NATO OTAN
NORTH ATLANTIC COUNCIL
CONSEIL DE L'ATLANTIQUE NORD

13 December 2017

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Silence Procedure ends:
19 Dec 2017 17:30

IBAN AUDIT ON THE 2016 FINANCIAL STATEMENTS OF THE NATO PROVIDENT FUND (NPF)

Note by the Secretary General

1. I attach the International Board of Auditors for NATO (IBAN) report on the audit of the 2016 financial statements of the NATO Provident Fund.

2. The IBAN report sets out an unqualified opinion on the financial statements and qualified opinion on compliance.

3. The IBAN report has been reviewed by the Resource Policy and Planning Board (RPPB) (see Annex). I do not believe that this matter requires discussion in the Council. Consequently, unless I hear to the contrary by **17:30 hrs on Tuesday 19 December 2017**, I shall assume that the Council has noted the IBAN report on the 2016 financial statements of the NATO Provident Fund and agreed to the public disclosure of this report, the IBAN audit and the associated 2016 financial statements.

(Signed) Jens Stoltenberg

Annex 1: RPPB Report
Enclosure 1: IBAN Audit

1 Annex
1 Enclosure

Original: English

IBAN AUDIT ON THE 2016 FINANCIAL STATEMENTS OF THE NATO PROVIDENT FUND

Report by the Resource Policy and Planning Board (RPPB)

Reference:
a) IBA-AR(2017)24 - IBAN audit

Introduction

1. This report deals with the IBAN audit of the 2016 financial statements of the NATO Provident Fund (NPF) (reference a))

Discussion

2. The IBAN have issued an unqualified audit opinion on the financial statements and a qualified opinion on compliance for the financial year 2016. The IBAN observed material weaknesses in internal control over financial reporting and the need to enforce controls over the reconciliation of bank balances. There were no observations to follow up from previous audits.

3. The IBAN observed that two material accounting errors were made which required correction with the issuance of revised financial statements by the International Staff's (IS) Office of Financial Control (OFC) in mid July 2017. The IBAN also found three other errors in the financial statements that needed to be corrected which indicated to the IBAN that the IS was not fully ready to issue the financial statements to the Board when it did so on 31 March 2017.

4. The IBAN recommendations to improve the internal controls over financial reporting to ensure the accuracy and overall quality of the financial statements and supporting documentation have been accepted by the IS Financial Controller who also points out that no erroneous payments were made to third parties as a result of the accounting errors.

Conclusion

5. The RPPB notes that action is in hand to address the issues identified by the IBAN and expects these issues not to recur in subsequent financial statements.

Recommendation

6. The RPPB recommends that the Council:

   a) note the IBAN report (IBA-AR(2017)24) along with the present report; and,

   b) agree to the public disclosure of this report, the IBAN audit (reference a) and the associated 2015 financial statements of the NPF.

19 July 2017 FC(2017)039-REV1

NATO PROVIDENT FUND

Financial Statements
2016

Table of Contents

pp Jens STOLTENBERG
Secretary General

Stephane CHAGNOT
Financial Controller

Annex 1 to
FC(2017)039-REV1

The NATO Provident Fund
Statement of Net Assets Available for Benefits

(All amounts in EUR)	Notes	Current Year 31-Dec-2016	Prior Year 31-Dec-2015
Assets			
Cash and Cash Equivalents	(3)	117,775.15	1,122,140.38
Investments	(4)	2,937,907.38	5,427,652.55
Accounts Receivable			
Outstanding Contributions	(5)	0.00	0.00
Other Receivables	(6)	583,874.39	0.00
Bank interest accrued	(7)	0.00	8.34
Rounding on Net Asset Value		0.00	0.00
Total assets		**3,639,556.92**	**6,549,801.27**
Liabilities			
Payable to former staff	(8)	466,759.78	1,653,406.67
Payable to other NATO bodies	(9)	915,955.15	0.00
Bank charges to be paid	(7)	104.67	6.05
Miscellaneous Gains/Losses	(10)	0.00	6,781.51
Rounding on Net Asset Value		0.00	0.05
Total Liabilities		**1,382,819.60**	**1,660,194.28**
Net assets available for benefits		**2,256,737.32**	**4,889,606.99**

