	<b>NATO</b>	NORTH ATLANTIC COUNCIL
	<b>OTAN</b>	CONSEIL DE L'ATLANTIQUE NORD

**NATO UNCLASSIFIED**

17 January 2022

**DOCUMENT**  
C-M(2022)0001-AS1

**RESOURCE POLICY AND PLANNING BOARD**

**IBAN AUDITOR'S REPORT ON THE 2019 FINANCIAL YEAR STATEMENTS OF  
SCIENCE AND TECHNOLOGY ORGANISATION (STO)**

**ACTION SHEET**

On 14 January 2022, under the silence procedure, the Council noted the RPPB report at annex to C-M(2022)0001, agreed its conclusions and recommendations, and agreed to the public disclosure of this report, the IBAN Auditor's Report and associated 2019 financial statements of STO.

(Signed) Jens Stoltenberg  
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2022)0001.

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05 January 2022

**DOCUMENT**  
C-M(2022)0001  
**Silence Procedure ends:**  
**14 Jan 2022 15:30**

**RESOURCE POLICY AND PLANNING BOARD**

**IBAN AUDITOR'S REPORT ON THE 2019 FINANCIAL YEAR STATEMENTS OF  
SCIENCE AND TECHNOLOGY ORGANISATION (STO)**

**Note by the Secretary General**

1. I attach the International Board of Auditors for NATO (IBAN) Auditor's Report on the 2019 financial statements of Science and Technology Organisation (STO). The IBAN Auditor's Report set out unqualified opinions on both the 2019 financial statements and on compliance.
2. The IBAN Auditor's Report has been reviewed by the Budget Committee and approved by the Resource Policy and Planning Board (RPPB) (see Annex 1).
3. I do not believe this issue requires further discussion. Therefore, **unless I hear to the contrary by 15:30 hours on Friday, 14 January 2022**, I shall assume the Council notes the RPPB report, agrees its conclusions and recommendations, and agrees to the public disclosure of this report, the IBAN Auditor's Report and associated 2019 financial statements of STO.

(Signed) Jens Stoltenberg

Annex 1: RPPB Report  
Enclosure 1: IBAN Report and Financial Statements

Original: English

**RESOURCE POLICY AND PLANNING BOARD**

**IBAN AUDITOR'S REPORT ON THE 2019 FINANCIAL YEAR STATEMENTS OF  
SCIENCE AND TECHNOLOGY ORGANISATION (STO)**

Reference: AC/335-N(2020)0051-REV1 + AS1

1. On Friday, 25 June, 2021, the Board approved the Budget Committee report on the International Board of Auditors for NATO (IBAN) Auditor's Report on the 2019 financial statements of Science and Technology Organisation (STO) at Appendix 1. The Budget Committee report is to be forwarded to Council to note the IBAN Auditor's Report on the 2019 STO Financial Statements, and agree the conclusions and recommendation on public disclosure. The IBAN Auditor's Report sets out unqualified opinions on the 2019 financial statements and on compliance for STO.
2. As a result of not recognizing two Vessels as Property, Plant & Equipment in the Statement of Financial Position, there is a risk that the STO does not provide reliable information to the users of the Financial Statements. This Key Audit Matter is highlighted in the Budget Committee report at Appendix 1 and provides the RPPB with the means to address this and other issues.
3. In line with the handling arrangements (Reference) the report at Appendix 1 is circulated for approval by the Board under silence procedure. This report takes into consideration the comments received by Nations and was approved by the Budget Committee under silence procedure on 16 June 2021.

**IBAN AUDITOR'S REPORT ON THE 2019 FINANCIAL YEAR STATEMENTS OF STO****Report by the Budget Committee**

## References:

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|--------------------|--|
| A. IBA-A(2020)0122 | IBAN's Auditor's Report on the audit of 2019 financial statements of the STO |
| 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 Budget Committee (BC) addresses IBAN's Auditor's Report on the 2019 financial statements of the Science and Technology Organisation (STO). IBAN Auditor's Report set out unqualified opinions on both the financial statements and compliance for STO in 2019 (Reference A). The Report also raised a Key Audit Matter on the recognition of assets in the Statement of Financial position.

**AIM**

2. This report provides BC advice on key issues from IBAN Auditor's Report to enable the Resource Policy and Planning Board (RPPB) to reflect on strategic issues or concerns emanating from the audit of financial statements of NATO entities and to recommend courses of action to the Council as applicable, which has the potential to improve transparency, accountability and consistency.

**DISCUSSION**

3. When an audit opinion is unqualified IBAN may, in accordance with International Standards of Supreme Audit Institutions (ISSAI 2705), issue a Key Audit Matter (ISSAI 2701)<sup>1</sup> that is of most significance in the audit of the financial statements of the current period. For 2019 IBAN issued a Key Audit Matter regarding Observation 1 in IBAN's Auditor's Report for STO that covers the recognition of the fair value of STO's Vessels. IBAN recommended that STO improves the reliability of information presented in the Financial Statements by recognising the Vessels in its financial statements.

4. In 2019, IBAN made five observations and recommendations, no observations impacted the audit opinion on the financial statement or on compliance. The five new observations relate to the recognition of the fair value of assets, errors and inconsistent accounting policies in STO Financial Statements, the set-up of procedures for temporary

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<sup>1</sup> For unqualified audit opinions those matters raised to Council that, in IBAN's professional judgement, were of most significance in the audit of the financial statements of the current period.

loans and improvements needed regarding the Office of a Chief Scientist (OCS) and Collaboration Support Office (CSO) Budget Execution Statements. Also, IBAN followed up on the status of observations and recommendations from the previous years' audits and found that one is open, two remain in-progress and six were closed.

5. The BC commends STO for their effort in addressing IBAN's recommendations and welcomes the positive trend in continued unqualified audit opinions and the prompt closure of previous year observations.

5.1 Observation 1 (Key Audit Matter): IBAN found that STO does not recognize the two Vessels (insured value at the time of the audit, of approximately EUR 50 million), as Property, Plant & Equipment (PP&E) in the Statement of Financial Position. In accordance with the NATO Accounting Framework (NAF) (Reference C) STO may consider PP&E acquired prior to 1 January 2013 as fully expensed. However, in order to provide reliable information to the users of the Financial Statements<sup>2</sup> and given the value of the Vessels IBAN considers that they should be recognised in the Financial Statements as PP&E assets while stating that the current accounting treatment is compliant with the NATO Accounting Framework. In addition, IBAN found that STO Financial Statements do not disclose relevant additional information regarding ownership, obligations and financial responsibilities of the Vessels. IBAN also found an incorrect statement in the note to the Financial Statements regarding the custody of the Vessels.

5.1.1 The BC sees merit in enhancing the disclosure of the Vessels and proposes that STO, although compliant with the NAF, should improve the reliability of information presented in the Financial Statements, by recognising in its notes the Vessels controlled by STO. In this respect, to provide a true and fair view, while applying NAF, STO should enhance the information in the disclosure note better highlighting the ownership, obligations and financial responsibilities. The BC proposes that STO continues to capitalise enhancements and upgrades to the Vessels. Furthermore, the BC understands that STO will take further steps in this respect while IBAN would re-examine this observation during the course of audit of 2020 STO financial statements. The BC believes there is also room for improvement in the clarity of applicable accounting rules for financial statements and proposes that the issue of the value of the assets, more specifically the consistency between IPSAS 1 and IPSAS 17 adaptation is addressed as a part of the NAF review.

5.2 Observation 2: IBAN found that STO did not disclose that 2018 comparative figures regarding personnel costs were restated to correct errors identified in 2018 financial statements. Also, the personnel expenses in the STO's Statement of Financial Performance do not reconcile with the disclosure notes.

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<sup>2</sup> According to IPSAS 1, "reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent".

5.2.1 The BC supports the recommendation by IBAN, as agreed by STO, that STO reconciles all financial data and discloses the restatement of comparative figures in its financial statements.

5.3 Observation 3: IBAN found that internal control processes related to the temporary loans among NATO Reporting Entities are not included in the written procedures for STO. Temporary loans are aimed at solving a temporary liquidity problem for Reporting Entities within the IMS Budget Group (comprising the International Military Staff (IMS), NATO Defense College (NDC) and STO) whereas the transfer of appropriations of the IMS Budget Group is aimed at reallocating appropriations between budgets.

5.3.1 STO did not fully concur with the observation because this practice has been in place for a number of years and Nations at the BC have been informed of this long-standing practice several times. STO agreed to consider adding additional clarification to Finance Operating Procedures across the IMS Budget Group. The BC supports IBAN recommendations citing that for recurring temporary loans granted by IMS to NDC and STO-CSO, the process and associated terms and conditions should be included in operating procedures in compliance with Article 12 of the NATO Financial Regulations (NFRs) (Reference B) on internal control. Additionally, the BC notes that the topic of granting temporary loans will be considered in the upcoming review of NFRs.

5.4 Observation 4: IBAN found inconsistencies between accounting methods and policies applied by the executive bodies of STO (OCS, CSO and CMRE) which are not adjusted during the financial statements preparation process nor disclosed in the notes to the financial statements. In its reply, STO agreed to the recommendation while noting that this adjustment does not have a material effect on the financial statements.

5.4.1 The BC supports IBAN recommendation that STO prepares financial statements using consistent accounting policies and methods for its three executive entities or discloses the differences in the notes to the financial statement.

5.5 Observation 5: IBAN found that CSO's Budget Execution Statements of OCS and CSO do not distinguish between the special carry forward approved by the BC nor contain any related disclosure note. In addition, OCS and CSO do not present any details on budgetary authorisation, transfers or revision.

5.5.1 The BC supports the recommendation by IBAN, as agreed by STO, that STO improve the presentation of the Budget Execution Statement and disclosure notes for OCS and CSO.

5.6 Prior year closed observation: IBAN closed observations on the control and the use of leave, compliance with NATO Civilian Personnel Regulations (CPRs) in the area of HR management and on the HR control environment in CMRE. It also closed the observation on the acceptance of CMRE deliverables by ACT and obtaining related party disclosures from the Science and Technology Board.

5.7 Prior year observation open and in-progress: Progress is noted in respect of the prior year observations, notably by updating the staff instructions on the duration of employments for consultants and internal audit assessment. However, further improvement is still needed in compliance with NATO CPRs on the engagement of consultants, in the area of internal control, risk management and accounting.

## CONCLUSIONS

6. IBAN Auditor's Report set out unqualified opinions on both the financial statements and compliance for STO in 2019. No new observations impacted the audit opinion for STO in 2019. Five new observations were raised for STO, including one Key Audit Matter. As of the date of the respective IBAN Auditor's Reports a total of two prior year observations for STO were in-progress, one was open and six prior year observations were closed.

7. In 2019, IBAN identified that improvements were needed concerning recognition of STO's assets, reconciliation and disclosure of financial data, presentation of the Budget Execution Statements and temporary loans between NATO Reporting Entities. In this regard, the BC supports IBAN's recommendation that STO improves the reliability and disclosure of information presented in the financial statements. Subsequently, IBAN audit of 2020 financial year statements of STO will address whether the rectification made by STO in the form of enhanced disclosure in the financial statements will tackle its recommendation. Furthermore, the BC proposes this issue to be assessed as part of the NAF review. The BC further proposes that consistent accounting policies are disclosed in the notes to the financial statements and that a procedure for temporary loans between NATO Reporting Entities is formally agreed. The BC also notes that the topic of granting temporary loans will be included in the upcoming review of NFRs.

8. In respect of prior year observations, the BC welcomes the significant progress made by STO on the control of duration of employment of consultants and in the area of internal audit and supports IBAN's recommendation that STO continues with its progress in compliance with CPRs, in the area of internal control and accounting.

## RECOMMENDATIONS

9. The BC invites the Resource Policy and Planning Board to recommend that the Council:

9.1 note this report and IBAN Auditor's Report at reference A;

9.2 approve the conclusions at paragraphs 6 to 8; and

9.3 approve the public disclosure of this report, IBAN Auditor's Report and the associated 2019 financial statements of STO, in line with agreed policy at reference D.



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IBA-A(2020)0122  
17 November 2020

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

Cc: NATO Permanent Representatives  
Chairman/NATO Chief Scientist, Science and Technology Board  
Chairman, Science and Technology Organisation Finance and Audit Sub-Group  
Director, Centre for Maritime Research and Experimentation  
Director, Science and Technology Collaboration Support Office  
Financial Controller, International Military Staff/Science and Technology Organisation  
Chairman, Resource Policy and Planning Board  
Branch Head, Secretariat and Finance Branch, NATO Office of Resources  
Private Office Registry

Subject: ***International Board of Auditors for NATO (IBAN) Auditor's Report and Letter of Observations and Recommendations on the audit of the Science and Technology Organisation (STO) Financial Statements for the year ended 31 December 2019 – IBA-AR(2020)0010***

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

IBAN's Report sets out an unqualified opinion on the Financial Statements of the Science and Technology Organisation (STO) and on compliance for financial year 2019.

The Report also raises a Key Audit Matter drawing attention to the fact that STO does not recognise the two Vessels under its control, as Property, Plant & Equipment (PP&E) in its Statement of Financial Position.

Yours sincerely,

Daniela Morgante  
Chair

Attachments: As stated above.

