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20 December 2021

DOCUMENT
C-M(2021)0032-AS1

**IBAN REPORT ON MAIN FINDINGS FROM THE 2019 FINANCIAL STATEMENTS
AUDITS**

ACTION SHEET

On 17 December 2021, under the silence procedure, the Council noted the RPPB report, approved its conclusions and recommendations, noted the IBAN Report and agreed to the public disclosure of this report and the IBAN Report.

(Signed) Jens Stoltenberg
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2021)0032.

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3 December 2021

DOCUMENT
C-M(2021)0032
Silence Procedure ends:
17 Dec 2021 15:30

**IBAN REPORT ON MAIN FINDINGS FROM THE 2019 FINANCIAL STATEMENTS
AUDITS**

Note by the Secretary General

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 2019 Financial Statements Audits. The IBAN Report provides an overview to Council on the main findings of the 2019 financial statements audits to further enhance Council's ability to oversee and account for the Organisation's limited resources.
2. The IBAN Report has been reviewed by the RPPB (see Annex 1).
3. I do not believe this issue requires further discussion in Council. Therefore, **unless I hear to the contrary by 15:30 hours on Friday, 17 December 2021**, I shall assume that the Council noted the RPPB report, approved its conclusions and recommendations, noted the IBAN Report and agreed to the public disclosure of this report and the IBAN Report.

(Signed) Jens Stoltenberg

Annex 1: RPPB report
Enclosure 1: IBAN Report on Main Findings from
the 2019 Financial Statements
Audits

Original: English

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**IBAN REPORT ON MAIN FINDINGS FROM THE 2019 FINANCIAL STATEMENTS
AUDITS****Report by the Resource Policy Planning board**

References:

- A. IBA-M(2021)0002-REV1 – IBAN Report to Council on Main Findings from the 2019 Financial Statements Audits
- B. C-M(2015)0025 – NATO Financial Regulations (NFR)
- C. C-M(2016)0023 – NATO Accounting Framework (NAF)
- D. PO(2015)0052 – Wales Summit tasker on transparency and accountability

INTRODUCTION

1. This report by the RPPB addresses the IBAN report on main findings from the 2019 financial statements audits (reference A). The IBAN report provides an overview to Council on the main findings of the 2019 financial statements audits to further enhance Council's ability to oversee and account for the organisation's limited resources.

AIM

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

DISCUSSION

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 and cash flows; and that funds have been properly used for the settlement of authorised expenditure and are in compliance with the regulations (reference B). During the course of audit, due to the COVID-19 pandemic and associated travel restrictions, IBAN conducted part of its audit work remotely and performed less on-site visits compared to a typical audit year.

4. Size and scale of reporting entities. In 2019 NATO reporting entities had annual expenses ranging from approximately EUR 1 million to EUR 3,351 million and therefore experienced varying degrees of complexity and materiality in financial reporting and accountabilities depending on their size and mandate.

4.1. IBAN opinions and prior year observations:

4.1.1. The IBAN notes the generally stable trend from 2017 to 2019 in the number of unqualified audit opinions on financial statements (19 in 2017, 23 in 2018 and 19 in 2019) and an increasing trend of unqualified audit opinions on compliance (from 14 in 2017 to 20 in 2019) out of currently 22 NATO reporting entities.

4.1.2. During the same period, the number of qualified opinions on financial statements and compliance declined as IBAN raised a qualified opinion only for the NATO Airborne Early Warning and Control Programme Management Agency (NAPMA) and the NATO Communications and Information Organisation (NCIO). Two observations impacted the audit opinion on the financial statements for NAPMA and one observation impacted the audit opinion on the financial statements and on compliance for NCIO. The NAPMA observation relates to the recognition of contractor acquired property as Property, Plant & Equipment (PP&E) and to an understatement of revenue related to a grant received. The observation for NCIO relates to the completeness of PP&E and intangible assets, including assets under construction. The stable trend of unqualified opinions on the financial statements reflects in overall terms that NATO is continuing and needs to continue its efforts regarding the implementation of the NATO Accounting Framework (NAF) (reference C). The increased number of unqualified opinions on compliance reflects improved compliance with regulations in force. NATO Reporting Entities need to continue their effort in implementing the NAF.

4.1.3. The number of newly issued observations slightly increased between 2018 and 2019 after decreasing between 2017 and 2018 (54 in 2017, 33 in 2018 and 39 in 2019). Among prior year recommendations, the IBAN notes a decreasing number of open recommendations from 2017 to 2019 while recommendations in-progress remained stable since 2018. IBAN's analysis of all outstanding recommendations indicate that NATO reporting entities are generally addressing IBAN recommendations in a timely matter, since 88 recommendations, or 89% of all recommendations are within three years and ten recommendations, or 11% are older than three years.

