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17 January 2022

DOCUMENT
C-M(2022)0005-AS1

**IBAN AUDIT REPORT ON THE AUDIT OF 2020 FINANCIAL STATEMENTS OF
INTERNATIONAL MILITARY STAFF (IMS), NATO DEFENCE COLLEGE (NDC) AND
2020 RESTATED FINANCIAL 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)0005, agreed its conclusions and recommendations, noted the IBAN Audit Reports and agreed to the public disclosure of this report, the IBAN Audit Reports and associated 2020 financial statements of IMS, NDC and STO.

(Signed) Jens Stoltenberg
Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2022)0005.

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05 January 2022

DOCUMENT
C-M(2022)0005
Silence Procedure ends:
14 Jan 2022 15:30

IBAN AUDIT REPORT ON THE AUDIT OF 2020 FINANCIAL STATEMENTS OF INTERNATIONAL MILITARY STAFF (IMS), NATO DEFENCE COLLEGE (NDC) AND 2020 RESTATED FINANCIAL STATEMENTS OF SCIENCE AND TECHNOLOGY ORGANISATION (STO)

Note by the Secretary General

1. I attach the Resource Policy and Planning Board (RPPB) report on the International Board of Auditors for NATO (IBAN) Audit Reports on the audit of the 2020 financial statements of the International Military Staff (IMS) and NATO Defence College (NDC) and on the 2020 restated financial statements of the Science and Technology Organisation (STO). These IBAN Audit Reports set out unqualified opinions on both the 2020 financial statements and on compliance.
2. The IBAN Audit Reports have been reviewed by the RPPB (see Annex 1).
3. I do not believe this issue requires further discussion. Therefore, **unless I hear to the contrary by 15:30 hours on Friday, 14 January 2022**, I shall assume the Council notes the RPPB report, agrees its conclusions and recommendations, notes the IBAN Audit Reports and agrees to the public disclosure of this report, the IBAN Audit Reports and associated 2020 financial statements of IMS, NDC and STO.

(Signed) Jens Stoltenberg

Annex 1: RPPB report
Enclosure 1: IBAN audit + financial statements

Original: English

IBAN AUDIT REPORT ON THE AUDIT OF 2020 FINANCIAL STATEMENTS OF INTERNATIONAL MILITARY STAFF (IMS), NATO DEFENCE COLLEGE (NDC) AND 2020 RESTATED FINANCIAL STATEMENTS OF SCIENCE AND TECHNOLOGY ORGANISATION (STO)

Report by the Resource Policy and Planning Board (RPPB)

References:

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|----|-----------------|---|
| A. | IBA-A(2021)0059 | IBAN Audit Report on the audit of 2020 financial statements of the International Military Staff (IMS) |
| B. | IBA-A(2021)0060 | IBAN Audit Report on the audit of 2020 financial statements of the NATO Defense College (NDC) |
| C. | IBA-A(2021)0113 | IBAN Audit Report on the audit of 2020 restated financial statements of the Science and Technology Organisation (STO) |
| D. | C-M(2015)0025 | NATO Financial Regulations (NFR) |
| E. | PO(2015)0052 | Wales Summit tasker on transparency and accountability |

INTRODUCTION

1. This report by the RPPB addresses the IBAN Audit Reports on the audit of 2020 financial statements of the IMS and NDC and the IBAN Audit Report on the 2020 restated financial statements of the STO. The IBAN Audit Reports set out unqualified opinions on the financial statements and on compliance of the IMS, NDC and on the restated financial statements and on compliance of the STO for financial year 2020 (references A, B and C).

AIM

2. This report highlights key issues in the IBAN Audit Reports (references A, B and C) to enable the Board to reflect on strategic challenges emanating from the audit of financial statements of NATO entities and to recommend courses of action to Council as applicable, which have the potential to improve transparency, accountability and consistency.

DISCUSSION

3. In 2020, the IBAN made five new observations with recommendations for the IMS, NDC and STO, neither observation impacted the audit opinions on the financial statements or on compliance. One observation that is the same for all three entities relates to the fair presentation of financial statements and budget information while the other two observations covered the need for the STO to improve the internal control process and for the NDC to reduce the use of physical cash. Also, the IBAN followed up on the status of outstanding recommendations from the previous years' audits. For the IMS, the IBAN noted that three recommendations were in-progress and for the NDC one recommendation is open and two

remain in-progress. For the STO, the IBAN noted that four recommendations were closed, one is open and three remain in-progress.

3.1. IMS, NDC and STO Observation 1: The IBAN found that information on Nations' decision on direct conversion of lapses into advance contributions was disclosed in the notes to the financial statements on deferred revenue and not in the note on payables which includes lapses. Although the information on the conversion of lapses into advanced contributions was included in the notes to the financial statements, the Board supports the IBAN's recommendation that information is sufficiently disclosed in the notes to the financial statements on accounts impacted, such as payables and deferred revenue.

3.2. NDC Observation 2: The IBAN found that the NDC has a long-standing practice of making payments in cash for subsidised fees to its course members. Although NDC has made progress in this area, due to the significant level of payments in cash, the Board supports the IBAN's recommendation that the NDC ensure a sound financial management of cash by reducing the cash payments for subsidised fees and introducing other type of payment methods such as prepaid credit cards or cheques.

3.3. STO Observation 2: The IBAN found material omissions and errors in the STO budget execution statements and errors in the STO cash flow statement. In this respect, the Board supports the IBAN's recommendation that the STO strengthens its internal control over the preparation of the financial statements, in particular to ensure that the preparation, review and reporting process of the financial statements is fully documented and implemented¹.

3.4. IMS prior year observations in-progress: In order to close the IBAN's recommendation on temporary loans between NATO reporting entities, the IMS revised the standard operating procedure (SOP), which became effective in January 2021. This recommendation remains in-progress until the IBAN's verification of the application of the SOP. Additionally, more notable progress is still required for the IMS in the area of internal control, risk management and internal audit and on the effectiveness of the IMS risk management policy.

3.5. NDC prior year observations in-progress: More progress is still required for the NDC in the area of internal control, risk management and internal audit and on the effectiveness of the NDC risk management policy.

3.6. NDC and STO prior year open observation: As the updated internal control processes related to the temporary loans among NATO reporting entities are still not included in the written procedures for the NDC and STO this observation remains open.

¹ These misstatements were corrected in the restatement financial statements submitted to IBAN on 25 June 2021.

3.7. STO prior year closed observations: To close last year's observations, the STO prepared 2020 financial statements using consistent accounting policies and methods for its three executive entities and improved the presentation of the Budget Execution Statement and disclosure notes for Office of a Chief Scientist (OCS) and Collaboration Support Office (CSO). It also revised the note on personnel expenses and reconciled its amount in the Statement of Financial Performance. Furthermore, to close a 2017 financial year observation the STO implemented an updated workflow on the engagement of consultants in compliance with NATO Civilian Personnel Regulations (CPRs).

3.8. STO prior year observations in-progress: Regarding the observation on recognition of the fair value of STO's vessels, the IBAN found that the STO included further disclosure in its financial statements, better highlighting the status, roles and responsibilities related to the custody of the vessels. In accordance with the IBAN Audit Report (reference C) the IBAN will re-examine this observation during the course of the audit of the 2021 STO financial statements. Although some progress was noted, further improvements are still required in the area of internal control, risk management and internal audit.

3.9. Prior year observations in-progress or open for more than three years: The Board is generally concerned regarding the qualified opinions and open observations that apply to all NATO reporting entities, especially those that have remained open for more than three years. When advising on assessment of the financial statements of the IMS, NDC and STO, the Board notes that these three audit reports include unqualified audit opinions and in this case the only concern relates to one outstanding observation for the STO open for more than three years. In this respect, the Board invited the International Staff – NATO Office of Resources (IS-NOR), in coordination with IBAN, to advise the Board whether further discussion with the management/governance of this entity or more focused Board recommendations to Council are necessary to accelerate actions on this outstanding item. The following paragraph covers related in-progress observation.

3.9.1. STO prior year observation in-progress for more than three years: For the 2014 financial year, the IBAN made an observation on the improvements needed in accounting for CMRE to recognise its customer funded status and to management accounting by project. In its audit report, the IBAN states that management accounting by project has progressed during last year. However, it is not yet embedded in a coherent integrated system using formalised and traceable processes to reconcile the assessment of project progress with financial data. In particular, the reconciliation between Time Accounting (Replicon) and Project Budgets needs to be implemented. The Board note the progress made in addressing this observation; however, due to its longevity, recommends the STO to accelerate actions on this outstanding item. The Board recommends that Council invites the STO to provide a clear remedial action plan to the Council with deadlines on the implementation of the recommendation, submitted with the STO's response on the IBAN audit of the 2021 financial statements.

CONCLUSIONS

4. The IBAN Audit Reports set out unqualified opinions on the financial statements and on compliance of the IMS and NDC and on the restated financial statements and on compliance of the STO in 2020. No new observations impacted the audit opinion for the IMS, NDC and STO in 2020. Five new observations were raised for the IMS, NDC and STO. As of the date of the respective IBAN Audit Reports on the 2020 financial statements ten prior year observations for the IMS, NDC and STO were open or in-progress and four were closed.

5. The IBAN recommended that the IMS, NDC and STO disclose sufficient relevant information on the conversion of lapses into advance contribution in the notes to the financial statements on accounts impacted by this, such as payables and deferred revenue. Furthermore, the IBAN recommended the reduction of payments in cash for the NDC and strengthening of internal controls for the STO. In this regard, the Board supports the IBAN's recommendations.

6. In respect of prior year observations, the Board notes the improvements made by the IMS, NDC and STO and supports the IBAN's recommendation that the IMS, NDC and STO update written procedures regards the temporary loans among NATO reporting entities and continue with their progress in the area of internal control, risk management and internal audit and on the effectiveness of risk management policy. As regards recognition of the fair value of STO's vessels, the Board acknowledges the progress made by the STO and notes that the IBAN will re-examine this observation during the course of the audit of the 2021 STO financial statements.

7. As regards the IBAN's recommendation for the 2014 financial year to the CMRE, the Board recommends that the CMRE develop a methodology that will allow it to determine the costs (surplus of deficit) per project, including the allocation of overhead costs to individual project. In addition, the Board urges the CMRE to use all of its efforts in order to close the observation in 2021 by embedding the management accounting by project in a coherent integrated system using formalised and traceable processes to reconcile the assessment of project progress with financial data. In this respect, the Board recommends that Council invites the STO to provide an action plan to the Council with deadlines on the implementation of the recommendation, submitted with the STO's response on the IBAN audit of the 2021 financial statements.

RECOMMENDATIONS

8. The Resource Policy and Planning Board recommends that the Council:
- 8.1. note this report and the IBAN Audit Reports at references A, B and C;
 - 8.2. agree the conclusions at paragraphs 4 to 7;

8.3. invite the STO to provide an action plan to the Council with deadlines on the implementation of the outstanding recommendation, submitted with the STO's response on the IBAN audit of the 2021 financial statements; and,

8.4. agree to the public disclosure of the 2020 financial statements for the IMS and NDC, 2020 restated financial statements for the STO, their associated IBAN Audit Reports and this report in line with agreed policy at reference E.



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IBA-A(2021)0059
15 June 2021

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

Cc: NATO Permanent Representatives
Director, International Military Staff
Financial Controller, International Military Staff
Chairman, Resource Policy & Planning Board
Branch Head, Secretariat and Finance Branch, NATO Office of Resources
Private Office Registry

Subject: ***International Board of Auditors for NATO (IBAN) Audit Report on the audit of the International Military Staff's (IMS) Financial Statements for the year ended 31 December 2020 – IBA-AR(2021)0014***

IBAN submits herewith its approved Audit Report with a Summary Note for distribution to the Council.

IBAN's report sets out an unqualified opinion on the Financial Statements of the International Military Staff and on compliance for financial year 2020.

