NATO OTAN
NORTH ATLANTIC COUNCIL
CONSEIL DE L'ATLANTIQUE NORD



19 May 2023

**DOCUMENT**
PO(2023)0164-AS1 (INV)



# IBAN REPORT ON MAIN FINDINGS FROM THE 2021 FINANCIAL STATEMENTS AUDITS

## ACTION SHEET

On 17 May 2023, under the silence procedure, the Council noted the RPPB Report, agreed its conclusions and recommendations, noted the IBAN Report attached to PO(2023)0164 (INV) and agreed to the public disclosure of this report and the IBAN Report.

(Signed) Jens Stoltenberg
Secretary General

NOTE: 1. This Action Sheet is part of, and shall be attached to PO(2023)0164 (INV).

**NATO UNCLASSIFIED**
Releasable to Sweden

10 May 2023

**DOCUMENT**
PO(2023)0164 (INV)
**Silence Procedure ends**:
**17 May 2023 – 17:30**



To: Permanent Representatives (Council)

From: Secretary General

## IBAN REPORT ON MAIN FINDINGS FROM THE 2021 FINANCIAL STATEMENTS AUDITS

1. I attach the Resource Policy and Planning Board (RPPB) report on the International Board of Auditors for NATO (IBAN) Report to Council on Main Findings from the 2021 Financial Statements Audits. The IBAN Report provides an overview to Council on the main findings of the 2021 financial statements audits to further enhance Council's ability to oversee and account for the Organisation's resources.

2. The IBAN Report has been reviewed by the RPPB (see Annex 1).

3. I do not believe this issue requires further discussion. Therefore, **unless I hear to the contrary by 17:30 hours on Wednesday, 17 May 2023**, I shall assume the Council noted the RPPB report, agreed its conclusions and recommendations, noted the IBAN Report and agreed to the public disclosure of this report and the IBAN Report.

(Signed) Jens Stoltenberg

1 Annex
1 Enclosure

Original: English

# IBAN REPORT ON MAIN FINDINGS FROM THE 2021 FINANCIAL STATEMENTS AUDITS

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

References:

| | | |
|---|---|---|
| A. | IBA-M(2022)0150 | IBAN Report to Council on Main Findings from the 2021 Financial Statements Audits |
| B. | C-M(2015)0025 | NATO Financial Regulations (NFR) |
| C. | C-M(2016)0023 | NATO Accounting Framework (NAF) |
| D. | PO(2022)0503 (INV) | IBAN Audit Report on the audit of 2021 financial statements of NATO Communications and Information Organisation (NCIO) |
| E. | PO(2015)0052 | Wales Summit tasker on transparency and accountability |

## INTRODUCTION

1. This report by the RPPB addresses the IBAN report on main findings from the 2021 financial statements audits (reference A). The IBAN report provides an overview to Council on the main findings of the 2021 financial statements audits to further enhance Council's ability to oversee and account for the organisation's resources.

## AIM

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

## DISCUSSION

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

4. In IBAN's view, in order to improve the quality of financial information in support of decision-making, based on the legal framework of NATO, a simplification of NATO's Financial Reporting and Accountability Framework (FRAF) is possible by decreasing the number of general purpose financial statements and audit reports without any loss in transparency and accountability. The RPPB generally supports the potential simplification of financial reporting and proposes further deliberations to obtain more details regarding this topic.

5. Size and scale of Reporting Entities. In 2021 NATO Reporting Entities had annual expenses ranging from approximately EUR 1 million to EUR 2,795 million and therefore experienced varying degrees of complexity and materiality in financial reporting and

accountabilities depending on their size and mandate. For 2021, the IBAN also provided information on Total Operational Budget Expenditure in 2021 per NATO Reporting Entity acting as an Agent.

5.1. IBAN audit opinions, current and prior year observations:

5.1.1. The IBAN notes the stable trend from 2019 to 2021[1] in the number of unqualified audit opinions issued both on financial statements (20 in 2019, 21 in 2020 and 20 in 2021) and on compliance (21 in 2019, 19 in 2020 and 20 in 2021). However, seven financial statements were resubmitted to the IBAN after the 31 March 2022 deadline, by five NATO Reporting Entities[2], correcting material misstatements or disclosures found during the audit, potentially qualifying the audit opinion on the financial statements. This indicates that significant progress in the financial reporting process and internal controls is still required.

5.1.2. During the same period, the overall number of qualified opinions on financial statements and compliance remained generally constant ranging from two to four per annum. Nevertheless, the number of qualified opinions on compliance decreased from one qualified opinion in 2021 compared to three in 2020. In 2021, the IBAN issued a qualified audit opinion on the 2021 financial statements and on compliance for the NATO Communications and Information Organisation (NCIO). The observation for NCIO relates to the completeness of Property, Plant & Equipment (PP&E) and intangible assets, including assets under construction. At the RPPB meeting held on 20 October 2022, the RPPB expressed its expectations for the NCIO to meet all the necessary requirements to implement this recommendation by the end of 2022 (reference D). The constant trend of unqualified opinions on the financial statements reflects in overall terms that NATO is continuing its efforts regarding the implementation of the NATO Accounting Framework (NAF) (reference C).

5.1.3. The total number of observations and recommendations has decreased in 2021 by about 20% as well as the number of newly issued observations (40 in 2019, 41 in 2020 and 34 in 2021). Among prior year recommendations, the IBAN also notes a reduced number of recommendations in-progress and open recommendations in 2021. IBAN's analysis of all outstanding recommendations indicate that NATO Reporting Entities are generally addressing and implementing IBAN recommendations in a timely manner[3], confirmed by the trend of improvement in the quality of information in the financial statements and in compliance with NATO Financial Regulations (NFR) (reference B). However, there is still a number of outstanding recommendations that need to be addressed, some of which related to resubmissions correcting material errors.

---

[1] In 2021, the IBAN audit mandate covered 21 NATO Reporting Entities compared to 22 in 2019 and 2020.

[2] This year, two NATO Reporting Entities requested the IBAN to audit a second resubmission of their financial statements.

[3] 29 recommendations out of 82, or 35%, relate to the prior three financial years (2018-2020), and 19 recommendations, or 23%, relate to recommendations raised in the 2017 financial year or before.

5.1.4. In 2021, the IBAN communicated one Emphasis of Matter paragraph to draw users' attention to a matter presented or disclosed in the NATO Support and Procurement Organisation (NSPO) 2021 financial statements. No key audit matters or other matters were raised in 2021.

6. Grouping of observations and recommendations: The IBAN categorised the observations and recommendations into five distinct themes for their report:

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

6.1. While being the most significant in terms of total number, the first theme shows decrease in the number of IBAN observations and recommendations from 44 to 33 from 2020 to 2021. It relates to the preparation and presentation of the financial statements, budget execution statements, accounting and associated internal control and IT processes. However, it also relates to the open recommendation regarding the recognition of post-employment liabilities in the NATO Reporting Entities' financial statements to comply with the NAF (IPSAS 39, Employee Benefits), which will be addressed through a separate RPPB report.

6.2. The number of recommendations in the second theme have remained substantially stable since 2019 and there were eleven recommendations in 2021 for seven NATO Reporting Entities. It calls for more progress by NATO Reporting Entities to improve financial accounting and reporting of PP&E as well as inventory and intangible assets. Given the significant amounts involved, this theme is important as it may lead to qualified opinions in the future.

