policy**

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

**Reclassification of financial statements of previous years**

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

**Use of estimates**

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

**Foreign currency transactions**

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

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

**Financial risks**

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

All the financial instruments are recognised in the Statement of Financial Position at their fair value.

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

a. Foreign currency exchange risk

The exposure to foreign currency risk is limited as the majority of the NATO-IS's expenditures are made in EUR. The current bank accounts are held in EUR, CAD, CHF, DKK, GBP, NOK and USD. There are accounts with local banks for the Information and Liaison Offices in New York, Moscow, Kyiv, Tbilisi, Chisinau and Tashkent. The currency risk associated with these holdings is considered limited in consideration of the level of the aggregated amount held in these accounts.

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

b. Credit risk

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

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

c. Liquidity risk

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

d. Interest rate risk

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

**Current Assets**

a. Cash and cash equivalents

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

This includes funds managed on behalf of third parties are held in cash and are presented as a liability. They are accounted for when cash is effectively received.

b. Receivables

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

Contributions receivable are recognised when a call for contribution, based on the approved budget, has been issued to the funding Nations. These receivables represent the uncollected contributions from Member Nations. No allowance for loss is recorded with respect to Member countries' assessed contributions receivable.

c. Prepayments

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

d. Inventories

Inventories held across the IS are not considered to be material.

**Fixed assets (Property, Plant & Equipment and Intangible Assets)**

a. Property, Plant & Equipment

As mentioned above, NATO's adaptations of IPSAS were spelled out in C-M(2013)0039 of July 2013, which included IPSAS 17 Property Plant and Equipment. It is described as follows:

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

Capitalization thresholds relevant to the financial statement are as follow:

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

In light of the forthcoming move to a New NATO HQ in 2017, it has been decided, in general, that core PPE relating to the current HQ and Building Z will be fully expensed as will any fixed equipment and furniture that is not to be transferred to the New HQ. Only movable items purchased with a view to being used again in the New HQ/Building Z environment will be capitalized.

Where and as appropriate, specific pieces of PPE (for example buildings), will be broken down into component parts to allow depreciation of different parts of the asset at different rates. The IS has considered PP&E acquired prior to 1 January 2013 as fully expensed. For PPE held prior to 1 January 2013, and not previously recognized as an asset, the IS will provide a brief description in the Notes below.

NATO-IS deems that the NAC, by approving this guideline, recognized that the resources necessary to deal with the issues capitalising the legacy assets would exceed the benefits. In light of this and, combined with the fact that substantial assets will not survive the move to the New NATO HQ in 2017, NATO-IS decided to apply the IPSAS principle of balance between Benefit and Cost (IPSAS 1, Appendix A).

b. Intangible Assets

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

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

NATO Intangible Assets Capitalization Thresholds – NATO-IS will capitalise each intangible asset item that is above the following agreed NATO thresholds:

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

NATO-IS will capitalize all controlled intangible assets above the NATO Intangible Asset Capitalization Threshold. For anything below the threshold, the IS will have the flexibility to expense specific items.

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

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

NATO-IS will capitalize other types of intangible assets acquired after 1 January 2013 including:

- Copyright
- Intellectual Property Rights
- Software development

NATO-IS may consider intangible assets acquired prior to 1 January 2013 as fully expensed. The IS looked as far back as 2006 in establishing values of work in progress, especially software under development.

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

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

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

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

**Current liabilities**

a. Payables

Payables are amounts due to Nations in relation with budget rules or to third parties for goods received and services provided that remain unpaid. This includes an estimate of accrued obligations to third parties for goods and services received but not yet invoiced.

b. Advances and Unearned revenue

Funds are always called in advance of their need because NATO-IS has no capital that would allow it to pre-finance any of its activities.

Unearned revenue represents participating Nations' contributions which have been called for current budgets but that have not yet been recognised as revenue in the absence of matching expenses.

Advances are recognised when calls in relation to future year budgets are issued. Advances made by contributing nations outside of the call for contributions process are recorded when cash is received.

**Leases**

In addition to lease agreements that NATO-IS has signed for its own use, lease contracts were signed by NATO-IS for some delegations' accommodation; the related costs are charged back to the occupants in relation to the surface they occupy in the leased buildings.

**Revenue and expense recognition**

a. Revenue from non-exchange transactions

Revenue comprises contributions from Member nations. Contributions to be called from Member Nations, based on the budget approved by the North Atlantic Council, are initially recorded as unearned revenue liabilities. Because contributions are subject to conditions that, if unfulfilled, require the return of the transferred resources, the entity recognises a liability until the condition is fulfilled.

Assessed contributions for the NATO-IS Civil Budget are accounted for as unearned revenue when called; revenue is recognised and the liability is discharged when the conditions are fulfilled. Revenue is recognised in that it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. The balance of unspent contributions and other revenues which relate to future periods are deferred accordingly.

In-kind contributions of services are currently not recognised in the Statement of Financial Performance. The number of Voluntary National Contributions (VNCs) staff is disclosed in the "employee disclosure" section below.

b. Revenue from exchange transactions

Resources of revenue from exchange transactions are measured at fair value of the consideration received or receivable and are recognised when goods and services are delivered. This is revenue in relation to the reimbursement of administrative support and common operating costs, PMIS and accommodation costs.

Voluntary contributions such as pledges in relation to Trust Funds are accounted for as unearned revenue when confirmed by the donor, revenue is recognised and the liability is discharged when the conditions are fulfilled.

c. Long term unearned revenue

The budget resources provided by Nations for the funding of capital expenditure are recognised as a liability in the Statement of Financial position as long term unearned revenue.