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
International Military Staff (IMS)
for the year ended 31 December 2020**

The International Military Staff (IMS) is the core military staff in NATO HQ. It is the executive body of the Military Committee (MC), NATO's senior military authority. The role of the IMS is to provide strategic military advice and staff support for the MC. The IMS is also tasked with ensuring that the policies and decisions of the MC are implemented by the appropriate NATO bodies.

The other component parts of the IMS Reporting Entity are:

- The NATO Standardisation Office (NSO), which is an independent NATO office composed of Military and Civilian staff headed by a Director. The mission of the NSO is to initiate, co-ordinate, and support and administer the standardisation activities conducted under the authority of the NATO Committee for Standardisation.
- The IMS Outreach, which includes partnership activities with nations in North Africa (Mediterranean Dialogue), the Middle East (Istanbul Cooperation Initiative), and with Afghanistan, Iraq, Pakistan and the African Union (Other Military Cooperation).

The above components are incorporated into one set of financial statements, which is the subject of this report.

The total expenses of the IMS, the NSO and Outreach Activities for the year ended 31 December 2020 were EUR 26.6 million.

IBAN issued an unqualified opinion on the financial statements and on compliance for the year ended 31 December 2020.

IBAN made one observation and recommendation. These findings are listed below and do not impact the audit opinion on the financial statements and on compliance:

1. Fair presentation of conversion of lapsed appropriations into advanced contributions

IBAN followed up on the status of observations and recommendations from the previous years' audits and found that three remain in progress.

The Audit Report was issued to the International Military Staff (IMS) whose comments have been included, with the IBAN's position on those comments where necessary.

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IBA-AR(2021)0014

11 June 2021

INTERNATIONAL BOARD OF AUDITORS FOR NATO

AUDIT REPORT ON THE FINANCIAL STATEMENTS OF THE

INTERNATIONAL MILITARY STAFF

(IMS)

FOR THE YEAR ENDED 31 DECEMBER 2020

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

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INDEPENDENT EXTERNAL AUDITOR'S REPORT TO THE NORTH ATLANTIC COUNCIL

Financial Statements

Opinion on the Financial Statements

The International Board of Auditors for NATO (IBAN) has audited the Financial Statements of IMS, for the 12 month period ended 31 December 2020, issued under document reference IMSTAM(FC)-0014-2021, and submitted to IBAN on 29 March 2021. These Financial Statements comprise the Statement of Financial Position as at 31 December 2020, 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 2020, 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 2020.

In our opinion, the Financial Statements give a true and fair view of the financial position of IMS as at 31 December 2020, and of its financial performance, its cash flows and budget execution for the 12 month period ended 31 December 2020, in accordance with accounting requirements and reporting standards consistent with the NATO Accounting Framework (NAF).

Basis for 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 2200-2899) 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 IMS 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 31st 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.

Compliance

Opinion on Compliance

Based on the procedures we performed, 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 Head of the NATO reporting entity 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, 11 June 2021



Daniela Morgante
Chair

OBSERVATIONS AND RECOMMENDATIONS

IBAN made one observation and recommendation.

This observation does not impact the audit opinion on the financial statements and on compliance:

1. Fair presentation of conversion of lapsed appropriations into advanced contributions

IBAN followed up on the status of observations and recommendations from the previous years' audits and found that three remain in progress.

The Audit Report was issued to IMS whose comments have been included, with the IBAN's position on those comments where necessary.

1. FAIR PRESENTATION OF CONVERSION OF LAPSED APPROPRIATIONS INTO ADVANCED CONTRIBUTIONS**Reasoning**

1.1 In accordance with Article 34.1 of NATO Financial Regulations (NFRs), NATO bodies shall adhere to the accounting requirements and reporting standards consistent with the NATO Accounting Framework as approved by the North Atlantic Council (NAC). The NATO Accounting Framework is an adapted version of International Public Sector Accounting Standards (IPSAS) as issued by the International Public Sector Accounting Standards Board.

1.2 In accordance with NFRs Article 6, the Director General of IMS (DGIMS) principal financial advisor is the IMS Financial Controller (FC). The IMS FC exercises in the name of the DGIMS responsibility for financial matters. Furthermore, the NFRs require the 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 NATO Accounting Framework.

1.3 According to FRP XXIX 11): *All lapsed appropriations have to be returned to the Nations. Such refunds shall be effected by deduction from the first call following submission of the financial statements.*

1.4 According to Section 1 – General Provisions, Preamble of the NFRs: *The Budget Committee may grant on specific and temporary exemption from provisions of the present FRP (Financial Rules and Procedures).*

1.5 In accordance with paragraph 27 of IPSAS 1, financial statements shall present fairly the financial position, financial performance and cash flows of an entity.

Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in IPSASs. The application of IPSASs, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.

1.6 According to paragraph 29 of IPSAS 1, in addition to compliance with applicable IPSAS, a fair presentation also requires an entity to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

Observation

1.7 In December 2020, due to the difficulties and uncertainties created by the COVID-19 pandemic, Nations decided to convert a portion of the 2020 lapsed budget appropriations into advanced contributions, for the approved NATO Command Structure Entities and Programmes (NCSEP) budget of 2021 (Ref. BC-D(2020)0176-FINAL). This decision affected the presentation of lapses and advances in the financial statements of multiple NCSEP budget holders at 31 December 2020.

1.8 IBAN noted that the presentation and disclosure of the accounting treatment of this decision differs between the 2020 financial statements of the different NCSEP budget holders. This is not consistent and may create difficulties for the users of the financial statements to compare between the financial statements of the NATO Reporting Entities concerned as prescribed by IPSAS 1.

1.9 IMS disclosed the following information in Note 8 on Deferred Revenue to the 2020 IMS Financial Statements in relation to the above: *Current deferred revenue consists mostly of advanced contributions for the next financial year, including lapses, and budget deferred revenue (carry forwards) for which corresponding expenses will be incurred after the reporting date. Exceptionally, nations have decided to convert 4.2MEUR of the 4.5MEUR lapses shown on the budget execution statement in Annex 1, to advances from the nations for 2021.*

1.10 The audit revealed that IMS did not disclose the decision described above in Note 7. This note only stated that *“The Payables to nations are appropriations that have not been spent or miscellaneous income that are due to the Nations. They include lapses, miscellaneous income from operational results, financial results and any budget over and under-calls”*. The Board considers this information as imperfect as it does not assert the specific circumstances and pronouncement thereto for the 2020 financial year in respect of the treatment of lapsed credits.

1.11 While IMS disclosed the conversion of EUR 4.2 million out of EUR 4.5 million of lapsed budget appropriations into an advance from the Nations in relation to the approved budget for 2021 in Note 8 on Deferred revenue, the information is also relevant for users of the financial statements that read Note 7 on Payables as this note

contains information on the lapsed budget appropriations that have to be returned to Nations.

Recommendation

1.12 IBAN recommends IMS to ensure, when Nations in the future decide to convert lapses directly into advanced contributions, that sufficient relevant information is disclosed in the notes to the financial statements on accounts impacted by this, such as Payables and Deferred Revenue.

FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS

IBAN followed up on the status of observations from the previous years' audit. The observations and recommendations, the 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>(1) IMS FY 2019 IBA-AR(2020)0005, paragraph 1</p> <p>EFFECTIVENESS OF THE IMS RISK MANAGEMENT POLICY</p> <p>IBAN's Recommendation IBAN recommends that IMS strengthens its risk management procedures in order to ensure their effectiveness in accordance with Article 11 of the NFRs, and subsequently requests an evaluation by the IMS Internal Auditor as per FRP XI (5) for monitoring and validation purposes.</p>	<p>A new risk management policy was approved and signed by the IMS Director General on 18 June 2020. The IMS has implemented the risk management framework, following the guidance in the policy as a standardised format across the entire organisation. The policy is defining the escalation criteria and the setup of a Risk Management Board, thereby addressing all internal audit recommendations made in 2019.</p> <p>IMS intends to request an evaluation by the IMS Internal</p>	<p>Observation In-Progress.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
	Auditor for monitoring and validation purposes in 2021.	
<p>(2) IMS FY 2019 IBA-AR(2020)0005, paragraph 2</p> <p>TEMPORARY LOANS BETWEEN NATO REPORTING ENTITIES</p> <p>IBAN's Recommendation IBAN recommends that IMS clarifies the internal control process related to the approval and payment of temporary loans, by ensuring that this process and associated loan terms and conditions are included in a written procedure approved by the IMS Director General.</p>	<p>IMS revised the standard operating procedure on budgetary and finance matters (Ref. IMSSOP-8), which was approved and signed by the IMS Director General on 4 January 2021, and which became effective on 15 January 2021.</p> <p>Since the revised standard operating procedure only became effective in 2021, the recommendation remains in progress until IBAN has verified that the approved process results in loan terms and conditions that define the duration, guarantees, and obligations associated to the temporary loans.</p>	<p>Observation In-Progress.</p>
<p>(3) ENTITY FY 2017 IBA-AR(2018)0005, paragraph 1</p> <p>IMPROVEMENTS REQUIRED IN THE AREA OF INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT</p> <p>IBAN's Recommendation a) Prepare an entity-wide risk management policy, including financial risk management, applicable throughout the organization, b) Document the internal controls and associated risks in place for main processes within the IMS operations and assess the compliance with the framework chosen,</p>	<p>a) Status: Observation Closed as per IBA-AR(2019)0008.</p> <p>b) An IMS Internal Control Framework (ICF) was prepared by the IMS office of the Financial Controller and was presented to the Audit Advisory Panel at their meeting on 8 December 2020. The IMS Internal Control Framework was formally approved and signed by the IMS Director General on 14 January 2021.</p> <p>The compliance with the framework chosen still needs to be assessed</p>	<p>Observation In-Progress.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
<p>c) Improve the disclosure of information in the Statement of Internal Controls to ensure compliance with the FRPs Article 12,</p> <p>d) Conduct an internal audit, through outsourcing if considered more appropriate, that fully evaluates the effectiveness of the system of internal control and risk management throughout the IMS.</p>	<p>during an internal audit. In preparation of this assessment, the Internal Auditor reviewed the IMS Internal Control Framework in December 2020 and mapped the existing internal controls in place, to address the associated risks, for main processes within the IMS operations, in line with the COSO guidance.</p> <p>Status: In-Progress.</p> <p>c) Status: Observation Closed as per IBA-AR(2019)0008</p> <p>d) This recommendation concerns both the system of internal control and the risk management policy of IMS.</p> <p>As per our audit report on the 2019 IMS Financial Statements (IBA-AR(2020)0005), in accordance with the 2019 internal audit plan for IMS, the NCIA internal auditor fully evaluated the effectiveness of the IMS Risk Management Policy.</p> <p>In 2020, internal audit performed a mapping exercise of existing internal controls against COSO principles in preparation of an internal audit on the effectiveness of the internal control system. In 2021, internal audit intends to further support IMS via the provision of a control self-assessment questionnaire on the effectiveness of the system of internal control and an evaluation of the answers submitted.</p> <p>Status: In-Progress.</p>	

INTERNATIONAL MILITARY STAFF (IMS) FORMAL COMMENTS ON THE AUDIT REPORT AND THE INTERNATIONAL BOARD OF AUDITORS (IBAN) POSITIONS**OBSERVATION 1:
FAIR PRESENTATION OF CONVERSION OF LAPSED APPROPRIATIONS INTO
ADVANCED CONTRIBUTIONS*****IMS' Formal Comments***

Do not fully concur.

Sufficient, relevant information to explain the conversion of lapses into advanced contributions was included in note 8 on deferred revenue to the financial statements. The notes to the Financial Statements are to be seen as a whole and as such, we deemed there was no need to disclose the same information twice, in note 7 on payables and in note 8 where it was more relevant.

IBAN's Position

IBAN considers that the information to explain the conversion of lapses into advanced contributions included in the notes to the IMS 2020 Financial Statements was not sufficient. This is because Note 7 states that *Payables to nations [...] include lapses*, without specifying that lapses converted into advanced contributions in 2020 based on BC-D(2020)0176-FINAL were not included in Payables. IBAN therefore maintains its recommendation.

FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS***IMS' Formal Comments***

Regarding the follow-up of previous years' observations, we agree to IBAN's status assessment and work towards addressing the remaining recommendations.