6.3. The number of recommendations in the third theme has remained relatively stable for the last three years while the number of recommendations in the fourth theme significantly decreased since 2020 from 14 to six. These two themes include recommendations related to procurement processes and arrangements between NATO Reporting Entities or with Nations as well as recommendations related to revenues, calculation of customer rates and overhead assumptions and cash management. While being the second most significant in terms of total number, the number of recommendations in the fifth theme declined from 28 in 2020 to 25 in 2021. The majority of recommendations were related to compliance with the NFRs on risk management, internal control, the statement of internal control and internal audit.

7. The RPPB recognises the IBAN's key role in providing independent assurance and advice to Council and is encouraged to note the stable number of unqualified opinions and new recommendations issued during the past three years. The RPPB also welcomes the decrease in the number of observations and recommendations since last year and the

readiness of entities to close them. On the other hand, the RPPB expresses concerns with regards the resubmission of seven financial statements made by five NATO Reporting Entities after 31 March 2022 correcting material misstatements or disclosure. It clearly indicates that progress is still needed to strengthen internal controls over the financial reporting process in compliance with the NAF. In order to mitigate the risk of its continuous resubmission, the RPPB expects adequate actions from the management of the corresponding entities to prevent this trend from becoming a systematic issue.

8. In addition, the RPPB notes that in order to address observations that are in-progress or open for more than three years, a clear remedial action plan should be provided to the Council with deadlines on the implementation of the outstanding recommendations, submitted with the auditee's response on the IBAN audit of the 2022 financial statements.

**CONCLUSIONS**

9. The RPPB welcomes the assessment undertaken by IBAN on the main audit findings on the 2021 financial statements of NATO Reporting Entities allowing Council to focus on strategic issues and provide an overall assessment on the progress made by NATO Reporting Entities in connection with improving financial management, transparency, accountability and consistency.

10. The RPPB welcomes the stable trend in the total number of unqualified audit opinions and new recommendations and the decrease in the number of observations and recommendations in 2021.

11. Notwithstanding, the RPPB notes IBAN concern that:

11.1. Five NATO Reporting Entities (ACO, IS, NAHEMO, NAPMA and NCPS)[4] were required to resubmit their financial statements to correct material errors in order to obtain unqualified audit opinion on financial statements; thus demonstrating that progress is still needed in strengthening internal controls over the financial reporting process in compliance with the NAF and therefore expects actions from the respective management to resolve this recurring issue.

11.2. Although new monitoring measures have been implemented by the RPPB, there continues to be several outstanding unresolved observations and recommendations older than three years. The RPPB should recall the Council tasking whereas five NATO Reporting

---

[4] Allied Command Operations, International Staff, NATO Helicopter Design and Development Production and Logistics Management Organisation, NATO Airborne Early Warning and Control Programme Management Agency and NATO Coordinated Pension Scheme.

Entities (IMS, NDC, STO, NSPO and BGX)[5] need to submit action plans with mitigation measures on in-progress or open observations for 2017 financial year to the Council with the auditee's response on the IBAN audit of the 2022 financial statements. The RPPB will continue to closely monitor the issue, supported by IBAN.

12. The RPPB generally supports the IBAN's initiative to simplify the financial reporting pending details on its implementation modalities. However, the RPPB will further discuss the matter later in 2023 to ensure simplification does not come at the cost of accountability and transparency.

13. In order to address the IBAN recommendation on the recognition of post-employment liabilities, the RPPB notes that its handling is envisaged for 2023.

**RECOMMENDATIONS**

14. The Resource Policy and Planning Board recommends that the Council:

14.1. note this report and the IBAN audit report at reference A;

14.2. agree the conclusions at paragraphs 9 to 13; and

14.3. agree to the public disclosure of the IBAN audit report and this report in line with agreed policy at reference E.



[5] International Military Staff, NATO Defense College, NATO Science and Technology Organisation, NATO Support and Procurement Organisation and NATO Battlefield Information, Collection and Exploitation Systems Group Executive.

Enclosure to
PO(2023)0164 (INV)

International Board of Auditors for NATO
Collège international des auditeurs externes de l'OTAN

Brussels - Belgium

**NATO UNCLASSIFIED**

IBA-A(2022)0150
14 December 2022

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

Cc: NATO Permanent Representatives
Chair, Resource Policy & Planning Board
Branch Head, Resource Management Branch, NATO Office of Resources
Private Office Registry

Subject: ***International Board of Auditors for NATO (IBAN) Report on Main Findings from the 2021 Financial Statements audits – IBA-M(2022)0003***

IBAN submits herewith the approved Report on Main Findings from the 2021 Financial Statements audits for distribution to the Council. Considering its strategic and forward-looking nature, I would be pleased to present the Report to the Council for discussion.

Yours sincerely,

Daniela Morgante
Chair

Attachments: As stated above.

**NATO UNCLASSIFIED**

International Board of Auditors for NATO
1110 Brussels, Belgium
Email: mailbox.IBAN@hq.nato.int

NATO
OTAN

International Board
of Auditors for NATO

Brussels | Belgium



# IBAN REPORT
## on Main Findings from the 2021 Financial Statements Audits

## FOREWORD BY THE CHAIR

On behalf of the International Board of Auditors for NATO (IBAN), in accordance with our independent status set out in our Council-approved Charter and with International Standards of Supreme Audit Institutions, I am delighted to share with you the Special Report to the North Atlantic Council (Council) on Main Findings from the 2021 Financial Statements Audits. The purpose of this Report is to provide an annual overview on the main findings of the 2021 financial statements audits of NATO Reporting Entities.

NATO's 21 Reporting Entities, which operate under one of NATO's three juridical personalities, have different levels of annual expenses ranging from approximately EUR 1 million to EUR 2,795 million in 2021. Such significant number of Reporting Entities, all of which are preparing general-purpose financial statements, is an indicator of the complexity of NATO's current Financial Reporting and Accountability Framework (FRAF).

In this context, with the aim to serve the interests of our stakeholders in the best way possible, we provide through this Report aggregated information on our audit findings and, thereby, additional support to Council's ability to oversee and account for the Organisation's resources, as well as enhanced transparency and accountability over their use.

Daniela Morgante
Chair
International Board of Auditors for NATO

## TABLE OF CONTENTS



**Annex**

# 1. IBAN'S RESPONSIBILITIES REGARDING FINANCIAL STATEMENTS AUDITS

## 1.1 IBAN's Mandate Regarding Financial Statements Audits

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

- **NATO Body** denotes civilian or military headquarters and other organisations established pursuant to the North Atlantic Treaty, subject to the provisions of either the 1951 Ottawa Agreement or the 1952 Paris Protocol.

- **NATO Reporting Entity** refers to a NATO body or an identifiable budget or area of activity that prepares financial statements. A NATO Reporting Entity may comprise one or more NATO civilian and military bodies, entities, budgets, or activities.

1.1.2 IBAN's mandate regarding financial statements audit covers 21 NATO Reporting Entities that operate under one of the three juridical personalities created by the NATO Member States. Our mandate also covers the financial audit of NATO non-appropriated funds, as far as they are included in the financial statements of a NATO Reporting Entity.

1.1.3 Nineteen NATO Reporting Entities operate under the juridical personality possessed by NATO by virtue of the Ottawa Agreement. These NATO Reporting Entities constitute an integral part of the NATO juridical personality. Three of them are the NATO benefit schemes that apply to all NATO International Civilians, including those employed under the two Allied Commands, Allied Command Operations (ACO) and Allied Command Transformation (ACT). The International Staff (IS) carries out the financial management of the different NATO benefits schemes centrally.

1.1.4 ACO and ACT are NATO Reporting Entities that exercise respectively the juridical personalities possessed by the Supreme Headquarters Allied Powers Europe (SHAPE) and HQ Supreme Allied Commander Transformation (SACT) by virtue of the Paris Protocol. ACO and ACT respectively include SHAPE and HQ SACT, and their subordinate NATO bodies authorised to act on their behalf. ACO also incorporates Crisis Response Operations (CRO), field or mission headquarters and units that have a legal position entirely governed by their applicable mission-specific legal framework.