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**Summary Note for Council  
by the International Board of Auditors for NATO (IBAN)  
on the audit of the Financial Statements of the  
Science and Technology Organisation (STO)  
for the year ended 31 December 2019**

IBAN audited the Science and Technology Organisation (STO), which was established as a NATO Reporting Entity on 1 July 2012. Its mission is to help position the Nations' and NATO's Science and Technology investments as a strategic enabler of the knowledge and technology advantage for the defence and security posture of NATO nations and partner Nations.

The STO comprises three executive bodies: the STO Office of the Chief Scientist (OCS) located in Brussels, Belgium, under the authority of the Chief Scientist; the STO Collaboration Support Office (CSO) located in Neuilly-sur-seine, France, under the authority of its Director; and the STO Centre for Maritime Research and Experimentation (CMRE) located in La Spezia, Italy, under the authority of its Director.

IBAN issued an unqualified opinion on the Financial Statements of the Science and Technology Organisation (STO) and on compliance for financial year 2019.

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

IBAN raised a Key Audit Matter addressed to Council regarding Observation 1, as it is in our professional judgment of most significance in the audit of the 2019 Financial Statements.

The main findings, which do not impact the audit opinion on the financial statements and on compliance, are listed below and:

1. Recognition of the fair value of STO's Vessels.
2. Errors in Note 13 regarding Personnel Expenses.
3. Temporary loans between NATO Reporting Entities.
4. Consistent accounting policies in STO Financial Statements.
5. Improvements to the Presentation of the Budget Execution Statements of OCS and CSO.

IBAN followed up on the status of observations and recommendations from the previous years' audits and found that one is open, two remain in-progress and six were closed.

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ANNEX 2  
IBA-AR(2020)0010

13 November 2020

**INTERNATIONAL BOARD OF AUDITORS FOR NATO**

**AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF THE  
THE SCIENCE AND TECHNOLOGY ORGANISATION**

**(STO)**

**FOR THE YEAR ENDED 31 DECEMBER 2019**

PUBLICLY DISCLOSED - PDN(2022)0009 - MIS EN LECTURE PUBLIQUE

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**INDEPENDENT EXTERNAL AUDITOR'S REPORT  
TO THE NORTH ATLANTIC COUNCIL****Report on the Audit of the Financial Statements****Opinion on the Financial Statements**

The International Board of Auditors for NATO (IBAN) has audited the Financial Statements of Science and Technology Organization (STO), for the 12 month period ended 31 December 2019 issued under document reference STO-OCS(2020)0020 and submitted to IBAN on 30 March 2020. These Financial Statements comprise the Statement of Financial Position as at 31 December 2019, the Statement of Financial Performance, the Statement of Changes in Net Assets/Equity and the Statement of Cash Flow, for the 12 month period ended 31 December 2019, including a summary of significant accounting policies and other explanatory notes. In addition, the Financial Statements include a Budget Execution Statement for the 12 month period ended 31 December 2019.

In our opinion, the Financial Statements give a true and fair view of the financial position of STO as at 31 December 2019, and of its financial performance, its cash flows and budget execution for the 12 month period ended 31 December 2019, in accordance with accounting requirements and reporting standards consistent with the NATO Accounting Framework (NAF).

**Key Audit Matter: STO does not recognise the fair value of its Vessels**

We draw attention to the fact that STO does not recognise the Alliance NATO Research Vessel (NRV) and the Leonardo Coastal Research Vessel (CRV) under its control since July 2012, as Property, Plant & Equipment (PP&E) in its Statement of Financial Position. These Vessels have an insured value of approximately EUR 50 million. When compared to STO's total PP&E amounting to EUR 4 million and total assets amounting to EUR 18 million reported in 2019, not recognising these Vessels materially impacts the reliability of the Financial Statements.

Our audit opinion is not modified in respect of this matter, as the current accounting treatment is compliant with the NATO Accounting Framework, whereby a NATO Reporting Entity may consider PP&E acquired prior to 1 January 2013 as fully expensed.

However, IPSAS 1 also requires an entity to present information in a manner that meets qualitative characteristics, such as reliability. According to IPSAS 1, "*reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent*".

Therefore, IBAN recommends that STO improve the reliability of information presented in the Financial Statements, by recognising in its financial statements the Vessels controlled by STO as PP&E assets measured at fair value, in accordance with IPSAS 1.

### **Basis of Opinion on the Financial Statements**

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

We have conducted our audit in accordance with the International Standards of Supreme Audit Institutions (ISSAI 2000-2899) developed by the International Organisation of Supreme Audit Institutions (INTOSAI) and in accordance with the additional terms of reference defined in our Charter.

We are independent in accordance with the INTOSAI Code of Ethics and we have fulfilled our other ethical responsibilities in accordance with these requirements. The responsibilities of the members of IBAN are more extensively described in the section «Auditor's Responsibilities for the Audit of the Financial Statements» and in our Charter.

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

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

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

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

This confirmation covers the design, implementation and maintenance of internal controls relevant to the preparation and presentation of financial statements that are auditable and free from material misstatement, whether due to fraud or error. This also covers reporting on the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there are plans to liquidate the entity or to cease its operations, or there is no realistic alternative but to do so.

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

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

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

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

represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

### **Report on Compliance**

#### **Opinion on Compliance**

Nothing has come to our attention, as part of our audit of the Financial Statements that causes us to believe that funds have not been properly used for the settlement of authorised expenditure or are not in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations.

#### **Basis for Opinion on Compliance**

We have conducted our compliance audit in accordance with the International Standards of Supreme Audit Institutions (ISSAI 4000-4899) developed by the International Organisation of Supreme Audit Institutions (INTOSAI) and in accordance with the additional terms of reference defined in our Charter.

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

#### **Management's Responsibility for Compliance**

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

The Science & Technology Board, chaired by the Chief Scientist is responsible and accountable for sound financial management. The financial administration of NATO bodies and 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.

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

In addition to the responsibility to provide reasonable assurance about whether the financial statements as a whole are free from material misstatement, the IBAN Charter

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

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

Brussels, 13 November 2020



Daniela Morgante  
Chair

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ANNEX 3  
IBA-AR(2020)0010

13 November 2020

**INTERNATIONAL BOARD OF AUDITORS FOR NATO**

**LETTER OF OBSERVATIONS AND RECOMMENDATIONS  
FOR THE SCIENCE AND TECHNOLOGY ORGANISATION**

**(STO)**

**FOR THE YEAR ENDED 31 DECEMBER 2019**

PUBLICLY DISCLOSED - PDN(2022)0009 - MIS EN LECTURE PUBLIQUE

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## Introduction

The International Board of Auditors for NATO (IBAN) audited the Science and Technology Organisation (STO) Financial Statements for the year ended 31 December 2019, and issued an unqualified opinion on the Financial Statements and on compliance, and a Key Audit Matter addressed to Council.

STO includes three executive bodies, the Office of Chief Scientist (OCS), the Collaboration Support Office (CSO) and the Centre for Maritime Research and Experimentation (CMRE).

STO is part of the International Military Staff (IMS) Budget Group, which includes the International Military Staff (IMS) and the NATO Defense College (NDC).

## Observations and Recommendations:

During the audit, IBAN made five observations and recommendations, which have no impact on the audit opinions on the Financial Statements and on compliance.

IBAN raised a Key Audit Matter addressed to Council regarding Observation 1, as it is in our professional judgment of most significance in the audit of the 2019 Financial Statements.

1. Recognition of the fair value of STO's Vessels.
2. Errors in Note 13 regarding Personnel Expenses.
3. Temporary loans between NATO Reporting Entities.
4. Consistent accounting policies in STO Financial Statements.
5. Improvements to the Presentation of the Budget Execution Statements of OCS and CSO.

IBAN followed up on the status of observations and recommendations from the previous years' audits and found that one is open, two remain in-progress and six were closed.

The observations and recommendations raised during the audit as well as the follow-up of the previous years' observations, which have not been included in the IBAN's Letter of Observations and Recommendations, are included in a Management Letter addressed to STO management. This is because IBAN considers that these matters are to be addressed by Management and therefore fall under STO's executive responsibility.

**OBSERVATIONS AND RECOMMENDATIONS****1. RECOGNITION OF THE FAIR VALUE OF STO'S VESSELS****Reasoning**

1.1 In accordance with the NATO Accounting Framework (NAF) C-M(2016)0023, a *“NATO Reporting Entity is a NATO entity which is required to produce financial statements and where the audit opinion is addressed to Council”*.

1.2 STO is a NATO Reporting Entity, which operates under the juridical personality possessed by the North Atlantic Treaty Organisation (NATO) by virtue of the Ottawa Agreement. NATO's juridical personality is separate from the juridical personality possessed by Headquarter, Supreme Allied Command Transformation (HQ SACT) by virtue of the Paris Protocol. Allied Command Transformation (ACT) is a NATO Reporting Entity, which operates under the juridical personality possessed by HQ SACT.

1.3 The NRV Alliance Vessel is in operation since 1988, and the CRV Leonardo Vessel was commissioned in 2001. From a legal standpoint, legal authority over the Vessels remained with HQ SACT until 2015. In addition, ACT was until 2015 the NATO Reporting Entity designated as the legal custodian of the two science Vessels. On 10 December 2015, the Resource Policy and Planning Board (RPPB), approved with AC/335-N(2015)0080-Rev3 the transfer of ownership of the Vessels from HQ SACT to NATO, with delegated custody given to CMRE.

1.4 The RPPB also approved, in this same document, a transition of the flag and military crew under a new Memorandum of Understanding (MOU) between Centre for Maritime Research and Experimentation (CMRE) and the Italian Ministry of Defence signed on 22 December 2015. Paragraph 2.2 of this MOU states that: *“CMRE is the NATO legal authority having custody of the Vessels on behalf of the NATO Alliance and is empowered to act for NATO on all matters concerning the Vessels. Accordingly, the Vessels are assigned to the supervision and control of the Director of the CMRE. The management of the vessels may be shared with or delegated to a suitably appointed Ship Owners' Representative under the Director's supervision.”*

1.5 From a financial reporting perspective, according to the NAF (IPSAS 17 Adapted), Property, Plant and Equipment (PP&E) should be capitalised in a NATO Reporting Entity's financial statements and therefore reported on the face of the Statement of Financial Position *“if the asset is controlled by the NATO Reporting Entity. However, the NAF also states that” NATO Reporting Entities: [...] May consider PPE acquired prior to 1 January 2013 as fully expensed.* Therefore, if a NATO Reporting Entity acquired control over an asset prior to 1 January 2013, it may decide not to recognise it on the face of the Statement of Financial Position and only comply with the disclosure requirements of the NAF.

1.6 The 10 criteria that may indicate control over NATO PP&E are defined in the NAF (IPSAS 17 Adapted). The NAF further states that *“If the NATO Reporting Entity responds positively to six of the [...] criteria, it is likely that the asset is controlled by the NATO Reporting Entity. In this case, the reporting entity will need to capitalise the assets in its Financial Statements (if it is also above the capitalisation threshold).”* The control criteria applies irrespective of whether the entity is the legal owner of the asset.

1.7 Until July 2012, ACT controlled from a financial reporting standpoint the two Vessels operated by the NATO Undersea Research Centre (NURC). This is because NURC was reported as a segment of ACT and was not as a separate NATO Reporting Entity. As part of the Agency Reform, a new Executive Body called Centre for Maritime Research and Experimentation (CMRE) was established as a segment of the STO Reporting Entity. In July 2012 Council decided to transfer all NURC activities to CMRE. This transfer led also from a financial reporting perspective to a simultaneous transfer of control over the Vessels from ACT to STO, in accordance with the control criteria defined in the NAF.

1.8 The NAF states that NATO Reporting Entities may consider PP&E acquired prior to 1 January 2013 as fully expensed. Therefore, our audit opinion is not modified in respect of this matter, as the current accounting treatment is compliant with the NATO Accounting Framework, whereby a NATO Reporting Entity may consider PP&E acquired prior to 1 January 2013 as fully expensed.

1.9 However, we draw your attention to the fact that IPSAS 1, which is part of the NAF, also requires an entity to present information in a manner that meets qualitative characteristics, such as relevance and reliability. According to IPSAS 1, *“reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent”*.

1.10 Moreover, when an asset is capitalised in the financial statements, IPSAS 17 on PP&E states that: *“Where an asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.”*, and *“For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the item’s fair value as at the date of acquisition.”* In addition, according to the Accounting Policy for Property, Plant and Equipment, under paragraph 3.1.1, *“The cost of an item of PP&E is first recognised as an asset in the Financial Statements of a NATO entity if: [...] the cost or fair value can be measured reliably (estimates are also permitted)”*.

1.11 IPSAS 17 also states that *“An entity evaluates [...] all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. [...] A condition of continuing to operate an item of property, plant and equipment (for example, an*

*aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognized in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied”.*

## Observations

1.12 STO does not recognise the NRV Alliance and CRV Leonardo Vessels under its control since July 2012, as PP&E in its Statement of Financial Position. These Vessels have an insured value of approximately EUR 50 million, whilst STO reports in its 2019 Financial Statements total PP&E amounting to EUR 4 million and total assets to EUR 18 million.