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.

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.



INTERNATIONAL MILITARY STAFF
ETAT-MAJOR MILITAIRE INTERNATIONAL



29 March 2021

IMSTAM(FC)-0014-2021

CHAIR, INTERNATIONAL BOARD OF AUDITORS FOR NATO (IBAN)

INTERNATIONAL MILITARY STAFF (IMS) FINANCIAL STATEMENTS 2020

1. Please find attached the 2020 International Military Staff (IMS) Financial Statements, issued in accordance with NATO Financial Regulation (NFR) Article 35.1.
2. I can confirm that, in accordance with NFR Financial Rules and Procedures (FRP) XXXV (4), the IMS 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 issued, but should be presented to Council no later than 31 August 2021 (NFR 15.2). As such, the IMS is not yet in a position to anticipate any potential representations that may be made to the RPPB, regarding the Audit Report.
5. The IMS therefore reserves its position on public disclosure of the eventual IBAN Audit Report.

RUI M.M. DA SILVA
PRTCV
Financial Controller
International Military Staff &
Science and Technology Organisation

Enclosure:

1. IMS Financial Statements FY 2020

Copy To: DIRECTOR NHQC3S, DIRECTOR CS, DIRECTOR NSO, EXCO,
MA DGIMS, FC, RECORDS

Action Officer: Ms A. MUEFFKE, Principal Administrator (Finance) to FC IMS, (4593)



INTERNATIONAL MILITARY STAFF (IMS) FINANCIAL STATEMENTS 2020



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

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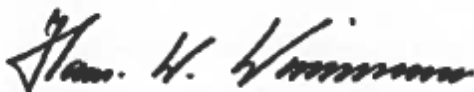
Introduction

The IMS provides strategic and military advice and staff support to the Military Committee (MC), which advises the North Atlantic Council (NAC) on military aspects of policy, operations and transformation within the Alliance. It is responsible for preparing assessments and analysis on NATO military issues, identifying areas of strategic and operational interest, and proposing courses of action. It also ensures that the appropriate NATO military bodies implement NATO decisions and policies on military matters.

The IMS 2020 Financial Statements have been prepared in accordance with the NATO Accounting Framework, based on the International Public Sector Accounting Standards (IPSAS) as adapted by NATO and the NATO Financial Regulations (NFRs). They are presented in a commonly adopted layout. The expenses are charged over three budgets covering the IMS (Budget Code – BC 301), NATO Standardization Office (NSO) (BC 302) and Outreach (BC 501). The current status of the NATO-Iraq Trust Fund is presented in Annex 2 to the financial statements. The budgetary expenses are recorded on an accrual basis, i.e. in the period in which the goods or services are delivered. Any exception to that principle is outlined in Annex 1 to the financial statements, which provides a comparison between the Budget Execution and IPSAS.

The IMS Financial Controller (FC) is also the FC of the Science and Technology Organization (STO) and the NATO Defense College (NDC). The IMS, STO and NDC are therefore related parties under a common Financial Controller.

Throughout 2020, the Military Committee supported by the International Military Staff continued to operate throughout the challenges posed by the pandemic. The NATO Military Authorities played a crucial role in countering and halting the spread of coronavirus. IMS supported the creation and approval of Operational Allied Hand and the establishment of a pandemic trust fund. While optimal delivery was hampered, NATO Headquarters Consultation, Command and Control Staff (NHQC3S) and NSO adapted and sustained activities throughout the pandemic. COVID-19 had a significant impact on the IMS Outreach Programme budget execution, partially delegated to the NDC, as the majority of the events and visits after March 2020 were cancelled. The effects of such an unpredictable event and the consequent changes in plans are clearly visible in these financial statements along with the increased amount of lapsed budget credits in 2020. Still, despite the pandemic constraints, interoperability between Allies and Partners was maintained and the key objectives of Deterrence and Defence have been achieved.



Hans-Werner Wiermann
Lieutenant General, German Army
Director General
International Military Staff



Rui M.M. da Silva
PRTC - Financial Controller

Statement on Internal Control FY 2020

The Director General, International Military Staff (DGIMS), exercises overall responsibility for IMS risk management and internal control systems, in accordance with Articles 11.1 and 12.1 of the NATO Financial Regulations (NFRs).

The IMS 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 12.2).

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 IMS 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 2020 and up to the date of these financial statements.

The systems of risk management and internal financial control are designed to manage and minimize rather than entirely eliminate risk at the IMS. Risk management and internal financial controls can therefore provide only a reasonable, but not absolute, assurance of effectiveness. The risks addressed at the IMS include risks to IMS 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 IMS provide a network of internal controls that can be assessed using the five key components of the COSO Framework:

Control Environment

The culture and ethical values of the overall control environment are established by senior management. Measures for the promotion of ethical values include: IMS participation in the NATO-wide 'Building Integrity' initiative; the promulgation of the NATO Code of Conduct to all IMS staff; and disclosures on any senior management related party transactions in our annual financial statements.

Oversight is provided by the NATO Military Committee (MC), supported by various subcommittees, who routinely scrutinize IMS Senior Management reports on strategic operational matters.

On financial matters, interim Budgetary Execution Reports are presented to and reviewed by the NATO Budget Committee twice per year. In addition, IMS financial requirements comprising the yearly budget proposals are screened and reviewed by the nations at various oversight fora.

The Audit Advisory Panel (AAP) makes periodic assessments as to whether Internal Audit is properly resourced and has the appropriate standing. It reviews, provides input to and endorsement of, internal audit planning. It reviews the findings and recommendations of Internal Audit and the IBAN, and reviews management responses and follow-up actions.

The AAP provides DGIMS with an annual report which includes an assessment on the effectiveness of risk management, internal control, and external financial reporting, along with advice and recommendations for DGIMS.

An IMS Internal Control Framework (ICF) was adopted by the Audit Advisory Panel on 8 December 2020 and approved by DGIMS on 14 January 2021. The ICF is based on COSO's Internal Control – Integrated Framework (2013).

The current management structure of the IMS was reviewed by a panel of military experts in support of the Military Committee and was re-established under the authority of the NATO Secretary General in May 2016. An internal review is currently on-going to assess the necessary changes required to the personnel structure to achieve the IMS goals and objectives. The overall structure of the IMS incorporates clearly defined responsibilities and authorities in the pursuit of operational objectives.

Risk Assessment

DGIMS has appointed a Risk Management coordinator in accordance with NFR Article 11. He has established a Risk Management Board (RMB) which shall prepare documentation for optimal decision making at the Executive Management Board (EMB). The RMB ensures that risk management is conducted thoroughly and consistently across all IMS divisions in accordance with the updated Risk Management Policy. The EMB regularly monitors actions mitigating the significant risks identified.

Control Activities

The IMS operates a 'Tasker Tracker' mechanism; the mechanism uses software to launch, monitor and control ongoing progress towards management's operational requirements, in accordance with deadlines and operational priorities.

In the financial domain, the IMS finance and accounting system (FinS) has built-in approval workflows and controls, together with audit trails. The controls are designed in order that transactions are recorded consistently, accurately and in accordance with applicable rules and regulations.

IMS leadership is supported by the Executive Management Board which meets on a routine basis to review internal processes and to inform decision making.

Information and Communication

IMS internal communications are enhanced by strong reporting lines, based on military principles. The IMS has an extensive standard operating policy on the management of information and communications. This provides for effective communications in pursuit of operational objectives.

Communication also provides for the effective functioning of internal control. The Audit Advisory Panel, for example, reports to the Director General.

The IMS communicates externally on matters affecting the functioning of internal control mechanisms via the Statement on Internal Control, which is included with

the annual financial statements. External audits include examinations of internal controls and compliance. The results of these audits are reviewed by various oversight authorities and made available to the general public along with the financial statements.

Monitoring

An outsourced Internal Audit service provider is engaged on a periodic basis, to undertake internal audit assignments. The IMS is also subject to annual external audit from the International Board of Auditors for NATO (IBAN).

Recommendations and observations arising from audits are assessed by the Audit Advisory Panel reporting to the Director General. The results are then assessed by the Executive Management Board, who initiate any appropriate actions.

The Director General of the IMS and the Financial Controller have a collective responsibility for reviewing the effectiveness of the system of internal control. Our review is informed by the above five COSO components and by the work of IMS Senior Managers, external audits and internal audits.

No significant issues regarding financial or operational matters were raised in 2020 during the IBAN external audit of the IMS Financial Statements 2019, resulting in an unqualified opinion. IBAN observed on the need for strengthening of risk management procedures and clarification of the internal control process related to the temporary shortfall of funds in IMS Budget Group entities. IMS has strengthened the IMS Risk Management Policy in 2020 and adopted an internal control framework. The standard operating procedures for budgetary and financial matters were updated for strengthening and clarification in 2020.

In 2020, the internal auditor of the NCIA Agency has mapped the internal control processes at the IMS to compare with best practice. The next step is to conduct a formal internal control self-assessment survey in order to evaluate the effectiveness of the internal control system throughout the IMS.

Overall, we are satisfied that the risk management and internal financial control systems in operation across the IMS during the year 2020 were reasonably adequate and effective, while acknowledging the need for a formally documented assessment of internal control to be undertaken in 2021.




Hans-Werner Wiermann
Lieutenant General, German Army
Director General
International Military Staff



Rui M.M. da Silva
PRTCV - Financial Controller

IMS
Statement of Financial Position
as at 31 December 2020
(in EUR)

		<u>2020</u>	<u>2019</u>
Assets			
Current Assets			
	Notes		
Cash and cash equivalents	2	14,908,730	11,025,871
Receivables	3	10,846	63,674
Prepayments	4	853,738	892,378
		<u>15,773,314</u>	<u>11,981,923</u>
Non-current Assets			
Property, plant and equipment	5	53,218	14,207
Intangible assets	6	50,469	82,797
		<u>103,687</u>	<u>97,004</u>
Total Assets		<u>15,877,001</u>	<u>12,078,927</u>
Liabilities			
Current Liabilities			
Payables	7	3,146,346	5,197,878
Deferred revenue	8	12,595,780	6,784,045
		<u>15,742,126</u>	<u>11,981,923</u>
Non-current Liabilities			
Deferred revenue	8	134,875	97,004
Total Liabilities		<u>15,877,001</u>	<u>12,078,927</u>



Hans-Werner Wiermann
Lieutenant General, German Army
Director General
International Military Staff



Rui M.M. da Silva
PRTCV - Financial Controller

The notes on pages 11 to 22 form an integral part of these financial statements.

The financial statements were issued to the International Board of Auditors for NATO on 29 March 2021.

IMS
Statement of Financial Performance
for the year ended 31 December 2020
(in EUR)

		<u>2020</u>	<u>2019</u>
	Notes		
Revenue			
Revenue	9	26,565,871	27,856,509
Total Revenue		<u>26,565,871</u>	<u>27,856,509</u>
Expenses			
Personnel	10	11,523,459	11,016,358
Contractual supplies and services	11	14,990,431	16,768,478
Depreciation and amortization	5,6	51,980	71,673
Total Expenses		<u>26,565,871</u>	<u>27,856,509</u>
Surplus/(Deficit) for the period		<u>-</u>	<u>-</u>

IMS
Cash Flow Statement
for the year ended 31 December 2020
(in EUR)

		<u>2020</u>	<u>2019</u> <u>Restated</u>
Cash Flows from operating activities	Notes		
Surplus/(Deficit) for the period		-	-
Non-cash movements			
Depreciation and amortization	5,6	51,980	71,673
(Decrease)/Increase in payables		(2,051,532)	(1,521,787)
(Decrease)/Increase in other current liabilities		5,811,735	(193,080)
(Increase)/Decrease in receivables		52,828	(8,021)
(Increase)/Decrease in other current assets		38,640	(78,497)
(Decrease)/Increase in long-term provisions		37,871	(23,261)
Net cash flows from operating activities		<u>3,941,522</u>	<u>(1,752,972)</u>
Cash flows from investing activities			
Purchase of property, plant and equipment	5	(58,663)	(48,413)
Net cash flows from investing activities		<u>(58,663)</u>	<u>(48,413)</u>
Cash flows from financing activities			
Cash out from IMS BG transfer	2	(400,000)	(1,650,000)
Cash in from IMS BG transfer		400,000	1,650,000
Net cash flows from financing activities		<u>-</u>	<u>-</u>
Net increase/(decrease) in cash and cash equivalents		<u>3,882,859</u>	<u>(1,801,385)</u>
Cash and cash equivalents at the beginning of the period		11,025,871	12,827,256
Cash and cash equivalents at the end of the period	2	14,908,730	11,025,871

IMS
Statement of Changes in Net Assets
for the year ended 31 December 2020
(in EUR)

Balance at 31 December 2018	-
Surplus/(Deficit) for the period	-
Change in net assets/equity for the year ended 2019	<u>-</u>
Balance at 31 December 2019	-
Surplus/(Deficit) for the period	-
Change in net assets/equity for the year ended 2020	<u>-</u>
Balance at 31 December 2020	<u>-</u>

Notes

1 Significant accounting policies

1.1 Basis of preparation

The IMS Financial Statements 2020 have been prepared 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 comply with the financial requirements of the NATO Financial Regulations (NFRs) and the associated Financial Rules and Procedures (FRPs) as well as with IMS directives and policies.