1.1.5 The following table presents the total expenses of each NATO Reporting Entity according to their Statement of Financial Performance.

## Table 1: Total Expenses in 2021 per NATO Reporting Entity

| Juridical Personality | NATO Reporting Entity | Currency (in million) | Total Expenses 2021 (1) | Total Expenses 2020 (1) |
|---|---|---|---|---|
| **Ottawa Agreement (1951)** | | | | |
| NATO (Ottawa) | BGX - BICES Group Executive | Not disclosed | Classified | Classified |
| | DCPS - Defined Contribution Pension Scheme (2) | EUR | 45 | 27 |
| | IMS - International Military Staff | EUR | 28 | 27 |
| | IS - International Staff (3) | EUR | 299 | 289 |
| | MSIAC - Munitions Safety Information Analysis Center (4) | EUR | 2 | 2 |
| | NAGSMO - NATO Alliance Ground Surveillance Management Organisation (5) | EUR | 7 | 7 |
| | NAHEMO - NATO Helicopter Design and Development Production and Logistics Management Organisation (5) | EUR | 13 | 12 |
| | NAMEADSMO in Liquidation - NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Organisation in Liquidation (5) | USD | 1 | 1 |
| | NAMMO - NATO Multi-Role Combat Aircraft Development Production and In-Service Support Management Organisation (5) (6) | EUR | - | 575 |
| | NAPMA - NATO Airborne Early Warning and Control Programme Management Agency | USD | 23 | 43 |
| | NATO CPS/DBPS - NATO Coordinated Pension Scheme/Defined Benefit Pension Scheme (2) | EUR | 217 | 207 |
| | NCIO - NATO Communications and Information Organisation | EUR | 791 | 770 |
| | NDC - NATO Defense College | EUR | 11 | 9 |
| | NEFMO - NATO European Fighter Aircraft Development, Production and Logistic Management Organisation (5) (6) | EUR | - | 3,541 |
| | NETMA - NATO Eurofighter 2000 and Tornado Management Agency | EUR | 46 | 46 |
| | NFO - NATO Naval Forces Sensor and Weapons Accuracy Check Sites Office (4) | EUR | 1 | 1 |
| | NNHQ - New NATO Headquarters (3) | EUR | n/a | 5 |
| | NSPO - NATO Support and Procurement Organisation | EUR | 2,795 | 3,388 |
| | RMCF - Retirees Medical Claims Fund (2) | EUR | 31 | 31 |
| | STO - Science and Technology Organisation | EUR | 35 | 34 |
| **Paris Protocol (1952)** | | | | |
| SHAPE | ACO - Allied Command Operations | EUR | 1,138 | 1,065 |
| HQ SACT | ACT - Allied Command Transformation | EUR | 148 | 139 |

Source: IBAN data

<u>*Notes to Table 1*</u>

*(1) All expenses are expressed in EUR million, closest rounding, except for NAMEADSMO in Liquidation and NAPMA, which are expressed in USD million. Total expenses in 2020 are based on the audited 2020 Financial Statements. Expenses presented in this table are drawn from the financial statements of each NATO reporting entity and include costs invoiced between NATO reporting entities. As NATO (Ottawa) does not prepare combined financial statements for the 19 entities operating under its single juridical personality, in which inter-entity transactions would be eliminated, it is not possible to present the total amount of net expenses incurred by NATO (Ottawa).*

*(2) The benefits provided by these benefit schemes apply to NATO international civilians employed by all NATO Reporting Entities concerned, in accordance with the Civilian Personnel Regulations under the Ottawa Agreement and Paris Protocol. Financial Statements of NATO benefit plans do not contain a statement of financial performance with expenses, in compliance with International Accounting Standard (IAS) 26 that applies via the hierarchy in International Public Sector Accounting Standards (IPSAS) 3 to the preparation of financial statements of retirement benefit plans. Therefore the total decrease in net assets available for benefits are shown for all NATO benefit plans.*

*(3) In 2021, the activity of the New Headquarters (NHQ) was incorporated in the financial statements of IS (n/a: not applicable).*

*(4) MSIAC and NFO are NATO Reporting Entites only in respect of activities carried out by IS in relation to MSIAC and NFO.*

*(5) This amount of expense corresponds solely to the administrative budget expenses incurred by the entity and reflects its financial performance regarding its role as an agent. Expenditure reported under the operational budget is detailed in Table 2 below.*

*(6) The 2021 Financial Statements of NAMMO and NEFMO were prepared for the first time on the basis that they are agents instead of principals. Therefore, NAMMO and NEFMO's operational expenditures in 2021 are not reported as an expense in their respective Statement of Financial Performance. These expenditures continue to be reported in their respective operational budget execution report annexed to the Financial Statements, which is subject to audit by IBAN.*

1.1.6 IBAN also audits operational budget expenditures reported by NATO Reporting Entities acting as an agent on behalf of third party participating NATO Nations. Operational budget expenditures are not included in the NATO Reporting Entities' expenses and are reported in an operational budget execution report included in the financial statements as a separate annex. The following table presents the total operational budget expenditure for each NATO Reporting Entity acting as an agent on behalf of third party participating NATO Nations:

**Table 2: Total Operational Budget Expenditure in 2021 per NATO Reporting Entity acting as an Agent**

| Juridical Personality | NATO Reporting Entity | Currency (in million) | Total Expenditure 2021 (1) | Total Expenditure 2020 (1) |
|---|---|---|---|---|
| **Ottawa Agreement (1951)** | | | | |
| NATO (Ottawa) | NAGSMO | EUR | 85 | 95 |
| | NAHEMO | EUR | 1,035 | 1,374 |
| | NAMEADSMO i.L. | USD | 0 | 0 |
| | NAMMO | EUR | 585 | 565 |
| | NEFMO | EUR | 4,034 | 3,372 |

Source: IBAN data

(1) *Expenditure per NATO Reporting Entity acting as an agent, as shown in the operational budget execution report included in their respective Financial Statements as a separate annex in accordance with the NATO Financial Regulations. Carried-forward commitments are excluded from this amount. All operational budget expenditures are expressed in EUR million or EUR equivalent, closest rounding, except for NAMEADSMO in Liquidation, which are expressed in USD million. Total expenditures in 2020 are based on the audited 2020 Financial Statements.*

1.1.7 As shown in Table 1 above, NATO's 21 Reporting Entities, which operate under three juridical personalities, have different levels of annual expenses ranging from approximately EUR 1 million to EUR 2,795 million in 2021. The significant number of reporting entities, all of which are preparing general-purpose financial statements, is an indicator of the complexity of NATO's current Financial Reporting and Accountability Framework (FRAF). According to the NATO Accounting Framework (IPSAS 1), *"General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees."*

1.1.8 IBAN therefore reiterates its support for a simplification of NATO's FRAF, while improving the quality of financial information in support of decision-making. A simplification based on the legal framework of NATO would be more in line with the aim of the NATO Accounting Framework/general purpose financial statements and at the same time improve accountability and transparency to both internal and external stakeholders. This approach would lead to a decrease from 21 to 3 general-purpose financial statements and audit reports without any loss in transparency and accountability. Indeed, the financial information of individual NATO entities would continue to be published in separate budget execution reports annexed to the financial statements and as separate segments in the notes to the financial statements.