1.13 According to the NAF, a NATO Reporting Entity may consider PP&E acquired prior to 1 January 2013 as fully expensed. The current accounting treatment by STO is therefore compliant with the NAF adaptation to IPSAS 17. However, IPSAS 1 also requires an entity to present information in a manner that meets qualitative characteristics, such as reliability.

1.14 According to IPSAS 1, “*reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent*”. Given the significant value of the Vessels, IBAN considers that their current accounting treatment by STO does not provide reliable information to the users of the Financial Statements, in accordance with IPSAS 1.

1.15 Consequently, in accordance with paragraph 6.4 of the *IPSAS 17 Adapted – Property, Plant and Equipment* of the NAF, these Vessels need to be recognised as PP&E assets and measured at fair value. The total insured value of the two Vessels was approximately EUR 50 million at the date of the transfer. This provides in our view a reliable, market-based evidence of the value of the vessels, by measuring their replacement cost and fair value.

1.16 According to STO’s Financial Statements, the “*NRV Alliance undergoes one major and on minor upkeep on a five year period cycle*”. Furthermore, CMRE did not recognise any liabilities related to future dismantling costs for its vessels in the STO Financial Statements. However the upkeep and dismantling costs may need to be recognised in the financial statements in accordance with the NAF.

1.17 In addition, we found that Note 4 to the Financial Statements states that HQ SACT is the custodian of the two Vessels. According to this note, HQ SACT’s juridical personality established by virtue of the Paris Protocol had in 2019 custody over the NRV Alliance and CRV Leonardo Vessels. However, this disclosure is factually incorrect as Nations approved in 2015 the transfer of delegated legal custody of the Vessels to CMRE as part of the transfer of legal authority from HQ SACT

(established by virtue of the Paris Protocol) to NATO (established by virtue of the Ottawa Agreement).

## Recommendations

IBAN recommends that STO improves the reliability of information presented in the Financial Statements, by:

- a. Recognising in its financial statements the Vessels controlled by STO as Property, Plant and Equipment assets measured at fair value, in accordance with IPSAS 1.
- b. Correcting the error disclosed in Note 4 to the Financial Statements related to the custody of the Vessels and disclose relevant additional information regarding ownership, obligations and financial responsibilities of the Vessels.
- c. Reviewing the accounting treatment and disclosure of the Vessel upkeep and dismantling costs in the Financial Statements, in accordance with IPSAS 17.

## 2. SIGNIFICANT ERRORS IN NOTE 13 REGARDING PERSONNEL EXPENSES

### Reasoning

2.1 The NATO Financial Regulations (NFRs) require the Financial Controller (FC) to exercise the responsibility of budgeting, accounting and reporting activities of the NATO entity. This includes being responsible for the financial internal control system and for the preparation of the financial statements in accordance with the NAF.

2.2 According to IPSAS 1:

- A complete set of financial statements comprises [...] *Notes, comprising a summary of significant accounting policies and other explanatory notes.*
- Notes shall [...] *Provide additional information that is not presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement, but that is relevant to an understanding of any of them.*
- *Comparative prior-period information shall be presented for all amounts shown in the financial statements and notes. Comparative information shall be included when it is relevant to an understanding of the current period's financial statements.*

2.3 In accordance with IPSAS 3, an entity shall disclose the nature of a prior period error, the amount of the correction for each financial statement line item affected, and the amount of the correction at the beginning of the earliest prior period presented.

2.4 It is important to ensure that information provided in the notes to the financial statements is free from errors, complete and matches the amounts disclosed in the primary statements, in order to avoid misinterpretations by the users of the financial statements.

### Observations

2.5 Salaries and employment benefits disclosed in the 2018 column of Note 13 to the Financial Statements regarding Basic Salary, Allowances, Post-employment Benefits and Employer's Contribution to Insurance of EUR 16,536,156 were restated to correct errors identified in the 2018 Financial Statements. However, Note 13 does not disclose the fact that the 2018 comparative figures were restated and therefore different from those disclosed in the 2018 Financial Statements.

2.6 Moreover, as raised in the previous year's Letter of Observations, the breakdown of salaries and employment benefits disclosed in Note 13 do not reconcile with total Personnel Expenses disclosed on the face of the Statement of Financial Performance amounting to EUR 19.3 million in 2019 and EUR 17.9 million in 2018. STO has still not included a description of the EUR 2 million difference in the disclosure note.

### Recommendations

2.7 IBAN recommends that STO ensures that Note 13 to the Financial Statements regarding personnel expenses reconciles to the face of the Statement of Financial Performance and discloses the fact that comparative figures were restated. This can be achieved by ensuring that internal controls over the preparation of financial statements are effective.

## 3. TEMPORARY LOANS BETWEEN NATO REPORTING ENTITIES

### Reasoning

3.1 STO is part of the IMS Budget Group, which includes the STO (including the OCS, CSO and CMRE), IMS and NDC. These three reporting entities have the same Financial Controller, however, they fall under the responsibility of separate Heads. Accordingly, STO, IMS and NDC are autonomous entities in terms of overall responsibility and accountability.

3.2 Article 6 of the NFRs states that "*the management of appropriated funds is a responsibility of the Financial Controller*". The appropriated funds of each IMS budget

group entity are intended to be used for purposes covering the activities as per the approved budget for each entity. In order to implement these activities, the IMS Financial Controller is authorised to transfer appropriations between budget headings in accordance with Article 26 of the NFRs and FRP XXVI. The IMS Financial Controller is also authorised to transfer appropriations between the three reporting entities under his/her responsibility in accordance with those same regulations and rules.

3.3 The nature of a transfer of appropriations among entities of the IMS Budget Group differs from the nature of a temporary loan received from or granted by another reporting entity of the IMS Budget Group. This is because a transfer is aimed at reallocating appropriations between budgets in order to allow for the funds to be committed in a different way than initially agreed upon, while the loans are aimed at solving a temporary liquidity problem and should not impact the final commitment of the appropriated funds.

3.4 Although the NFRs and the IMS Financial Controller Delegation of Authority for Financial Matters are very clear regarding the rules applicable to transfers of appropriations, they do not include any specific rules or responsibilities concerning providing or receiving temporary loans or similar payments between NATO Reporting Entities. In the absence of an explicit regulation or rule, Article 12 of the NFRs on internal control therefore allocates the ultimate responsibility to safeguard assets, including cash, to the Head of NATO Reporting Entities.

### **Observations**

3.5 STO-CSO faces recurring cash flow difficulties due to a schedule for the receipt of advances and contributions that does not correspond to the timing of its disbursements.

3.6 For multiple years, STO has received temporary loans from IMS after issuing a request for receiving funds to cover for its cash shortfalls. This allowed STO to achieve its strategic objectives as foreseen without delays, and allowed STO to make payments in a timely manner.

3.7 The IMS Financial Controller informed the Budget Committee (BC) in the past of the need for requesting and granting loans among entities of the IMS Budget Group due to liquidity problems. The BC took note of this information, as documented in decision sheets BC-DS(2016)0038 and BC-DS(2017)0036.

3.8 The CSO requested in November 2019 a temporary loan of EUR 500 thousand from IMS to cover its cash shortfall, pending the payment of the final call for funds. Based on prior practice, this year-end cash need appears to be recurrent, as a similar loan amounting to EUR 1.35 million and EUR 2 million was also requested respectively for 2018 and 2017. The temporary loan was fully reimbursed to IMS before the end of the financial year.

3.9 The process followed for the request and approval of the temporary loan is that the Head of Budget and Finance of CSO requests the loan in writing to the IMS Financial Controller. The funds are transferred upon written approval by the Office of the Financial Controller. The IMS Financial Controller supervises the loan granting and receiving internal control process.

3.10 Although the Office of the Financial Controller has approved the temporary loan, the process followed by CSO for requesting and receiving loans from IMS was not included in a procedure approved by the CSO Director, nor was the process followed by IMS for granting loans to CSO included in a procedure approved by the IMS Director General in accordance with Article 12 of the NFRs.

3.11 If recurring temporary loans are requested and received by CSO from IMS, it is important that the process and associated terms and conditions (e.g. duration, guarantees, and obligations) are included in a procedure approved by the Financial Controller and the Heads of the NATO Reporting Entities involved in compliance with Article 12 of the NFRs on internal control.

### Recommendations

3.12 IBAN recommends that STO clarifies the internal control process for CSO related to the request, receipt and repayment of temporary loans, by ensuring that these processes and associated loan terms and conditions are included in a written procedure approved by the CSO Director.

## 4. CONSISTENT ACCOUNTING POLICIES IN STO FINANCIAL STATEMENTS

### Reasoning

4.1 According to IPSAS 3, *“an entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an IPSAS specifically requires or permits categorization of items for which different policies may be appropriate. If a Standard requires or permits such categorization, an appropriate accounting policy shall be selected and applied consistently to each category”*.

4.2 It is important to ensure that NATO Reporting Entities set consistent accounting policies to ensure that users of the Financial Statements are provided with relevant and reliable information regarding the entity.

### Observations

4.3 STO prepares financial statements that include three executive entities, OCS, CSO and CMRE.



4.4 We found discrepancies between accounting methods and policies applied by the executive bodies of STO, which are not adjusted during the financial statements preparation process to ensure consistency in the presentation of financial information in accordance with IPSAS 3.

4.5 For example:

- STO starts depreciating its fixed assets acquired by CMRE on the 1st of January of the year of acquisition. However STO starts depreciating its fixed assets acquired by CSO on the acquisition date on a pro rata basis. In 2019, if STO had applied the acquisition date method consistently, this would have resulted in an overstatement of the depreciation charge for the year of approximately EUR 555 thousand.
- STO accrues EUR 533 thousand for untaken leave regarding CMRE, but does not do so for CSO. However, as at 31st of December 2019, CSO accumulated 171 days of untaken leave for NATO civilian staff.

4.6 These different accounting policies are also not disclosed in the notes to the Financial Statements.

## Recommendations

4.7 IBAN recommends that STO prepares financial statements using consistent accounting policies and methods for its three executive entities in accordance with IPSAS 3.

## 5. IMPROVEMENTS TO THE PRESENTATION OF THE BUDGET EXECUTION STATEMENTS OF OCS AND CSO

### Reasoning

5.1 The NATO Financial Rules and Procedures (FRPs) apply to all common funded entities under the jurisdiction of the Budget Committee.

5.2 According to Chapter 1, Budget Cycle for OCS and CSO of the STO Financial Rules and Procedures (STO FRPs), commitments are to comply with the overall policy in the NFRs and FRPs for NATO common funded entities (especially Article 25 of the NFRs on commitments, contract authority and carry forward and related FRPs).

5.3 Article 25.6 of the NFRs states that a special carry forward is uncommitted appropriations for a clearly identified purpose. Further, the FRPs Article XXV states that *the Financial Controller shall ensure that the annual financial statements clearly demonstrate, by annotations as required, the amount of special carry forward authorisations per budget and the purpose for which the special carry forward was*

*authorized. The execution status of such special carry forward appropriations should also be clearly identified in the in-year budget execution reviews.*

5.4 Further, according to Article 26 of the NFRs, all transfers shall be recorded in the annual financial statement.

5.5 Finally, according to the FRPs Article XXIII, the Budget Committee shall establish and issue to the Financial Controller instructions for the preparation and submission of in-year reviews of execution of, and revised forecast against, approved annual budgets. The Military Budget Guidance - Processes, Procedures & Work-Plan: 2020 Budget Guidance & 2019 Budget Execution (BC-D(2019)0037-FINAL) approved by the Budget Committee, requires the final budget execution statement to be presented in the annual financial statements. This guidance document also requires the budget execution report to present a comparison of the initial budget authorised and the revised budgets.

### **Observations**

5.6 CSO's Budget Execution Statement discloses a total of EUR 407 thousand of carry forwards. Out of this total, we found that EUR 300 thousand in fact corresponds to a special carry forward approved by the Budget Committee in December 2019 (BC-DS(2019)0069). These funds will be used to replace the security window infrastructure in the CSO building. We found that the STO financial statements did not include any detailed note disclosure related to this special carry forward and its authorised purpose.

5.7 In addition, the Budget Execution Statements of OCS and CSO did not present the initial budgets authorised, budgetary transfers and revised budgets, nor did the notes contain any details of the budgetary transfers executed.

### **Recommendations**

5.8 IBAN recommends that STO improve the presentation of the Budget Execution Statement for OCS and CSO and the note disclosures in line with the NFRs, FRPs and the Military Guidance regarding the 2020 Budget and 2019 Budget Execution.

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

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

The Open status is used for recommendations that are open and for which no notable progress has been achieved to date. The In-progress status is used for open recommendations when the NATO Reporting Entity has started to implement the recommendation or when some (but not all) sub-recommendations are closed. The Closed status is used for recommendations that are closed because they have been implemented, are superseded, or have lapsed. In the case where there are sub-recommendations, the status related to each sub-recommendation is indicated in the Action Taken column.