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

In accordance with Article 2 of the NFRs, the financial year covered by these financial statements is 1 January 2020 to 31 December 2020.

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 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. The principle accounting policies are set out below.

1.2 Accounting estimates and judgements

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.

1.3 Changes in accounting policy and standards

The same accounting policies are applied within each period and from one period to the next, unless a change in accounting policy meets one of the criteria set in IPSAS 3. For the 2020 financial statements, the accounting policies have been applied consistently throughout the reporting period. Within the cash flow statement, a presentational change has been made to show cash transfers within the IMS Budget Group which have a net effect of zero.

1.4 Changes in pronouncements

At the date of authorisation of these financial statements, the IMS has not applied the following new and revised IPSAS that have been issued but are not yet effective. The effective dates of the following have been deferred due to COVID-19:

- IPSAS 41 Financial Instruments
- IPSAS 42 Social Benefits
- Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)
- Collective and Individual Services (Amendments to IPSAS 19)
- Improvements to IPSAS, 2019

It is not expected that the adoption of these standards will have a material impact on the financial statements of the IMS in future periods.

1.5 Foreign currency transactions

These financial statements are prepared in euro, which is the functional and reporting currency of the IMS. Foreign currency transactions are accounted for at the NATO exchange rates prevailing on the transaction date in the general ledger. Monetary assets and liabilities at year-end which were denominated in foreign currencies are assessed for materiality and if material are translated into euro using the applicable NATO exchange rates as at 31 December 2020. Realized and unrealized gains and losses resulting from the settlement of such transactions and from the revaluation at the reporting dates of monetary assets and liabilities denominated in foreign currencies are recognized in the Statement of Financial Position and Performance. An assessment was made of all assets and liabilities in foreign currencies as at 31 December 2020. The amount of unrealized gains is deemed immaterial.

1.6 Consolidation

Consolidated financial statements include the financial results of the controlling entity and its controlled entities.

While Morale and Welfare activities are under the control of the head of the NATO body, in accordance with the NATO Accounting Framework departure from IPSAS 6, they have not been consolidated into these financial statements. A separate activity report is submitted to the Budget Committee as required by the NFRs, and summary information is presented in Note 14.

1.7 Services in-kind

The IMS received services in-kind in the form of military personnel provided by the NATO nations. Such personnel are assigned to specific, military positions on the Peacetime Establishments (PE) of the IMS (see Note 10). In these financial statements, services in-kind are recognized neither as revenue nor as an asset.

1.8 Financial instruments

The IMS uses only non-derivative financial instruments as part of its normal operations. These financial instruments include: cash, bank accounts, deposit accounts, accounts receivable, provisions and cash transfers between NATO entities.

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

Credit Risk: In the normal course of business, the IMS incurs credit risk from trade receivables and transactions with banking institutions. The IMS 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 2020 is equal to the total amount of bank balances, short-term deposits, and receivables disclosed in the statement of financial position. Receivables considered uncollectible are adequately provided for. There is a very limited credit risk associated with the realization of these instruments.

Currency risk: The IMS' exposure to foreign currency exchange risk is very limited, as most transactions are in euros.

Liquidity risk: The liquidity risk is based on the assessment of whether the organization will encounter difficulties in meeting its obligations associated with financial liabilities. There is a very limited exposure to liquidity risk because the budget funding mechanism guarantees contributions in relation to approved budgets. The accuracy of forecasting cash requirements as well as the delay in payment represent the main liquidity risk.

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

1.9 Leases

Leases are classified as finance leases whenever the terms of the lease transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under lease contracts are recognized as an expense in the statement of financial performance on a straight line basis over the lease term.

1.10 Cash and cash equivalents

Cash and cash equivalents are defined as short-term assets. They include current bank accounts, deposits held with banks, pre-paid credit cards and other short term highly liquid investments.

1.11 Receivables

Receivables are stated at net realizable value, after provision for doubtful and uncollectible debts.

Contributions receivable are recognized when a call for contribution has been issued to the member nations. No allowance for loss is recorded with respect to member countries' assessed contributions receivable except for exceptional and agreed technical reasons.

1.12 Prepayments

Prepayments and deposits are payments to suppliers, employees and other NATO entities in advance of the period to which they pertain.

1.13 Property, plant and equipment

Property, plant and equipment with finite useful lives that are acquired separately are carried at initial cost less accumulated depreciation and any recognized impairment losses. Depreciation is recognized on a straight-line basis over their estimated useful lives. Full depreciation is charged in the month of acquisition and nil in the month of disposal. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period with the effect of any changes in estimate accounted for on a prospective basis. Property, plant and equipment is derecognized upon disposal or when no future economic benefit is expected. The cost and any related accumulated depreciation are removed from the accounting records.

1.14 Intangible assets

Intangible assets with finite useful lives that are acquired separately are carried at initial cost less accumulated amortization and any recognized impairment losses. Amortization is recognized on a straight line basis over their estimated useful lives. Full amortization is charged in the month of acquisition and nil in the month of disposal. The estimated useful lives, residual values and amortization method are reviewed at the end of each reporting period with the effect of any changes in estimate accounted for on a prospective basis. Intangible assets are derecognized when no future economic benefit is expected. The cost and any related accumulated amortization are removed from the accounting records.

1.15 Impairment of tangible and intangible assets

The carrying values of non-current assets are reviewed for impairment when events or changes in circumstances indicate that they may be not recoverable. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Any provision for impairment is charged against the statement of financial performance in the year concerned.

1.16 Payables

Payables (including amounts due to other NATO entities) are initially recognized at their fair value and subsequently measured at amortized cost. This includes estimates of accrued obligations for goods and services received but not yet invoiced.

1.17 Deferred revenue and advances

Deferred revenue represents contributions from nations and/or third parties that have been called for current or prior years budgets but that have not yet been recognized as revenue. Funds are called in advance of their need because the entity has no capital that would allow it to pre-finance any of its activities. Advances are contributions called or received related to future budgets.

1.18 Employee benefits – Post-employment benefits

IMS civilian employees either participate in the Defined Contribution Pension Scheme (DCPS) or the Coordinated Pension Scheme (NATO Defined Benefit Plan).

The assets and liabilities for all NATO post-employment benefit schemes are accounted for centrally at NATO Headquarters by the International Staff and therefore are not recognized in these financial statements.

Defined Contribution plan: The assets of the plan are held separately from those of IMS in funds under the control of independent trustees or an Administrator. The IMS is required to contribute a specified percentage of payroll costs to the DCPS to fund the benefits. Payments to the DCPS are recognized as an expense when employees have rendered service entitling them to the contributions. The only obligation of IMS with respect to the DCPS is to make the specified contributions.

Defined Benefit plan: Employees who joined NATO before 1 July 2005 are members of the NATO Coordinated Pension Scheme which is a funded defined benefit plan. Under the plan and 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. Staff members whose length of service is not sufficient to entitle them to a retirement pension are eligible for a leaving allowance.

Continued Medical Coverage: Some qualifying retirees may also benefit from Continued Medical Coverage (CMC).

1.19 Revenue recognition

Revenue comprises contributions from member nations and other customers to fund the entity's budgets. It is recognized as revenue in the Statement of Financial Performance in the year for which the contributions are used for their intended purpose as envisioned by the budgets. The balance of unspent contributions and other revenues that relate to future periods are deferred accordingly. 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.

Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the entity recognizes a liability until the condition is fulfilled.

1.20 Financial result

The financial result represents the net of bank interest earned, bank charges incurred and exchange rate gains and losses due to transactions in foreign currency. It is recognized as a payable to nations in order to return it to the nations.

1.21 Trust funds

The IMS manages the NATO-Iraq Trust Fund on behalf of the contributing nations. NATO recognizes an asset when it controls access to the asset and gains economic benefit or service potential but matches this to an equal liability. In its Statement of Financial Performance, the IMS does not recognize any expenditure or revenue in relation to the trust funds which it does not control.

2 Cash and cash equivalents

(in EUR)	<u>2020</u>	<u>2019</u>
Petty cash	-	700
Advances	20,000	15,000
Current bank accounts IMS	13,756,627	10,498,478
Current bank accounts NATO-Iraq Trust	138,780	138,780
Cash equivalents	993,324	372,914
Total Cash and Cash Equivalents	<u>14,908,730</u>	<u>11,025,871</u>

Cash and cash equivalents are short-term liquid assets. Deposits are held in interest bearing bank accounts in immediately available funds. Cash holdings are largely determined by the timing of receipts from the nations, which arrive in two instalments, generally in April and December.

Cash equivalents are held in euros and are funds invested on a short term deposit or business account.

During the year, cash transfers amounting to 400,000 EUR (2019: 1,650,000 EUR) were provided to other entities in the IMS Budget Group in order to cover temporary shortfalls of funds related to the calls for contributions. As at 31 December 2020 all of these cash transfers have been repaid. Within the cash flow statement, a presentational change has been made to show cash transfers within the IMS Budget Group, which have a net effect of zero.

3 Receivables

(in EUR)	<u>2020</u>	<u>2019</u>
Accrued revenue	456	410
Receivables from third parties	10,389	63,264
Total Receivables	<u>10,846</u>	<u>63,674</u>

Accrued revenue consists of bank interest earned in 2020, but for which the cash is received in 2021.

Receivables from third parties include several invoices for procurement and services on behalf of third parties. Most of the balance is for a VAT reimbursement on the purchase of a new vehicle.

4 Prepayments

(in EUR)	2020	2019
Prepaid expenses	157,550	229,378
Advances and prepayments to suppliers	696,188	663,000
Total Prepayments	853,738	892,378

The most significant element of prepaid expenses is the 2021 portion of the instalments for education allowances that cover the entire school year 2020-2021. The advances relate to the provision of contractually agreed working capital for research projects.

5 Property, plant and equipment

(in EUR)	2020	2019
Cost opening balance	315,961	358,880
Additions	58,663	-
Disposals	(39,634)	(42,919)
Cost closing balance	334,990	315,961
Accumulated depreciation opening balance	301,754	326,473
Current year depreciation	19,652	18,201
Retired depreciation	(39,634)	(42,919)
Accumulated depreciation closing balance	281,773	301,754
Net Carrying Amount	53,218	14,207

The useful life of the vehicles used in the calculation of depreciation is 5 years. The depreciation charge for the year was 19,652 EUR (2019: 18,201 EUR).

In 2020, other than the two vehicles shown in the above table there are no write-offs or disposals of property that meet the disclosure criteria in the NATO Financial Regulations. Proceeds of sale of property plant and equipment amounting to 6,360 EUR were realised in 2020 (2019: 4,793 EUR). They are included under payables to nations to be reimbursed via the call for contribution in the following year.