Earned revenue will be progressively recognised from long term unearned revenue, in an amount equal to annual depreciation of the related non-current assets, as future economic benefits and service potential will flow to the NATO international Staff when the asset is operational.

**NOTE 3: CASH AND CASH EQUIVALENTS**

The current bank accounts at NATO HQ are held in EUR, CAD, CHF, DKK, GBP, NOK and USD. Deposits are held in interest-bearing bank current accounts that are immediately available.

NATO-IS has information and liaison offices in New York, Moscow, Kyiv, Tbilisi, Tashkent and Chisinau. Current accounts of these offices are held with local banks.

Cash is also held for Trust Funds for which NATO-IS is the executing agent and therefore acts as the principal.

The NATO-IS manages, as Treasurer, a series of accounts for third parties, essentially for various Trust Fund projects not financed by the common funding principle.

Funds managed on behalf of third parties are held in cash or as a receivable if they correspond to an unpaid non-budgetary contribution in relation to nationally funded elements. In the case of an anticipated contribution, they are accounted for when cash is effectively received. The corresponding amounts are presented as a current liability.

**NOTE 4: SHORT TERM INVESTMENTS**

There has been no short term investment in consideration of the situation of interest rates on highly liquid and high quality paper.

**NOTE 5: CURRENT ASSETS: ACCOUNTS RECEIVABLE**

Contributions receivable from NATO member Nations are essentially funds requested from the Nations to finance the Civil Budget and the advances called in relation to the following year Civil Budget that remain unpaid at year end. In accordance with the standard procedure, one advance for the 2015 budget was called in 2014 and two calls for contributions were issued in 2015: in February and in November. In 2015 an advance was called for the 2016 budget. Other receivables from NATO member Nations correspond mainly to amounts due in due in relation to common operating costs, administrative support and rental of office accommodation.

Receivables from member Partner Nations and others correspond to amounts due in relation to common operating costs, administrative support, rental of modular buildings, accommodation fees of Partner buildings, items procured on behalf of third parties, etc.

Receivables from the Post Employment Benefit Schemes are cash advances to the Defined Contribution Pension Scheme to ease the payment of invalidity and retirement annuities.

Undercalled receivables (at year-end 2014) relates to a EUR 3,448,725 portion of lapsed civil budget credits end 2013 which the budget committee decided to re-use for 2014. This amount was originally deducted from the calls issued in 2013, as the decision by the budget committee was taken after the call was issued. This situation was not readjusted in 2014 and therefore was regularized in 2015 in accordance with NFRs governing the Call for Contribution process.

**NOTE 6: PREPAYMENTS**

Prepayments to staff members correspond to advances to be regularised (education allowances for the following year, travel on duty) and loans as provided by the CPRs.

Prepayments to suppliers relate mostly to rental fees for the year to come, which have to be paid in advance.

## NOTE 7: OTHER CURRENT ASSETS

Nothing to report.

## NOTE 8: INVENTORIES

Other inventories for office supplies, maintenance supplies, medicines and munitions are valued, at year-end 2015, at EUR 791,014.15 based on a hybrid method imposed by the various types of software used in the IS. Inventories represent less than 0.4% of the annual IS budget.

## NOTE 9: NON CURRENT ASSETS: RECEIVABLES

Nothing to report.

## NOTE 10: PROPERTY, PLANT AND EQUIPMENT

The following principles have been applied.

### Property, Plant and Equipment

Infrastructure, plant and equipment are stated under the accounting principles mentioned in Note 2 above.

This consists principally of costs related to the NR2 and audiovisual equipment.

Network Realignment and Robustness (NR2) is part of a strategic plan to revitalize the management and support of Information and Communications Technology (ICT) within the Headquarters. This element delivered a hardware and software upgrade to the physical infrastructure for which the bulk was delivered prior to close of 2012.

### Land and buildings

Land and buildings are shown at fair value, based on internal valuation and judgment on each reporting date.

Belgium has granted to NATO by way of concession a plot of land on which NATO is authorized to erect all necessary buildings and facilities needed to perform its functions. A symbolic price is paid annually for the rent. NATO is the full owner of all structures built thereon. Belgium remains the sole and full owner of the land, which is public domain ("domaine publique"). The concession ends 180 days after NATO has left the buildings and facilities. At the end of the concession, there will be no property rights transferred to NATO. As a consequence, given the indefinite economic life of land and the specific nature of concessions, the use of the land is classified as an operational lease. The rent charged by the host nation is recognised as an expense in the Statement of Financial Performance.

The original buildings of the current HQ site are estimated as having a zero value in consideration of their age, of the terms of the concession agreement, of the limited value for money of an evaluation study and of the planned move to new premises in 2017.

Material and non-recorded items purchased prior to 1 January 2013 are the fourth wing of Building Z assessed at the historical cost of EUR 2.566 million and the Secretary General's residence with an assessed market value of EUR 10,300,000 as at November 2013.

## NOTE 11: INTANGIBLE ASSETS

Intangible assets are stated at historical cost minus accumulated depreciation and any recognized impairment loss. The assets deemed valid are software/hardware systems that are work in progress and will be continue to be used in the new HQ. They are as follows:

- Digital Assets Management System (DAMS) – this is a Public Diplomacy tool that will make NATO's digital assets accessible in multiple formats to the media. It will improve the retrieval and availability of multimedia files to all NATO Staff and will serve as Public Diplomacy's single shared storage platform for all public digital assets.

- Enterprise Resource Planning (ERP) – this Oracle based software will enable NATO-IS to more effectively manage and report on the human and financial resources under its responsibility by integrating business processes from Finance, Budget, Procurement, Facility Management, and Human Resources (HR).