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
<p><b>(1) STO FY 2018</b> <b>IBA-AR(2019)0010, paragraph 1</b></p> <p><b>BREAKDOWN OF SALARIES AND EMPLOYMENT BENEFITS REPORTED IN THE NOTES TO THE FINANCIAL STATEMENTS IS INCORRECT.</b></p> <p><b>IBAN's Recommendation</b> In order to avoid errors in the preparation of the financial statements and its notes, IBAN recommends that STO ensures that its internal controls over the preparation of financial statements are effective. This can be achieved by developing a quality control checklist to document the reconciliation exercise between the primary financial statements and the notes.</p>	<p>IBAN found a significant error in the breakdown of salaries and employment benefits reported in note 13 to the 2019 STO Financial Statements, as reported in observation 2. This observation is superseded by Observation 2 and is therefore closed.</p>	<p>Observation Closed.</p>
<p><b>(2) STO FY 2018</b> <b>IBA-AR(2019)0010, paragraph 2</b></p> <p><b>IMPROVEMENT NEEDED IN THE TECHNICAL ATTACHMENT TO THE AGREEMENT BETWEEN CMRE AND ACT REGARDING THE TIMELY ACCEPTANCE OF CMRE DELIVERABLES.</b></p> <p><b>IBAN's Recommendation</b> In order to improve the timely acceptance of CMRE deliverables, IBAN recommends that CMRE liaise with ACT in view of updating the Technical Attachment to the MoA, possibly by including time-bound criteria to accept or reject CMRE deliverables for Future Solutions (FUSOL) projects.</p>	<p>Although improvements have not been made in the technical arrangement, CMRE has liaised with ACT and addressed the pending issues.</p> <p>Following this, acceptance of deliverables has been improved leading to the reduction of receivables for 2019 to an</p>	<p>Observation Closed.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
	acceptable level. The same applies for the period until June 2020.	
<p><b>(3) STO FY 2017</b> <b>IBA- AR(2018)0017, paragraph 1</b></p> <p><b>WEAKNESSES IN THE COMPLIANCE WITH NATO CIVILIAN PERSONNEL REGULATIONS FOR PERFORMANCE EVALUATION, PROMOTIONS AND ALLOCATION OF ALLOWANCES</b></p> <p><b>IBAN's Recommendation</b> IBAN recommends to implement an effective performance management system in compliance with the CPR to be completed by the end of the year 2018.</p>	<p>In the first quarter of 2019, a performance review was done for 2018. A performance review procedure was set up for the 2019 cycle in accordance with the staff instruction dated February 2019 and signed by the Director. Objectives were set and a Mid-Term review took place in June 2019. Due to the COVID-19 crisis, the cycle was not closed in March 2020 but only in May 2020. The documents were archived in the Human Resources Branch and are one of the elements that are taken into account by the Tenure Board, while discussing contract extensions. For the 2020 cycle, objectives were set, but due to the COVID-19 crisis, the Mid-Term Review in June 2020 was cancelled.</p>	<p>Observation <b>Closed.</b></p>
<p><b>4) STO FY 2017</b> <b>IBA- AR(2018)0017, paragraph 2</b></p> <p><b>WEAKNESSES IN THE CONTROL AND THE USE OF LEAVE</b></p> <p><b>IBAN's Recommendation</b> The Board recommends that CMRE implement a sound control environment over the use of the time recording system, including:</p> <p>a)The establishment of written procedures to define the roles and responsibilities of the personnel, line managers and Human Resource section on the control of time management, including leave requests.</p> <p>b)The performance of regular reconciliations of leave requests reported to the Human Resource section with the leave reported in the time recording system, including corrective actions if necessary.</p> <p>c)Ensuring that medical certificates are</p>	<p>Written procedures defining the roles and responsibilities of the personnel, line managers and Human Resource Branch on the control of time management, including leave requests were established with effective date 01 Jan 2020. Observation <b>closed.</b></p> <p>CMRE installed in 2019 a new timesheet record management tool that replaced the actual system on 1 January 2020 and increased the control of time management, including the leave request. Observation <b>closed.</b></p> <p>In 2019, we verified well documented and effective controls related to sick leave</p>	<p>Observation <b>Closed.</b></p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
<p>provided for sick leave requests exceeding two consecutive days and that any unjustified sick leave is converted into annual leave, if necessary.</p> <p>d)The tracking of the use of cruise leave, including applying the provisions of the CPRs in regards to untaken cruise leave.</p>	<p>requests. Observation <b>closed</b>.</p> <p>A new instruction was approved in 2019 and became effective as from 1 January 2020. The calculation of the cruise leave is clarified and in compliance with the NATO Civilian Personnel Regulations (CPRs). The payment of the amounts are included in the monthly payroll cycle and executed by HQ IS. Controls are in place via the new timesheet reporting tool and through a second level via the involvement of the International Staff (IS) payroll unit. Observation <b>closed</b>.</p>	
<p><b>(5) STO FY 2017</b> <b>IBA- AR(2018)0017, paragraph 3</b></p> <p><b>CMRE IMPROVEMENT NEEDED IN COMPLIANCE WITH CIVILIAN PERSONNEL REGULATIONS (CPR) ON THE DURATION OF EMPLOYMENT OF CONSULTANTS</b></p> <p><b>IBAN's Recommendation</b></p> <p>3.1 IBAN recommends that CMRE updated the staff instructions 90 on VRP to take into account the requirements of the CPR on the use of consultants.</p> <p>3.2 IBAN recommends CMRE to define and keep the record of the circumstances and exceptional and defined cases which would require the service of consultants over a period exceeding 90 and 180 days.</p>	<p>A staff instruction was issued in April 2019 that takes into account the criteria set in Article 69 of the NATO CPRs on the duration of employments for consultants. Observation <b>closed</b>.</p> <p>We understand that a new template will be implemented in order to ensure a more efficient and effective control over the circumstances and exceptional defined cases, which would require the service of consultants over a period exceeding 90 and 180 days. Observation <b>in-progress</b>.</p>	<p>Observation <b>In-progress</b>.</p>
<p><b>(6) STO FY 2017</b> <b>IBA- AR(2018)0017, paragraph 4</b></p> <p><b>FURTHER IMPROVEMENTS REQUIRED IN THE AREA OF RISK MANAGEMENT, INTERNAL CONTROL, AND INTERNAL AUDIT.</b></p> <p><b>IBAN's Recommendation</b></p> <p>The Board recommends that the STO:</p> <p>b) Complete the on-going work of assessing and documenting the system of internal control and risk management procedures to support compliance with NFR Articles 11 and 12, FRPs XI and XII, and the internal control framework that it chooses.</p>	<p>The work related to documenting and assessing internal controls is on-going. Observation <b>in-progress</b>.</p> <p>The internal audit assessment took place in 2019. Observation <b>closed</b>.</p>	<p>Observation <b>In-progress</b>.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
<p>c) Ensure internal audit activities evaluate risk management and internal control throughout the STO.</p>		
<p><b>(7) STO FY 2016</b> <b>IBA-AR(2017)16, paragraph 2</b></p> <p><b>CMRE – IMPROVEMENTS TO BE DONE IN THE CONTROL ENVIRONMENT OF HUMAN RESOURCES</b></p> <p><b>IBAN’s Recommendation</b> The Board recommends that CMRE issue an Office Notice in which it clearly defines the supporting documents to be provided in order to justify any change of home leave address.</p>	<p>Clarifications were communicated to staff. A document exists that clearly defines the supporting documents to be provided in order to justify any change of home leave address. No issues were observed during 2019.</p>	<p>Observation <b>Closed.</b></p>
<p><b>(8) STO FY 2016</b> <b>IBA-AR(2017)16, paragraph 4</b></p> <p><b>NO RELATED PARTY DECLARATION OBTAINED FROM THE STB</b></p> <p><b>IBAN’s Recommendation</b> STO should fully comply with the requirements of the NATO Accounting Framework in respect to related party disclosures, including making inquiries of governing bodies to ensure the completeness of related party transactions.</p>	<p>Senior management and senior national representatives have provided relevant documentation.</p>	<p>Observation <b>Closed.</b></p>
<p><b>(9) STO FY 2014</b> <b>IBA-AR(2015)36, paragraph</b></p> <p><b>CENTRE FOR MARITIME RESEARCH AND EXPERIMENTATION (CMRE) – IMPROVEMENTS NEEDED IN ACCOUNTING TO RECOGNIZE ITS CUSTOMER FUNDED STATUS / IMPROVEMENTS NEEDED TO MANAGEMENT ACCOUNTING BY PROJECT</b></p> <p><b>IBAN’s Recommendation</b> The Board recommends that CMRE develop a methodology that will allow it to determine the costs per project, including the allocation of overhead costs to individual projects. This will allow for the determination of surplus or deficit by project, and provide management with information that is useful in managing the business.</p>	<p>Management accounting by project has not yet been implemented.</p>	<p>Observation <b>Open.</b></p>

**SCIENCE AND TECHNOLOGY ORGANISATION (STO) FORMAL COMMENTS  
ON THE LETTER OF OBSERVATIONS AND RECOMMENDATIONS AND  
THE INTERNATIONAL BOARD OF AUDITORS (IBAN) POSITIONS**

**OBSERVATION 1:  
RECOGNITION OF THE FAIR VALUE OF STO'S VESSELS**

***STO's Formal Comments***

*Do not fully concur with the observation nor with recommendation 1.a, agree with recommendations 1.b and 1.c.*

*As stated in IBAN's observation, the accounting treatment of the vessels is compliant with the NATO Accounting Framework (NAF). The NAF clearly states that, "Where this adaptation conflicts with another requirement of IPSAS **this adaptation shall apply.**" The STO is concerned that IBAN is weighing IPSAS 1 more heavily than the NAC approved NAF, and in so doing is contradicting the NAF, which includes IPSAS 1.*

*The STO agrees with the recommendation that further disclosure, better highlighting the status, roles and responsibilities of NATO, the Centre for Maritime Research and Experimentation (CMRE) and the Italian Navy is needed.*

**IBAN's Position**

**IBAN acknowledges that the NAF includes an adaptation to IPSAS 17 on PP&E, which states that NATO Reporting Entities may consider PP&E acquired prior to 1 January 2013 as fully expensed. However, this NAF adaptation is not mandatory, as it does not state that NATO Reporting Entities shall consider PP&E acquired prior to 1 January 2013 as fully expensed. There is therefore no conflict between the NAF adaptation to IPSAS 17 on PP&E and the requirement of IPSAS 1 to present information in a manner that meets qualitative characteristics, such as relevance and reliability. As this recommendation does not contradict the NAF, we trust this position should address any potential concerns on this matter.**

**OBSERVATION 2:  
SIGNIFICANT ERRORS IN NOTE 13 REGARDING PERSONNEL EXPENSES**

***STO's Formal Comments***

*Recommendation agreed.*

**OBSERVATION 3:  
TEMPORARY LOANS BETWEEN NATO REPORTING ENTITIES****STO's Formal Comments**

*Do not fully concur with the observation.*

*STO does not fully concur with the IBAN observation. The process has been in place for a number of years and Nations at the Budget Committee have been informed of this long-standing practice several times. While the NFRs are largely silent on cash advances, they give the Financial Controller responsibilities for the management of appropriated and non-appropriated funds and the authority to make transfers of approved authorizations permissible in accordance with article 26. However, with the aim of complying with best management practice, the IMS Financial Controller will consider adding additional clarification to Finance Standard Operating Procedures across the IMS Budget Group (comprising of the IMS, NDC and STO).*

**IBAN's Position**

**In our view, the provisions of Article 26 of the NFRs and FRP XXVI do not apply to loaning funds between STO and IMS. IBAN therefore reiterates its recommendation that STO ensures, with the Financial Controller, that processes and associated conditions regarding such loans are included in a written procedure approved by Senior Management.**

**OBSERVATION 4:  
CONSISTENT ACCOUNTING POLICIES IN STO FINANCIAL STATEMENTS****STO's Formal Comments**

*Recommendation agreed.*

*STO will consider to align their accounting policies in the future, while noting that this alignment will not have a material effect on the financial statements. However, the STO has reservations with how IBAN has presented the supporting information leading to their recommendation and that this could mislead the reader on the perceived materiality of this observation. The two examples given by IBAN in para 4.5 do not provide the full information, as they only consider Collaboration Support Office's (CSO) depreciation policy, without comparing the impact when using CMRE's policy. In example 1, had CSO aligned their depreciation calculation to CMRE's policy, this would have resulted in an immaterial overstatement of approximately EUR 10 thousand compared to IBAN's calculation of EUR 555 thousand. In example 2, the*



*untaken leave balance of CSO, not quantified by IBAN, equates to approximately EUR 50 thousand which is also not considered material.*

**IBAN's Position**

**IBAN established that this observation does not materially impact the audit opinion. Nevertheless, we consider that accounting policies need to be consistently applied as a matter of principle, to avoid misleading users of the Financial Statements. The two examples provided by IBAN in the observation were given for illustration purposes, mainly in order to highlight qualitative inconsistencies rather than quantitative ones.**

**OBSERVATION 5:  
IMPROVEMENTS TO THE PRESENTATION OF THE BUDGET EXECUTION  
STATEMENTS OF OCS AND CSO**

***STO's Formal Comments***

*Recommendation agreed.*

**GLOSSARY OF TERMS**

In accordance with International Standards of Supreme Audit Institutions (ISSAI 2705), 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.

When an audit opinion is unqualified, in accordance with auditing standards, three types of paragraphs may also be communicated in the auditor's report:

- Key Audit Matters (ISSAI 2701): 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.
- Emphasis of Matter (ISSAI 2706): 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; we will include an Emphasis of Matter paragraph in the auditor's report provided.
- Other Matter (ISSAI 2706): 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; we will include an Other Matter paragraph in the auditor's report.