6 Intangible assets

(in EUR)	Software	
	2020	2019
Cost opening balance	409,043	360,630
Additions	-	48,413
Disposals	-	-
Cost closing balance	409,043	409,043
Accumulated amortization opening balance	326,246	272,773
Current year amortization	32,328	53,473
Accumulated amortization closing balance	358,573	326,246
Net Carrying Amount	50,469	82,797

The useful life of software systems used in the calculation of amortization is 4 years.

The amortization charge for the year was 32,328 EUR (2019: 53,473 EUR).

In general, software is considered to be internally developed, however an assessment is made for each individual case to determine whether the asset can be considered as acquired off-the-shelf.

In 2020, no intangible assets were purchased (2019: 48,413 EUR).

7 Payables

(in EUR)	2020	2019
Payables to suppliers	334,493	586,376
Accruals	2,363,639	3,180,356
Payables to nations	413,791	1,429,049
Other payables	34,423	2,097
Total Payables	3,146,346	5,197,878

Payables are short-term liabilities to third parties directly related to the activities and operations of the IMS. The average credit period on purchases is 30 days. The IMS has financial risk management policies in place to ensure that all payables are paid within the pre-agreed credit terms.

Accruals are mainly related to goods and services received on the scientific projects of the IMS.

The Payables to nations are appropriations that have not been spent or miscellaneous income that are due to the nations. They include lapses, miscellaneous income from operational results, financial results and any budget over and under-calls.

8 Deferred revenue

(in EUR)	<u>2020</u>	<u>2019</u>
Deferred revenue - carry forwards	457,000	145,265
Deferred revenue - trust funds	138,780	138,780
Advanced contributions for next year	12,000,000	6,500,000
Total current deferred revenue	<u>12,595,780</u>	<u>6,784,045</u>
Investment in PPE and intangible assets	134,875	97,004
Total non-current deferred revenue	<u>134,875</u>	<u>97,004</u>
Total deferred revenue	<u>12,730,655</u>	<u>6,881,050</u>

Current deferred revenue consists mostly of advanced contributions for the next financial year, including lapses, and budget deferred revenue (carry forwards) for which corresponding expenses will be incurred after the reporting date. Exceptionally, nations have decided to convert 4.2MEUR of the 4.5MEUR lapses shown on the budget execution statement in Annex 1, to advances from the nations for 2021.

The deferred revenue for trust funds is the corresponding liability for the cash received by nations to fund the NATO-Iraq Trust Fund (see Annex 2).

Non-current deferred revenue represents the net carrying amount of property, plant and equipment and intangible assets as at 31 December 2020. The revenue will be recognized in the year when the depreciation and amortization expense will be recognized.

9 Revenue

(in EUR)	<u>2020</u>	<u>2019</u>
Revenue from contributions	26,513,890	27,784,836
Revenue released from deferred revenue	51,980	71,673
Total Revenue	<u>26,565,871</u>	<u>27,856,509</u>

Revenue from contributions is revenue received from the member nations to cover the operational expenses of the IMS.

Revenue released from deferred revenue represents revenue released in respect of property, plant and equipment depreciation and amortization of intangible assets.

10 Personnel expenses

Employees are compensated for the service they provide in accordance with rules and amounts established by NATO. The compensation consists of basic salary, various allowances, health insurance, pension plan and other benefits as agreed with each host nation and the protocols of NATO.

Peacetime Establishment (PE):

	Approved PE - IMS	Filled Positions - IMS	Approved PE - NSO	Filled Positions - NSO	Approved PE - IMS and NSO	Positions - IMS and NSO
Civilians (MBC)*	86	78	16	15	102	93
Military	317	282	26	22	343	304
Voluntary National Contribution (VNC)	21	18	-	-	21	18
IS-CIV VNC	25	22	-	-	25	22
National Manpower Overage (NMO)	23	23	-	-	23	23
Host Nation	2	1	-	-	2	1
PFP	11	7	2	1	13	8
Local Wage Rate (LWR)	1	1	-	-	1	1
Civilians (CBC)	16	10	-	-	16	10
Twinned posts (TP)**	4	4	2	1	6	5
Total Ceiling posts	402	360	42	37	444	397
Total Posts	505	446	46	39	551	485

* 1 additional post as result of the application of SMAP-18 (Manpower Guidelines for the Temporary Filling of Established Military NU Posts with NICs. SMAP 18 provides a procedure by which commanders can seek to fill military NU mission essential posts with NICs on a temporary basis - MC-0216-4(AAP-16(D)) approved with IMS PE Change 4 2019

** A twinned post is a post on a Peacetime Establishment (PE) which combines two or more separate posts on one or more PEs where the respective workload does not justify the presence of an incumbent for each post. When two or more International posts are linked as "twinned posts", only one is counted in the International Manpower Ceiling. (MC-0216-4(AAP-16(D)))

The breakdown of salaries and other personnel related expenses is as follows:

(in EUR)	2020	2019
Employment of personnel	10,899,209	10,424,538
Recruitment and separation	87,996	50,744
Clothing	1,200	1,200
Training	36,466	100,139
Post-employment benefits	498,589	439,737
Total expenses	11,523,459	11,016,358

Untaken leave: The balance of untaken leave at the end of 2020 was 1074 days (2019: 576 days) for IMS and 108 days (2019: 93 days) for NSO. The associated cost is recognized as an accrual. The increase in untaken leave is due to the impact of COVID-19 measures and restrictions.

11 Contractual supplies and services

Contractual supplies and services are expenses required for administrative support to the Military Committee. General support expenses mainly include costs for facility and infrastructure operation and maintenance, while mission support is mainly costs for CIS and scientific research contracts. The expenses are further broken down as follows:

(in EUR)	<u>2020</u>	<u>2019</u>
General support	3,512,576	3,761,839
Mission support	10,958,053	11,304,625
Travel transportation	181,362	754,940
Grants and subsidies	336,515	932,025
Miscellaneous costs	1,925	15,049
Total expenses	<u>14,990,431</u>	<u>16,768,478</u>

Operating leases: All leases of the IMS are cancellable and are recognized as an expense on a straight-line basis over the lease term. They have been classified as operating leases as they do not transfer substantially all the risks and rewards incidental to ownership. The classification has been based on the fact that the ownership is not transferred by the end of the lease term, the lease term does not cover the majority of the item's estimated economic life and the leases do not contain a bargain purchase option.

In 2020 the IMS had one contract for lease of a vehicle with an annual cost of 79,200 EUR (2019: 79,200 EUR).

12 Related parties

The key management personnel includes: the Director General IMS, Directors, and the Financial Controller. They are all rotated, typically every three years, and with the exception of the Financial Controller, have only management oversight of routine operating and maintenance activities. The detailed work related to these tasks tends to be undertaken by staff officers. The IMS Financial Controller is also the Financial Controller of the Science and Technology Organization (STO) and the NATO Defense College (NDC), forming together the IMS Budget Group. The IMS, STO and NDC are therefore related parties under a common Financial Controller.

The other key management personnel of the entity have no significant known related party relationships that could affect the operation of this reporting entity. Key management are remunerated in accordance with the applicable national or NATO pay scales. They do not receive from NATO any additional remuneration for Board responsibilities or access to preferential benefits such as the entitlement to receive loans over and above those available to all NATO personnel under normal rules.

During the year, the IMS entered into transactions with NATO entities outside the IMS Budget Group. The fees charged for these transactions were an appropriate allocation of the costs incurred.

13 Representation Allowance

Representation Allowance is available to certain designated NATO high level officials whose position entails responsibility for maintaining relationships of value to NATO. In 2020, three senior IMS officials received Representation Allowances.

The total entitlement was 39,000 EUR (2019: 39,000 EUR) and the actual expenses were 15,739 EUR (2019: 31,502 EUR). The decrease in actual expenses is due to the impact of COVID-19 measures and restrictions.

14 Morale and Welfare Activities

The IMS carried out Morale and Welfare Activities (MWA) in 2020 for which a detailed annual special purpose report is presented to the Budget Committee. Morale and Welfare Activity is an activity of a NATO body that enhances the quality of life, promotes cohesion and integrity, and/or contributes to the physical and mental wellbeing of eligible individuals. At the IMS, the MWA mainly relate to the sale of petrol products, rationed items and the language training centre.

The position of MWA at year-end is:

(in EUR)	2020
Cash and cash equivalents	52,742
Total liabilities including provisions and contingent liabilities	28,458

As of year-end, no full-time equivalent staff directly support the MWA.

Four staff support the MWA as a minor part of their duties. The total extent of their MWA responsibilities amounts to less than one part-time equivalent.

15 Events after reporting date

There have been no other material events between the reporting date and the date the financial statements are authorized for issue that would affect the amounts recognized in these financial statements.

IMS
Budget Execution Statement
for the year ended 31 December 2020
(in EUR)

	Initial Budget	Transfers	BA2	Transfers	BA3	Transfers	Final Budget	Commitments	Expenses	Total Spent	Carry Forward	Lapsed
BUDGET 301 (IMS) 2020												
Chapter 1	9,426,417	350,000	9,776,417	-	9,776,417	-	9,776,417	-	9,735,566	9,735,566	-	40,851
Chapter 2	17,411,369	- 350,000	17,061,369	-	17,061,369	-	17,061,369	457,000	13,461,460	13,918,460	457,000	3,142,909
Chapter 3	60,000	-	60,000	-	60,000	-	60,000	-	31,188	31,188	-	28,812
TOTAL	26,897,786	-	26,897,786	-	26,897,786	-	26,897,786	457,000	23,272,664	23,685,213	457,000	3,212,573
BUDGET 302 (NSO) 2020												
Chapter 1	1,789,203	-	1,789,203	-	1,789,203	-	1,789,203	-	1,758,370	1,758,370	-	30,833
Chapter 2	1,219,650	-	1,219,650	-	1,219,650	-	1,219,650	-	1,084,885	1,084,885	-	134,765
TOTAL	3,008,853	-	3,008,853	-	3,008,853	-	3,008,853	-	2,843,255	2,843,255	-	165,599
BUDGET 501 (OTRCH) 2020												
Chapter 1	159,690	-	159,690	-	159,690	-	159,690	-	29,524	29,524	-	130,166
Chapter 2	1,404,310	-	1,404,310	-	1,404,310	-	1,404,310	-	357,484	357,484	-	1,046,826
TOTAL	1,564,000	-	1,564,000	-	1,564,000	-	1,564,000	-	387,008	387,008	-	1,176,992
TOTAL FY2020	31,470,639	-	31,470,639	-	31,470,639	-	31,470,639	457,000	26,502,927	26,915,476	457,000	4,555,163
BUDGET 301 (IMS) 2019												
Chapter 2	86,602	-	86,602	-	86,602	-	86,602	-	86,602	86,602	-	-
Chapter 3	58,663	-	58,663	-	58,663	-	58,663	-	58,663	58,663	-	-
TOTAL	145,265	-	145,265	-	145,265	-	145,265	-	100,815	145,266	-	-
TOTAL FY2019	145,265	-	145,265	-	145,265	-	145,265	-	100,815	145,266	-	-
TOTAL ALL BUDGETS	31,615,904	-	31,615,904	-	31,615,904	-	31,615,904	457,000	26,603,742	27,060,742	457,000	4,555,163

The budget covers the financial year from 1 January 2020 to 31 December 2020 and includes the following budgets: 301 (IMS), 302 (NSO) and 501 (Outreach). The initial budget and subsequent revisions are reviewed and issued by the Budget Committee.

In accordance with the NFRs, all changes between the initial and the final budget due to transfers of appropriations were either authorized by the Budget Committee, or were within the authority of the IMS Financial Controller. These changes are presented in the Budget

Execution Statement. The lapses are mainly due to delays in the Chief Information Office (CIO) programme of work, lower than expected SLA occupancy costs and reduced travel and hospitality due to COVID-19 restrictions.

The credits carried forward are presented in the Budget Execution Statement as required by the NATO Financial Regulations and the FRPs. They represent the unexpended balances at year-end for which there is a legal liability or a Budget Committee decision and are equal to the deferred revenue – carry forwards (see Note 8).