- Integrated Library System (ILS) – the project is designed to provide an online library automation solution to support the daily operations of the IS Library (which is part of PDD) ranging from cataloguing and circulation procedures to delivering resources and services via its website.

- Web Content Management (WCM) – the project will update and improve the web based content management system for the public website of NATO Headquarters.

- Enterprise Information Management (EIM) is a core multi-year program of procedures and integrated software applications to manage information throughout NATO HQ and ensure that information is handled effectively and securely.

- Project Portfolio Management System (PPM) is part of a NATO Resource Reform process under the aegis of the NATO Office of Resources (NOR). The system will provide the necessary functionality for collecting, analysing, validating, recording, consolidating and reporting information on current and planned common funded military resources in terms of Investment, Operation and Maintenance and Manpower costs.

**Depreciation**

Straight-line depreciation method is used for all categories, with the life cycles being in keeping with those stated in the change in accounting policy.

**Impairment of fixed assets**

The carrying amounts of fixed assets are reviewed for impairment if events or changes of circumstances indicate that they may not be recoverable. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the impairment loss. Any provision for impairment losses is charged against the Statement of Financial Performance in the year concerned.

**NOTE 12: OTHER NON-CURRENT ASSETS**

Nothing to report.

**NOTE 13: CURRENT LIABILITIES: PAYABLES**

**Payable to Nations**

For the Civil Budget, receipts linked to interest, foreign exchange difference gain and bank charges are deducted from the contributions due by Nations to fund the Civil Budget in the following year; the deduction is made in the second call.

Miscellaneous receipts correspond to amounts collected by NATO-IS for services rendered to staff (e.g. private phone calls) or services rendered to and works performed for entities, including delegations, present on the HQ site (e.g. telephone, refurbishment works, cabling). They also include amounts related to Science for Peace and Security grants returned to NATO-IS. These receipts come as a deduction in the calculation of the contributions due from nations to fund the Civil Budget in the following year; the deduction is made in the second call.

There is a payable in relation to the reimbursable salaries due to certain countries (United States, Norway and the Netherlands) for civilian staff members who are paid directly by their governments. This amount payable is usually used by the nations in question applying it against their annual project contribution.

Other payables to Nations consist of monies relating to balances of closed Trusts Funds for which NATO-IS is awaiting instructions on the redistribution of funds, to the settlement of the closure of former NATO entities (HAWK Agency) and AGS Support Staff Cell, to ad-hoc contributions by some nations to specific projects such as "Advisory Team in Kosovo", "Partnership Network, "DEEP" and "Women Peace and Security, to a number of Nations' voluntary Civil Budget advances and to amounts resulting from IBAN audits of multinationally funded entities awaiting further use. Due to an oversight, the amount of common operating costs deducted from the calls in 2014 was limited to that charged to member Nations, resulting in EUR 1,003,345.03 not being deducted. This situation was regularized in 2015.

**Stikker Fund**

The Stikker Fund originates from a donation made by former Secretary General D.U. Stikker in the 1960s. In accordance with the conditions laid down by the donor, the Fund is used for special financial aid to NATO staff in exceptional and distressing circumstances.

**Payable to NATO bodies**

This includes amounts received from NATO bodies in support projects funded by the Civil Budget.

**NOTE 14: CURRENT LIABILITIES: DEFERRED REVENUE**

Unearned revenue corresponds to contributions called in 2015 or before, but for which corresponding expenses will be incurred after the reporting date of 31 December 2015.

The unearned revenue includes principally those amounts of contributions which will be spent in subsequent years on the NATO Civil Budget as credits carried-forward resulting from the budget execution in accordance with the NATO Financial Regulations. This may include funds for which no purchase order has been issued at year end – this relates to a special carry-forward of credits authorized by the NAC.

**NOTE 15: CURRENT LIABILITIES: LAPSED CREDITS**

Lapsed credits are budget funds for which no legal liability exists. They cannot be spent in subsequent years. Lapsed credits are deducted from the contributions due from Nations to fund the Civil Budget in the second call of the following year. For the PMIS, lapsed credits are deducted from the amounts due by the NATO participating entities for the following year. This principle does not apply to the Office of Shared Services, as exceptionally agreed by the Budget Committee.

**NOTE 16: CURRENT LIABILITIES: ADVANCES**

Advances called amounting to EUR 46,200,000 relate to funding the 2016 Civil Budget (EUR 45,500,000 previous year). In addition, some Nations made ad hoc advance contributions.

An advance of EUR 400,000 was called for the OSS relating to the 2016 budget. (end 2014: advance of EUR 210,000 relating to the 2015 budget).

**NOTE 17: SHORT TERM PROVISIONS**

Nothing to report.

**NOTE 18: CURRENT LIABILITIES: OTHER CURRENT LIABILITIES**

Nothing to report.

**NOTE 19: NON-CURRENT LIABILITIES: PAYABLES**

Nothing to report.

**NOTE 20: NON-CURRENT LIABILITIES: LONG TERM PROVISIONS**

Nothing to report.

**NOTE 21: NON-CURRENT LIABILITIES: DEFERRED REVENUE**

Long term unearned revenue is unearned revenue in relation to net carrying amounts of PP&E and intangible assets. Revenue is recognised over the estimated life cycle of the PP&E and the intangible assets when PP&E and intangible assets are recognized.

**NOTE 22: OTHER NON-CURRENT LIABILITIES**

Nothing to report.

**NOTE 23: ACCUMULATED SURPLUSES / DEFICITS**

Corresponds to miscellaneous surpluses generated outside of the budget execution context.

**NOTE 24: REVENUE FROM NON-EXCHANGE TRANSACTIONS**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the result can be measured reliably.