**NATO UNCLASSIFIED**

30 March 2020

STO-OCS(2020)0020

Chair, International Board of Auditors for NATO (IBAN)

**Subject : The Science and Technology Organization consolidated Financial Statements for the Year ended 31 December 2019**

1. Please find attached the 2019 Science and Technology Organisation (STO) Financial Statements, issued in accordance with NATO Financial Regulation (NFR) Article 35.1, and the STO Charter C-M(2012)0046 Article 25.
2. I can confirm that, in accordance with NFR Financial Rules and Procedures (FRP) XXXV (4), the STO can agree to public disclosure of these Financial Statements.
3. Notwithstanding the above, as stated in C-M(2012)0041, public disclosure of IBAN Audit Reports is a matter for Council decision, based upon the recommendation of the RPPB. Decisions are informed by the NATO policy on public disclosure of documents (C-M(2008)0116).
4. The IBAN Audit Report covering these Financial Statements has not been completed, but should be issued to Council prior to 31<sup>st</sup> August 2020 (NFR 15.2). As such, the STO is not yet in a position to anticipate any potential representations that may be made to the RPPB, regarding the Audit Report.
5. The STO therefore reserves its position on public disclosure of the eventual IBAN Audit Report.

Dr. Bryan WELLS  
NATO Chief Scientist  
Chairman, Science and Technology Board (STB)

Annex 1: STO Financial Statements FY 2019

Copy to: Financial Controller International Military Staff & Science and Technology Organization, Director Collaboration Support Office (CSO), Director Center Maritime Research and Experimentation (CMRE), Head of Finance CSO, Head of Finance CMRE

Action Officer: Mr. Andrea Tonizzo, Acting Head of Budget & Finance CMRE

**NATO UNCLASSIFIED**



Financial Statements of the

# **NATO SCIENCE AND TECHNOLOGY ORGANIZATION**

31 December 2019



## Index

Executive Summary .....	2
Statement on Internal Control .....	3
STO Consolidated Statement of Financial Position.....	5
STO Consolidated Statement of Financial Performance.....	6
STO Consolidated Statement of Cash Flow.....	7
STO Consolidated Statement of Change in Net Assets.....	9
NOTES TO THE STO CONSOLIDATED FINANCIAL STATEMENTS .....	10
Basis for Preparation.....	10
Accounting estimates and judgments.....	10
Changes in pronouncements .....	11
Foreign Currency Transactions .....	11
Consolidation .....	11
Services In-Kind .....	11
Financial Instruments disclosure/presentation .....	12
Assets .....	13
Liabilities .....	14
Net Assets .....	15
Revenue and Expense Recognition .....	16
Surplus or Deficit for the Period .....	16
NOTE 1. Cash and cash equivalents .....	17
NOTE 2. Receivables.....	17
NOTE 3. Prepayments .....	17
NOTE 4. Property, Plant and Equipment.....	18
NOTE 5. Payables .....	19
NOTE 6. Deferred revenue.....	19
NOTE 7. Advances .....	20
NOTE 8. Provision.....	20
NOTE 9. Other current liabilities.....	20
NOTE 10. Deferred Revenue – Non-current liabilities.....	20
NOTE 11. Retained Earnings .....	21
NOTE 12. Revenue .....	22
NOTE 13. Expenses.....	22
NOTE 14. Contingent liabilities .....	24
NOTE 15. Segment Reporting .....	24
NOTE 16. Related parties .....	25
NOTE 17. Events after reporting date.....	26
NOTE 18. Morale & Welfare activities .....	26
APPENDIX 1 – TO THE NOTES TO THE FINANCIAL STATEMENTS.....	27

## Executive Summary

The role of NATO Science and Technology (S&T) is to cover basic and applied research broadly in the engineering, physical, and information, human, medical and social sciences, and to deliver a range of products and services essential to NATO and NATO Nations. They are:

- Supporting the core tasks of the Alliance as set out in the NATO Strategic Concept;
- Supporting technological and knowledge advantages, thereby being a critical force multiplier;
- Providing the evidence-base to support informed decision-making; and
- Helping to mitigate evolving threats and risks, including supporting public diplomacy.

The STO is composed of the Science and Technology Board (STB); three Executive Bodies; and Scientific and Technical Committees.

Governance of the STO is vested in the STB, which reports to the NAC through the Military Committee and the Conference of National Armaments Directors (CNAD). Leadership of the STO is exercised by the Chief Scientist through his roles as; Chair of the STB and, Senior Scientific Advisor to NATO leadership.

The three executive bodies of the STO are:

- a. The Office of the Chief Scientist (OCS), located within NATO Headquarters, Brussels, provides executive and administrative support to the NATO Chief Scientist in fulfilling his/her roles as the Chair of the Science & Technology Board (STB) and the Senior Scientific Advisor at NATO Headquarters.
- b. The S&T Collaboration Support Office (CSO), located in Neuilly sur Seine, Paris, provides the executive and administrative support to the collaborative S&T activities conducted through the STO Scientific and Technical Committees and their subordinate working groups.
- c. The Centre for Maritime Research and Experimentation (CMRE) located in La Spezia, Italy, organizes and conducts scientific research and technology development and delivers innovative and field-tested S&T solutions to address the defence and security needs of the Alliance.

The STO Financial Statements 2019 have been produced in accordance with the NATO Accounting Framework. This Accounting Framework is based on International Public Sector Accounting Standards (IPSAS), as adapted by NATO. The Financial Statements are also produced in accordance with the NATO Financial Regulations (NFRs) and are presented in a commonly adopted layout.



Dr Bryan Wells  
NATO Chief Scientist  
Chairman, NATO Science and Technology Board



Rui M.M. da Silva  
Financial Controller  
International Military Staff &  
Science and Technology Organisation

## Statement on Internal Control

The Chief Scientist and Chairman of the Science and Technology Board (STB), together with the Directors of the Centre for Maritime Research and Experimentation (CMRE) and the Collaborative Support Office (CSO), as Heads of the three Executive Bodies of the STO, collectively exercise overall responsibility for the maintenance of a sound system of Risk Management and Internal Control, in accordance with Articles 11.1 and 12.1 of the NATO Financial Regulations (NFRs).

The STO Financial Controller is responsible for financial risk management, and for establishing financial risk management standards (NFR Financial Rules and Procedures XI.3 and XI.4). In addition, the Financial Controller is responsible for the system of internal financial and budgetary control (NFR 11.2).

The systems of Risk Management and Internal Financial Control are based on an on-going process designed to identify the principal risks to the achievement of STO policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. This process has been in place for the year ended 31 December 2018 and up to the date of these Financial Statements.

The systems of Risk Management and Internal Financial Control are designed to manage and minimize risk at the STO. Risk Management and Internal Financial Controls can therefore provide only a reasonable, but not absolute, assurance of effectiveness. The risks addressed at the STO include risks to STO operational aims and objectives; compliance with the NFRs; the reliability of financial information; and the safeguarding of assets.

The Risk Management and Financial Control processes at the STO provide a network of internal controls that can be assessed using the five key components of the COSO Framework:

Control Environment: Senior management establishes the culture and ethical values of the overall control environment. Measures for the promotion of ethical values include STO participation in the NATO-wide 'Building Integrity' Initiative; the promulgation of the NATO Code of Conduct to all STO staff; and disclosures on any senior management related party transactions in the annual financial statements. The Science and Technology Board (STB), supported by various subgroups, who routinely scrutinize STO Senior Management reports, provide oversight.

On Financial matters, interim Budgetary Execution Reports are presented to and reviewed by the NATO Budget Committee three times a year for the common-funded entities. In addition, STO financial requirements comprising the yearly budget proposals are screened and reviewed by the Nations. For the customer-funded entity, the financial execution and the annual financial plan are submitted to and screened by the STB Finance and Audit Sub-Group (FASG).

Risk Assessment: The heads of each executive body regularly monitor actions mitigating the significant risks identified. Risk Management processes continue to be developed, with the assistance of external consultants when necessary. The Science & Technology Board (STB) is routinely informed about risks affecting the STO, via the work of the STB Finance and Audit Sub Group (FASG).

Control Activities: In the financial domain, the STO finance and accounting system - 'FinS' - has built-in approval workflows and controls, together with audit trails. The controls are designed so that the transactions are recorded consistently, accurately and in accordance with the applicable rules and regulations.

The heads of each executive body are supported by an executive management board, which meets routinely to review internal processes and to inform decision-making.

Information and Communication: Strong reporting lines enhance STO internal communications. The STO has extensive guidance on the management of information and communications. This promotes effective communications in pursuit of operational objectives.

The STO also communicates externally on matters affecting the functioning of internal control mechanisms including the Statement on Internal Control, comprising part of the Financial Statements, which is released to the public. External Audits include examinations of internal controls and compliance. The results of these audits are made available and discussed by various oversight authorities.

Monitoring: An outsourced Internal Audit service provider is engaged on a periodic basis, to undertake internal reviews on behalf of the STO Financial Controller. The STO is also subject to annual external audits from the International Board of Auditors for NATO (IBAN). Recommendations and observations arising from audits are assessed by the FASG reporting to the STB.

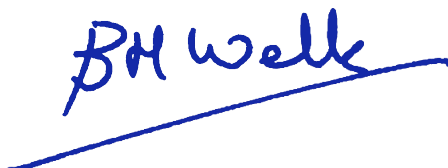
The Chairman of the STB and Financial Controller have collective responsibility for reviewing the effectiveness of the system of internal control. The review is informed by the above five COSO components, and by the work of STO Senior Managers, External Audits, Internal Audits, and the work of various sub-committees reporting to the STB, including the Finance and Audit Sub-Group (FASG).

No significant issues regarding financial or operational matters were raised in 2019. The IBAN External Audit of the 2018 Financial Statements - undertaken in 2019 - resulted in an unqualified opinion, observing in all executive bodies, the need for more formal documentation on risk management and internal financial control. The STO is addressing the formal documentation and, as such, has issued the STO Risk Management Policy in January 2019.

For CMRE, IBAN assessed progress for or closed a number of prior-year observations regarding the lack of compliance with the Civilian Personnel Regulations (CPRs) in a number of significant areas related to management of human resources. The CMRE continues to improve processes and procedures to comply with the CPRs.

In 2019, the internal auditor of the NCIA Agency, to whom the STO and IMS have outsourced the execution of their internal audit tasks, has further assessed the risk management processes at the three executive bodies of the STO. The outcome of the audit was a number of observations whose aim was to strengthen the existing risk management policy by explicitly defining the responsibilities for risk owners and the scoring and escalating criteria for better risk measurement.

Overall, we are satisfied that the Risk Management and Internal Financial Control systems in operation across the STO during the year 2019 were reasonably adequate and effective.



Dr Bryan Wells  
NATO Chief Scientist  
Chairman, NATO Science and Technology Board



Rui M.M. da Silva  
Financial Controller  
International Military Staff &  
Science and Technology Organisation



## STO Consolidated Statement of Financial Position

as at 31 December 2019  
(in EUR)

		<u>2019</u>	<u>2018*</u>	<u>2018</u>
	Notes			
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	1	8,291,897	9,283,716	9,283,716
Receivables	2	5,477,925	8,498,559	8,498,559
Prepayments	3	271,824	361,533	361,533
		<u>14,041,646</u>	<u>18,143,808</u>	<u>18,143,808</u>
<b>Non-current assets</b>				
Property, plant & equipment	4	4,043,983	4,353,584	3,963,783
		<u>4,043,983</u>	<u>4,353,584</u>	<u>3,963,783</u>
<b>Total assets</b>		<u>18,085,629</u>	<u>22,497,392</u>	<u>22,107,591</u>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Payables	5	3,102,932	4,088,927	4,088,927
Deferred revenue	6	406,678	246,442	246,442
Advances	7	2,775,130	3,398,539	3,398,539
Provisions	8	-	1,012,000	1,012,000
Other current liabilities	9	291,734	56,233	56,233
		<u>6,576,474</u>	<u>8,802,141</u>	<u>8,802,141</u>
<b>Non-current liabilities</b>				
Deferred revenue	10	399,226	273,715	273,715
		<u>399,226</u>	<u>273,715</u>	<u>273,715</u>
<b>Total liabilities</b>		<u>6,975,700</u>	<u>9,075,856</u>	<u>9,075,856</u>
Surplus/Deficit		(2,311,608)	(146,594)	(536,396)
Retained earnings	11	13,421,537	13,568,131	13,568,131
<b>Total net assets</b>		<u>11,109,929</u>	<u>13,421,536</u>	<u>13,031,735</u>
<b>Total net assets and liabilities</b>		<u>18,085,629</u>	<u>22,497,392</u>	<u>22,107,591</u>

\*Restated

Dr Bryan Wells  
NATO Chief Scientist  
Chairman, NATO Science and Technology Board

Rui M.M. da Silva  
Financial Controller  
International Military Staff &  
Science and Technology Organisation

The detailed notes on pages 17 to 26 form an integral part of these financial statements.