The NATO Provident Fund

Statement of Changes in Net Assets Available for Benefits

(All amounts in EUR)	Notes	Current Year	Prior Year
		31-Dec-16	31-Dec-2015
Increase in net assets			
Change in value of the Fund	(11)	114,394.13	243,792.44
Contributions	(12)	78,547.40	120,970.80
Housing loan reimbursements	(13)	0.00	32,239.36
Net Gains Invested	(14)	0.00	0.00
Miscellaneous	(15)	20,101.35	
Total increase in net assets available for benefits		**213,042.88**	**397,002.60**
Decrease in net assets			
Accounts closed (Staff)	(16)	2,389,215.45	4,877,598.03
OAP, Housing Loans and Advances on Full Settlement	(17)	456,680.00	287,000.00
Administrative expenses	(18)	0.00	201.51
Bank costs	(7)	17.10	59.45
Total decrease in net assets available for benefits		**2,845,912.55**	**5,164,858.99**
Net change for the year		-2,632,869.67	-4,767,856.39
Net assets available for benefits, beginning of year		4,889,606.99	9,657,463.38
Net assets available for benefits, end of year		**2,256,737.32**	**4,889,606.99**

**EXPLANATORY NOTES TO THE 2016 FINANCIAL STATEMENTS
OF THE NATO PROVIDENT FUND**

NOTE 1: GENERAL INFORMATION

Description of the Provident Fund

The NATO Provident Fund (the Fund) 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.

The Provident Fund is a cash purchase pension scheme. Both staff and NATO contribute to the Scheme. There is no long term liability for NATO related to the Provident Fund.

An account is opened for each member of the Fund. Contributions are invested according to a strategy approved by the Provident Fund Board of Supervisors and applicable to all members. Contributions are invested in a single fund, currently transferred to an insurance company which guarantees a minimum rate of return. Members can check the status of their accounts via a secure web portal.

Upon departure, the member’s account is disinvested.

The number of affiliates is decreasing steadily. At end 2016, 3 staff members were affiliated to the Fund (7 at end 2015 and 17 at end 2014). It is forecast that all members will have left the Fund by 2019.

The rules and principles governing the Provident Fund are provided under Annex VII of the NATO Civilian Personnel Regulations.

Financing

Monthly contributions are made by staff and NATO, being 7% and 14% respectively of basic salary.

Governance

The Fund is administered in accordance with the NATO Civilian Personnel Regulations (CPRs), Annex VII (A, B and C). The NATO Secretary General is responsible for its administration and is assisted by a consultative committee (Board of Supervisors) to carry out this task.

The CPRs (Annex VII.A. Article 3) state that the Board is chaired by the Assistant Secretary General, Executive Management and as Chairman of the Board is responsible for the administration and management of the Fund.

The Board consists of the Chair, six representatives of the administrative services of various NATO bodies, and six representatives of staff affiliated to the Provident Fund.

In 2013, in consideration of the reduced number of members, the Board decided it would only meet in cases of significant or unforeseen events affecting the Fund. As a consequence, it has not met since.

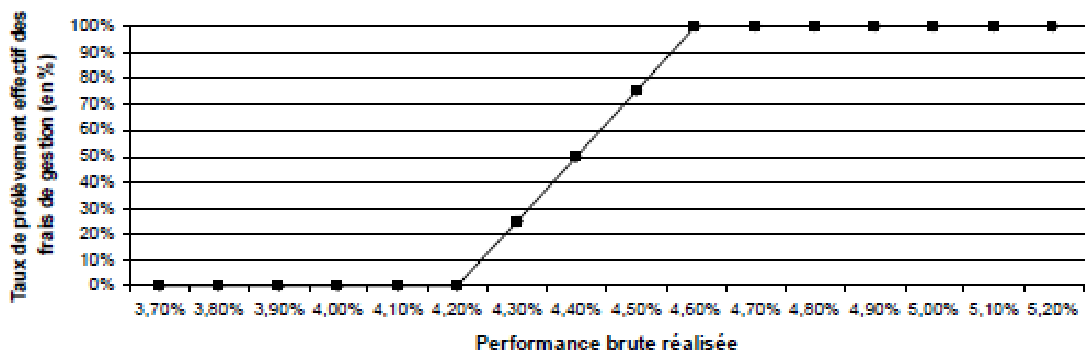
Board members do not receive any additional remuneration for their responsibilities or access to benefits from NATO.