1.1.9 In accordance with Article 1 of the IBAN Charter and based on a specific Council authorisation, IBAN also audits financial statements of non-NATO multi-nationally funded or sponsored entities that are not NATO Reporting Entities, but in which NATO has a particular interest. These entities are not NATO Reporting Entities because they do not operate under one of NATO's three juridical personalities. In addition, IBAN also audits under a separate Council mandate the SHAPE International

School, which is an integral element of SHAPE. According to the audit mandates of these entities, audit results are not reported to Council, but to their respective governing bodies. These financial audits do not form part of this report.

## 1.2 Financial Statements Audits and Reporting

1.2.1 IBAN is appointed by Council as the external auditor of NATO Bodies and other Reporting Entities in accordance with Article 14 of the NATO Financial Regulations (NFRs). According to this Article, IBAN shall operate under a Charter approved by Council. The function of IBAN regarding Financial Statements Audit in accordance with Article 2 of the IBAN Charter is:

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

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

1.2.2 In addition to financial statements audit, in accordance with Article 2 of its Charter, IBAN's functions also cover performance/value for money audit and the NATO Security Investment Programme (NSIP) audit. IBAN provides an audit report on the financial statements for every NATO Reporting Entity to the Council. The audit report on the financial statements includes an opinion on the financial statements, an opinion on compliance, and may contain audit observations and recommendations.

1.2.3 The IBAN opinion on the financial statements sets out whether the financial statements present fairly the financial position, financial performance, its cash flows, and, when applicable, the budget execution of the NATO Reporting Entity. The IBAN opinion on compliance presents whether something has come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure and are not in compliance with the regulations in force. The IBAN independent external auditor's report, which forms part of the audit report, therefore contains two separate audit opinions.

1.2.4 In the audit report on the financial statements, IBAN presents observations leading to qualified audit opinions and may include other observations that need to be brought to the attention of Council. Observations and recommendations raised during the audit, which have not been included in the IBAN's audit report addressed to Council, are set out in a management letter addressed to the Head of the NATO Reporting Entity.

1.2.5 IBAN conducts its financial audits in different phases, including audit planning, audit fieldwork and audit reporting. As part of the audit fieldwork phase, our audit teams perform audit tests and generally conduct on-site visits at the premises of the

NATO Reporting Entities. At the end of an on-site visit, we hold a debrief meeting with the entity's staff to discuss preliminary audit findings.

1.2.6 Our unclassified audit reports and the related financial statements are published on our website after Council agreement on public disclosure in line with agreed Council policies (C-M(2012)0041 and PO(2015)0052).

1.2.7 In accordance with Article 14 of our Charter, IBAN reports on the audited annual financial statements relating to NATO Reporting Entities. The purpose of this IBAN Report on Main Findings is to provide an overview of the main findings from the 2021 financial statements audits.

### 1.3 Audit Standards and Financial Statements Audit Objectives

1.3.1 IBAN undertakes its audits in accordance with the principles of the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI) as per Article 15 of the IBAN Charter. We are independent and politically neutral in accordance with the INTOSAI Code of Ethics. Our financial audits are conducted according to the International Standards of Supreme Audit Institutions (ISSAI), which are officially authorised and endorsed by INTOSAI. We apply ISSAIs 2200-2899 to the financial statements audit component and ISSAI 4000 and 4200 to the compliance audit component.

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

1.3.3 The objective of the audit of compliance is to obtain independent assurance about whether something has come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure and are not in compliance with the regulations in force. This objective includes issuing an independent external auditor's report that includes an audit opinion on compliance.

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

- An **unqualified opinion** is when IBAN issues an opinion that the financial statements and budget execution report are stated fairly and nothing has come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the rules and regulations.

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

- A **disclaimer** is issued when the audit scope is severely limited and IBAN cannot express an opinion, or when there are material uncertainties affecting the financial statements or the use of funds.

- An **adverse opinion** is issued when the effect of an error or disagreement is so pervasive and material to the financial statements that IBAN concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

1.3.5 Three types of paragraphs may also be communicated in the independent external auditor's report, in accordance with auditing standards:

- **Key Audit Matters** are those matters that, in IBAN's professional judgement, were of most significance in the audit of the financial statements of the current period. Key Audit Matters are addressed to Council.

- An **Emphasis of Matter** is communicated if IBAN considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in our judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

- An **Other Matter** is communicated if IBAN considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in our judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

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

1.4.1 Management's responsibility for the financial statements is laid down in the NFRs (C-M(2015)0025) and Council approved deviations. The Financial Controller is responsible for submitting the financial statements for audit to IBAN no later than 31 March following the end of the financial year.

1.4.2 The financial statements of NATO Reporting Entities are prepared in accordance with the NATO Accounting Framework (C-M(2016)0023 and C-M(2019)0026), adapted from International Public Sector Accounting Standards

(IPSAS). In addition, budget execution reports are, when applicable, annexed to the financial statements as required by Article 34.4 of the NFRs.

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

1.4.4 The financial statements of each NATO Reporting Entity are signed by the respective Head and Financial Controller. Their confirmation in signing the financial statements covers, but is not limited to, the establishment and maintenance of financial governance, resource management practices, internal controls and financial information systems to achieve the efficient and effective use of resources.

1.4.5 This confirmation covers the design, implementation and maintenance of internal controls relevant to the preparation and presentation of financial statements that are auditable and free from material misstatement, whether due to fraud or error. It also includes the responsibility for ensuring adequate audit trails in accordance with the NFRs Articles 4.1 and 12.3. The confirmation also covers reporting on the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there are plans to liquidate the entity or to cease its operations, or there is no realistic alternative but to do so.

1.4.6 Management's Responsibility for compliance arises from the fact that all NATO staff, military and civilian, are obligated to comply with the NFRs, associated Financial Rules and Procedures and internal implementing directives. These include the NATO Civilian Personnel Regulations (CPRs) for civilian staff and other applicable regulations, rules and procedures.

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

## 2. MAIN FINDINGS FROM THE 2021 FINANCIAL STATEMENTS AUDITS

### 2.1 Summary of Audit Opinions

2.1.1 The main findings from the 2021 Financial Statements Audits of the 21 NATO Reporting Entities cover the audit opinions and other paragraphs issued on the financial statements and on compliance, and the observations and recommendations addressed to Council. In order to place these findings into perspective, the audit results related to the 2021 financial statements are compared with the prior two years.

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

**Table 3: Audit Opinions on the financial statements and on compliance**

| Financial statements | 2021 | 2020 | 2019 (1) |
|---|---|---|---|
| Unqualified (1) | 20 | 21 | 20 |
| Qualified | 1 | 1 | 2 |
| Adverse | - | - | - |
| Disclaimer | - | - | - |
| Total (2) | 21 | 22 | 22 |

| Compliance | 2021 | 2020 | 2019 |
|---|---|---|---|
| Unqualified (1) | 20 | 19 | 21 |
| Qualified | 1 | 3 | 1 |
| Adverse | - | - | - |
| Disclaimer | - | - | - |
| Total (2) | 21 | 22 | 22 |

Source: IBAN data

*Notes*

*(1) The total number of unqualified opinions on the Financial Statements and on compliance for 2019 both increased by 1 compared to the information presented in the IBAN Report on Main Findings from the 2019 Financial Statements Audits (IBA-M(2021)0002-REV1). This change is due to the fact that the 2019 Audit Report for NAMEADSMO in Liquidation was issued after the release of IBA-M(2021)0002-REV1 due to COVID-19 and related travel restrictions.*

*(2) In 2021, our audit mandate covered 21 NATO Reporting Entities compared to 22 in 2020 and 2019. This is because the activities of the New NATO Headquarters were integrated into the financial statements of IS as from 2021, in accordance with the NATO Accounting Framework.*

2.1.3 The table above shows that the number of qualified audit opinions on the financial statements have remained relatively stable over three years, with only 1 out of 21 NATO Reporting Entities qualified in the 2021 financial year. We also note a decrease in qualified opinions on compliance, with 1 out of 21 NATO Reporting Entities qualified in 2021 compared to 3 out of 22 in 2020. It is also worth noting together with these encouraging results, the number of financial statements resubmitted to IBAN for audit by NATO Reporting Entities for the financial year 2021 and 2020 (see section 2.5 below).