4.2. Key Audit Matter:

4.2.1. The IBAN, in the Audit Report of the NATO Science and Technology Organisation (STO) Financial Statements for 2019, for the first time, raised a Key Audit Matter. The Key Audit Matter is addressed to Council in unqualified audit reports on issues that, in IBAN's independent professional judgement, were of most significance in the audit of the financial statements. The STO observation relates to the recognition of two NATO Research Vessels in its Statement of Financial Position.

5. 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.

5.1. While being the most significant in terms of total number, the first theme shows the improvement with the number of IBAN observations and recommendations reducing from 46 in 2017 to 38 in 2019. 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.

5.2. The number of recommendations in the second theme have remained stable since 2017 and there were ten recommendations in 2019 for eight NATO reporting entities. It calls for more progress by NATO reporting entities to improve internal control, accounting and reporting of PP&E and inventories, covering both tangible and intangible assets. Given the amounts involved, this theme is significant as it may lead to qualified opinions in the future.

5.3. The number of recommendations in the third theme reduced from 12 in 2017 to nine in 2019 while the number of recommendations in the fourth theme doubled from seven in 2017 to 14 in 2019 driven by 11 new recommendations for ten NATO reporting entities. These two themes include recommendations related to procurement processes and arrangements between NATO reporting entities or with Nations as well as recommendations related to the management and reporting of funds, revenue and cash. While being the second most significant in terms of total number, the number of recommendations in the fifth theme reduced from 39 in 2017 to 27 in 2019. It included recommendations related to compliance with the NATO Financial Regulations (NFR) (reference B) on risk management, internal control, the statement of internal control and internal audit and those associated with validity of information, approval of revised budgets and special carry forwards and obtaining related party declarations.

6. The Board recognises the IBAN's critical role in providing independent assurance and advice to Council and is encouraged to note the steady number of unqualified opinions on financial statements and an increased number of unqualified opinions on compliance issued during the past three years. For the same period, the Board also notes a decline in qualified opinions. On the other hand, the Board expresses concerns with regards to the qualified opinions and open observations especially those that have remained open for more than three years. Therefore, the Board invites the IS-NOR, in coordination with IBAN, to advise the Board whether further discussion with the management/governance of those entities or more focused Board recommendations to Council are necessary to accelerate actions on those outstanding items. The Board also welcomes the role IBAN plays in disseminating information to relevant stakeholders to improve the preparation of financial statements, as every reporting entity should have a thorough understanding of International Public Sector Accounting Standards (IPSAS), NFRs and NAF.

CONCLUSIONS

7. The Board welcomes the analysis undertaken by IBAN on the audit findings on the 2019 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.

8. The Board is pleased by the reduced number of qualified opinions and new recommendations in the past three years, which show an improving trend in financial reporting. However, the Board raises its concerns regards the aging of certain observations and their progress being outstanding for more than three years. The Board also welcomes IBAN disseminating information on relevant topics to improve the preparation of financial statements. Furthermore, the Board acknowledges continued efforts are required on PP&E, inventories and intangible assets which was in 2019, the main cause of audit qualification. Implementation of risk management, internal controls and internal audit continues to be an area of concern. In this regard the Board, while encouraging NATO bodies and reporting entities to make progress in these areas, notes the upcoming review of the NFR will assess the options to address some concerns on the lack of clarity and simplicity.

RECOMMENDATIONS

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

9.1. notes this report and the IBAN report at reference A;

9.2. agrees to the public disclosure of the IBAN report and this report in line with agreed policy at reference D.



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IBA-A(2021)0105-REV1
24 September 2021

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
Resource Policy and Planning Board representatives, NATO delegations
Private Office Registry

Subject: ***International Board of Auditors for NATO (IBAN) Report on main findings from the 2019 Financial Statements audits – IBA-M(2021)0002-REV1***

IBAN submits herewith its approved revised version of the Report for distribution to the Council.

Yours sincerely,

Daniela Morgante
Chair

Attachments: As stated above.

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IBAN REPORT

on Main Findings from the 2019
Financial Statements Audits

FOREWORD BY THE CHAIR

On behalf of the International Board of Auditors for NATO (IBAN), it is my pleasure to share with you the Report to Council on Main Findings from the 2019 Financial Statements Audits. The purpose of this Report is to provide an overview to the North Atlantic Council (Council) on the main findings of the 2019 financial statements audits covering NATO Bodies and other NATO Reporting Entities.