The budget and the financial statements are not prepared on the same basis. In the financial statements only current year depreciation/amortization is recognized as an expense, while in the budget all non-current assets are fully expensed during the year. The following table summarizes the differences:

(in EUR)	<u>2020</u>	<u>2019</u>
Total expenses, Statement of Financial Performance	26,565,871	27,856,509
Capital and investments	89,851	-
Contractual supplies and services	-	48,413
Depreciation and amortization	(51,980)	(71,673)
Total expenses, Budget Execution Statement	<u>26,603,742</u>	<u>27,833,249</u>

Of the 89,851 EUR capital and investment additions, 58,663 EUR relates to property, plant and equipment additions in 2020, and 31,188 EUR relates to the prepayment of a 2021 addition.

NATO-Iraq Trust Fund
Status as at 31 December 2020
(in EUR)

Fiscal Year	In-country courses	Out-of-country courses			Total
	Expenses	Expenses	Slots offered	Slots taken	
2005	133,235	1,494,235	123	200	1,627,470
2006	966,684	1,355,890	444	253	2,322,574
2007	745,024	1,230,390	223	197	1,975,414
2008	2,900,068	1,105,880	230	208	4,005,948
2009	200,557	1,263,332	220	208	1,463,889
2010	218,647	1,737,842	412	336	1,956,489
2011	44,135	1,733,875	468	420	1,778,010
2012	-	23,366	23	15	23,366
2013	-	176,359	42	42	176,359
2014	-	10,340	-	-	10,340
2015	-	301,817	62	62	301,817
2016	-	1,565,362	340	268	1,565,362
2017	-	55,568	4	4	55,568
2018	-	99,180	7	7	99,180
2019	-	42,345	4	4	42,345
2020	-	-	-	-	-
Total	5,208,350	12,195,781			17,404,131
NATO-IRAQ Trust Fund - Status as at 31 December 2020					
Fund donated					17,176,421
Interest earned (net of finance costs)					366,490
Fund used					17,404,131
Fund available					138,780

Note: In 2020 there were no expenses. The funds available are equal to the cash as at 31 December 2020.



NORTH ATLANTIC TREATY ORGANIZATION
ORGANISATION DU TRAITÉ DE L'ATLANTIQUE NORD
INTERNATIONAL BOARD OF AUDITORS
COLLÈGE INTERNATIONAL DES AUDITEURS EXTERNES DE L'OTAN

NATO UNCLASSIFIED

IBA-A(2021)0060
15 June 2021

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

Cc: NATO Permanent Representatives
Commandant, NATO Defense College
Financial Controller, International Military Staff
Head Budget & Finance Branch, NATO Defense College
Chairman, Resource Policy & Planning Board
Branch Head, Secretariat and Finance Branch, NATO Office of Resources
Private Office Registry

Subject: ***International Board of Auditors for NATO (IBAN) Audit Report on the audit of the NATO Defense College's (NDC) Financial Statements for the year ended 31 December 2020 – IBA-AR(2021)0015***

IBAN submits herewith its approved Audit Report with a Summary Note for distribution to the Council.

IBAN's report sets out an unqualified opinion on the Financial Statements of the NATO Defense College and on compliance for financial year 2020.

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
NATO Defense College (NDC)
for the year ended 31 December 2020**

The International Board of Auditors for NATO (IBAN) audited the NATO Defense College (NDC), which is responsible for organising courses and other programmes designed to prepare selected officers and officials for important NATO and NATO-related appointments, and to disseminate awareness of NATO initiatives and interests. The total expenses of NDC for the year ended 31 December 2020 were EUR 8.75 million.

IBAN issued an unqualified opinion on the financial statements and on compliance for the year ended 31 December 2020.

IBAN made two observations and recommendations. These findings are listed below and do not impact the audit opinion on the Financial Statements and on compliance:

1. NDC needs to reduce the use of physical cash
2. Fair presentation of Financial Statements and Budget Information

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

The Audit Report was issued to the NATO Defense College (NDC) whose comments have been included, with the IBAN's position on those comments where necessary.

The observations and recommendations and the follow-up of the previous years' observations and recommendations that are not in the Audit Report are included in a Management Letter addressed to the NATO Defense College (NDC) management. This is because IBAN considers that these matters are to be addressed by Management and therefore fall under the NATO Defense College (NDC) executive responsibility.

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IBA-AR(2021)0015

11 June 2021

INTERNATIONAL BOARD OF AUDITORS FOR NATO

AUDIT REPORT ON THE FINANCIAL STATEMENTS OF THE

NATO DEFENSE COLLEGE

(NDC)

FOR THE YEAR ENDED 31 DECEMBER 2020

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

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

The International Board of Auditors for NATO (IBAN) has audited the Financial Statements of NATO Defense College (NDC), for the 12 month period ended 31 December 2020, issued under document reference IMSTAM (FC)-0011-2021 REV2, and submitted to IBAN on 30 March 2021. These Financial Statements comprise the Statement of Financial Position as at 31 December 2020, 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 2020, 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 2020.

In our opinion, the Financial Statements give a true and fair view of the financial position of the NATO Defense College (NDC) as at 31 December 2020, and of its financial performance, its cash flows and budget execution for the 12 month period ended 31 December 2020, in accordance with accounting requirements and reporting standards consistent with the NATO Accounting Framework (NAF).

Basis for 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 2200-2899) 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 NATO Defense College (NDC) 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 31st 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.

Compliance

Opinion on Compliance

Based on the procedures we performed, 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 Head of the NATO reporting entity 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, 11 June 2021



Daniela Morgante
Chair

OBSERVATIONS AND RECOMMENDATIONS

IBAN made two observations and recommendations.

These observations do not impact the audit opinion on the financial statements and on compliance:

1. NDC needs to reduce the use of physical cash
2. Fair presentation of Financial Statements and Budget Information

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

The Audit Report was issued to NDC whose comments have been included, with the IBAN's position on those comments where necessary.

The observations and recommendations and the follow-up of the previous years' observations and recommendations that are not in the Audit Report are included in a Management Letter addressed to NDC management. This is because IBAN considers that these matters are to be addressed by Management and therefore fall under NDC executive responsibility.

1. NDC NEEDS TO REDUCE THE USE OF PHYSICAL CASH

Reasoning

1.1 According to the Article 3 of the NATO Financial Regulations (NFRs), *the Secretary General, the Supreme Commanders and the other Heads of NATO bodies are responsible and accountable for sound financial management and shall put in place the necessary governance arrangements to ensure and maintain this. This shall include, but is not limited to, the establishment and maintenance of financial governance, resource management practices, internal controls and financial information systems to achieve the efficient and effective use of resources.*

1.2 As per the article 4.d paragraph 5 of the NDC Standard Operating Procedure (SOP111), *In line with NATO and HN guidance, the primary option for payments/collections is processing through bank transfer or other traceable instruments (cheque – credit/debit cards), limiting cash transactions to duly justified reasons only.*

Observation

1.3 Each year, NDC pays subsidised fees to its course members. Financial support for subsidised members attending the Senior Course can cover transportation, accommodations, meals, field studies and travel accommodation. At the end of every

course, an overview of all expenses incurred is made and every three months an invoice is sent to International Military Staff (IMS) to request funding from the IMS outreach budget.

1.4 NDC paid in cash subsidisation fees of EUR 206,671 to its course members during the financial year 2020. Payments amounted to EUR 1.6 million during the financial year 2019. Payments of EUR 1.6 million in 2019 included internal accounting adjustments conducted via the cash account. The decrease observed in cash payments in 2020 is also due to lower activity and cancellation of NDC activities related to field studies following COVID-19 restrictions. When NDC is operating in normal conditions, the level of payments made in cash remains high.

1.5 According to NDC, this long-standing practice of making payments in cash is explained by the fact that course members encounter difficulties to open a bank account when they arrive to join courses. Although difficulties still remain due to administrative constraints experienced by some of NDC's beneficiaries, NDC agrees that use of cash must be limited to the furthest extent. In the future, the intent is to reduce payments in cash and in the longer term to replace them by cheques or credits cards.

1.6 The payment of subsidised fees in cash to course members are documented and based on supporting evidence (invoices, contracts, etc.) submitted to the NDC Budget and Finance Branch by the beneficiaries. Internal controls are in place with a double review of amounts paid, the existence of a cash register, and the recording of payments in the accounting system.

1.7 Nevertheless, IBAN believes that holding and managing this level of cash increases the risks of errors and fraud. Moreover, handling high level of cash is time consuming and requires strict procedures such as the physical counting of cash regularly. NDC therefore needs to put in place modern and more reliable procedures for payment of subsidies.

Recommendation

1.8 Given the College's significant level of payments in cash, IBAN recommends that NDC ensure a sound financial management of cash and mitigate the risk of errors and fraud by reducing the level of payments made in cash of subsidised fees and introducing other type of payment methods (prepaid credits cards, cheques).

2. FAIR PRESENTATION OF FINANCIAL STATEMENTS AND BUDGET INFORMATION

Reasoning

2.1 In accordance with Article 34.1 of NFRs, NATO bodies shall adhere to the accounting requirements and reporting standards consistent with the NATO

Accounting Framework (NAF) as approved by the North Atlantic Council (NAC). The NAF is an adapted version of International Public Sector Accounting Standards (IPSAS) as issued by the International Public Sector Accounting Standards Board.

2.2 Furthermore, the NFRs require the Financial Controller 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 NATO Accounting Framework.

2.3 According to Financial Rules and Procedures (FRP) XXIX 11): *All lapsed appropriations have to be returned to the Nations. Such refunds shall be effected by deduction from the first call following submission of the financial statements.*

2.4 According to Section 1 – General Provisions, Preamble of the NFRs: *The Budget Committee may grant on specific and temporary exemption from provisions of the present FRP.*

2.5 In accordance with paragraph 27 of IPSAS 1, financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in IPSASs. The application of IPSASs, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.

2.6 According to paragraph 29 of IPSAS 1, in addition to compliance with applicable IPSAS, a fair presentation also requires an entity to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

Observation

2.7 In December 2020, due to the difficulties and uncertainties created by the COVID-19 pandemic, Nations decided to convert a portion of the 2020 lapsed budget appropriations into advanced contributions, for the approved NATO Command Structure Entities and Programmes (NCSEP) budget of 2021 (Ref. BC-D(2020)0176-FINAL). This decision affected the presentation of lapses and advances in the financial statements of multiple NCSEP budget holders at 31 December 2020.

2.8 IBAN noted that the presentation and disclosure of the accounting treatment of this decision differs between the 2020 financial statements of the different NCSEP budget holders. This is not consistent and may create difficulties for the users of the financial statements to compare between the financial statements of the NATO Reporting Entities concerned as prescribed by IPSAS 1.

2.9 NDC disclosed the following information in Note 7 on Deferred Revenue and Advances to the 2020 NDC Financial Statements in relation to the above: *Current deferred revenue consists mostly of budget deferred revenue or advanced contributions for the next financial year, but for which corresponding expenses will be incurred after the reporting date. Exceptionally, nations have decided to convert 1.56MEUR of the 2.0MEUR lapses shown on the budget execution statement in Annex 1, to advances from the nations for 2021. Advance contributions will be deducted from the 1st assessment call for 2021.*

2.10 NDC did not disclose the decision described above in Note 6 on Payables. This note states that: *Within payables, presentational changes have been made. As of 2020 liabilities from operational results, from financial results and from lapses have been moved out of deferred revenue and included under payables to nations. The comparative balances for 2019 have been restated accordingly. Payables to nations will be offset in the 2nd assessment call for 2021.* IBAN considers this information as imperfect as it does not assert the specific circumstances and pronouncement thereto for the 2020 financial year in respect of the treatment of lapsed credits.

2.11 While Note 7 on Deferred Revenue and Advances does disclose the conversion of EUR 1.6 million of lapsed budget appropriations into an advance from Nations for the approved budget of 2021, this information is also relevant for users of the financial statements that read Note 6 on Payables as this note contains information on the lapsed budget appropriations that have to be returned to Nations.