The financial statements were issued to the International Board of Auditors for NATO on 31 of March 2020

## STO Consolidated Statement of Financial Performance

for the year ended 31 December 2019  
(in EUR)

	<u>2019</u>	<u>2018*</u>	<u>2018</u>
Notes			
<b>Revenue</b>	<sup>12</sup>		
Revenue	30,775,055	34,055,081	34,055,081
Financial revenue	228,763	18,084	18,084
<b>Total revenue</b>	<u>31,003,818</u>	<u>34,073,165</u>	<u>34,073,165</u>
<b>Expenses</b>	<sup>13</sup>		
Personnel	19,288,294	17,908,633	17,908,633
Contractual supplies and services	12,516,873	15,373,123	15,762,925
Depreciation and amortization	1,471,177	863,618	863,618
Finance costs	39,082	74,385	74,385
<b>Total expenses</b>	<u>33,315,426</u>	<u>34,219,759</u>	<u>34,609,561</u>
<b>Surplus/(Deficit) for the period</b>	<u>(2,311,608)</u>	<u>(146,594)</u>	<u>(536,396)</u>

\*Restated

## STO Consolidated Statement of Cash Flow

(in EUR)

	<u>2019</u>	<u>2018*</u>	<u>2018</u>
<b>Cash flow from operating activities</b>			
Surplus/(Deficit)	(2,311,608)	(146,594)	(536,396)
<b>Non-cash movements</b>			
Depreciation/ Amortisation	1,471,177	863,618	863,618
Increase in payables and provision	(1,997,994)	1,534,523	1,534,523
Increase / (decrease) in other current liabilities	(227,672)	1,107,408	1,107,408
Increase / (decrease) in deferred revenue	125,510	66,168	66,168
Decrease / (Increase) in other current assets	89,709	219,300	219,300
(Increase) / Decrease in receivables	3,020,634	(5,219,500)	(5,219,500)
<b>Net cash flow from operating activities</b>	<u>169,756</u>	<u>(1,575,077)</u>	<u>(1,964,879)</u>
<b>Cash flow from investing activities</b>			
Purchase of property plant and equipment / Intangible assets	(1,161,576)	(1,240,913)	(851,112)
<b>Net cash flow from investing activities</b>	<u>(1,161,576)</u>	<u>(1,240,913)</u>	<u>(851,112)</u>
<b>Cash flow from financing activities</b>	-	(2,000,000)	(2,000,000)
<b>Net cash flow from financing activities</b>	<u>-</u>	<u>(2,000,000)</u>	<u>(2,000,000)</u>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<u>(991,820)</u>	<u>(4,815,990)</u>	<u>(4,815,991)</u>
<b>Cash and cash equivalent at the beginning of the period</b>	<u>9,283,716</u>	<u>14,099,707</u>	<u>14,099,707</u>
<b>Cash and cash equivalent at the end of the period</b>	<u>8,291,896</u>	<u>9,283,716</u>	<u>9,283,716</u>

\*Restated

**STO Consolidated Statement of Change in Net Assets**

for the year ended 31 December 2019

(in EUR)

	<b>Commitments / Legal Obligations</b>	<b>Depreciation Reserve</b>	<b>Vessels Reserve</b>	<b>Net Equity Fund</b>	<b>General Reserve</b>	<b>Total</b>
<b>Balance at the end of the period 2017</b>	2,571,696	3,768,743	1,115,486	3,500,000	2,612,206	13,568,131
Surplus/(deficit) for the period	(1,251,012)	(78,676)	(500,486)	-	1,293,778	(536,396)
<b>Change in net assets/equity for the year ended 2018</b>	(1,251,012)	(78,676)	(500,486)	-	1,293,778	(536,396)
<b>Balance at the end of the period 2018</b>	1,320,684	3,690,067	615,000	3,500,000	3,905,984	13,031,735
Correction		389,801				389,801
<b>Restated balance</b>	1,320,684	4,079,868	615,000	3,500,000	3,905,984	13,421,536
Surplus/(deficit) for the period	138,804	(435,110)	-	-	(2,015,302)	(2,311,608)
<b>Change in net assets/equity for the year ended 2019</b>	138,804	(435,110)	-	-	(2,015,302)	(2,311,608)
<b>Balance at the end of the period 2019</b>	1,459,488	3,644,758	615,000	3,500,000	1,890,682	11,109,928

## NOTES TO THE STO CONSOLIDATED FINANCIAL STATEMENTS

### Basis for Preparation

The STO financial statements have been prepared in accordance with the NATO Accounting Framework (NAF) as adopted by the NATO Council. The NATO Accounting Framework is an adaptation of the International Public Sector Accounting Standards (IPSAS).

The financial statements comply with the financial requirements of the NATO Financial Regulations (NFRs) and the relevant entity directives and policies. In instances where there is a conflict between IPSAS and the NFRs this has been noted.

The financial statements have been prepared on a going-concern basis.

The financial statements have been prepared on the historical cost basis except for financial instruments that are measured at fair value at the end of each reporting period. The principal accounting policies are set out below. They have been applied consistently to all periods presented. The accounting principles recognized as appropriate for the recognition, measurement and reporting of the financial position, performance and cash flows on an accrual-based accounting using historical costs have been applied consistently throughout the reporting period.

In accordance with Article 2.1 of the NFRs, the financial year of the STO is 1 January to 31 December.

The STO is composed of the Science and Technology Board (STB) and three executive bodies: the Centre for Maritime Research and Experimentation (CMRE), the Collaboration Support Office (CSO) and the Office of the Chief Scientist (OCS).

### Accounting estimates and judgments

In accordance with IPSAS and generally accepted accounting principles, the financial statements necessarily include amounts based on estimates and assumptions made by the management and based on historical experience as well as on the most reliable information available. In exercising the judgements to make the estimates, a degree of caution was included in light of the principle of 'prudence' required by IPSAS in order not to overstate assets or revenue or understate liabilities or expenses.

The estimates and underlying assumptions are reviewed on an ongoing basis. These estimates and assumptions affect the amounts of assets, liabilities, revenue and expenses reported. By their nature, these estimates are subject to measurement uncertainty. The effect of changes to such estimates and assumptions in future periods could be significant to the financial statements.

The statements for 2018 have been restated following the reclassification of expenses related to an asset under construction and not booked as Work in Progress in 2018. The related asset has been put into use in 2019.

## Changes in pronouncements

No accounting standard has been adopted earlier than the application date as stated in the IPSAS standards.

IPSAS 40 (Public Sector Combinations) and the revised Cash Basis IPSAS became effective 1 January 2019. Both standards have not been adopted by the STO for the 2019 Financial Statements.

## Foreign Currency Transactions

These financial statements are presented in Euro, which is the STO functional and reporting currency. Foreign currency transactions are converted into Euro at the NATO exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at year-end are converted into Euro using the NATO exchange rates applicable at 31 December 2019. Resulting realized and unrealized gains and losses are recognized in the Statement of Financial Performance.

## Consolidation

The STO comprises the Science and Technology Board (STB) and three separate executive bodies:

<b>Entity NAME</b>	<b>LOCATION</b>
Office of the Chief Scientist (OCS)	Brussels – Belgium
Collaboration Support Office (CSO)	Neuilly-sur-Seine – France
Centre for Maritime Research & Experimentation (CMRE)	La Spezia – Italy

According to Article 25 of the Charter of the NATO Science and Technology Organization, the Chief Scientist, supported by the STO Financial Controller, shall submit to the STB and the International Board of Auditors for NATO (IBAN) Consolidated Annual Financial Statements.

The three bodies have a separate Director (Head of NATO Body), and a separate budget or revenue stream. None of the bodies has control over the others, as defined in IPSAS 35 - para. 18-22.

## Services In-Kind

The STO received services in-kind in the form of military personnel provided by the NATO Member Nations. Such personnel are assigned to specific military positions on the personnel establishments of the executive bodies and / or provided as voluntary contributions. This also includes military personnel

assigned to the crew of the research vessels ALLIANCE and LEONARDO. In these financial statements, services in-kind are recognized neither as revenue nor as an asset.

### Financial Instruments disclosure/presentation

STO uses only non-derivative financial instruments as part of its operations. These financial instruments include cash, bank accounts, deposit accounts, accounts receivable, provisions and loans between NATO entities.

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

**Credit Risk:** In the normal course of business, STO incurs credit risk from trade receivables and transactions with banking institutions. The STO manages its exposure to credit risk by:

- Holding current account bank balances and short-term deposits with registered banking institutions with a high credit rating;
- Maintaining credit control procedures over receivables.

The maximum exposure as at 31 December 2019 is equal to the total amount of bank balances, short-term deposits, and receivables disclosed in the Statement of Financial Position. There is a very limited credit risk associated with the realization of these instruments. Receivables considered uncollectible are adequately accounted for.

**Currency risk:** The STO's exposure to foreign currency exchange risk is limited, as most of its transactions are dealt with in Euros. A limited number of transactions are accounted for in other currencies.

**Liquidity risk:** The liquidity risk is based on the assessment whether the organization will encounter difficulties in meeting its obligations associated with financial liabilities.

For CSO & OCS there is a very limited exposure to liquidity risk because of the budget funding mechanism that guarantees contributions in relation to approved budgets. The limited risks are primarily the validity of forecast that result in the calls for contributions. For CMRE liquidity, risk is minimized by the cash available in the Net Equity Fund (NEF) and by the policy of requiring pre-payments & stage payments from customers.

**Interest rate risk:** The organization is restricted from entering into commercial borrowings and investments, and therefore there is no interest rate risk identified.

Financial assets and financial liabilities are recognized when the entity becomes a party to the contractual provisions of the instrument.

## Assets

### *a. Cash and cash Equivalents*

Cash and cash equivalents include petty cash, current bank accounts, deposits held with banks, other short-term investments (with a maturity of three months or less).

### *b. Short-term investments*

Short-term investments are with a maturity of more than three and less than twelve months.

### *c. Receivables*

Receivables are stated at net realisable value, which approximates fair value, after provision for doubtful and uncollectible debts. It can also include amounts due from other NATO entities and/or staff members.

### *d. Inventories*

The STO assesses inventories under IPSAS 12 and the outcome of this assessment is that the value of the inventories is immaterial in both value and nature of the items. Consequently, inventory is fully expensed on receipt.

### *e. Prepayments*

Prepayments are mainly in respect of advance payments made to third parties.

### *f. Property, Plant and Equipment (PP&E)*

Property, plant and equipment, with the exception of land, are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is recognized so as to write off the cost of the assets less their residual values over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation methods are reviewed at the end of each reporting period, with the effect of any changes in estimate are accounted for on a prospective basis.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is



recognized in the Statement of Financial Performance.

PP&E categories for capitalized assets are listed in the table below:

Category	Threshold	Depreciation Period (Years)	Method
Installed equipment	30,000	10	Straight line
Vehicles	10,000	5	Straight line
Mission equipment	50,000	3	Straight line
Automated information systems	50,000	3	Straight line

In accordance with the NATO Accounting Framework, PP&E acquired prior to 1 January 2013 has been fully expensed and the STO does not foresee any grouping of assets.

*g. Impairment of tangible assets*

At the end of each accounting period, the entity reviews the carrying amounts of its tangible assets to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated, being the greater of the asset's fair value less costs to sell and value in use. Impairment losses, if any, are recognized in the Statement of Financial Performance.

## Liabilities

*a. Payables*

Payables (including amounts due to other NATO entities) are amounts due to third parties for goods and services received that remain unpaid at the reporting date. They are recognized at their fair value. This includes estimates of accrued obligations for goods and services received at year-end but not yet invoiced.

*b. Deferred Revenue*

For the common-funded entities, CSO and OCS, deferred revenue represents contributions from Nations that have been called for current or prior year budgets but for which corresponding charges will be incurred after the reporting period. Deferred revenue is recognized incrementally and equally with the depreciation expenses. The reserve for depreciation is the counterpart of the PP&E and Intangible Assets Net Book Value.

For CMRE, deferred revenue represents revenue from customers for current or prior year activities for which goods have not been delivered or services have not been rendered at year-end.

*c. Advances*

For CSO and OCS, advances are income or contributions from member nations or third parties called or received, that are related to future year budgets.

For CMRE, advances from customers are either cash received as working capital or result from advance billing to customers where the rate of expenditure has fallen behind the agreed payment milestones.

*d. Provisions*

Provisions are recognized when the entity has a legal or constructive obligation as a result of past event, and where it is probable that an outflow of resources will be required to settle the obligation, and where a reliable estimate of the amount of the obligation can be made.

*e. Employee benefits*

STO employees participate to the Coordinated Pension Scheme or the Defined Contribution Pension Scheme (DCPS). The STO also contributes to the Retirees' Medical Claims Fund (RMCF) that is a reserve to ensure that sufficient resources are available to enable NATO to meet its obligations under Art 51.2 of the Civilian Personnel Regulations (CPRs).

The assets and liabilities for the above NATO pension schemes and the RMCF are held and accounted for centrally at NATO International Staff (NATO IS) and therefore are not recognized in the STO financial statements.

DCPS: The STO contributes a specified percentage of payroll costs to the DCPS. In addition to the employer's contribution, a portion of the employees' salaries is deducted and contributed to the DCPS. The employer's contributions are recognized as an expense during the year the services are rendered and represent the total pension obligation of the STO.