Investment Strategy

In 2007, per PO(2007)0059), Council approved rules adapting the governance of the Fund as well as a new financial management approach in order to address the issue of the decreasing number of affiliates.

Throughout the years, the Fund has consistently been managed with the aim of obtaining a steady return against a low degree of risk. In 2008, the Board approved a solidarity-based investment strategy to address the investment needs of the Fund and following an open call for bids, an insurance company, SOGECAP, was selected on 4 June 2009. SOGECAP's insurance contract guarantees the capital and a minimum net annual return of 3%.

SOGECAP is contractually committed to reduce its fees if the gross return is below 4.6%. The diminution is gradual (see graph below) if the gross return is lower. No management fees are charged if the gross return is less than 4.2%.



NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

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

Declaration of conformity

The financial statements of the NATO Provident Fund have been prepared in accordance with the NATO Financial Regulations and International Accounting Standard 26, "Accounting and Reporting by Retirement Benefit Plans". The NATO Accounting Framework, which is an adapted version of the International Public Sector Accounting Standards (IPSAS), does not have a specific standard for accounting and reporting by retirement benefit plans.

The accounting system currently used by the Fund is accrual based.

Basis of presentation

The financial statements have been prepared on a going-concern basis: the Provident Fund will continue operating for the foreseeable future.

In accordance with the Regulations of the Provident Fund all amounts are expressed in Euro.

Changes in accounting policy

There are no changes to report.

Foreign currency transactions

All contributions are made and accounted for in euro.

The amounts standing to the credit of affiliates should be paid in the currency of the country where the body employing them is located. All affiliates are currently employed in bodies based in the Euro zone. However, depending on their nationality, staff might request the redemption of their holdings in a currency other than Euro. Transfers are made at the NATO parity rates prevailing on the date the account is closed.

Cash and Equivalents

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

Invested Funds

At the end of each reporting period, a valuation of the Fund is made by the insurance company at market value.

Contributions

Employer and employee contributions are jointly received on the Provident Fund account from the various NATO payroll centres on a monthly basis. They are received and accounted for in euro. An accrued amount is booked for amounts due but not received by year end.

Receivables

Receivables are stated at net realisable value. No allowance for loss is recorded for receivables relating to NATO bodies' statutory contributions.

Payables

Payables are amounts due to third parties based on goods received or services provided that remain unpaid. This includes, as required, an estimate of accrued obligation for goods received or services provided but not yet invoiced.

Financial Risks

Financial instruments

The Provident Fund uses only non-derivative financial instruments as part as its normal operations. These financial elements include cash bank accounts, deposit accounts, accounts receivable and funds invested with SOGECAP.

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

The Provident Fund is exposed to a variety of financial risks, including credit risk, market (price) risk and liquidity risk. The maximum exposure as at 31 December 2015 is equal to the total amount of bank balances, short term deposits, investment funds, and receivables.

Credit risk

The Provident Fund incurs credit risks from cash and cash equivalent held with banks and receivables. There is very limited credit risk associated with the realization of these elements.

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

ING Bank Credit Ratings as at 07/02/2017

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

SOGECAP was rated A for long-term and A-1 for short-term counterparty credit risk and insurer financial strength by S&P on 16 February 2017.

At year end 2015, SOGECAP had a solvency ratio of 108% (108% in 2014). The ratio as of 31 December 2016 was not known at the date of issuance.

SOGECAP is wholly owned by SOCIETE GENERALE which is rated as follows:

Société Générale	Credit Ratings as at 16/02/2017		
	Fitch	Moody's	S&P
Short term	F1	P1	A-1
Long term	A	A2	A

Concerning receivables, the credit risk is managed by maintaining control procedures over receivables. These consist essentially of contributions due by NATO agency payroll centres. This risk is considered limited since these agencies are funded by member nations which are considered credit worthy.

Currency risk

The Provident Fund is exposed to foreign currency exchange risk arising from fluctuations in currency rates. This risk is limited since the scheme receives contributions only in Euro, the investments underlying the insurance contract are in Euro and members' holdings are accounted for in Euro. However, staff may request payment of their holdings in a currency other than Euro and currency fluctuations may occur between the date the staff formally retires and the date the payment is made.