The total revenue from non-exchange transactions is essentially related to NATO-IS. Budget contributions, when called, are booked as unearned revenue and subsequently recognised as revenue when earned. The revenue recognition is matched with the recognition of expenses against the budgets.

**NOTE 25: REVENUE FROM EXCHANGE TRANSACTIONS**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the result can be measured reliably.

The total revenue from exchange transactions is broken down as follows. For the IS: revenue in relation to the reimbursement to the Civil Budget of administrative support and common operating costs, revenue received from concessions, miscellaneous income. For the PMIS: contributions from other NATO bodies to cover the expenses of the PMIS system according to their proportion of established posts. For Trust Funds: revenue matching the costs of activites undertaken by NATO-IS as executive agent for Trust funds. For Partners' Accommodation: rent charged principally to Partner Countries for office space at NATO HQ (Buildings V/VA/Woerner).

**NOTE 26: OTHER REVENUE**

Corresponds to miscellaneous income such as: gains on disposal of fixed assets, staff private phone calls, works in national delegations, etc.

**NOTE 27: FINANCIAL REVENUE**

Financial revenue (being principally from the Civil Budget) is revenue from exchange transactions measured at fair value received or receivable for interests and foreign exchange gains.

## NOTE 28: EXPENSES

### Wages, salaries and employee benefits

The personnel related costs include all staff expenses, as well as other non-salary related expenses in support of common funded activities. The amounts include expenses for salaries and emoluments for approved NATO-IS positions and temporary personnel, for other salary related and non-related allowances including overtime, medical exams, recruitment, installation and removal and for contracted consultants and training in accordance with Civilian Personnel Regulations.

### Operating costs: rents, supplies and consumables used

The operating costs relate primarily to costs necessary to the day to day operation of the HQ, as well as travel expenses. This item includes expenses classified as Capital expenditure from a budget perspective (to include items such as IT, security, television and radio studios etc.) but that did not qualify as capital from an IPSAS perspective.

### Programmes and grants

The majority of grants are considered expended upon notification, to the beneficiary, of the decision to attribute the grant/award. Programmes and grants is a broad term that covers activities with Partners and NATO nations ranging from funding seminars and conferences through NGOs, to bringing groups of experts to NATO HQ for briefings and attributing grants in the framework of the Science for Peace Security Programme (the latter being the main component). It also includes the cost of running NATO Information and External Offices in Russia, Ukraine, Georgia, Central Asia, Moldova and New York.

Programmes and grants expenses include advances paid to beneficiaries of grants.

### Depreciation and amortization

No amounts are budgeted for depreciation and amortization.

### Financial costs

Financial costs include expenses for banking costs and foreign exchange losses.

### Other expenses

Other expenses is revenue received from concessions and transferred the Staff Centre and summer camps. They also include the amount of net interest revenue and miscellaneous income that will be returned to the Nations, and are booked as a payable in the Statement of Financial Position.

## NOTE 29: RESULT OF THE PERIOD (SURPLUS/DEFICIT)

The surplus/deficit is realised from the activities in support of Partner accommodation.

## NOTE 30: CASH FLOW STATEMENT

In accordance with the new NATO Accounting Framework, the cash flow statement is presented based on the indirect method, whereas up to 2014 the direct method was used.

The difference with amounts in the Statement of Financial Position is due to erroneous transactions with other NATO entities managed by IS OFC which were regularised after year end 2015.

**NOTE 31: BUDGET INFORMATION**

**Presentation of budget information in the financial statements**

For the purposes of these financial statements, the term budget is understood as corresponding to a formal approval of expense limits by the North Atlantic Council or the Budget Committee. It does not correspond to situations where the term budget may be used for more managerial purposes and/or is used to forecast expenditure rather than limit its attributions.

From a budget perspective, the International Staff Financial Statements include the budget transactions of the following budget entities: the NATO Civil Budget (i.e. that of the NATO Headquarters in Brussels, essentially but not exclusively the International Staff), the NATO Wide PMIS, and the Office of Shared Services.

Presently, none of these budgets is publicly available.

The actual amounts referred to by IPSAS 24 ("amounts that result from execution of the budget") are considered to be the actuals and the commitment of appropriations when the corresponding services or goods could not be received in the course of the year.

**Budget Execution Rules and Principles**

The following comments relate to the Civil Budget since it is the most important entity. The analysis and processes apply to a very large extent to the other two budget entities.

The initial approved budget corresponds to total credits authorised by the North Atlantic Council, normally at the end of the previous financial year. During the year the budget is adjusted as required. The final authorisation is the approved credit situation as reported at the end of the financial year including budgetary increases/decreases approved by the Budget Committee and transfers approved by the Budget Committee or by the Financial Controller, depending on thresholds.

The Civil Budget is prepared for the same period (1 January to 31 December) and encompasses the same entity (NATO International Staff) as these financial statements but the basis is different.

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

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

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

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

The Civil Budget is prepared and executed as follows:

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

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

3) Commitments, because they are an advance acceptance, and because payments cannot be made above approved credit levels, typically include an estimation factor and are (if only slightly) higher than the actual amount eventually paid. This results in commitments being higher than the actual expenses and in credits eventually lapsing. Generally lapse rates for Personnel, Operations and Maintenance or Capital tend to be smaller than for Programmes because they can be estimated more accurately.

4) Commitments are only made in respect of future payments (old rules) or expenses (new rules) relating to the initial purpose of the commitment. Commitments for capital expenditures are normally made in the year during which the purchase order is issued. In accrual accounting, the related costs would not appear in the Statement of Financial Performance but in the Balance Sheet and only upon reception of the works, goods or services. Conversely, there is no budgetary commitment of appropriations for non-cash flow transactions such as capital depreciation or provisions which would normally appear in the Statement of Financial Performance under accrual accounting.