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

Travel restrictions and confinement measures imposed as part of the COVID-19 pandemic led to a number of constraints for our financial statements audits. These constraints presented challenges on both the reporting entity and IBAN sides. While maintaining our independence, and thanks to strong cooperation, we were able to deliver almost all of our mandate within a timely manner given the circumstances.

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



Daniela Morgante
Chair
International Board of Auditors for NATO

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1. IBAN'S RESPONSIBILITIES REGARDING FINANCIAL STATEMENTS AUDITS

1.1 IBAN's Mandate Regarding Financial Statements Audits

1.1.1 In accordance with Article 1 of its Charter, the International Board of Auditors for NATO (IBAN) 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 NATO Bodies and other NATO Reporting Entities that operate under one of the three juridical personalities created by the NATO member States. The North Atlantic Treaty Organisation (the Organisation) possesses one of these three personalities by virtue of the Ottawa Agreement. The two Supreme Headquarters, Supreme Headquarters Allied Powers Europe (SHAPE) and Headquarters Supreme Allied Command Transformation (HQ SACT), each possess one of the other two personalities by virtue of the Paris Protocol. Our mandate also covers the financial audit of non-appropriated funds, as far as they are included in the financial statements of a NATO Reporting Entity.

1.1.3 Twenty NATO Reporting Entities operate under the juridical personality possessed by the Organisation by virtue of the Ottawa Agreement. These NATO Reporting Entities constitute an integral part of the Organisation. Three of the 20 NATO Reporting Entities are the NATO benefit schemes. These benefit schemes apply to all NATO International Civilians including those employed by the two Allied Commands, Allied Command Operations (ACO) and Allied Command Transformation (ACT). The International Staff carry out the financial management of the NATO benefits schemes centrally.

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

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1.1.5 IBAN's mandate regarding the audit of the 2019 financial statements therefore covers 3 juridical personalities and includes 22 NATO Reporting Entities. The following table presents total expenses for each NATO Reporting Entity.

Table 1: Total Expenses in 2019 per NATO Reporting Entity

Juridical Personality	NATO Reporting Entity	Currency (in million)	Total Expenses 2019 (1)
Ottawa Agreement (1951)			
NATO	BGX - BICES Group Executive	Not disclosed	Classified
	DCPS - Defined Contribution Pension Scheme (3)	EUR	25
	IMS - International Military Staff	EUR	28
	IS - International Staff	EUR	278
	MSIAC - Munitions Safety Information Analysis Center (5)	EUR	2
	NAGSMO - NATO Alliance Ground Surveillance Management Organisation (2)	EUR	8
	NAHEMO - NATO Helicopter Design and Development Production and Logistics Management Organisation (2)	EUR	12
	NAMEADSMO in Liquidation - NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Organisation in Liquidation (2)	USD	2
	NAMMO - NATO Multi-Role Combat Aircraft Development Production and In-Service Support Management Organisation	EUR	489
	NAPMA - NATO Airborne Early Warning and Control Programme Management Agency	USD	69
	NATO CPS - NATO Coordinated Pension Scheme (3)	EUR	202
	NCIO - NATO Communications and Information Organisation	EUR	797
	NDC - NATO Defense College	EUR	10
	NEFMO - NATO European Fighter Aircraft Development, Production and Logistic Management Organisation	EUR	2,262
	NETMA - NATO Eurofighter 2000 and Tornado Management Agency	EUR	45
	NFO - NATO Naval Forces Sensor and Weapons Accuracy Check Sites Office (5)	EUR	1
	NNHQ - New NATO Headquarters (4)	EUR	13
	NSPO - NATO Support and Procurement Organisation	EUR	3,351
	RMCF - Retirees Medical Claims Fund (3)	EUR	29
	STO - Science and Technology Organisation	EUR	33
Paris Protocol (1952)			
SHAPE	ACO - Allied Command Operations	EUR	1,056
HQ SACT	ACT - Allied Command Transformation	EUR	148

Source: IBAN data

Notes to Table 1

- (1) All expenses are expressed in EUR million except for NAMEADSMO in Liquidation and NAPMA, which are expressed in USD million. The totals include expenses between NATO Reporting Entities. It is therefore not possible to provide the total expenses for NATO.
- (2) The expenses as per financial statements only contain costs incurred in connection to the administrative budget, reflecting NATO's role as an agent. IBAN also audits the operational expenditure of NAGSMO, NAHEMO and NAMEADSMO in Liquidation, which amounted respectively to EUR 131.1 million, EUR 1,108.7 million and USD 1.2 million for 2019.
- (3) 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 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.
- (4) The New Headquarters (NHQ) is an activity of the International Staff.
- (5) MSIAC and NATO FORACS Office are NATO Reporting Entities only in respect of activities carried out by the International Staff in relation to MSIAC and NATO FORACS Office.