Coordinated Pension Scheme: Employees who have joined NATO before 1 July 2005 are members of the NATO Coordinated Pension Scheme which is a defined benefit plan. Upon completion of 10 years employment with NATO, the employees are entitled to retirement benefits of 2% per year of service of final basic salary on attainment of a retirement age of 60. There is no further pension obligation for the STO, as the future liabilities have been transferred to NATO IS.

## Net Assets

Net assets are the residual interest in the assets of the entity after deducting its liabilities.

NATO entities perform their activities on a no profit / no loss basis over the reporting period. However, this does not prohibit the realisation of an operating surplus or deficit in the financial reporting period.

## Revenue and Expense Recognition

### *a. Revenue*

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. Revenue includes contributions from Member Nations and income from customers to fund STO activities.

For common-funded bodies (CSO and OCS), revenue is recognized in the year when these appropriated funds are used for their intended purpose as envisioned for STO's programmes. Unused contributions and other revenue that relate to future periods are deferred accordingly.

For CMRE, revenue is recognized as goods and services are delivered to customers.

Interest income is accrued on a time-basis, by reference to the principal outstanding and at the effective interest rate applicable.

Bank interests earned and accrued as of 31 December 2019, realised and unrealised exchange rate revenue, in accordance with IPSAS 4 – Effect of the foreign exchange rate -, are recognized as financial revenue.

### *b. Expenses*

Expenses are recognized when occurred. Expenses are accrued when goods and services are received.

Bank charges, realised and unrealized exchange rate losses are recognized as finance costs.

## Surplus or Deficit for the Period

For CSO and OCS, no surplus or deficit is recorded because revenue is recognized up to the amount of the expenses incurred during the year. Any unused contributions and miscellaneous income are recorded as other current liability (see note 10). This amount represents a liability owed to the funding nations to be deducted from the contributions called in the following year.

For CMRE, surplus or deficit is recorded because revenue is recognized based on goods and services delivered to the customers.

**NOTE 1. Cash and cash equivalents**

	(in euro)	
	<b>2019</b>	<b>2018</b>
Petty Cash	2,954	1,206
Current accounts	8,288,943	9,282,510
<b>Total</b>	<b>8,291,897</b>	<b>9,283,716</b>

Bank accounts are held in highly liquid non-interest and interest-bearing accounts.

Current bank accounts are held in EUR, GBP and USD.

**NOTE 2. Receivables**

Receivable from NATO Entities at year-end 2019 include CMRE invoices to NATO HQ SACT for the 2019 Programme of Work.

Other receivables are mainly invoices to be established for services that have been provided to CMRE customers at the end of the reporting period.

The insurance reimbursable for NRV alliance repairs is EUR 1,106,866. It has been recognized based on the expenditures incurred during 2019.

**NOTE 3. Prepayments**

In addition, STO entities have maintenance contracts that are financed over several fiscal years. The amount associated with future fiscal years is recorded as a prepayment.

**NOTE 4. Property, Plant and Equipment**

STO's PP&E include mission equipment (maritime vehicles and associated equipment), AIS equipment, vehicles and installed equipment. Some additions are booked as work in progress at year-end.

(in euro)

	Mission Equipment	AIS Equipment	Vehicles	Installed Equipment	Working in progress	Total
<b>Gross Book Value (1 Jan 2019)</b>	2,583,391	509,415	55,608	2,601,763	1,738,789	7,488,966
Accumulated Depreciation	(1,909,879)	(399,891)	(13,184)	(812,428)		(3,135,382)
<b>Net Book Value (1 Jan 2019)</b>	<b>673,512</b>	<b>109,524</b>	<b>42,424</b>	<b>1,789,335</b>	<b>1,738,789</b>	<b>4,353,584</b>
Additions in 2019	1,997,108	-	-	250,830	572,045	2,819,983
Adjustments in 2019					(1,658,407)	(1,658,407)
Depreciation in 2019	(1,110,371)	(74,661)	(11,122)	(275,023)		(1,471,177)
<b>Net Book Value (31 Dec 2019)</b>	<b>1,560,249</b>	<b>34,863</b>	<b>31,302</b>	<b>1,765,142</b>	<b>652,427</b>	<b>4,043,983</b>
<b>Gross Book Value (31 Dec 2019)</b>	<b>4,580,499</b>	<b>509,415</b>	<b>55,608</b>	<b>2,852,593</b>	<b>652,427</b>	<b>8,650,542</b>
Accumulated Depreciation (31 Dec 2019)	(3,020,250)	(474,552)	(24,306)	(1,087,451)	-	(4,606,559)
<b>Net Book Value (31 Dec 2019)</b>	<b>1,560,249</b>	<b>34,863</b>	<b>31,302</b>	<b>1,765,142</b>	<b>652,427</b>	<b>4,043,983</b>

The depreciation charge for the year 2019 was 1,471,177EUR (2018 EUR 863,618)

**Write Off**

In accordance with the NATO Financial Regulations (NFRs Art. 17.1 and 17.4), a global statement of amounts written-off shall be reported in the annual financial statements.

In 2019, CSO and CMRE wrote-off property with a Net Book Value of nil.

**STO - Assets purchased prior to the implementation of the NATO Accounting Framework**

CSO owns one staff car purchased before 1 January 2013.

CMRE owns around 100 assets purchased prior to the implementation of the NATO accounting framework (1 January 2013).

- *Vessels (custodian is Headquarter, Supreme Allied Command Transformation HQ SACT)*
  - *The NRV Alliance*
  - *The CRV Leonardo*
- *IT Equipment*
  - *Disaster recovery*
  - *Satellite communication system*
  - *Various workstations and servers*
- *Mission Equipment*
  - *Multiple types of autonomous vehicles*
  - *Towed acoustics arrays*
  - *Multiple types of sonar*
- *Vehicles (car and forklift)*
- *Machinery*
  - *Shredding machine*

- *Installed Equipment*
  - *Air condition systems for the new and old building*
  - *Uninterrupted Power Supply (UPS) systems*
  - *TV closed circuit system*

The premises of the three entities are generally provided by the Host Nation at no cost or at a nominal charge. Leaseholds improvements done post 1 January 2013 are capitalized in accordance with the STO accounting policies.

## NOTE 5. Payables

	(in euro)		
	2019	2018	Variance
Payables to Suppliers	1,299,843	2,884,276	(1,584,433)
Accruals for Goods and Services	1,269,725	693,481	576,244
Accruals for Untaken Leave	533,365	511,169	22,196
<b>Total</b>	<b>3,102,933</b>	<b>4,088,926</b>	<b>(985,993)</b>

Payables are short-term (less than one year) liabilities to third parties directly related to the activities and operations of the STO.

The average credit period on purchases is 30 days. STO has financial risk management policies in place to ensure that all payables are paid within the pre-agreed credit terms.

Untaken leave is recognized as a short-term employee benefit where these benefits are expected to be settled totally within 12 months after the end of the annual reporting period in which the employees render the related employment service. Untaken leave is measured on an undiscounted basis using remuneration rates in force on the last day of the reporting period.

## NOTE 6. Deferred revenue

The deferred revenue at year-end 2019 is related to Programme of Work activities and associated commitments not fully delivered by suppliers at 31 December 2019 due to delays from contractors unable to fulfil their deliveries as planned.

**NOTE 7. Advances**

	(in euro)		
	<b>2019</b>	<b>2018</b>	<b>Variance</b>
From customers	1,022,710	1,646,118	(623,408)
Contributions	1,750,000	1,750,000	-
Other	2,421	2,421	-
<b>Total</b>	<b>2,775,131</b>	<b>3,398,539</b>	<b>(623,408)</b>

Advances from contributions are related to cash called from the Nations for the following financial year. This is only applicable to the common-funded organizations (CSO and OCS).

**NOTE 8. Provision**

	<b>Insurance</b>
<b>Balance at 1 January 2019</b>	<b>1,012,000</b>
Addition provision in the year	-
Provision used during the course of the year	(1,012,000)
<b>Balance at 31 December 2019</b>	<b>-</b>

The NATO Research Vessel ALLIANCE repairs (No2 Main Propulsion Generator and Gas Turbine propulsion Generator) have been completed during 2019. The provision has been fully utilized. therefore no provision has been recorded in this fiscal year

**NOTE 9. Other current liabilities**

Other current liabilities are mainly lapses from budget authorizations unspent during the financial year and miscellaneous income to be returned to the Nations.

**NOTE 10. Deferred Revenue – Non-current liabilities**

The deferred revenue for the capitalization of PP&E of the common funded entities (CSO and OCS) represents depreciation not yet expensed. The revenue is recognized in the year of depreciation expense.

**NOTE 11. Retained Earnings**

The loss/or surplus of the period (EUR 2,311,608) reduced the retained earnings, which are allocated as follows:

Reserve	Commitments / Legal Obligations	Depreciation Reserve*	Vessels Reserve	Net Equity Fund	General Reserve	Total
<b>Net Equity 31st December 2018</b>	<b>1,320,684</b>	<b>4,079,868</b>	<b>615,000</b>	<b>3,500,000</b>	<b>3,905,984</b>	<b>13,421,536</b>
Net change in Vessels Reserve			-			-
Net change in PPE		(435,110)				(435,110)
Net change in Commitment	138,804					138,804
Net change in General Reserve					(2,015,302)	(2,015,302)
<b>Net Equity 31st December 2019</b>	<b>1,459,488</b>	<b>3,644,758</b>	<b>615,000</b>	<b>3,500,000</b>	<b>1,890,682</b>	<b>11,109,928</b>

\*Restated

**Commitments**

The reserve for commitments represents the value of orders for goods and services placed in one fiscal year, but neither received nor invoiced until the following fiscal year(s).

**Depreciation Reserve**

The depreciation reserve represents the NBV of assets and a source of future depreciation expense. This amount has been restated for 2018 following the reclassification of EUR 398,802 of expenses related to an asset under construction and not booked as Work in Progress in 2018. The related asset, a VLFSAS system, has been put into use in 2019.

**Vessels Reserve**

The reserve is used to accumulate resources in current periods to fund future, major vessel upkeep projects. NRV Alliance undergoes one major and one minor upkeep on a five-year period cycle.

**Net Equity Fund (NEF)**

The STO Charter states that the governing board may establish a Net Equity Fund (NEF) to facilitate the CMRE operations (C-M(2012)0046 articles 23.3 and 24.1). The fund was established to provide liquidity for projects, to act as a buffer for project gains and losses, and to be a source of funds for investments.

**General Reserve**

This represents accumulated surpluses (retained earnings) available for allocation in subsequent financial periods. An amount of EUR 2,015,302 has been used to cover the reduction in revenue (Vessels operation and projects move forward into 2020)



**NOTE 12. Revenue**

	(in euro)		
	2019	2018	Variance
Revenue from Contributions	6,794,519	6,707,176	87,343
Revenue from Services	23,980,535	27,347,905	(3,367,370)
Financial Revenue	228,763	18,084	210,679
<b>Total</b>	<b>31,003,817</b>	<b>34,073,165</b>	<b>(3,069,348)</b>

Revenue recognition is based on the STO accounting policies outlined at page 16.

**NOTE 13. Expenses****Personnel expenses**

Personnel expenses include civilian and military personnel expenses as well as other non-salary related expenses. The amounts include expenses for salaries and emoluments for approved NATO civilian and temporary personnel, for other salary related and non-related allowances including overtime, medical examinations, recruitment, installation, and removal and for contracted consultants and training.

The personnel establishments (PE) of the STO entities are shown in the table below.

Personnel Establishment	PE - Authorized			PE - Filled		
	Mil	Civ	Total	Mil	Civ	Total
CSO	14	35	49	11	31	42
OCS	5	4	9	4	2	6
CMRE - Customer Funded positions	9		9	7		7
<b>International Manpower Ceiling</b>	<b>28</b>	<b>39</b>	<b>67</b>	<b>22</b>	<b>33</b>	<b>55</b>
CMRE - Customer Funded positions		169	169		145	145
Voluntary National Contributions			-			-
<b>Total</b>	<b>28</b>	<b>208</b>	<b>236</b>	<b>22</b>	<b>178</b>	<b>200</b>

The figure above reflects the number of filled positions on 31 December 2019.

The breakdown of salaries and employment benefits is as follows:

	<b>2019</b>	<b>2018</b>
Basic Salary	12,710,214	12,032,590
Allowances	2,137,322	2,212,655
Post-employment Benefits	968,114	843,275
Employer's Contrib. to Insurance	1,477,671	1,447,636
<b>Total</b>	<b>17,293,320</b>	<b>16,536,156</b>

### Untaken Leave

The balance of untaken leave as of 31 December 2019 is shown below:

<b>Entity</b>	<b>2019</b>
	(in days)
OCS	4.0
CSO	171.0
CMRE	1,757.0
<b>Total</b>	<b>1,932.0</b>

### Contractual supplies and services expenses

Supplies and Services include expenses required for STO activities: general administrative costs, maintenance costs of buildings/grounds, communications and information systems, transportation, travel expenses, representation/hospitality and miscellaneous expenses.

**NOTE 14. Contingent liabilities**

Contingent Liabilities have been determined under the criteria set out in IPSAS 19 and are based on the realistic and prudent estimates of the expenditure required to settle future legal obligations.