5) On an exceptional basis, the NATO member Nations may approve the special carry-forward of appropriations without any prior legal commitment, for instance for projects at their initiation stage or planned expenditures. In accrual accounting there would be no expense recorded.

6) The balance of unused budgetary appropriations (not committed) lapses and is returned to Member Nations at year-end. Lapses may include cases where a project was eventually not completed or started, and therefore lead to no expense.

Outstanding commitments can be carried forward during two years. However, member Nations may agree to a further carry-forward.

**The NATO Civil Budget**

The Civil Budget is based on an Objective Based Budgeting (OBB) system which links financial and human resources to Global Objectives. Contributions to these Global Objectives by IS Divisions and Independent Offices are broken down into Operational Objectives. The OBB system is based on eight Global Objectives which are defined at a political and strategic level of the Organization.

The eight objectives are set out below:

| | |
|---|---|
| A | ACTIVE OPERATIONS |
| C | ALLIANCE CAPABILITIES |
| P | CONSULTATION AND COOPERATION WITH PARTNERS |
| R | PUBLIC RELATIONS |
| N | CONSULTATION PROCESS |
| M | OPERATIONAL ENVIRONMENT OF THE HEADQUARTERS SITE |
| G | GOVERNANCE AND REGULATION |
| S | HEADQUARTERS SECURITY |

The budget classification is also based on the economic nature of the expenses broken down into four Resource Pools as follows:

Resource Pool 1: Personnel
Resource Pool 2: Operations and Maintenance
Resource Pool 3: Capital
Resource Pool 4: Programmes

All budget transactions, commitments and payments are tracked according to a classification by Objective and by Resource Pool.

An analysis of budget execution is provided at Annex 4 for what concerns the NATO Civil Budget.

**Initial Civil Budget – Revised Civil Budget**

The initial Civil Budget for 2015 was approved, in December 2014, in the amount of EUR 187,200,000, of which EUR 80,000 were frozen. The latter amount was partially unfrozen and amount of EUR 42,000 remained frozen. No change was made when the Budget was revised in November 2015. The amounts include costs related to the Provident Fund and Defined Contribution Pension Scheme contributions.

The Civil Budget is subject to a "zero nominal growth" budgetary policy which applies to the Core Budget (i.e. total excluding the pension contributions mentioned above). The amount approved for the Core Budget was EUR 181,996,000 for the initial budget (same as for 2014).

**Personnel Management Information System (PMIS)**

A specific budget entity was put in place to manage the costs related to the work carried out by the IS in setting up and managing an Integrated Payroll Personnel Management Information System. Its funding is provided through contributions by the NATO bodies who are members of the PMIS, in proportion to their staffing levels.

The PMIS budget for 2015 was approved by the Budget Committee in the amount of EUR 142,750 (BC-D(2015)0040 and ADD1). It was not revised.

A budget execution statement is provided at Annex 4.

**Office of Shared Services Budget**

An amount of MEUR 5.8 was made available for the pre-financing of the initial Agency Reform transition costs as part of the MTRP 2012-2016 (C-M(20110067). The Budget Committee agreed a framework mechanism for the management and control of the funds related to the initial transition costs and subsequently to the budget allocation of the pre-financed credits to allow full oversight (BC-D(2012)0202-REV1 and BC-D(2011)0209-ADD1). Council agreed this as part of the 2012 Military Budget Recommendations (C-M(2011)0099). The full implementation of OSS at NATO was estimated to cost between MEUR 24.2 and 28.3 as described in the Office of Shared Services Business Case (PO(2011)0239). In considering the Office of Shared Services (OSS) request for the 2013 budget, Nations requested that the Chairman BC inform the Chairman RPPB of the BC's intention to use the pre-financing agreed in 2012 to cover the 2013-2015 costs of the OSS within the agreed total pre-financing amount of EUR 5.8 million (OCB(2012)0039 and BC-DS(2012)0041).

The BC agreed to the 2013 pre-financed allocation of EUR 795,500 and that any unused funds from 2012 could be used in 2013 and onwards in 2014 and 2015 for the OSS.

The 2015 OSS initial budget was agreed in the amount of EUR 577,700, half of which was frozen pending NAC agreement with regard to the way ahead on the implementation of the NATO Shared Services Initiative (BC-DS(2014)0068). A request to unfreeze the remaining amount was submitted to the Budget Committee and approved (BC-DS(2015)0031). On 20 May 2015, the Budget Committee agreed to increase the 2015 OSS pre-financed allocation by EUR 1,200,000 to a total of EUR 1,757,700. This increase takes into account a first tranche of expenses related to the implementation of Phase I of General Procurement Shared Services in 2015. For the further phases in 2016 and 2017, NSPA has requested EUR 900,000 each year (BC-DS(2015)0090).

A budget execution statement is provided at Annex 4.

## NOTE 32: SEGMENTS

The tables below provide segment information for financial performance and financial position statements for 2015.