1.1.6 As shown in the above table, NATO Reporting Entities have different levels of annual expenses ranging from approximately EUR 1 million to EUR 3,351 million in 2019. NATO Reporting Entities therefore experience varying degrees of complexity and materiality in financial reporting and accountabilities depending on their size and mandate.

1.1.7 A simplification of NATO's Financial Reporting and Accountability Framework (FRAF) is possible (see Table 1), 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 General Purpose Financial Statements and at the same time improve accountability and transparency to external stakeholders.

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

1.2 Financial Statements Audits and Reporting

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

- *that the activities of the NATO bodies have been carried out with efficiency, effectiveness and economy (performance audit/value for money audit);*
- *that the expenditures incurred by member countries (Host Nations) or NATO bodies in respect of the NSIP have been carried out in compliance with the regulations in force (NSIP audit).*

1.2.3 IBAN provides an audit report on the financial statements for every NATO Reporting Entity to the North Atlantic Council. The audit report on the financial statements contains an independent external auditor's report, and observations and recommendations. The independent external auditor's report includes an opinion on the financial statements and an opinion on compliance.

1.2.4 The IBAN opinion on the financial statements sets out whether the financial statements present fairly their financial position, financial performance, its cash flows and budget execution. The IBAN opinion on compliance presents whether the funds have been properly used for the settlement of authorised expenditure and are in compliance with the regulations in force. The IBAN Independent Auditor's Report therefore contains two separate audit opinions.

1.2.5 In each audit report on the financial statements, IBAN reports observations leading to modified audit opinions and any other observations that we consider should be brought to the attention of Council. Observations and recommendations raised during the audit, which have not been included in the IBAN's audit report addressed

to Council, are set out in a management letter addressed to the Head of the NATO Reporting Entity.

1.2.6 IBAN conducts its financial audits in different phases, including audit planning, audit fieldwork and audit reporting. As part of the audit fieldwork, our audit teams generally conduct on-site visits at the premises of the NATO Reporting Entities and have extensive dialogue and interactions with the auditees. At the end of an on-site visit, we hold a debrief meeting with the entity's staff to discuss preliminary audit findings. Due to the COVID-19 pandemic and associated travel restrictions, IBAN conducted part of its audit work remotely as we were able to perform less on-site visits.

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

1.2.8 In accordance with Article 14 of its Charter, IBAN prepares and presents each year reports on the audited annual financial statements relating to NATO bodies and other NATO Reporting Entities. The purpose of this IBAN Report on Main Findings is to provide an overview of the main findings from the 2019 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 and ISSAI 4000 to the compliance audit component.

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

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

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

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

1.3.5 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 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 annexed to the financial statements as required by Article 34.4 of the NFRs.

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

1.4.3 The Financial Statements of each NATO Reporting Entity are signed by the respective Head and Financial Controller. In signing the Financial Statements, both the Head and the Financial Controller confirm the establishment and maintenance of financial governance, resource management practices, internal controls and financial information systems to achieve the efficient and effective use of resources.

1.4.4 This confirmation covers the design, implementation and maintenance of internal controls relevant to the preparation and presentation of financial statements that are auditable and free from material misstatement, whether due to fraud or error. It also includes the responsibility for ensuring adequate audit trails in accordance with the NFRs Article 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.

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

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

2. MAIN FINDINGS FROM THE 2019 FINANCIAL STATEMENTS AUDITS

2.1 Summary of Main Findings

2.1.1 The main findings from the 2019 Financial Statements Audits of the 22 NATO Reporting Entities cover the audit opinions issued on the financial statements and on compliance, and the observations and recommendations addressed to Council. Due to COVID-19 and related travel restrictions, the audit of NAMEADSMO in Liquidation

has not yet been completed. The final audit report will be issued to Council at the earliest possible time and the result of this audit does not form part of this report.

2.1.2 In order to place these findings into perspective, the audit results related to the 2019 financial statements are compared with the prior two years. The following audit opinions were issued on the financial statements and on compliance:

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

	2019	2018	2017	
Financial statements	Unqualified	19	23	19
	Qualified	2	1	5
	Adverse	-	-	-
	Disclaimer	-	-	-
	Pending (1)	1	-	-
	Total (2)	22	24	24
Compliance	2019	2018	2017	
	Unqualified	20	22	14
	Qualified	1	2	10
	Adverse	-	-	-
	Disclaimer	-	-	-
	Pending (1)	1	-	-
Total (2)	22	24	24	

Source: IBAN data

Notes

- (1) The 2019 final audit report for NAMEADSMO in Liquidation has not yet been issued due to COVID-19 and related travel restrictions.
- (2) In 2019, our audit mandate covered 22 NATO Reporting Entities compared to 24 in 2017 and 2018. The Provident Fund was closed in 2018 and the activities of the NATO Staff Centre were integrated into the financial statements of the International Staff as from 2019, in accordance with the NATO Accounting Framework.