2.1.4 The table below presents the audit opinions issued by IBAN per NATO Reporting Entity for the 2021 financial statements and two comparative years.

## Table 4: Audit Opinions per NATO Reporting Entity

| Reporting Entity | 2021 F/S (1) Opinion | 2021 Compliance Opinion | 2020 F/S (1) Opinion | 2020 Compliance Opinion | 2019 (3) F/S (1) Opinion | 2019 (3) Compliance Opinion |
|---|---|---|---|---|---|---|
| ACO | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| ACT | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| BGX | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| DCPS | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| IMS | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| IS | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| MSIAC | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NAGSMO | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NAHEMO | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NAMEADSMO in Liquidation | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NAMMO | Unqualified | Unqualified | Unqualified | **Qualified** | Unqualified | Unqualified |
| NAPMA | Unqualified | Unqualified | Unqualified | Unqualified | **Qualified** | Unqualified |
| NATO CPS/DBPS | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NCIO | **Qualified** | **Qualified** | **Qualified** | **Qualified** | **Qualified** | **Qualified** |
| NDC | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NEFMO | Unqualified | Unqualified | Unqualified | **Qualified** | Unqualified | Unqualified |
| NETMA | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NFO | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| NNHQ (2) | n/a | n/a | Unqualified | Unqualified | Unqualified | Unqualified |
| NSPO | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| RMCF | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| STO | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified | Unqualified |
| Unqualified (3) | 20 | 20 | 20 | 21 | 23 | 22 |
| Qualified | 1 | 1 | 2 | 1 | 1 | 2 |

Source: IBAN data

<u>*Notes*</u>

*(1) Financial Statements (F/S).*

*(2) Not applicable (n/a) in 2021 as the activities of the New NATO Headquarters were integrated into the financial statements of IS as from 2021, in accordance with the NATO Accounting Framework.*

*(3) The total number of unqualified opinions on the financial statements and on compliance for 2019 both increased by 1 compared to the information presented in the IBAN Report on Main Findings from the 2019 Financial Statements Audits (IBA-M(2021)0002-REV1). This change is due to the fact that the 2019 Audit Report for NAMEADSMO in Liquidation was issued after the release of IBA-M(2021)0002-REV1 due to COVID-19 and related travel restrictions.*

## 2.2 Summary of Unqualified Audit Opinions

2.2.1 The audit opinions on the financial statements largely relate to the implementation of the NATO Accounting Framework, which is a comprehensive set of accounting standards adapted from IPSAS. Implementing this framework requires each individual NATO Reporting Entity to maintain a high level of knowledge and expertise in accrual-based accounting and IPSAS disclosure requirements.

2.2.2 Since 2019, the number of NATO Reporting Entities with unqualified audit opinions on the financial statements remained relatively stable with 20 out of 21 for financial year 2021. The stable trend of unqualified opinions on the financial statements reflects in overall terms the sustained quality of financial information available to final users of the financial statements. It is also worth considering that five NATO Reporting Entities resubmitted their financial statements to IBAN after the 31 March 2022 deadline, correcting material accounting mistakes or disclosures found during our audit, potentially qualifying the audit opinion on the financial statements subject to IBAN's decision. This shows that improvements to the financial reporting process and internal controls are still needed (see section 2.5 below).

2.2.3 The audit opinions on compliance largely relate to compliance with the provisions of the NFRs. For NATO Reporting Entities with unqualified opinions on compliance, no material issue came to our attention related to the proper use of funds for the settlement of authorised expenditure and compliance with the regulations in force. The 2015 revision of the NFRs introduced a number of new requirements that NATO Reporting Entities largely implemented.

2.2.4 The number of unqualified audit opinions on compliance increased from 19 to 20 over the same period. The relatively stable number of unqualified opinions on compliance generally reflects NATO's compliance with the regulations in force.

## 2.3 Summary of Qualified Audit Opinions

2.3.1 IBAN maintains its qualified opinions of 2018, 2019 and 2020 on the 2021 Financial Statements and on compliance for the NATO Communications and Information Organisation (NCIO), regarding Property, Plant and Equipment (PP&E), Intangible Assets and assets under construction. The qualification relates to both the disclosure requirements of the NATO Accounting Framework and compliance with the NFRs. The assets concerned mainly relate to NATO Security Investment Programme (NSIP) projects. For example, amongst others, assets related to the Air Command and Control System (ACCS), crypto equipment and Communications and Information Systems (CIS) related to the New NATO Headquarters.

2.3.2 NCIO made improvements in the note disclosures required by the NATO Accounting Framework. NCIO included in its 2021 Financial Statements a new note on the types and the locations of CIS assets that were under construction prior to 1 January 2018 and were still assets under construction at 31 December 2021.

## 2.4 Overview of paragraphs communicated in the 2021 independent external auditor's reports

2.4.1 In accordance with ISSAIs, IBAN included one Emphasis of Matter paragraph in the independent external auditor's reports on the NATO Support and Procurement Organisation (NSPO) 2021 Financial Statements. This paragraph draws users' attention to issues with the classification of advances disclosed in NSPO's 2021 Financial Statements. No key audit matters or other matters were raised in 2021.

## 2.5 Financial statements resubmitted after 31 March 2022 deadline

2.5.1 According to the NFRs, the deadline for submitting the 2021 financial statements for audit to IBAN was 31 March 2022. As of 31 March 2022, all of the 21 financial statements were received by IBAN.

2.5.2 During the audit of the 2021 financial statements, IBAN agreed to audit the financial statements resubmitted after 31 March 2022 by the following five NATO Reporting Entities:

**Table 5: Resubmitted Financial Statements per NATO Reporting Entity**

| Resubmitted Financial Statements | F/S 2021 (1) | | F/S 2020 (1) | F/S 2019 (1) |
|---|---|---|---|---|
| NATO Reporting Entities | Month Resubmitted | N° of Resubmissions | N° of Resubmissions | N° of Resubmissions |
| ACO | May 2022 | 1 | - | - |
| ACT (2) | n/a | - | 1 | - |
| IS | June & July 2022 | 2 | 1 | 1 |
| NAHEMO | June & July 2022 | 2 | 1 | 1 |
| NAMEADSMO in Liquidation (2) | n/a | - | 1 | 1 |
| NAPMA | July 2022 | 1 | - | 1 |
| NATO CPS/DBPS | July 2022 | 1 | - | - |
| NCIO (2) | n/a | - | 1 | 1 |
| NEFMO (2) | n/a | | - | 1 |
| NFO (2) | n/a | - | 1 | - |
| STO (2) | n/a | - | 1 | - |
| Total F/S Resubmissions | | 7 | 7 | 6 |
| Total NATO Reporting Entities | | 5 | 7 | 6 |

Source: IBAN data

*Notes*

*(1) Financial Statements (F/S).*

*(2) Not applicable (n/a)*

2.5.3 The resubmissions made by five NATO Reporting Entities after 31 March 2022 represent 24% of the 21 Financial Statements submitted to IBAN for audit (for the 2020 financial year there were 7 resubmissions, representing 32% of the 22 Financial Statements audited by IBAN). This year, two NATO Reporting Entities requested IBAN to audit a second resubmission of their Financial Statements.