Liquidity risk

A liquidity risk could arise from a short term liquidity requirement. There is a very limited exposure to liquidity risk because contributions needed to pay the insurance premiums are paid by NATO bodies which receive contributions from member states funding the related budgets, or income from their customers which generally are other NATO bodies funded through their approved budgets. On occasion, NATO-IS makes cash advances to ease-up payment procedures. With regard to capital, the insurance contract guarantees the payment of the affiliates' accounts due upon closure of their account in the Provident Fund.

Interest rate risk

The Provident Fund is restricted from entering into borrowings.

The contract with the insurance company guarantees a minimum rate of return of 3% per annum. The contract renews automatically at the end of each year from 31 December 2016 forward unless terminated in writing by one of the parties.

NOTE 3: CASH AND CASH EQUIVALENTS

Besides the funds managed by SOGECAP, the Provident Fund holds one bank account to collect contributions to be transferred to SOGECAP for investment and to transfer funds to the affiliates after redemption by SOGECAP. This amount corresponds to the funds held on the bank account at the year end.

Cash held end 2016 is essentially made of the net result of treasury operations with the International Staff and of staff member contributions for the month of December 2016 waiting to be transferred. Cash held end 2015 also included funds received from the fund manager awaiting detailed payment instructions from beneficiaries; this is the main reason for the decrease in cash holdings.

NOTE 4: INVESTMENTS

The decrease in the invested amounts is due to the reduction in the number of Provident Fund members.

In 2016 the gross and net returns to NATO were both 3.00% (3.40% in 2015). In accordance with the contract, SOGECAP received no management fee.

The funds underlying the insurance contract are invested in the "Top Croissance 6" mutual fund, which had a total market value of assets under management of EUR 14.4 billion. At 31 December 2016, the asset distribution was as follows:

Asset Allocation

	% end 2016	% end 2015
Fixed Income (fixed rate)	79.0%	79.9%
Fixed Income (variable rate)	1.6%	1.7%
Convertible Bonds	0.3%	0.4%
Equities and Equity Mutual Funds	9.1%	8.6%
Mutual funds (bonds)	6.2%	5.3%

Real Estate	4.2%	3.8%
Liquidity	-0.4%	0.3%
Total	100.00%	100.0%

Bond portfolio rating breakdown:

RATING	end 2016	end 2015
AAA	8.9%	10.9%
AA	50.4%	50.9%
A	25.4%	23.3%
BBB	13.0%	12.2%
BB	2.1%	2.2%
B	0.2%	0.5%
	100.0%	100.0%

Sovereign bond allocation by country:

Sovereign bonds country allocation in %	end 2016	end 2015
Australia	1.3	1.5
Austria	0.3	0.3
Belgium	2.4	2.6
Canada	1.6	1.7
Finland	0.3	0.4
France	59.7	62.1
Germany	0.1	0.1
Ireland	1.9	1.5
Italy	5.8	6.1
Luxembourg	3.3	3.8
Netherlands	3.7	3.2
Norway	0.0	0.5
Spain	5.3	5.7
Sweden	1.5	0.8
Other	5.0	3.0
United Kingdom	4.6	3.8
USA	3.2	2.8
	100.0	100.0

NOTE 5: OUTSTANDING CONTRIBUTIONS RECEIVABLE

Contributions are paid on a monthly basis. Receivables relate to outstanding contributions due at the end of the year but paid in the following year. As at 31 December 2016, there were no uncollected contributions for covered parties.

NOTE 6: OTHER RECEIVABLES

An amount of EUR 583,874.39 was due from the International Staff at the end of 2016 to regularize miscellaneous treasury operations.

NOTE 7: INTERESTS AND BANK CHARGES

This corresponds to interest earned on the transition bank account and received during the following year and to related bank charges due.

NOTE 8: PAYABLE TO FORMER STAFF - CLOSED ACCOUNTS TO BE SETTLED.

This corresponds to the value of the affiliates' accounts closed in December and loans to current affiliates to be paid to them at the beginning of the following year.

The reduction of the amount from year to year is linked to the number of staff in such situation and their respective holdings.

NOTE 9: PAYABLE TO OTHER NATO BODIES

Corresponds to amounts due to NATO bodies who, in accordance with Provident Fund regulations, have advanced 1/3 of staff members' accounts before final settlement.

Amounts may be due to the NATO International Staff for advances it may make to enable the Provident Fund to settle the accounts of affiliates. There were no such advances end 2015. The advances end 2016 were reimbursed in early 2017.