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

2.1.4 The table below presents the audit opinions issued by IBAN per NATO Reporting Entity for the 2019 financial statements and two comparative years.

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Table 3: Audit Opinions per NATO Reporting Entity

Reporting Entity	2019		2018		2017	
	F/S (1) Opinion	Compliance Opinion	F/S (1) Opinion	Compliance Opinion	F/S (1) Opinion	Compliance Opinion
ACO	Unqualified	Unqualified	Unqualified	Unqualified	Qualified	Qualified
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	Qualified	Qualified
MSIAC	Unqualified	Unqualified	Unqualified	Qualified	Unqualified	Qualified
NAGSMO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Qualified
NAHEMO	Unqualified	Unqualified	Unqualified	Unqualified	Qualified	Qualified
NAMEADSMO in Liquidation	Pending	Pending	Unqualified	Unqualified	Unqualified	Unqualified
NAMMO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NAPMA	Qualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NATO CPS	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Qualified
NATO Provident Fund (2)	n/a	n/a	Unqualified	Unqualified	Unqualified	Unqualified
NATO Staff Centre (2)	n/a	n/a	Unqualified	Unqualified	Unqualified	Qualified
NCIO	Qualified	Qualified	Qualified	Qualified	Qualified	Qualified
NDC	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NEFMO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NETMA	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NFO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NHQ	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
NSPO	Unqualified	Unqualified	Unqualified	Unqualified	Qualified	Qualified
RMCF	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
STO	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified	Qualified

Unqualified	19	20	23	22	19	14
Qualified	2	1	1	2	5	10
Pending audit opinion (3)	1	1	-	-	-	-

Source: IBAN data

Notes

(1) Financial Statements (F/S).

(2) Not applicable (n/a) in 2019 as the Provident Fund was closed in 2018 and the activities of the NATO Staff Centre were integrated into the financial statements of the International Staff as from 2019, in accordance with the NATO Accounting Framework.

(3) The 2019 final audit report for NAMEADSMO in Liquidation has not yet been issued due to COVID-19 and related travel restrictions.

2.2 Summary of Unqualified Opinions

2.2.1 Since 2017, the number of unqualified audit opinions on the financial statements remained stable with 19 out of a total of 22 NATO Reporting Entities being

unqualified. The number of unqualified audit opinions on compliance increased from 14 to 20 over the same period.

2.2.2 The stable trend of unqualified opinions on the financial statements reflects in overall terms that NATO is continuing and needs to continue its efforts regarding the implementation of the NATO Accounting Framework. The increased number of unqualified opinions on compliance reflects improved compliance with regulations in force.

2.2.3 The audit opinions on the financial statements largely relate to the implementation of the NATO Accounting Framework. The NATO Accounting Framework is a complex set of accounting standards adapted from IPSAS. Implementing this framework requires individual NATO Bodies and other NATO Reporting Entities to maintain continuous high level of knowledge and expertise.

2.2.4 The audit opinions on compliance largely relate to compliance with the provisions of the NFRs. For NATO Reporting Entities with unqualified opinions on compliance, we found no material matters related to the proper use of funds for the settlement of authorised expenditure and compliance with the regulations in force. The revised NFRs in 2015 introduced a number of new requirements that NATO Bodies and other NATO Reporting Entities largely implemented.

2.2.5 IBAN raised a Key Audit Matter in the Independent Auditor's Report on the 2019 Financial Statements of the NATO Science and Technology Organization (STO). Key Audit Matters are those matters that, in IBAN's professional judgement, were of most significance in the audit of the 2019 financial statements. The Key Audit Matter was raised because STO does not recognise the two Vessels under its control since 2012 as Property, Plant and Equipment (PP&E) in the Statement of Financial Position. The Vessels have an insured value of approximately EUR 50 million. Our audit opinion is not modified, as the current accounting treatment is compliant with the NATO Accounting Framework whereby PP&E acquired prior to 1 January 2013 may be considered as fully expensed. However, IPSAS 1 also requires an entity to present information in a manner that meets qualitative characteristics, such as reliability.