In 2016, the Italian authorities re-issued a claim to the CMRE for contributions to the Italian National Health System. The claim covers all NATO entities in Italy, and dates back to the 1980's. The NATO HQ legal services are aware of this matter, and the claims are suspended pending resolution of the issue between NATO and Italy.

As of the date of the Financial Statements, the CMRE is not aware that the claim will be substantiated, and can make no estimate as to when this case will be resolved. There is a remote possibility of a future obligation and the CMRE assessment is that no settlement will be made.

**NOTE 15. Segment Reporting**

In accordance with IPSAS 18, the STO discloses segment information for its three executive bodies as provided in the STO Charter: CSO, CMRE and OCS (detailed in Appendix 1).

The segment reporting includes the Statement of Financial Position, Performance and Budget Execution. CMRE does not report the Budget Execution Statement because the entity is customer funded.

**NOTE 16. Related parties**

The key management personnel of the STO, and the STB National Representatives, have no significant known related party relationships that could affect the operations of the STO. However, the STO Financial Controller is also the Financial Controller of the NATO Defence College (NDC) and the International Military Staff (IMS). The STO, IMS and NDC are therefore related parties.

Key management personnel include the following officials:

Science & Technology Board	<ul style="list-style-type: none"> <li>NATO National Representatives on STB</li> </ul>
Office of the Chief Scientist	<ul style="list-style-type: none"> <li>NATO Chief Scientist</li> </ul>
Centre for Maritime Research and Experimentation	<ul style="list-style-type: none"> <li>CMRE Director</li> <li>CMRE Chief Operating Officer &amp; Deputy Director</li> </ul>
Collaborative Support Office	<ul style="list-style-type: none"> <li>CSO Director</li> <li>CSO Deputy Director</li> </ul>

**Compensation of key management personnel**

STO Board members receive no remuneration or access to preferential benefits such as the entitlement to receive loans from NATO for their Board responsibilities.

STO key management personnel are remunerated in accordance with the published NATO salary scales. The compensation consists of basic salary, various allowances, health insurance, pension plan and other benefits as agreed with each Host Nation.

	2019	2018
Basic salaries	422,027	431,001
Allowances	79,477	70,594
Post-employment benefits	50,643	50,253
Employer's contribution to Insurance	49,158	51,278
<b>Total</b>	<b>601,305</b>	<b>603,126</b>

**Representation Allowance**

The Heads of the STO Executive Bodies are entitled to and receive Representation Allowance for establishing and maintaining relationships of value for their organizations. In 2019, the total amount of Representation Allowance spent in accordance with the NATO Guidelines<sup>1</sup> was EUR 10,364.

**NOTE 17. Events after reporting date**

On the date of signing of these accounts there has been no material event, favourable or unfavourable incurred between the year-end and the date when the Financial Statements have been authorized for issue that would have affected these statements.

**NOTE 18. Morale & Welfare activities**

Morale and Welfare Activities (MWA) such as sport, community service, retail and concessionary activities are conducted by the CMRE.

In accordance with the NATO Accounting Framework, these activities shall not be consolidated into the respective financial statements of NATO reporting entities.

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<sup>1</sup> PO(2016)0100 dated 20 December 2016

## APPENDIX 1 – TO THE NOTES TO THE FINANCIAL STATEMENTS

## Segment Reporting

COLLABORATIVE SUPPORT OFFICE  
STATEMENT OF FINANCIAL POSITION

as at 31 December 2019  
(in EUR)

		<u>2019</u>	<u>2018</u>
	Notes		
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	1	2,016,212	1,726,823
Receivables	2	211,888	319,076
Prepayments	3	61,768	80,448
		<u>2,289,868</u>	<u>2,126,347</u>
<b>Non-current assets</b>			
Property, plant & equipment	4	399,225	273,715
		<u>399,225</u>	<u>273,715</u>
<b>Total assets</b>		<u>2,689,093</u>	<u>2,400,062</u>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Payables	5	332,295	374,874
Deferred revenue	6	406,677	246,442
Advances	7	1,502,421	1,502,421
Provisions	8	-	-
Other current liabilities	9	48,475	2,610
		<u>2,289,868</u>	<u>2,126,347</u>
<b>Non-current liabilities</b>			
Deferred revenue	10	399,225	273,715
		<u>399,225</u>	<u>273,715</u>
<b>Total liabilities</b>		<u>2,689,093</u>	<u>2,400,062</u>
Surplus/Deficit		-	-
Retained earnings	11	-	-
<b>Total net assets</b>		<u>-</u>	<u>-</u>
<b>Total net assets and liabilities</b>		<u>2,689,093</u>	<u>2,400,062</u>

**COLLABORATIVE SUPPORT OFFICE  
STATEMENT OF FINANCIAL PERFORMANCE**



for the year ended 31 December 2019  
(in EUR)

	<u>2019</u>	<u>2018</u>
	Notes	
<b>Revenue</b>	12	
Revenue	5,914,229	5,781,191
Financial revenue	3,228	5,646
<b>Total revenue</b>	<u>5,917,457</u>	<u>5,786,837</u>
<b>Expenses</b>	13	
Personnel	3,586,721	3,735,538
Contractual supplies and services	2,282,571	2,017,831
Depreciation and amortization	44,937	27,822
Finance costs	3,228	5,646
<b>Total expenses</b>	<u>5,917,457</u>	<u>5,786,837</u>
<b>Surplus/(Deficit) for the period</b>	<u>-</u>	<u>-</u>

CENTRE FOR MARITIME RESEARCH & EXPERIMENTATION  
STATEMENT OF FINANCIAL POSITIONas at 31 December 2019  
(in EUR)

		<u>2019</u>	<u>2018*</u>	<u>2018</u>
	Notes			
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	1	5,771,198	7,276,892	7,276,892
Receivables	2	5,261,504	8,178,499	8,178,499
Prepayments	3	200,979	254,473	254,473
		<u>11,233,681</u>	<u>15,709,864</u>	<u>15,709,864</u>
<b>Non-current assets</b>				
Property, plant & equipment	4	3,644,757	4,079,869	3,690,067
		<u>3,644,757</u>	<u>4,079,869</u>	<u>3,690,067</u>
<b>Total assets</b>		<u>14,878,438</u>	<u>19,789,733</u>	<u>19,399,931</u>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Payables	5	2,745,800	3,710,078	3,710,078
Deferred revenue	6	-	-	-
Advances	7	1,022,710	1,646,118	1,646,117
Provisions	8	-	1,012,000	1,012,000
Other current liabilities	9	-	-	-
		<u>3,768,510</u>	<u>6,368,196</u>	<u>6,368,195</u>
<b>Non-current liabilities</b>				
Deferred revenue	10	-	-	-
		<u>-</u>	<u>-</u>	<u>-</u>
<b>Total liabilities</b>		<u>3,768,510</u>	<u>6,368,196</u>	<u>6,368,195</u>
Surplus/Deficit		(2,311,608)	(146,595)	(536,397)
Retained earnings	11	13,421,537	13,568,131	13,568,131
<b>Total net assets</b>		<u>11,109,928</u>	<u>13,421,537</u>	<u>13,031,736</u>
<b>Total net assets and liabilities</b>		<u>14,878,438</u>	<u>19,789,733</u>	<u>19,399,931</u>

\*Restated



CENTRE FOR MARITIME RESEARCH & EXPERIMENTATION  
STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 31 December 2019  
(in EUR)

	<u>2019</u>	<u>2018*</u>	<u>2018</u>
	Notes		
<b>Revenue</b>	12		
Revenue	23,980,535	27,347,904	27,347,904
Financial revenue	225,536	12,437	12,437
<b>Total revenue</b>	<u>24,206,071</u>	<u>27,360,341</u>	<u>27,360,341</u>
<b>Expenses</b>	13		
Personnel	14,695,916	13,333,631	13,333,631
Contractual supplies and services	10,359,669	13,268,770	13,658,572
Depreciation and amortization	1,426,240	835,796	835,796
Finance costs	35,854	68,739	68,739
<b>Total expenses</b>	<u>26,517,679</u>	<u>27,506,936</u>	<u>27,896,738</u>
<b>Surplus/(Deficit) for the period</b>	<u>(2,311,608)</u>	<u>(146,595)</u>	<u>(536,397)</u>

\*Restated

OFFICE OF THE CHIEF SCIENTIST  
STATEMENT OF FINANCIAL POSITION

as at 31 December 2019  
(in EUR)

		<u>2019</u>	<u>2018</u>
	Notes		
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	1	504,487	280,002
Receivables	2	4,533	984
Prepayments	3	9,077	26,612
		<u>518,097</u>	<u>307,598</u>
<b>Non-current assets</b>			
Property, plant & equipment	4	-	-
		<u>-</u>	<u>-</u>
<b>Total assets</b>		<u>518,097</u>	<u>307,598</u>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Payables	5	24,838	3,974
Deferred revenue	6	-	-
Advances	7	250,000	250,000
Provisions	8	-	-
Other current liabilities	9	243,259	53,624
		<u>518,097</u>	<u>307,598</u>
<b>Non-current liabilities</b>			
Deferred revenue	10	-	-
		<u>-</u>	<u>-</u>
<b>Total liabilities</b>		<u>518,097</u>	<u>307,598</u>
Surplus/Deficit		-	-
Retained earnings	11	-	-
<b>Total net assets</b>		<u>-</u>	<u>-</u>
<b>Total net assets and liabilities</b>		<u>518,097</u>	<u>307,598</u>

OFFICE OF THE CHIEF SCIENTIST  
STATEMENT OF FINANCIAL PERFORMANCE



for the year ended 31 December 2019  
(in EUR)

	<u>2019</u>	<u>2018</u>
	Notes	
<b>Revenue</b>	12	
Revenue	880,290	925,985
Financial revenue	-	-
<b>Total revenue</b>	<u>880,290</u>	<u>925,985</u>
<b>Expenses</b>	13	
Personnel	718,371	839,463
Contractual supplies and services	161,919	86,522
Depreciation and amortization	-	-
Finance costs	-	-
<b>Total expenses</b>	<u>880,290</u>	<u>925,985</u>
<b>Surplus/(Deficit) for the period</b>	<u>-</u>	<u>-</u>

**Budget Execution Statement**

For the common funded elements of the STO, expenses are presented on a different basis in the statement of financial performance when compared to the budget execution statement: the statement of financial performance includes finance costs, and the PP&E depreciation expenses, whereas the purchasing costs of PP&E are recognised in the budget execution statement.

The following table is a reconciliation of actual budget amounts per the budget execution statement to actual expenses per the statement of financial performance:

**OFFICE OF CHIEF SCIENTIST****OFFICE OF CHIEF SCIENTIST****STATEMENT OF BUDGET EXECUTION AS AT 31 DECEMBER 2019**

EURO	Final Budget	Commitments	Expenses	Total Spent	Carry Forward	Lapsed
<b>BUDGET 907 (OCS) 2019</b>						
Chapter 71	877,782	-	718,371	718,371	-	159,411
Chapter 72	193,041	-	161,919	161,919	-	31,122
Chapter 73	-	-	-	-	-	-
<b>TOTAL BUDGET 907 (OCS)</b>	<b>1,070,823</b>	<b>-</b>	<b>880,290</b>	<b>880,290</b>	<b>-</b>	<b>190,533</b>

**COLLABORATIVE SUPPORT OFFICE****COLLABORATIVE SUPPORT OFFICE****STATEMENT OF BUDGET EXECUTION AS OF 31 DECEMBER 2019**

EURO	Final Budget	Commitments	Expenses	Total Spent	Carry-Forward	Lapsed
<b>BUDGET 908 (CSO) 2019</b>						
Chapter 71	3,912,774	-	3,874,007	3,874,007	-	38,767
Chapter 72	2,011,948	106,678	1,905,270	2,011,948	106,678	-
Chapter 73	321,872	300,000	21,872	321,872	300,000	-
<b>TOTAL</b>	<b>6,246,594</b>	<b>406,678</b>	<b>5,801,150</b>	<b>6,207,827</b>	<b>406,678</b>	<b>38,767</b>
<b>BUDGET 908 (CSO) 2018</b>						
Chapter 71	2,576	-	-	-	-	2,576
Chapter 72	85,866	-	80,590	80,590	-	5,276
Chapter 73	158,000	-	158,000	158,000	-	-
<b>TOTAL</b>	<b>246,442</b>	<b>-</b>	<b>238,590</b>	<b>238,590</b>	<b>-</b>	<b>7,852</b>
<b>TOTAL BUDGET 908 (CSO)</b>	<b>6,493,036</b>	<b>406,678</b>	<b>6,039,740</b>	<b>6,446,417</b>	<b>406,678</b>	<b>46,619</b>

**Budget Execution vs Financial Performance****COLLABORATIVE SUPPORT OFFICE**

	(in euro)
<b>Expenses</b>	<b>Actuals</b>
Personnel	3,874,007
Supplies and Services	1,985,860
Capital and Investments	179,872
<b>Total Expenses as per Budget Execution</b>	<b>6,039,739</b>
Property Plant and Equipment capitalized (Recognition from Capital and Investments)	(170,448)
Depreciation	44,938
Financial Costs	3,228
<b>Total Expenses as per Financial Performance</b>	<b>5,917,457</b>

For OCS there are no differences between the Budget Execution and the Financial Performance statement.