NOTE 10: MISCELLANEOUS GAINS/LOSSES

This corresponds to the cumulative amount of miscellaneous net income, essentially interests net of bank charges and fees on premiums. The Board of Supervisors agreed that the balance of bank interest above Euro 5,000.00 be distributed to affiliates' accounts rather than be used for payment of bank fees. (CSCP-R(2011)0001 dated 4 March 2011).

NOTE 11: UNREALISED GAIN IN VALUE OF THE FUND

The unrealised change in the value of the Fund is calculated as follows:

	2016	**2015**
Balance beginning of year	**4,889,606.99**	**9,657,463.38**
Contributions	78,547.40	120,970.80
Loan reimbursements	0.00	32,239.36
Accumulated interest invested	0.00	0.00
Accounts closed	-2,389,215.45	-4,877,598.03
O.A.P., Loans and advances	-456,680.00	-287,000.00
Administrative expenses		-201.51
Bank charges	-17.10	-59.45
(a)	**2,122,241.84**	**4,645,814.55**
(b) Net assets available end of year (excl. reguls.)	**2,236,635.97**	**4,889,606.99**
(b) - (a)	**114,394.13**	**243,792.44**

NOTE 12: CONTRIBUTIONS

Monthly contributions are made by staff and NATO, being 7% and 14% (netted as required from any OAP contribution, see Note below) respectively of basic salary. They are to be transferred as premiums to the insurance company and are credited to the individual account of the affiliates. The decrease in contributions is due to the reducing membership of the Provident Fund.

Contributions (in EUR)	2016	2015
Employer	52,364.93	80,647.20
Employee	26,182.47	40,323.60
TOTAL	**78,547.40**	**120,970.80**

NOTE 13: HOUSING LOAN REIMBURSEMENTS BY STAFF

According to the CPRs, Articles 54.1 and 54.2, each member of the Fund is entitled to withdraw an amount from his (her) account: for payment to an old-age pension scheme (OAP) or the pension scheme applying in his (her) national administration; or to ease a housing problem.

Housing Loans reimbursements are usually handled via deductions from their salaries and amounts are re-credited to the member's account. Staff may make exceptional reimbursement.

NOTE 14: NET GAINS INVESTED

The Board of Supervisors' decision (CSCP-R(2011)0001 dated 4 March 2011) stated that the balance of bank interest above Euro 5,000.00 should be distributed to affiliates' accounts rather than be used for payment of bank fees.

NOTE 15: MISCELLANEOUS

An amount of EUR 20,101.35 corresponds to a regularization of past transactions.

NOTE 16: ACCOUNTS CLOSED

Corresponds to the final settlement for staff who left the Organisation in the course of the year. In the long run, the evolution is driven by the declining membership of the Fund. However, given the small number of departing staff, this evolution can be irregular from one year to the other.

NOTE 17: OLD AGE PENSIONS, HOUSING LOANS AND ADVANCES ON FULL SETTLEMENT PAID TO STAFF

Staff can request, to have one-third of the amount of their individual account, paid in advance (not earlier than three months prior to their date of departure). The advance is made by each NATO entity, which is reimbursed when the affiliates' portfolio is disinvested.

According to the CPRs, Articles 54.1 and 54.2, each member of the Fund is entitled to withdraw an amount from his (her) account: for payment to an Old Age Pension scheme (OAP) or the pension scheme applicable in his (her) national administration, or to ease a housing problem.

The breakdown between OAP contributions, housing loans and advances on Full Settlements paid to affiliates at their request is as follows:

In EUR	2016	2015
Old Age Pensions	0.00	0.00
Housing Loans	0.00	0.00
Advances on Full Settlement	456,680.00	287,000.00
TOTAL	**456,680.00**	**287,000.00**

NOTE 18: ADMINISTRATIVE EXPENSES

These are essentially fees on premiums (0.18%) and bank costs.

NOTE 19: CONTINGENT ASSETS

None to report.

NOTE 20: CONTINGENT LIABILITIES

There are no material contingent liabilities arising from legal actions and claims that are likely to result in significant liability to the Provident Fund.

NOTE 21: RELATED PARTY TRANSACTIONS

The following party transactions took place during the year ended 31 December 2016.

NATO International Staff, in particular Executive Management – Human Resources and the Office of Financial Control, are responsible for the day-to-day management of the Provident Fund.