2.3 Summary of Qualified Audit Opinions

2.3.1 IBAN issued a qualified audit opinion on the 2019 financial statements for the NATO Airborne Early Warning and Control Programme Management Agency (NAPMA) and a qualified audit opinion on the 2019 financial statements and on compliance for the NATO Communications and Information Organisation (NCIO). As described in section 1.3, a qualified opinion on the financial statements means that IBAN was generally satisfied with the presentation of the financial statements, but that some key elements of the statements were not fairly stated or affected by a scope limitation. A qualified opinion on compliance means that specific issues have come to our attention that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the rules and regulations.

2.3.2 The qualified audit opinion on the 2019 Financial Statements for NAPMA relates to two observations. The first observation relates to the recognition of contractor acquired property as PP&E. Assets, such as laboratories, facilities, test equipment and tools, which are owned by NATO and controlled by NAPMA, were not recorded as PP&E. The second observation relates to an understatement of revenue related to a grant received. Since the activity was certified as completed and funds received, this grant should have been recorded as revenue.

2.3.3 The qualified audit opinions on the 2019 financial statements and on compliance for NCIO relate to the completeness of PP&E and Intangible Assets, including assets under construction. We were not able to obtain sufficient evidence in respect to the completeness of all property disclosed in the Statement of Financial Position and the notes to the financial statements. This also impacted the Statement of Financial Performance as Computer Information Systems (CIS) assets that were under construction as of 1 January 2018, including existing ones that continue after 1 January 2018, were fully expensed. In addition, we did not obtain sufficient evidence that comprehensive records of all property controlled by NCIO have been established and maintained as required by Article 12 of the NFRs. This article, which applies to all assets irrespective of when they were acquired, requires that comprehensive accounting records are established and maintained for all assets.

2.3.4 Due to the COVID-19 situation, we were unable to carry out annual physical checks at the NCIO CIS Sustainment Support Centre (CSSC) to confirm the value of inventory in accordance with the requirements of ISSAIs. We found no evidence to suggest that the true value was not disclosed in the Statement of Financial Position. Regarding the 2018 Financial Statements, IBAN's audit revealed no material errors. However, IBAN could not rely on previous year's findings to inform an opinion on the 2019 Financial Statements. As a result, we were unable to express an opinion on the value of inventory amounting to approximately EUR 47 million due to a lack of sufficient and appropriate evidence, as required by our auditing standards. We stress that this opinion is based on the COVID-19 situation, which is outside of NCIO's area of responsibility.

2.4 Summary of Observations and Recommendations

2.4.1 Each IBAN audit report includes observations and recommendations leading to modified audit opinions and other significant observations and recommendations brought to the attention of Council.

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

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

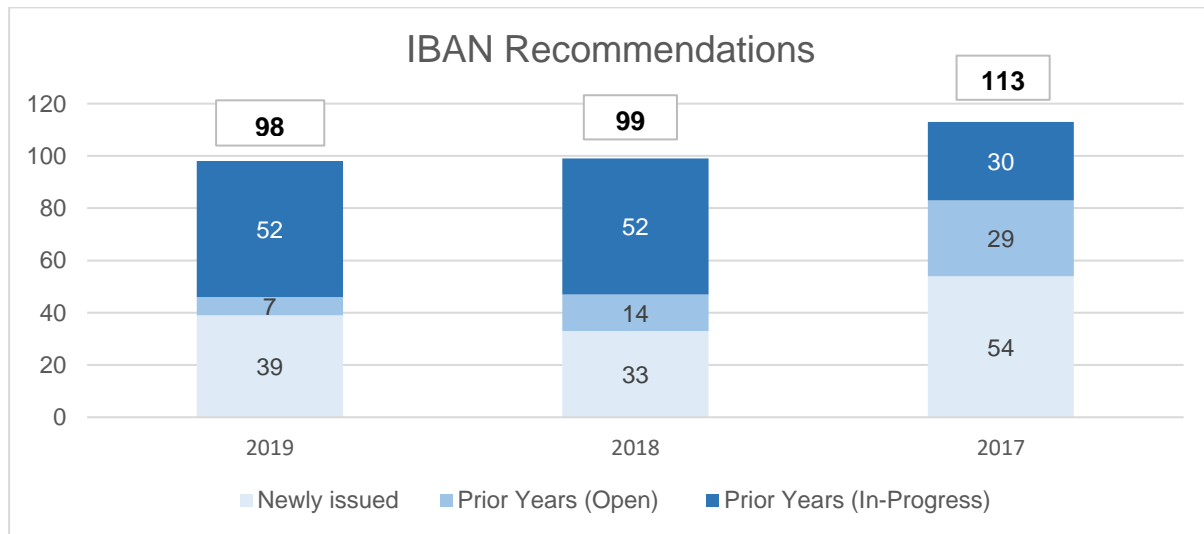
In-progress: is used for open recommendations when the NATO Reporting Entity has started to implement the recommendation or when some (but not all) sub-recommendations are closed;

Closed: is used for recommendations that are closed because they have been implemented, are superseded, or have lapsed.