INTERNATIONAL STAFF
**Statement of financial position**

As at 31 December 2015
(All amounts in EUR)

| | Notes | IS | PMIS | OSS | TRUST FUNDS | PARTNER ACCOMODATION | BUILDING Z REFURBISHMENT | ELIMINATION | 2015 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | | |
| ***Current assets*** | | | | | | | | | | |
| Cash and cash equivalents | 3 | 60,827,242.62 | -42,534.50 | 2,333,051.55 | 21,362,110.74 | -1,139,222.62 | -53,996.00 | 1,387,214.62 | 84,673,866.41 | 77,345,530.70 |
| Short term investments | 4 | | | | | | | | 0.00 | |
| Receivables | 5 | 57,444,161.07 | 51,887.25 | 5,238.01 | 2,911,562.44 | 548,033.30 | | | 60,960,882.07 | 43,121,081.80 |
| Prepayments | 6 | 1,973,616.41 | | | | 389,193.07 | | | 2,362,809.48 | 3,908,080.84 |
| Other current assets | 7 | | | | | 923,090.14 | -190,163.88 | 979,672.34 | 1,712,598.60 | |
| Inventories | 8 | 10,645.03 | | | | | | | 10,645.03 | 862,183.77 |
| | | **120,255,665.13** | **9,352.75** | **2,338,289.56** | **24,273,673.18** | **721,093.89** | **-244,159.88** | **2,366,886.96** | **149,720,801.59** | **125,236,877.11** |
| ***Non-current assets*** | | | | | | | | | | |
| Receivables | 9 | | | | | | | | 0.00 | |
| Property, plant & equipment | 10 | 695,006.81 | | | | | 138,383.68 | | 833,390.49 | 1,277,583.80 |
| Intangible assets | 11 | 16,072,319.51 | | | | | | | 16,072,319.51 | 14,498,137.57 |
| Other non-current assets | 12 | | | | 12,095.75 | | | | 12,095.75 | |
| | | **16,767,326.32** | **0.00** | **0.00** | **12,095.75** | **0.00** | **138,383.68** | **0.00** | **16,917,805.75** | **15,775,721.37** |
| **Total assets** | | **137,022,991.45** | **9,352.75** | **2,338,289.56** | **24,285,768.93** | **721,093.89** | **-105,776.20** | **2,366,886.96** | **166,638,607.34** | **141,012,598.48** |
| **Liabilities** | | | | | | | | | | |
| ***Current liabilities*** | | | | | | | | | | |
| Payables | 13 | -9,540,694.38 | -42.60 | -845,611.29 | -580,839.22 | 1,368,799.19 | -153,957.80 | | -9,752,346.10 | -28,965,507.32 |
| Deferred revenue | 14 | -49,477,744.87 | | -441,254.77 | -23,183,850.71 | -1,108,461.10 | 259,734.00 | | -73,951,577.45 | -45,530,170.78 |
| Lapsed Credits | 15 | -4,956,030.73 | | -372,691.27 | | | | | -5,328,722.00 | -5,031,199.01 |
| Advances | 16 | -46,200,000.00 | | -400,000.00 | | | | | -46,600,000.00 | -45,710,000.00 |
| Voluntary advance Member Nations | 16 | -4,499,794.87 | | | | | | | -4,499,794.87 | |
| Short term provisions | 17 | | | | | | | | 0.00 | |
| Other current liabilities | 18 | -4,409,771.00 | | -34,584.04 | 979,672.34 | -600,000.00 | | -2,366,886.96 | -6,431,569.66 | |
| | | **-119,084,035.85** | **-42.60** | **-2,094,141.37** | **-22,785,017.59** | **-339,661.91** | **105,776.20** | **-2,366,886.96** | **-146,564,010.08** | **-125,236,877.11** |
| ***Non-current liabilities*** | | | | | | | | | | |
| Payables | 19 | | | | | | | | 0.00 | |
| Long term provisions | 20 | | | | | | | | 0.00 | |
| Deferred revenue | 21 | -16,767,326.32 | | | | | | | -16,767,326.32 | -15,775,721.37 |
| Other non-current liabilities | 22 | -259,953.58 | | | -415,673.02 | | | | -675,626.60 | |
| | | **-17,027,279.90** | **0.00** | **0.00** | **-415,673.02** | **0.00** | **0.00** | **0.00** | **-17,442,952.92** | **-15,775,721.37** |
| **Total liabilities** | | **-136,111,315.75** | **-42.60** | **-2,094,141.37** | **-23,200,690.61** | **-339,661.91** | **105,776.20** | **-2,366,886.96** | **-164,006,963.00** | **-141,012,598.48** |
| **Net assets** | | | | | | | | | | |
| Capital assets | 23 | | | | | | | | 0.00 | |
| Reserves | 23 | | | | | | | | 0.00 | |
| Accumulated surpluses/ (deficits) | 23 | -911,675.79 | -9,310.15 | -244,148.19 | -1,088,633.93 | -381,431.98 | | | -2,635,200.04 | |
| **Total net assets/ equity** | | **-911,675.79** | **-9,310.15** | **-244,148.19** | **-1,088,633.93** | **-381,431.98** | **0.00** | **0.00** | **-2,635,200.04** | **0.00** |

INTERNATIONAL STAFF
Statement of financial performance

for the year ended 31 December 2015
(All amounts in EUR)