Administrative support provided by NATO International Staff for the administration of the Fund is charged to other NATO bodies according to a cost share which takes into account the number of their affiliates. This includes the cost of International Staff - Office of Financial Control personnel (50% Full Time Equivalent of a B5 grade staff). Costs related to the outsourced administration of affiliates' holdings (including Internet services service so that affiliates can see the value of their Fund on a monthly basis) are funded through the NATO Civil Budget.

In specific circumstances cash advances are made by the International Staff to ease-up payment procedures. Reimbursement to the NATO International Staff account is done as soon as technically possible.

The Fund does not hold any securities of the employer sponsor or, directly, of its related parties.

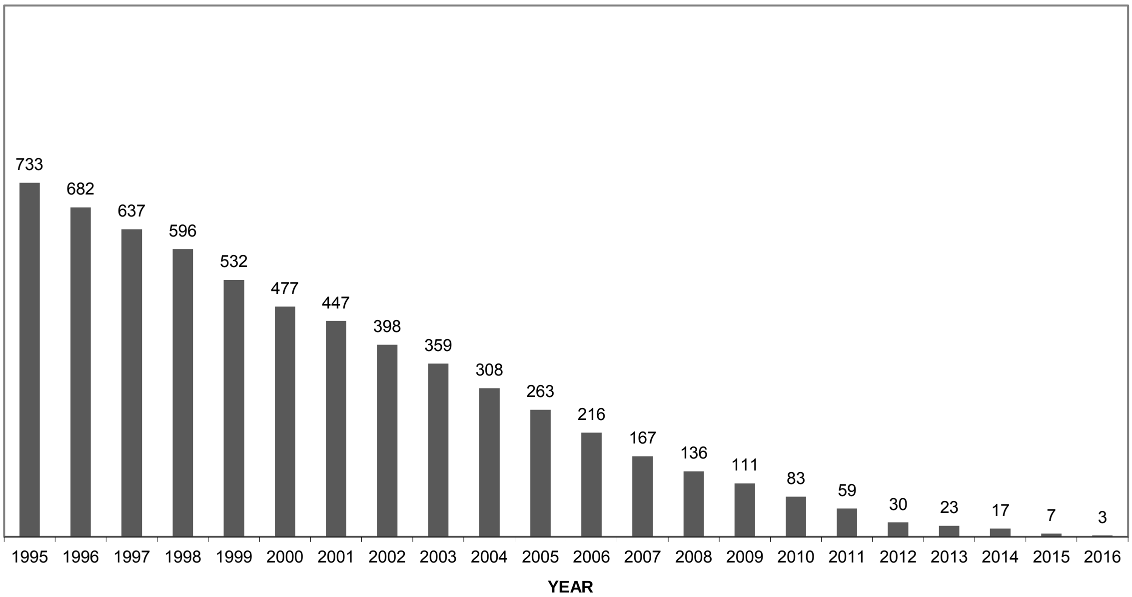
NOTE 22: KEY MANAGEMENT PERSONNEL

For the purpose of these financial statements, key management personnel are considered to be the Assistant Secretary General for Executive Management and the Financial Controller of the International Staff. Their remuneration is entirely covered by the NATO International Staff.

Members of the Provident Fund Board of Supervisors do not receive any additional remuneration or benefits in return for their responsibilities. The Board of Supervisors is chaired by the Assistant Secretary General for Executive Management. The International Staff Financial Controller is a member of the Board.

NOTE 23: STATISTICAL INFORMATION

NUMBER OF AFFILIATES TO THE PROVIDENT FUND
NOMBRE D' AFFILIES AU FONDS DE PREVOYANCE 1995 - 2016



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List of acronyms:

CPRs: Civilian Personnel Regulations
FTE: Full Time Equivalent
IPSAS: International Public Sector Accounting Standards
OAP: Old Age Pension
PF: Provident Fund

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

The Board audited the NATO Provident Fund which provides retirement benefits to civilian staff who joined NATO before 1 July 1974, and who are not members of the NATO Pension Scheme. The value of the Fund's net assets available for benefits at 31 December 2016 was EUR 2.3 million. As at that date, there were three members contributing to the Fund.

The Board issued an unqualified opinion on the NATO Provident Fund's Financial Statements and a qualified opinion on compliance for the year ended 31 December 2016.