2.5.4 These resubmissions corrected material misstatements or disclosures identified by IBAN during the audit period, potentially qualifying the audit opinion on the financial statements subject to IBAN's decision. This shows that significant progress continues to be needed to strengthen internal controls over the financial reporting process, including adequate audit trails, in order to ensure that the financial statements submitted by 31 March to IBAN for audit are prepared in accordance with the NATO Accounting Framework and free of material errors.

## 2.6 Summary of Observations and Recommendations

2.6.1 The IBAN audit report includes observations and recommendations leading to qualified audit opinions and may include other observations and recommendations that we consider should be brought to the attention of Council.

2.6.2 In addition to reporting on observations and recommendations issued for the financial year covered by the report, we perform a follow-up on the status of observations and recommendations from the previous years' audits. We reassess the status of outstanding recommendations, which can receive the status open, in-progress, or closed.

**Open**: is used for outstanding recommendations for which no notable progress has been achieved to date.

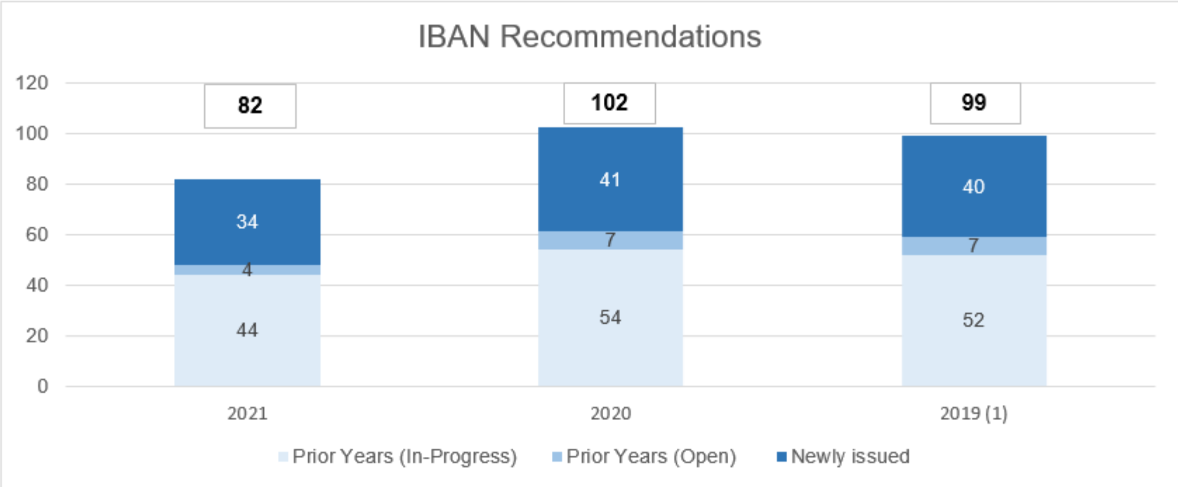
**In-progress**: is used for outstanding recommendations when the NATO Reporting Entity has started to implement the recommendation or when some, but not all, sub-recommendations are closed.

**Closed**: is used for previous years' audits' recommendations that were already implemented, superseded, or have lapsed.

*Overview of current and prior year recommendations*

2.6.3 The chart below contains an overview of all current and prior year recommendations as per IBAN audit reports for the financial years 2021, 2020 and 2019 based on the status of the recommendations described above. A recommendation often consists of several sub-recommendations, which are not presented below.

**Chart 1: Number of IBAN recommendations per status**




Source: IBAN data

(1) *The total number of newly issued recommendations in financial year 2019 increased by 1, from 39 to 40, compared to the information presented in the IBAN Report on Main Findings from the 2019 Financial Statements Audits (IBA-M(2021)0002-REV1). This change is due to the fact that the 2019 Audit Report for NAMEADSMO in Liquidation was issued after the release of IBA-M(2021)0002-REV1 due to COVID-19 and related travel restrictions.*

2.6.4 The chart above shows that the total number of recommendations for financial year 2021 decreased by about 20% to 82 recommendations compared to 102 and 99 in the previous two years. The share of recommendations per status has remained stable since the financial year 2019 with about 55% of recommendations in-progress and 40% relating to newly issued recommendations.

2.6.5 The above chart shows that NATO Reporting Entities are generally addressing and implementing prior year recommendations. This confirms the trend of improvement in the quality of information in the financial statements available to final users and in the efforts to comply with NATO regulations and rules. However, there are still a considerable number of outstanding recommendations that need to be addressed, some of which related to resubmissions correcting material qualifying errors.

*Summary of main findings per theme*

2.6.6 In order to present a more explanatory overview of the areas in which audit observations are being made, all audit observations from the 2021, 2020 and 2019 audit reports were categorised on the basis of five themes. This presentation of the observations allows IBAN to identify the areas in which most audit findings occur and, therefore, where improvements are needed. When a recommendation relates to more than one theme, it has been included in the category that we believe carries more weight.

### Table 6: Observations and Recommendations per theme

| IBAN Observations and Recommendations per Audit Theme | Total number of IBAN Observations and Recommendations | | | Of which, IBAN Observations and Recommendations leading to modified audit opinion | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | On F/S | | | On compliance | | |
| | 2021 | 2020 | 2019 | 2021 | 2020 | 2019 | 2021 | 2020 | 2019 |
| 1. Financial and budgetary accounting and reporting | 33 | 44 | 39 | - | - | - | - | 2 | - |
| 2. Property, plant, equipment, inventories and intangible assets | 11 | 10 | 10 | 1 | 1 | 2 | 1 | 1 | 1 |
| 3. Procurement, contracting and other arrangements | 7 | 6 | 9 | - | - | - | - | - | - |
| 4. Funding, revenue and cash management | 6 | 14 | 14 | - | - | 1 | - | - | - |
| 5. Compliance with other NATO regulations, rules and sound financial management principles | 25 | 28 | 27 | - | - | - | - | 2 | - |
| Total number of IBAN Observations and Recommendations | 82 | 102 | 99 | 1 | 1 | 3 | 1 | 5 | 1 |

Source: IBAN data.

2.6.7 A qualified audit opinion issued in an audit report may be the result of multiple observations and recommendations. This explains any difference between the above number of observations and recommendations leading to a qualification and the number of audit qualifications in a given financial year.

*<u>Financial and budgetary accounting and reporting</u>*

2.6.8 This theme includes recommendations relating to the preparation and presentation of the financial statements, budget execution reports, accounting and associated internal control and Information Technology (IT) processes. The total number of observations and recommendations decreased from 44 to 33 compared to 2020. This theme represents, also in 2021, more than 40% of all observations and recommendations.

2.6.9 During our audits, we identified errors and internal control weaknesses related to the preparation and presentation of financial statements and budget execution reports. In 2021, this led five NATO Reporting Entities to resubmit - in two cases twice - their financial statements for audit after 31 March 2021 in order to correct material qualifying errors.

2.6.10 Recommendations related to resubmitted financial statements covered the following main areas:

- The capitalisation by ACO of Depot Level Maintenance (DLM) for major inspections amounting to approximately EUR 136 million in 2021, and of NSIP funded assets handed-over amounting to approximately EUR 29 million in 2021;

- The lack of recognition by the IS of financial assets and liabilities amounting to EUR 109 million for the NATO Coordinated Pension Scheme (also referred to as the Defined Benefit Pension Scheme) funds held on IS bank accounts.