| | Notes | IS | PMIS | OSS | TRUST FUNDS | PARTNER ACCOMODATION | BUILDING Z REFURBISHMENT | 2015 | 2014 |
|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | | | |
| Non exchange revenue | 24 | -191,114,012.60 | -134,876.14 | -1,193,445.93 | -6,282,668.19 | -2,075,298.02 | | -200,800,300.88 | -171,489,524.00 |
| Exchange revenue | 25 | | | -190,739.22 | | | -323,730.00 | -514,469.22 | -14,422,062.52 |
| Other revenue | 26 | -488,843.60 | | | | | | -488,843.60 | -648,497.00 |
| Financial revenue | 27 | -119,260.48 | | -823.58 | -24,674.03 | | | -144,758.09 | -216,804.01 |
| **Total revenue** | | -191,722,116.68 | -134,876.14 | -1,385,008.73 | -6,307,342.22 | -2,075,298.02 | -323,730.00 | -201,948,371.79 | -186,776,887.53 |
| **Expenses** | | | | | | | | | |
| Personnel | 28 | 112,049,755.03 | 115,379.52 | 507,896.14 | 189,141.34 | | 115,776.20 | 112,977,948.23 | 116,350,070.12 |
| Contractual supplies and services | 28 | 78,483,748.90 | 19,490.57 | 877,101.54 | 5,066,976.36 | 1,380,476.70 | 207,953.80 | 86,035,747.87 | 68,684,526.91 |
| Depreciation and amortization | 28 | 754,482.64 | | | | | | 754,482.64 | 648,497.00 |
| Impairment | 28 | | | | | | | 0.00 | 0.00 |
| Provisions | 28 | | | | | | | 0.00 | |
| Other expenses | 28 | 372,929.93 | | | 1,037,654.14 | 694,821.32 | | 2,105,405.39 | 773,663.37 |
| Finance costs | 28 | 61,200.18 | 6.05 | 11.05 | 13,570.38 | | | 74,787.66 | 170,734.09 |
| **Total expenses** | | 191,722,116.68 | 134,876.14 | 1,385,008.73 | 6,307,342.22 | 2,075,298.02 | 323,730.00 | 201,948,371.79 | 186,627,491.49 |
| **Surplus/(Deficit) for the period** | 29 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -149,396.04 |

## NOTE 33: LEASES

An analysis of lease contracts was conducted and it was considered that some of them had characteristics that could have led them to be considered as finance leases (in the IPSAS 13 sense) in particular as relates to the rent of portacabins for temporary accommodation (e.g. Buildings V, VA) and the Manfred Wörner building. However in consideration of the fact that NATO-IS will move to new premises in 2017, the rental period will be shorter than the remaining economic life of this equipment. As a consequence, all leases in NATO IS are classified as operating leases. Fees payable under these lease agreements are accounted as expenses in the Statement of Financial Performance on a straight-line basis over the relevant lease term.

Belgium has granted to NATO by way of concession a plot of land on which NATO is authorized to erect all necessary buildings and facilities needed to perform its functions. A symbolic price is paid annually for the rent. NATO is the full owner of all constructions made. Belgium remains the sole and full owner of the land, which is public domain ("domaine public"). The concession ends 180 days after NATO has left the buildings and facilities. At the end of the concession, there will be no property rights transferred to NATO. As a consequence, given the indefinite economic life of land and the specific nature of concessions, the use of the land is classified as an operational lease. The rent charged by the host nation is recognised as an expense in the statement of financial performance.

The operating leases at the reporting date can be classified into three categories: temporary building offices, transport equipment and photocopiers.

## NOTE 34: RESTRICTIONS ON FIXED ASSETS

There are no restrictions on fixed assets.

## NOTE 35: CONTINGENT LIABILITIES

A number of contingent liabilities have been identified, but the total possible obligation relating to these items is not expected to be material.

However, it should be noted that in light of the current circumstances surrounding the operation of the NATO Staff Centre and its restructuring, Civil Budget resources may have to be used.

## NOTE 36: CONTINGENT ASSETS

Nothing to report.

**NOTE 37: EMPLOYEE DISCLOSURE**

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

At 31 December 2015, NATO-IS had an approved Personnel Establishment of 1,106 positions (1,110 end 2014) funded by the Civil Budget of which 1012 were occupied as of December 2015 (1,016 end 2014).

Also, NATO-IS receives "in kind" services provided by nationally funded personnel known as Voluntary National Contributions (VNCs). VNCs worked for the IS at HQ but also at the NATO external offices, or in support of specific projects on-site. During 2014, 61 VNCs (97 in 2013) worked for the IS at HQ.

The NATO-IS manages centrally three pension schemes, namely the Defined Benefit Pension Scheme (DBPS), the Provident Fund and the Defined Contribution Pension Scheme (DCPS), as well as the Retirees Medical Claims Fund (RMCF), covering staff employed by all NATO bodies. NATO wide financial statements are issued by the NATO-IS Office of Financial Control for the three pension schemes and the RMCF; therefore, no related assets or liabilities are recognised in these financial statements.

Only one staff member remains as an affiliate of the NATO Provident Fund (2 end 2014), which is a defined contribution pension scheme which provides retirement benefits to civilian staff recruited by NATO before 1 July 1974 and who decided not to join the Defined Benefit Pension Scheme set up at this date. Benefits are paid upon retirement as one lump sum, being the total of the individual right acquired. Monthly contributions, paid directly into the Fund, are made by staff and NATO, being 7% and 14% respectively of basic salary.

483 staff members (438 end 2014) participate in the Defined Contribution Pension Scheme (DCPS) administered by NATO. The DCPS provides that the NATO-IS budget makes a 12% monthly matching contribution to the staff members contributions for current service.

528 employees (576 end 2014) participate in NATO's Defined Benefit Pension Scheme (DBPS): a deduction of 9% of their salaries is made and contributed to the annual financing of this Scheme. These contributions are expensed during the year in which the services are rendered and represent the total pension obligation of the entity. The funding mechanism of the DBPS provides that Nations contribute, in the course of a given year, for the difference between amounts due to pensioners and staff contributions received.

Also, 11 staff members are employed on reimbursable basis with an agreement between NATO-IS and the United States. Their salary is paid directly by the US using national salary scales and the US is reimbursed the costs corresponding to the grade of the post occupied by the staff member. Those individuals are paid and accrue pension rights under a United States pension scheme. A similar agreement exists with the Netherlands and currently applies to 1 staff member. An agreement with Norway was signed in 2015 and applies to 2 staff members.