During the audit, the Board made three observations with recommendations which are summarised below:

One observation impacts the audit opinion on compliance:

1. Material weaknesses in internal control over financial reporting.

The remaining observation does not impact the audit opinion:

2. Controls over the reconciliation of bank balances need to be enforced.

The Auditor's Report (Annex 2) and the Letter of Observations and Recommendations (Annex 3) were issued to the International Staff whose comments have been included, see the Appendix to Annex 3.

ANNEX 2
IBA-AR(2017)24

31 August 2017

INTERNATIONAL BOARD OF AUDITORS FOR NATO

AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF THE NATO PROVIDENT FUND FOR THE YEAR ENDED 31 DECEMBER 2016

AUDITOR'S REPORT TO THE NORTH ATLANTIC COUNCIL AND STAFF MEMBERS AFFILIATED TO THE NATO PROVIDENT FUND

Report on the Financial Statements

The International Board of Auditors for NATO (Board) audited the attached financial statements of the NATO Provident Fund for the year ended 31 December 2016, which comprise the Statement of Net Assets Available for Benefits as at 31 December 2016, the Statement of Changes in Net Assets Available for Benefits and the Explanatory Notes, including a summary of significant accounting policies.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Accounting Standard (IAS) 26 *Accounting and Reporting by Retirement Benefit Plans*[1] and the requirements of the NATO Financial Regulations as authorized by the North Atlantic Council. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

[1] As the NATO Accounting Framework does not have a standard specific to accounting and reporting by retirement plans, the NATO International Staff presents the DCPS Financial Statements in accordance with IAS 26.

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

Opinion on Financial Statements

In our opinion, the financial statements present fairly, in all material respects, the financial position of NATO Provident Fund as of 31 December 2016, the changes in financial position thereof for the year then ended in accordance with IAS 26.

Report on Compliance

Management's Responsibility for Compliance

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

Auditor's Responsibility

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

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

Basis for Qualified Opinion on Compliance

The NATO Financial Regulations require the establishment of a system of internal control. We found material weaknesses in internal control over financial reporting due to material errors and misrepresented balances in the original financial statements issued to us on 31 March 2017. Further details can be found in observation 1 in the Letter of Observations and Recommendations (Annex 3). Furthermore, a material erroneous internal transfer payment was made from the Provident Fund bank account to an International Staff bank account, which indicates a material weakness in internal controls over internal transfer payments.

Qualified Opinion on Compliance

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

Brussels, 31 August 2017

Hervé-Adrien Metzger
Chairman

31 August 2017

INTERNATIONAL BOARD OF AUDITORS FOR NATO

LETTER OF OBSERVATIONS AND RECOMMENDATIONS

FOR THE NATO PROVIDENT FUND

FOR THE YEAR ENDED 31 DECEMBER 2016

Introduction

The International Board of Auditors for NATO (Board) audited the NATO Provident Fund Financial Statements for the year ended 31 December 2016, and issued an unqualified opinion on those financial statements and qualified opinion on compliance.

Observations and Recommendations

During the audit, the Board made two observations with three recommendations which are summarised herein:

One observation impacts the audit opinion on compliance:

1. Material weaknesses in internal control over financial reporting.

The remaining observation does not impact the audit opinion:

2. Controls over the reconciliation of bank balances need to be enforced.

There were no observations to follow-up from previous years' audits.

This Letter of Observations and Recommendations was formally cleared with the International Staff, and the formal comments are included (Appendix, Annex 3).

OBSERVATIONS AND RECOMMENDATIONS

1. MATERIAL WEAKNESSES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

Reasoning

1.1 According to paragraph VI 4) (c) of the NATO Financial Rules and Procedures (FRPs), 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, are controlled by periodic inspection.

1.2 According to Article 6.1 of the NATO Financial Regulations (NFRs), the Financial Controller is responsible for the organization and administration of the financial internal control system.

1.3 According to FRP XXXI "Management of Bank Accounts", the Financial Controller shall be responsible for the establishment and overall management of all bank and short term low risk investment accounts to be operated by the Treasury and Disbursing Officers designated pursuant to FRP VI.

1.4 According to best practices, the process of preparation of the financial statements involves a number of actors, performing multi-level review of the financial statements in order to ensure their quality and reduce the risk of material errors.