Recommendation

2.12 IBAN recommends NDC to ensure, when Nations in the future decide to convert lapses directly into advanced contributions, that sufficient relevant information is disclosed in the notes to the financial statements on accounts impacted by this, such as Payables and Deferred Revenue and Advances.

FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS

IBAN followed up on the status of observations from the previous years' audit. The observations and recommendations, the 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>(1) NDC FY 2019 IBA-AR(2020)0006, paragraph 1</p> <p>EFFECTIVENESS OF THE NDC RISK MANAGEMENT POLICY</p> <p>IBAN's Recommendation IBAN recommends that NDC strengthens its risk management procedures in order to ensure their effectiveness in accordance with Article 11 of the NFRs, and subsequently requests an evaluation by the NDC Internal Auditor as per FRP XI (5) for monitoring and validation purposes.</p>	<p>NDC did not update its risk register to include for each risk, the scoring, evaluation of impact and likelihood, the definition of mitigating actions, owners, actioners, and deadlines for implementation. NDC has not yet requested an evaluation by an internal auditor for monitoring and validation purposes in accordance with the FRPs.</p>	<p>Observation In-Progress.</p>
<p>(2) NDC FY 2019 IBA-AR(2020)0006, paragraph 2</p> <p>TEMPORARY LOANS BETWEEN NATO REPORTING ENTITIES</p> <p>IBAN's Recommendation IBAN recommends that NDC clarifies the internal control process 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 NDC Commandant.</p>	<p>NDC did not issue a written procedure approved by the NDC Commandant regarding temporary loans between NATO Reporting Entities.</p>	<p>Observation Open.</p>
<p>(3) NDC FY 2017 IBA-AR(2018)0006, paragraph 1</p> <p>IMPROVEMENTS REQUIRED IN THE AREA OF INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT</p> <p>IBAN's Recommendation IBAN recommends NDC to document the internal controls and associated risks in place for the main processes within NDC operations and assess the compliance with the framework chosen.</p>	<p>NDC started a process to review its risk management framework in order to identify new risks and update the risk register at the end of financial year 2020 and the beginning of financial year 2021. Some important steps were initiated with the endorsement by the NDC Commandant of the revised risk register template in January 2021.</p>	<p>Observation In-Progress.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
	<p>However, the risk register does not contain any information on how the actions taken are mitigating the identified risks. The specific internal controls in place designed to address each identified risk in the risk register are not documented yet.</p> <p>In addition, IBAN found areas where internal control processes should be strengthened and documented, specifically with respect to updating Standard Operating Procedures regarding cash management.</p>	

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

NATO DEFENSE COLLEGE (NDC) FORMAL COMMENTS ON THE AUDIT REPORT AND THE INTERNATIONAL BOARD OF AUDITORS (IBAN) POSITIONS

**OBSERVATION 1:
NDC NEEDS TO REDUCE THE USE OF PHYSICAL CASH**

NDC's Formal Comments

Agreed.

The NDC has already implemented initiatives aimed at reducing the use of cash paid to Course Members to the furthest extent. Cash payments have now been significantly reduced. Strong internal controls continue to be in place for any remaining cash payments.

**OBSERVATION 2:
FAIR PRESENTATION OF FINANCIAL STATEMENTS AND BUDGET INFORMATION**

NDC's Formal Comments

Do not fully concur.

Sufficient, relevant information to explain the conversion of lapses into advanced contributions was included in Note 7 on deferred revenue to the financial statements. The notes to the Financial Statements are to be seen as a whole and as such, we deemed there was no need to disclose the same information twice, in note 6 on payables and in note 7 where it was more relevant.

IBAN's Position

IBAN considers that the information to explain the conversion of lapses into advanced contributions included in the notes to the NDC 2020 Financial Statements was not sufficient. This is because Note 6 does not specify that lapses converted into advanced contributions in 2020 based on BC-D(2020)0176-FINAL were not included in Payables. IBAN therefore maintains its recommendation.

FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS

(1) NDC 2019 FY

IBA-AR(2020)0006, paragraph 1

EFFECTIVENESS OF THE NDC RISK MANAGEMENT POLICY

NDC's Formal Comments

Agreed to IBAN's assessment.

Additional information provided on current status.

Agreed

NDC is revising and adapting its risk register as part of a broader reorganization of internal planning and monitoring processes. NDC will reinforce their internal mechanisms of performance management and to ensure an effective achievement of their objectives.

The risk register will be fully revised in 2021 with an on-going assessment and adaptation in future years.

(2) NDC 2019 FY

IBA-AR(2020)0006, paragraph 2

TEMPORARY LOANS BETWEEN NATO REPORTING ENTITIES

NDC's Formal Comments

Agreed to IBAN's assessment.

Additional information provided on current status.

Not agreed, should be in-progress.

The IMS has revised their Standard Operating Procedure 8 (IMSSOP 8), issued on 04 January 2021, effective 15 January 2021, including a paragraph on cash transfers between IMS Budget Group entities. The NDC Commandant has formally acknowledged on 4 March 2021 the procedure defined by the new paragraph of the IMSSOP 8.

The NDC will update its SOP 111 (Financial Administration of the Disbursement Function and Advance Accounts) accordingly.

IBAN's Position

During the audit of the 2020 Financial Statements, the internal control process related to the request, receipt and repayment of temporary loans between NATO reporting entities was not included in a written procedure approved by the NDC Commandant. We take note of NDC's intention to update NDC SOP 111 and will follow this up during next year's audit. IBAN therefore maintains its recommendation.

(3) NDC 2019 FY

IBA-AR(2018)0006, paragraph 1

IMPROVEMENTS REQUIRED IN THE AREA OF INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT

NDC's Formal Comments

Agreed to IBAN's assessment.

Additional information provided on current status.

Agreed.

The NDC is revising their risk register to address the IBAN recommendation.

Furthermore, the NDC will make sure that all internal Standard Operating Procedures (SOPs) are updated on a timely basis.

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.

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.



INTERNATIONAL MILITARY STAFF
ETAT-MAJOR MILITAIRE INTERNATIONAL



30 March 2021

IMSTAM(FC)-0011-2021 REV2

CHAIR, INTERNATIONAL BOARD OF AUDITORS FOR NATO (IBAN)

REVISED VERSION 2 - NATO DEFENSE COLLEGE (NDC) FINANCIAL STATEMENTS 2020

1. Please find attached the 2020 NDC Financial Statements, issued in accordance with NATO Financial Regulation (NFR) Article 35.1. The revised document contains an update to the notes to the financial statements.
2. I can confirm that, in accordance with NFR Financial Rules and Procedures XXXV (4), the NDC 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 issued, but should be presented to Council no later than 31 August 2021 (NFR 15.2). As such, the NDC is not yet in a position to anticipate any potential representations that may be made to the RPPB, regarding the Audit Report.
5. The NDC therefore reserves its position on public disclosure of the eventual IBAN Audit Report.
6. The enclosed document supersedes the original basic document and REV1.

A handwritten signature in black ink, appearing to read 'Rui M.M. da Silva'.

RUI M.M. DA SILVA
PRTCV
Financial Controller
International Military Staff &
Science and Technology Organisation

Enclosure:

Revised version 2 of NDC Financial Statements FY 2020

Copy To: COMMANDANT NDC, HEAD OF FINANCE NDC, FC, RECORDS

Action Officer: Mrs. A. MUEFFKE, Principal Administrator (Finance) to FC IMS, (4593)

NATO DEFENSE COLLEGE FINANCIAL STATEMENTS

2020



Via Giorgio Pelosi, 1
00143 Rome
ITALY

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Introduction

1. The NATO Defense College (NDC) is a NATO Military body (NMB) of the Military Committee (MC) led by the Commandant, who reports to the Chairman of the Military Committee (CMC) through the Director General of the International Military Staff (DGIMS). Its mission is to contribute to the effectiveness and cohesion of the Alliance by developing its role as a major centre of education, outreach and research on transatlantic security issues. As the Alliance's premier academic institution, the NDC aspires to be regarded as the first choice for nations in the educational development of their senior officers and officials, and as a respected source of relevant policy-making advice.
2. Throughout 2020, the NDC experienced and shared in the impact of the COVID-19 pandemic as it took effect in Italy and around the world. The spread of the virus on a pandemic scale, and the related response measures necessary for the College to implement, not only caused deviations from the planned activities but also affected the modus operandi of NDC. While the successful achievement of core objectives remained a priority, special emphasis was put in ensuring business continuity and protecting the health of staff and course members at all times. The effects of such unpredictable event and consequent changes in plans are clearly visible in these Financial Statements and the increased amount of lapsed credits in 2020.
3. The NDC 2020 Financial Statements have been produced in accordance with the NATO Accounting Framework (NAF) based on the International Public Sector Accounting Standards (IPSAS) as adapted by NATO and the NATO Financial Regulations (NFRs). They are presented in a commonly adopted layout.
4. The expenses are charged over two budgets covering the NDC (budget code BC 303), elements of the Outreach Programme (BC 501) for which the NDC has operational control and, to a very minor extent, other non-appropriated reimbursable activities.
5. The budgetary expenses are recorded on an accrual basis, i.e. in the period in which the goods or services are delivered. Any exception to that principle is outlined in Annex 1 to the financial statements, which provides a comparison between the Budget Execution and IPSAS.
6. The IMS Budget Group covers a number of budgets and entities linked together for financial management purposes by a Financial Controller. The Financial Controller is the Financial Controller of the IMS, the Science and Technology Organisation (STO) and the NDC. The NDC and IMS are therefore related parties under a common Financial Controller.



Olivier RITTIMANN
Lieutenant General, French Army
Commandant
NATO Defense College



Rui M. M. DA SILVA
PRTCV - Financial Controller

NDC Statement of Internal Control FY 2020

In accordance with the NATO Financial Regulations (NFRs) as supplemented by the Financial Rules and Procedures (FRPs), the Commandant of the NATO Defense College (NDC) is responsible and accountable for implementing and maintaining a sound financial management. In particular, as set forth in articles 11 and 12 of the NFRs, the Commandant is responsible for implementing sound risk management procedures and effective internal control arrangements aimed at supporting the achievement of the organizational objectives.

The NDC Financial Controller, in accordance with articles XI.3 and XI.4 of the FRPs, is responsible for financial risk management and for establishing financial risk management standards, as well as responsible for the system of internal financial and budgetary control (NFR 12.2).

In order to meet the provisions of the NFRs, the NDC has established systems of Risk Management and Internal Control, which are being continuously enhanced with the aim to ensure the achievement of NDC mission and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. The systems of Risk Management and Internal Control are designed to manage and minimize, rather than entirely eliminate, risk at the NDC. Risk Management and Internal Control can therefore provide only a reasonable, but not absolute, assurance of effectiveness. The risks addressed at the NDC include risks to NDC operational aims and objectives; compliance with the NFRs; the reliability of financial information; and the safeguarding of assets. This process has been in place for the year ended 31 December 2020 and up to the date of these financial statements.

In accordance with the Budget Committee (BC) recommendation to adopt COSO as internationally-recognized Internal Control Framework, the risk management and financial control processes at the NDC provide a network of internal controls that can be assessed using the five key components of the COSO Framework:

Control Environment

The culture and ethical values of the overall control environment are established by senior management. The promotion of ethical values includes: NDC participation in the NATO-wide 'Building Integrity' Initiative; the promulgation of the NATO Code of Conduct to all NDC staff; the disclosures on any senior management related party transactions in NDC annual financial statements.

The NDC structure provides for clear, hierarchical reporting lines based on military principles, as well as functional reporting lines, and appropriate authorities and responsibilities are formally entrusted to personnel in accordance with their role within the organization.

Oversight is provided by the NATO Military Committee (MC), supported by various subcommittees, who routinely scrutinize NDC senior management reports on strategic operational matters.

On financial matters, interim Budgetary Execution Reports are presented to, and reviewed by, the NATO Budget Committee twice per year. In addition, NDC financial requirements comprising the yearly budget proposals are screened and reviewed by the nations at various oversight fora.

The Audit Advisory Panel (AAP) makes periodic assessments as to whether Internal Audit is properly resourced and has the appropriate standing. It reviews, provides input to and endorsement of, internal audit planning. It reviews the findings and recommendations of Internal Audit and the IBAN, and reviews management responses and follow-up actions.