Overview of current and prior year recommendations

2.4.3 The chart below contains an overview of all current and prior year recommendations as per IBAN audit reports for the financial years 2019, 2018 and 2017 based on the status of the recommendations described above.

Chart 1: Number of IBAN recommendations



Source: IBAN data

2.4.4 The above chart shows that the number of newly issued observations slightly increased between 2018 and 2019 after decreasing between 2017 and 2018. Among prior year recommendations, the share of recommendations in-progress remained stable since 2018. In general terms, this can be interpreted as a signal that financial reporting and compliance at NATO is in progress and NATO Reporting Entities are currently in the process of addressing our prior year recommendations.

2.4.5 It should be noted that the substance of audit observations and recommendations is more important than their number. IBAN has gradually reduced their number by grouping them as much as possible and creating sub-

recommendations where necessary. Therefore grouping is also a reason for the decrease in the number of observations and recommendations newly issued between 2017 and 2019.

Summary of main findings per theme

2.4.6 In order to present a more explanatory overview of the areas in which audit observations are being made, all audit observations from the 2019, 2018 and 2017 audit reports were categorised on the basis of five themes. This presentation of the observations allows us to identify the areas in which most audit findings occur, and the areas that still show room for improvement. When a recommendation relates to more than one theme, it has been included in the category that we believe carries more weight.

Table 4: 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					
	2019	2018	2017	On F/S			On compliance		
				2019	2018	2017	2019	2018	2017
1. Financial and budgetary accounting and reporting	38	40	46	-	-	5	-	-	3
2. Property, plant, equipment, inventories and intangible assets	10	8	9	2	2	3	1	1	2
3. Procurement, contracting and other arrangements	9	8	12	-	-	-	-	-	-
4. Funding, revenue and cash management	14	8	7	1	-	-	-	-	-
5. Compliance with other NATO regulations, rules and sound financial management principles	27	35	39	-	-	-	-	1	7
Total number of IBAN Observations and Recommendations	98	99	113	3	2	8	1	2	12

Source: IBAN data.

Financial and budgetary accounting and reporting

2.4.7 This theme includes recommendations relating to the preparation and presentation of the financial statements, budget execution statements, accounting and associated internal control and Information Technology processes. The number of recommendations reduced from 46 in 2017 to 38 in 2019.

2.4.8 During our audits, we identified errors and internal control weaknesses related to the preparation and presentation of financial statements. In 2019, in four cases, this led NATO Reporting Entities to re-submit their financial statements for audit in order to correct significant errors. IBAN approved to audit the re-submitted financial statements in accordance with our policy for these situations.

2.4.9 When taking into account the above re-submissions, financial reporting across NATO Reporting Entities generally remained stable. Continuous improvements are

still required in the internal controls related to the preparation of financial statements, including adequate audit trails as also required by the NFRs.

2.4.10 The recommendations mainly related to the following matters:

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

2.4.11 NATO as a whole does not recognise post-employment liabilities. Instead, these are disclosed in the notes to the financial statements of the two benefit funds. As of 31 December 2019, the post-employment liability for the Co-ordinated Pension Scheme amounted to EUR 8.4 billion and EUR 3.4 billion for the NATO Retirees Medical Claims Fund. The NATO Accounting Framework 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 11.8 billion post-employment liability. Not doing so would normally require an adaptation to the NATO Accounting Framework.

2.4.12 In 1997, Council approved 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

2.4.13 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 stable since 2017 and there were ten recommendations in 2019 for eight NATO Reporting Entities. Improvements are still

required in the financial accounting and reporting of PP&E, inventory and intangible assets to address the following weaknesses:

- Inaccurate and incomplete asset registers for tangible and intangible assets (including assets under construction), especially related to Computer Information Systems (CIS), NSIP funded assets and Contractor Acquired Property.
- Lack of an integrated system to manage and account for assets.
- Weaknesses in the accounting and capitalisation process.

2.4.14 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.

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

Procurement, contracting and other arrangements

2.4.16 This theme includes recommendations related to procurement processes and arrangements between NATO Reporting Entities or with Nations. The number of recommendations in this area reduced from 12 in 2017 to 9 in 2019. Our audits found some weaknesses in the procurement processes around source selection planning, justifications for deviations from competition to sole source procurement and the approval hereof and monitoring of potential conflicts of interest. They also include the need for signed technical arrangements for the use of NATO funded equipment and infrastructure in theatre and a memorandum of agreement and logistic support agreements with customer-funded agencies.