Also, the incorrect recognition of these funds by the DBPS as cash and cash equivalents rather than a financial asset (contractual right to receive cash and financial investment). Finally, the understatement by the IS of expenses and revenue relating to summit cash advances amounting to approximately EUR 2.6 million in 2021;

- The incorrect recognition by NAPMA of financial revenue amounting to USD 24 million in the Statement of Financial Position, rather than in the Statement of Financial Performance in accordance with the NATO Accounting Framework;

- Material errors by NAHEMO relating to accrued expenses (EUR 96 thousand), net equity (EUR 78 thousand), lack of capitalisation of assets under construction (EUR 111 thousand), disclosure of lease payments (EUR 250 thousand), understatement of unearned revenue (EUR 1.8 million), reclassification of unearned revenue (EUR 0.5 million), and understatement of supplier liabilities (EUR 23 million).

2.6.11 Resubmitted financial statements indicate that improvements are required in internal controls related to the preparation of financial statements submitted by 31 March, in order to avoid material errors occurring. Such internal controls include establishing adequate audit trails, as required by the NFRs.

2.6.12 Other recommendations mainly related to the following matters:

- Internal control weaknesses found in the financial reporting process, covering areas such as the presentation of the budget execution statements, the classification and recognition of customer advances, Morale and Welfare Activities (MWA), related party disclosures, NATO Airborne Early Warning & Control (NAEW&C) and Air Ground Surveillance (AGS) contribution in kind recognition and disclosure, the disclosure of a provision related to NSIP receivables, and the Central Pipeline European System (CEPS);

- IT control weaknesses, such as access rights and segregation of duties;

- Improvements needed in the monitoring, confirmation or follow-up of the cancellation of unused balances related to accrued liabilities, open payables to Member Nations, year-end confirmations, and accounts receivable and payable;

- The estimated financial impact of Resolute Support (RS) withdrawal was not yet available;

- The need to assess going forward whether NSPO is acting as an agent or a principal at the programme/activity level;

- Post-employment liabilities are not recognised by NATO Reporting Entities and are only disclosed in the notes to the financial statements of the NATO Coordinated Pension Scheme and the NATO Retirees Medical Claims Fund.

2.6.13 NATO Reporting Entities do not recognise post-employment liabilities. Instead, these are disclosed in the notes to the financial statements of the two defined benefit schemes. As of 31 December 2021, the post-employment liability for the NATO Coordinated Pension Scheme amounted to EUR 8.9 billion and EUR 4.7 billion for the NATO Retirees Medical Claims Fund. The NATO Accounting Framework (IPSAS 39) requires NATO Reporting Entities with employees contributing to the benefit funds to recognise a post-employment liability in their financial statements. Therefore, all NATO Reporting Entities with employees contributing to the benefit funds need in principle to recognise their share of the EUR 14.6 billion total post-employment liability. Not doing so would normally require an adaptation to the NATO Accounting Framework.

2.6.14 In 1997, Council decided not to account for the post-employment benefit liability (C-M(97)85) regarding defined benefit schemes. With the subsequent Council decision to implement IPSAS and the following Council approval of the NATO Accounting Framework, it is unclear whether the Council decision not to account for the post-employment benefit liability still applies. This is especially the case given that the NATO Accounting Framework does not include an adaptation to IPSAS 39, nor does it refer to this Council decision. Clarification in NATO's regulatory and accounting framework is needed in this respect.

*Property, plant, equipment, inventories and intangible assets*

2.6.15 This theme relates to the internal control, accounting and reporting of property, plant, equipment and inventories, covering both tangible and intangible assets. The number of recommendations have remained largely stable since 2019 with 11 recommendations in 2021 for seven NATO Reporting Entities. Improvements are still required in the financial accounting and reporting of PP&E, inventory and intangible assets to address the following issues and weaknesses:

- Lack of reliable and coordinated processes for updating asset registers and capitalising assets;

- Inaccurate and incomplete asset registers for tangible and intangible assets, including transfers of assets between NATO Reporting Entities;

- Incompleteness of recognition/disclosure of PP&E and intangible assets (including assets under construction), especially related to CIS, NSIP funded assets, maritime vessels and major upkeep costs of assets;

- Errors in the recognition of inventories in the financial statements.

2.6.16 From a compliance perspective, Article 12 of the NFRs on Internal Control requires NATO Reporting Entities to establish and maintain comprehensive accounting records of all assets and liabilities. Such accounting records include an inventory of PP&E and Intangible Assets, including assets under construction, indicating for instance the types of assets held, locations, the number of items per asset category and asset value. Article 12 of the NFRs applies to all assets, irrespective of when they were acquired. Establishing and maintaining a comprehensive inventory of assets is an important internal control to ensure the safeguard of the assets of NATO Reporting Entities.

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

*Procurement, contracting and other arrangements*

2.6.18 This theme includes recommendations related to procurement processes and arrangements between NATO Reporting Entities or with Nations. The number of recommendations in this area has remained relatively stable from nine in 2019 to six in 2020 and seven in 2021.

2.6.19 Our audits found some weaknesses in the procurement processes, covering areas such as the ability to demonstrate compliance with the NATO regulations for non-competitive solicitations, the approval of departing from standard procurement procedures, the monitoring and control of potential conflicts of interest in procurement, and the adaptation to the Value Added Tax regime. We also recommended clarifying the status of recoupment clauses in a supplier contract.

*Funding, revenue and cash management*

2.6.20 This theme includes recommendations related to the management and reporting of funds, revenue and cash. The number of observations and recommendations significantly decreased since 2020 from 14 to 6. These audit recommendations related to the accounting and reporting of revenue, calculation of customer rates and overhead assumptions, internal controls related to cash management, as well as the need to hold sufficient funds to cover future NATO retiree medical claim obligations.

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

2.6.21 The number of recommendations in this theme has declined from 28 in 2020 to 25 in 2021. The majority of recommendations relate to compliance with the revised NFRs on risk management, internal control, the statement of internal control and internal audit. These requirements cover all parts of NATO's operations, with a much broader scope than only financial and budgetary matters.

2.6.22 Other recommendations covered areas such as:

- The need to strengthen the ability to challenge the validity of information and solutions provided by the NATO customer-funded agencies;
- Missing prior approval of commitments and budget transfers in line with the NFRs, also involving special carry forward;
- The need to ensure prior approval of intra-budget transfers associated with the special carry forward of uncommitted appropriations;
- The need to clarify whether the SHAPE International School financial administration should be governed by the NFRs;
- The need to review and update NAHEMO's financial regulatory framework;
- The need to clarify the legal status of the shop on NSPO's premises and ensure compliance with MWA Regulations;
- Various non-compliance with the CPRs, MWA Regulations and representation allowance rules.

## 2.7 Aging of recommendations

2.7.1 The table below provides an overview of the aging of all recommendations categorised based on the five themes above.

**Table 7: Aging of recommendations per theme**

| IBAN Recommendations per Audit Theme | 2021 | 2018-2020 | 2017 or before |
|---|---|---|---|
| 1. Financial and budgetary accounting and reporting | 19 | 12 | 3 |
| 2. Property, plant, equipment, inventories and intangible assets | 5 | 5 | 1 |
| 3. Procurement, contracting and other arrangements | 2 | 1 | 3 |
| 4. Funding, revenue and cash management | 2 | 3 | 1 |
| 5. Compliance with other NATO regulations, rules and sound financial management principles | 6 | 8 | 11 |
| Total number of IBAN Recommendations | 34 | 29 | 19 |
| Grand total | 82 | | |

Source: IBAN data.

2.7.2 The above table shows that 29 recommendations out of 82, or 35%, relate to the prior three financial years (2018-2020), and 19 recommendations, or 23%, relate to recommendations raised in the 2017 financial year or before.