**NOTE 38: KEY MANAGEMENT PERSONNEL**

The North Atlantic Council is the governing body of NATO. It approves the Civil Budget further to screening and recommendation by the Budget Committee (BC) and the Resource Policy and Planning Board (RPPB). Members of the North Atlantic Council, the BC and the RPPB are nominated by their respective national authorities. They are paid on the basis of applicable national pay scales. They do not receive from NATO any additional remuneration for their responsibilities or access to benefits.

For the purposes of IPSAS 20 implementation, key management personnel of the International Staff are the Secretary General, the Deputy Secretary General, the Director of the Private Office, the seven Assistant Secretary Generals, the Senior Civilian Representative in Afghanistan and the three Directors of Independent Offices (Security, Resources and Financial Control). The aggregate remuneration and the number of individuals on a full time equivalent basis are:

Aggregate remuneration: EUR 3,124,070
Number of persons: 14

The Secretary General is provided with accommodation at no cost in premises belonging to the Organisation. The residence is serviced by three established posts. The cost of operating and maintenance of the residence and works are EUR 448,163.60 in 2015 (EUR 192,996.53 in 2014). The increase is due to renovation works. The residence was assessed in November of 2013 as being worth EUR 10,300,000. The Deputy Secretary General is provided with an approved special allowance to contribute towards the lease of accommodation suitable for representation at the Ministerial and distinguished visitor level. The Secretary General is entitled upon departure to a special leaving allowance, equal to one year's basic salary if a full four year term was served.

On 1 June, 2013, the NAC approved changes to the Representation Allowance system. A key element was that in lieu of monthly allowances being paid out and then reimbursed by the recipients if unused, recipients now submit receipts and are then reimbursed up to the allocated ceiling. The OFC is responsible for the day to day verification, with IBAN able to disallow expenses if deemed necessary.

A total of twelve senior staff positions are entitled to a Representation Allowance the use of which is subject to a specific control by the OFC. This includes the Secretary General, the Deputy Secretary General, the Director of the Private Office, the seven Assistant Secretary Generals one Deputy Assistant Secretary General and the Spokesperson. The gross amount paid was EUR 81,305.07 (EUR 89,137.39 in 2014). Unused funds and disallowed expenses are returned to the Organisation.

Key management staff have access to a pool of vehicles for official business.

There is no other remuneration or benefits to key management personnel and their family members. Key management personnel is entitled to receive loans which are also available to other members of the NATO International Staff.

**NOTE 39: RELATED PARTIES**

There have been the following related party relations.

**Member Nations and NATO bodies**

NATO-IS performs certain administrative support and common operating services for which in 2015 a total amount of, respectively EUR 6,301,560.23 (EUR 5,927,585.04 in 2014) and EUR 3,685,830.80 (EUR 3,797,403.10 in 2014) was charged to other NATO bodies and Member Nation delegations. These amounts come as a deduction to the budget contributions due from Nations to fund the Civil Budget.

Belgium provides military personnel in support of activities related to security (Delegation Militaire de la Sécurité Technique) for which EUR 490,431 in 2014 were charged by the Belgian Ministry of Defence and paid by the Civil Budget. Staff in support of communications (Communications Branch of the Situation Centre) is no longer provided directly to the International Staff but via the NCIA.

Also, 11 staff members are employed on reimbursable basis with an agreement between NATO-IS and the United States. Their salary is paid directly by the US using national salary scales and the US is reimbursed the costs corresponding to the grade of the post occupied by the staff member. Those individuals are paid and accrue pension rights under a United States pension scheme. A similar agreement exists with the Netherlands and currently applies to 1 staff member. An agreement with Norway was signed in 2015 and applies to 2 staff members.

**Member and Partner Nations**

The NATO-IS Office of Financial Control is the Treasurer for the operations related to a number of Trust Funds. The Trust Funds were authorized under NATO's Partnership for Peace Programme, the Mediterranean Dialogue Programme, the NATO-Russia Council, the NATO-Ukraine Commission and the NATO-Georgia Commission. The OFC also received financial resources on a bilateral ad-hoc basis from nations in support of specific activities conducted by NATO-IS or as a complement to the Civil Budget funding for certain activities. For Trust Funds a Lead Nation (NATO member) is normally designated. Partner nations can also participate in such additional funding. No management fees are charged by the IS to cover the related costs.

**Employee Benefits**

NATO-IS is responsible for the management at the NATO-wide level for the three pension systems (Provident Fund, Defined Benefit Pension Scheme, Defined Contribution Pension Scheme) and the Retirees Medical Claims Fund. Separate financial statements are issued by the NATO-IS Office of Financial Control. No management fees corresponding to the related costs incurred by NATO-IS are charged to these entities.

**Staff Centre**

In October 2013, Nations approved a new mandate for the Staff Centre under C-M(2013)0054 with a view to transitioning to a fully customer funded model in 2016. An Executive Board was established in 2013 to provide oversight of Staff Centre operations. The Chairman of the Board is nominated by the Secretary General and is currently the ASG EM. Other members of the Board include other Executive Management staff, the IMS Executive Officer and the Director of the Staff Centre. Two members of the Budget Committee attend ex-officio.

Appendix 1 Annex 1 of the C-M outlines under the heading of Category A, all activities that can receive Civil Budget funding.

NATO-IS provides certain administrative support and covers some operating and maintenance services to the Staff Centre in an estimated amount of EUR 1,036,975 (EUR 1,206,639 in 2014).

In accordance with the Council decision on the Mandate of the NATO HQ Staff Centre, the Staff Centre has its own financial statement.