Funding, revenue and cash management

2.4.17 This theme includes recommendations related to the management and reporting of funds, revenue and cash. The number of recommendations doubled from seven in 2017 to 14 in 2019. This is due to 11 new recommendations for 10 NATO Reporting Entities. The new audit recommendations mainly related to temporary loans between three NATO Reporting Entities, calculation of customer rates and overhead assumptions and the management of significant cash holdings and investments. Two recommendations related to the reporting and accounting of revenue of which one led to a qualified audit opinion on the financial statements of one NATO Reporting Entity.

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

2.4.18 The number of recommendations in this area reduced from 39 in 2017 to 27 in 2019. Out of a total of 27 recommendations in 2019, 17 were related to compliance with the revised NFRs on risk management, internal control, the statement of internal control and internal audit. These requirements cover all parts of NATO's operations, with a much broader scope than only financial and budgetary matters. The delay in achieving compliance with these rules is partly due to a lack of clarity as to who in practice is responsible and accountable for their implementation. In our view, any new revision to the NFRs should seek to clarify responsibilities related to internal control and risk management.

2.4.19 Other recommendations related to the need to strengthen the ability to challenge the validity of information and solutions provided by the NATO customer-funded agencies, approval of revised budgets and special carry forwards in line with the NFRs, and the need to obtain related party declarations from key management personnel including, if needed, from members of supervisory bodies and board of directors.

Aging of outstanding recommendations

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

Table 5: Aging of recommendations per theme

IBAN Recommendations per Audit Theme	Current year	1 - 3 Years	> 3 years	Total
1. Financial and budgetary accounting and reporting	17	17	4	38
2. Property, plant, equipment, inventories and intangible assets	5	5	-	10
3. Procurement, contracting and other arrangements	2	5	2	9
4. Funding, revenue and cash management	11	2	1	14
5. Compliance with other NATO regulations, rules and sound financial management principles	4	20	3	27
Total number of IBAN Recommendations	39	49	10	98

Source: IBAN data.

2.4.21 The above table shows that 88 recommendations, or 89% of all recommendations, are within three years. This indicates that NATO Reporting Entities addressed our recommendations in a timely matter. Only ten recommendations, or 11%, are older than three years.

2.4.22 The ten recommendations older than three years relate to eight NATO Reporting Entities. These recommendations mainly relate to weaknesses in financial reporting and accounting, such as insufficient confirmation of year-end assets and liabilities between NATO Reporting Entities. It also relates to compliance with NATO regulations, such as in the area of internal control, risk management and internal audit.

2.5 Conclusion

2.5.1 Our audits of the financial statements of NATO Reporting Entities show a stable number of unqualified opinions issued during the past three years. In addition, the relatively stable number of new recommendations we made remains encouraging.

2.5.2 Strengthening internal controls over the management and reporting of funds, revenue and cash, as well as over the accounting and financial reporting process, including maintaining adequate audit trails, may lead to further significant progress. Going forward NATO entities need to pay particular attention to the completeness of PP&E, inventories and intangible assets. In addition, we stress the importance of addressing our recommendation on recognising post-employment liabilities in a timely manner.

2.5.3 In light of the upcoming revision of the NATO Financial Regulations and 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 remains a core target going forward.

2.5.4 Improving the quality of financial information in support of decision-making is also possible by simplifying NATO's Financial Reporting and Accountability Framework (FRAF). A simplification based on the legal framework of NATO would be more in line with the aim of General Purpose Financial Statements and at the same time improve accountability and transparency to external stakeholders.

List of Abbreviations/Acronyms

ACO	Allied Command Operations
ACT	Allied Command Transformation
BGX	NATO Battlefield Information, Collection and Exploitation Systems Group Executive
Council	North Atlantic Council
DCPS	NATO Defined Contribution Pension Scheme
ERP	Enterprise Resource Programme
FORACS	Naval Forces Sensor and Weapons Accuracy Check Sites (FORACS)
F/S	Financial statements
HQ SACT	Headquarters Supreme Allied 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

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NAPMA	NATO Airborne Early Warning and Control Programme Management Agency
NATO	North Atlantic Treaty Organisation
NATO CPS	NATO Coordinated Pension Scheme
NCIO	NATO Communications and Information Organisation
NDC	NATO Defense College
NEFMO	NATO European Fighter Aircraft Development, Production and Logistic Management Organisation
NETMA	NATO Eurofighter 2000 and Tornado Management Agency
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
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

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