Observations

1.5 In the original financial statements issued on 31 March 2017, the NATO Provident Fund recognized a decrease in net assets available for benefits in the amount of EUR 1.9 million due to the closure of staff accounts in 2016. The Board found that a closure in the amount of EUR 456,680 was not captured in the accounting system. Had management correctly recorded the abovementioned redemption, the amount of staff accounts closed in 2016 and the related accounts payable as of 31 December 2016 would have been increased by EUR 456,680. This material error was corrected with the issuance of revised financial statements on 19 July 2017.

1.6 In December 2016, a consultant working for the International Staff's (IS) Office of Financial Control (OFC) performed an erroneous internal transfer of EUR 583,874 that was paid from the Provident Fund bank account to an IS bank account. The amount was repaid from the IS bank account in January 2017. This erroneous internal transfer payment was subsequently detected by the OFC. Nevertheless, this transaction indicates a weaknesses in internal controls over payment authorization and execution. Moreover, the amount was disclosed as "Outstanding Contributions" on the Statement of Net Assets Available for Benefits for the year ended 31 December 2016, which does not properly reflect the nature of the balance. This material error was corrected with the issuance of revised financial statements on 19 July 2017.

1.7 The Board found other errors in the financial statements:

- The financial statements included an increase in net assets available for benefits in the amount of EUR 20,101 related to miscellaneous income. The nature of the balance is prior period transactions that were not captured in the prior period accounting.

- The references to explanatory note numbers on the primary financial statements did not in all cases correspond to the actual explanatory notes (for example, Notes 5 to 9). This error was corrected with the issuance of revised financial statements on 19 July 2017.

- The bank charges for 2016, disclosed in Note 11, Unrealized Gain in Value of the Fund, did not reconcile to the amount of bank charges in the Statement of Changes in Net Assets Available for Benefits. While both amounts are immaterial, the difference indicates an underlying accounting weaknesses. This error was corrected with the issuance of revised financial statements on 19 July 2017.

1.8 These material errors and the fact that revised financial statements were issued on 19 July 2017 indicate to the Board that the IS was not fully ready to issue the financial statements to the Board when it did so on 31 March 2017. While issuing the financial statements to the Board for audit by 31 March in accordance with the NFRs is important, proper internal control need to be in place to ensure that the financial statements issued are fairly presented.

Recommendations

1.9 The Board recommends improving the system of preventive and detective controls over accounting and financial reporting and payment authorization and execution.

1.10 The Board recommends implementing the multi-level financial statements review process in order to ensure the mathematical accuracy and overall quality of the produced financial statements and supporting documentation.

2. CONTROLS OVER THE RECONCILIATION OF BANK BALANCES NEED TO BE ENFORCED

Reasoning

2.1 According to paragraph VI 4) (c) of the FRPs, 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.

Observation

2.2 The Board found that the IS did not perform monthly reconciliations of cash balances between the accounting system and bank statements during 2016. The IS provided the Board with a spreadsheet showing such a reconciliation as of 31 December 2016, although there was no evidence that this control was performed in a timely basis and it also was not signed by the preparer or reviewer.

Recommendation

2.4 The Board recommends performing and documenting monthly cash reconciliations between the bank balances and the amounts presented in the accounting system. This will help to identify misstatements (if any) on a timely basis. This should include signatures of the preparer and reviewer along with the dates.

INTERNATIONAL STAFF (IS) FORMAL COMMENTS ON THE LETTER OF OBSERVATIONS AND RECOMMENDATIONS

OBSERVATION 1., para 1.6: MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

International Staff's formal comments

The Financial Controller agrees with the recommendations.

Concerning the internal transfer transaction referred to at paragraph 1.6, it must be noted that it is a general ledger transaction, not an accounts payable one. It was done between bank accounts controlled by the IS. A transfer from one bank account to another, when the accounts are all under the control of NATO IS, does not incur the risks implied by IBAN's observation. Indeed, as noted by IBAN, the Office of Financial Control spotted the transaction as a duplication and reversed it in 2017. No erroneous payments were made to third parties and all payments were duly authorized.

OBSERVATION 2., para. 2.4: CONTROLS OVER THE RECONCILIATION OF BANK BALANCES NEED TO BE ENFORCED

International Staff's formal comments

The recommendation is agreed. Such reconciliations will be added to the current reconciliations between bank statements and the accounting system's cash management module.