2.7.3 The nineteen recommendations raised in the 2017 financial year or before relate to 12 NATO Reporting Entities. They concern all five themes, but predominantly compliance with NATO regulations, rules and sound financial management principles. These recommendations cover areas such as:

- Improvements needed to project-based management accounting;
- No central overview and management of existing or possible litigations, claims or other legal cases;
- Weaknesses in financial reporting and accounting, such as the lack of reliable and coordinated processes for capitalising assets and updating asset registers;
- The need for a memorandum of agreement and logistic support agreements with customer-funded agencies;
- The need to hold sufficient funds to cover future NATO retiree medical claim obligations;
- Compliance with NATO regulations, such as in the area of internal control, risk management and internal audit.

The table below present the outstanding recommendations per NATO Reporting Entity and per theme:

**Table 8: Outstanding recommendations from 2017 or before per NATO Reporting Entity and per theme**

| Year observation raised | NATO Reporting Entity | Theme | N°of Observations and Recommendations |
|---|---|---|---|
| 2012 | RMCF | 4. Funding, revenue and cash management | 1 |
| 2014 | STO | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| 2015 | DCPS | 1. Financial and budgetary accounting and reporting | 1 |
| | MSIAC | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| | NATO FORACS Office | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| | NSPO | 1. Financial and budgetary accounting and reporting | 1 |
| | NSPO | 3. Procurement, contracting and other arrangements | 1 |
| 2016 | ACO | 3. Procurement, contracting and other arrangements | 2 |
| | ACT | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| | NSPO | 1. Financial and budgetary accounting and reporting | 1 |
| | NAHEMO | 2. Property, plant, equipment, inventories and intangible assets | 1 |
| 2017 | BGX | 5. Compliance with other NATO regulations, rules and sound financial management principles | 2 |
| | IMS | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| | NDC | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| | NSPO | 5. Compliance with other NATO regulations, rules and sound financial management principles | 2 |
| | STO | 5. Compliance with other NATO regulations, rules and sound financial management principles | 1 |
| | | | 19 |

Source: IBAN data.

## 2.8 Conclusion

2.8.1 IBAN's audits of the financial statements of NATO Reporting Entities show a stable number of unqualified opinions issued during the past three years. It also shows a relatively stable number of new recommendations, which remains encouraging. IBAN recognises the decrease in the number of observations and recommendations since last year and the willingness of entities to close them. With respect to the unqualified opinions on the financial statements, confidence can be drawn from the fact that for the majority of NATO Reporting Entities, the audited financial statements present fairly their financial position, financial performance, and cash flows. Nevertheless, the seven resubmissions of financial statements made by five NATO Reporting Entities after 31 March 2022 (two Reporting Entities resubmitted their financial statements twice), correcting material qualifying misstatements or disclosures identified during the audit, indicates that progress is still needed to strengthen internal controls over the financial reporting process in compliance with the NATO Accounting Framework.

2.8.2 Strengthening internal controls over the accounting and financial reporting process, including maintaining adequate audit trails, as well as over the management and reporting of funds, revenue and cash, may lead to further significant progress. Going forward, NATO Reporting Entities need to pay particular attention to the completeness of PP&E, inventories and intangible assets, and to the need to maintain adequate audit trails. We stress the importance of addressing in a timely manner our prior year recommendations, also considering that a significant number of these are outstanding for more than three years.

2.8.3 In addition, we draw attention to our prior year recommendations on recognising post-employment liabilities. The NATO Accounting Framework (IPSAS 39) requires NATO Reporting Entities with employees contributing to the benefit funds to recognise a post-employment liability in their financial statements. Therefore, all NATO Reporting Entities with employees contributing to the benefit funds need in principle to recognise their share of the EUR 14.6 billion total post-employment liability. Not doing so would normally require an adaptation to the NATO Accounting Framework.

2.8.4 In light of the ongoing revision of the NFRs and upcoming revision of the NATO Accounting Framework, NATO will have the opportunity to ensure that the regulations, rules and procedures are fully suited to the complexity of the Organisation and the two Supreme Commands. Achieving full compliance with NATO regulations, rules and procedures, and the NATO Accounting Framework remains a central focus going forward.

2.8.5 Improving the quality of financial information in support of decision-making and external accountability is also possible by simplifying NATO's FRAF. A simplification based on the legal framework of NATO would be more in line with the underlying aim of the NATO Accounting Framework and at the same time improve accountability and transparency to both internal and external stakeholders. This approach would lead to a decrease from 21 to 3 General Purpose Financial Statements and audit reports without any loss in transparency and accountability, given that financial information of individual NATO entities would still be disclosed in separate budget execution reports annexed to the three financial statements and as separate segments in the notes to the financial statements.

## List of Abbreviations/Acronyms

| | |
|---|---|
| ACO | Allied Command Operations |
| ACT | Allied Command Transformation |
| BGX | NATO Battlefield Information, Collection and Exploitation Systems Group Executive |
| CEPS | Central European Pipeline System |
| CIS | Communications and Information Systems |
| Council | North Atlantic Council |
| CPRs | Civilian Personnel Regulations |
| DCPS | NATO Defined Contribution Pension Scheme |
| ERP | Enterprise Resource Programme |
| FORACS | Naval Forces Sensor and Weapons Accuracy Check Sites (FORACS) |
| FRAF | Financial Reporting and Accountability Framework |
| F/S | Financial statements |
| HQ SACT | Headquarters Supreme Allied Command Transformation |
| IBAN | International Board of Auditors for NATO |
| IMS | International Military Staff |
| INTOSAI | International Organization of Supreme Audit Institutions |
| IPSAS | International Public Sector Accounting Standards |
| IS | International Staff |
| ISSAI | International Standards of Supreme Audit Institutions |
| MSIAC | Munitions Safety Information Analysis Center |
| MWA | Morale and Welfare Activities |
| NAGSMO | NATO Alliance Ground Surveillance Management Organisation |
| NAHEMO | NATO Helicopter Design and Development Production and Logistics Management Organisation |

| | |
|---|---|
| NAMEADSMO in Liquidation | NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Organisation in Liquidation |
| NAMMO | NATO Multi-Role Combat Aircraft Development Production and In-Service Support Management Organisation |
| NAPMA | NATO Airborne Early Warning and Control Programme Management Agency |
| NATO | North Atlantic Treaty Organisation |
| NATO CPS/DBPS | NATO Coordinated Pension Scheme (CPS), also referred to as the Defined Benefit Pension Scheme (DBPS) |
| NCIO | NATO Communications and Information Organisation |
| NDC | NATO Defense College |
| NEFMO | NATO European Fighter Aircraft Development, Production and Logistic Management Organisation |
| NETMA | NATO Eurofighter 2000 and Tornado Management Agency |
| NFO | NATO FORACS Office |
| NFRs | NATO Financial Regulations |
| NNHQ | New NATO Headquarters |
| NSIP | NATO Security Investment Programme |
| NSPO | NATO Support and Procurement Organisation |
| NR | NATO Restricted |
| Ottawa Agreement | Agreement on the status of the North Atlantic Treaty Organization, National Representatives and International Staff, signed in 1951 in Ottawa |
| Paris Protocol | Protocol to the SOFA on the Status of International Military Headquarters signed in 1952 in Paris |
| PP&E | Property Plant and Equipment |
| RMCF | Retirees Medical Claims Fund |
| SOFA | Agreement between the Parties to the North Atlantic Treaty regarding the Status of their Forces signed in 1951 in London |

| | |
|---|---|
| SHAPE | Supreme Headquarters Allied Powers Europe |
| STO | NATO Science and Technology Organisation |