The AAP provides the Commandant with an annual report which includes an assessment on the effectiveness of risk management, internal control, and external financial reporting, along with advice and recommendations for the Commandant.

The overall mission and structure of the NDC was recently reviewed by the Military Committee, resulting into a revised "Policy Guidance for the NATO Defense College" (Document MC 123/10), noted by the North Atlantic Council (NAC) in July 2019, and which has been recently distributed to all Military Representatives for comments.

Risk Assessment

The NDC continues to develop internal risk management policies and procedures, adapting existing risk management frameworks, to better identify those events that if occurring may affect the achievement of its objectives. Risk identification and management is progressively being extended to all organizational elements of the NDC.

Although in the course of 2020 some of the planned efforts were adversely affected by the limitations imposed by COVID-19, it is anticipated that in the course of 2021 the NDC will deploy relevant initiatives to further enhance the understanding of the risks which are implied in the set strategy, in order to anticipate adverse events and take the necessary corrective measures.

Control Activities

The NDC, through its Command Group (CG) and other internal boards, monitors and controls ongoing progresses towards the achievement of the set objectives, in accordance with deadlines and operational priorities.

In the financial domain, the NDC finance and accounting system (FinS) has built-in approval workflows, controls and verifications, which grant the necessary segregation of responsibilities, together with relevant audit trails, and ensures sufficient control as regards consistency and accuracy of financial transactions, and compliance to the NFRs.

Information and Communication

The NDC structure with its clear reporting lines underpins internal communication. The internal boards structure is the primary channel of information flow across internal stakeholders, and informs decision-making at all levels. The NDC has a Standard Operating Procedure (SOP 97) for a secure user access to Communication & Information resources. This provides for effective communications in pursuit of operational objectives.

Important information is also disseminated through the staff by means of Weekly Bulletins and periodic All-Hands meetings called by the Commandant.

Communication also provides for the effective functioning of internal control. The Audit Advisory Panel, for example, reports to the Commandant.

The NDC communicates externally on matters affecting the functioning of internal control mechanisms via the Statement on Internal Control, which is included with the annual Financial Statements and is released to the general public. External audits include examinations of internal controls and compliance with applicable rules and regulations. The results of these audits are reviewed by various oversight authorities and made available to the general public along with the financial statements.

Monitoring Activities

An outsourced Internal Audit service provider is engaged on a periodic basis, to undertake internal audit assignments. On top, NDC internal reviews of non-appropriated funds are

conducted regularly. The NDC is also subject to annual external audit from the International Board of Auditors for NATO (IBAN).

Recommendations and observations arising from audits are assessed by the Audit Advisory Panel reporting to the Commandant. The results are then assessed by NDC senior management, who initiate any appropriate actions.

The Commandant of the NDC and the Financial Controller have a collective responsibility for reviewing the effectiveness of the system of internal control. Our review is informed by the above five COSO components and by the work of NDC senior managers, external audits, and internal audits.

No significant issues regarding financial or operational matters were raised in 2020. The IBAN External Audit of the 2019 Financial Statements resulted in an unqualified opinion. IBAN observed on the need for strengthening of risk management procedures and clarification of the internal control process related to the temporary shortfall of funds in IMS Budget Group entities. The NDC has taken the necessary measures to address both observations, on the one side implementing continuous improvement to risk management practices and on the other clarifying with the support of the IMS the principles underpinning the temporary transfer of cash between entities within the same budget group.

Overall, we are satisfied that the Risk Management and Internal Control systems in operation across the NDC during the year 2020 were reasonably adequate and effective. In recognizing that areas of improvements of the system of internal control still exist we want to further reinforce that in the course of 2021 the NDC will deploy additional initiatives to enhance the effectiveness of risk management and internal control, in particular in what concerns alignment of strategy and objectives with the mission, vision and values of the organization.

Olivier RITTIMANN
Lieutenant General, French Army
Commandant
NATO Defense College

Rui M. M. DA SILVA
PRTCV - Financial Controller

**NATO DEFENSE COLLEGE
STATEMENT OF FINANCIAL POSITION**

As at 31 December 2020
(in EUR)

	<i>Notes</i>	2020	(restated) 2019
ASSETS			
Current Assets			
Cash and Cash Equivalents	2	5,684,528	3,194,335
Receivables	3	16,437	51,598
Prepayments and Advances	4	1,725	15,385
Total Current Assets		5,702,691	3,261,319
Non-Current Assets			
Property, Plant & Equipment	5	12,406,766	12,876,240
Total Non-Current Assets		12,406,766	12,876,240
TOTAL ASSETS		18,109,457	16,137,558
LIABILITIES			
Current Liabilities			
Payables	6	880,374	811,319
Deferred Revenue & Advances	7	4,822,317	2,450,000
Total Current Liabilities		5,702,691	3,261,319
Non-Current Liabilities			
Non-Current Deferred Revenue	7	12,406,766	12,876,240
Total Non-Current Liabilities		12,406,766	12,876,240
TOTAL LIABILITIES		18,109,457	16,137,558
TOTAL NET ASSETS/EQUITY		-	-



Olivier RITTIMANN
Lieutenant General, French Army
Commandant



Rui M.M. DA SILVA
PRTCV - Financial Controller

The notes on pages 10 to 18 form an integral part of these financial statements.

The financial statements were issued to the International Board of Auditors for NATO on 30 March 2021.

**NATO DEFENSE COLLEGE
STATEMENT OF FINANCIAL PERFORMANCE**

For the year ended 31 December 2020
(in EUR)

	<i>Notes</i>	<u>2020</u>	<u>2019</u>
Revenue			
Revenue	8	8,749,703	10,268,775
Total Revenue		<u>8,749,703</u>	<u>10,268,775</u>
Expenses			
Personnel	9	5,275,500	5,535,595
Contractual Supplies and Services	10	2,517,417	4,040,557
Capital and Investments Budgeting		481,579	229,988
Depreciation	5	475,207	462,635
Total Expenses		<u>8,749,703</u>	<u>10,268,775</u>
SURPLUS / DEFICIT FOR THE PERIOD		<u>-</u>	<u>-</u>

NATO DEFENSE COLLEGE STATEMENT OF CASH FLOWS

For the year ended 31 December 2020

(in EUR)

	<i>Notes</i>	<u>2020</u>	<u>(restated) 2019</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
<i>Surplus/Deficit for the period</i>		-	-
Non-cash movements			
Depreciation / Amortization	5	475,207	462,635
Increase - (Decrease) in payables		69,056	368,355
Increase - (Decrease) in other current liabilities		2,372,317	(78,179)
(Increase) - Decrease in receivables		35,161	(15,577)
(Increase) - Decrease in other current assets		13,660	(10,237)
(Increase) - Decrease in Long-term Provisions		(469,474)	(173,062)
NET CASH FLOWS FROM OPERATING ACTIVITIES		<u>2,495,927</u>	<u>553,935</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property plant and equipment	5	(5,733)	(289,572)
NET CASH FLOWS FROM INVESTING ACTIVITIES		<u>(5,733)</u>	<u>(289,572)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Cash in from IMS BG cash transfer		400,000	1,150,000
Cash out from IMS BG cash transfer		(400,000)	(1,150,000)
NET CASH FLOWS FROM FINANCING ACTIVITIES		<u>-</u>	<u>-</u>
Net Increase - (Decrease) in cash and cash equivalents		<u>2,490,194</u>	<u>264,362</u>
Cash and cash equivalents at the beginning of the period		<u>3,194,335</u>	<u>2,929,973</u>
Cash and cash equivalents at the end of the period		<u>5,684,528</u>	<u>3,194,335</u>

**NATO DEFENSE COLLEGE
STATEMENT OF CHANGES IN NET ASSETS**

For the year ended 31 December 2020
(in EUR)

	Total
Balance at the beginning of the period 2019	-
Surplus / (deficit) for the period	-
Change in net assets/equity for the year ended 2019	-
Balance at the beginning of the period 2020	-
Surplus / (deficit) for the period	-
Change in net assets/equity for the year ended 2020	-

NOTES TO THE FINANCIAL STATEMENTS

1. Significant Accounting Policies

1.1. Basis of Preparation

The NATO Defense College (NDC) Financial Statements 2020 have been prepared in accordance with the NATO Accounting Framework (NAF). This accounting framework is based on International Public Sector Accounting Standards (IPSAS), as adapted by NATO. The financial statements comply with the financial requirements of the NATO Financial Regulations (NFRs) and the associated Financial Rules and Procedures (FRPs) as well as with NDC directives and policies.

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

In accordance with Article 2.1 of the NFRs, the financial year covered by these financial statements is 1 January to 31 December 2020.

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 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. The principal accounting policies are set out below.

1.2. Accounting Estimates and Judgements

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, revenues 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.

1.3. Changes in Accounting Policy and Standards

The same accounting policies are applied within each period and from one period to the next, unless a change in accounting policy meets one of the criteria set in IPSAS 3. For the 2020 financial statements, the accounting policies have been applied consistently throughout the reporting period. Within current liabilities, presentational changes have been made. As of 2020 liabilities from operational result, from financial result and liabilities from lapsed budgetary credits are presented within payables instead of deferred revenue. The balances related to these changes have been restated accordingly for the 2019 comparative information. Further detail is provided in the relevant notes. Within the cash flow statement, the presentation was changed to show cash transfers in and out during the year with a net effect of nil.

1.4. Changes in Pronouncements

At the date of authorisation of these financial statements, the NDC has not applied the following new and revised IPSAS that have been issued but are not yet effective. The effective dates of the following have been deferred due to COVID:

- IPSAS 41 Financial Instruments
- IPSAS 42 Social Benefits
- Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)
- Collective and Individual Services (Amendments to IPSAS 19)
- Improvements to IPSAS, 2019

It is not expected that the adoption of these standards will have a material impact on the financial statements of the NDC in future periods.

1.5. Foreign Currency Transactions

These financial statements are prepared in euro, which is the functional and reporting currency of the NDC. Foreign currency transactions are accounted for at the NATO exchange rates prevailing on the transaction date. Monetary assets and liabilities at year-end which were denominated in foreign currencies are assessed for materiality and if material are translated into euro using the applicable NATO exchange rates as at 31 December 2020. Realized and unrealized gains and losses resulting from the settlement of such transactions and from the revaluation at the reporting dates of monetary assets and liabilities denominated in foreign currencies are recognized in the statements of financial position and performance. An assessment was made of all assets and liabilities in foreign currencies as at 31 December 2020. The amount of unrealized gains is deemed immaterial.

1.6. Consolidation

Consolidated financial statements include the financial results of the controlling entity and its controlled entities.

While Morale and Welfare activities (MWAs) are under the control of the head of the NATO body, in accordance with the NAF departure from IPSAS 6 they have not been consolidated into these financial statements. A separate activity report is submitted to the Budget Committee as required by the NFRs, and summary information is provided at note 14.

1.7. Services In-Kind

The NDC received services in-kind in the form of military personnel provided by the NATO nations. Such personnel are assigned to specific, military positions on the Peacetime Establishments (PE) of the NDC (see Note 9). In these financial statements, services in-kind are recognized neither as revenue nor as an asset.

1.8. Financial Instruments

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

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

Credit Risk: In the normal course of business, NDC incurs credit risk from trade receivables and transactions with banking institutions. NDC 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 2020 is equal to the total amount of bank balances, short-term deposits, and receivables disclosed in the statement of financial position. Receivables considered uncollectible are adequately provided for. There is a very limited credit risk associated with the realization of these instruments.

Currency risk: The NDC's exposure to foreign currency exchange risk is very limited, as most transactions are in euros.

Liquidity risk: The liquidity risk is based on the assessment whether the organization will encounter difficulties in meeting its obligations associated with financial liabilities. There is a limited exposure to liquidity risk because the budget funding mechanism guarantees contributions in relation to approved budgets. The accuracy of forecasting cash requirements as well as the delay in payment represent the main liquidity risk.

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

1.9. Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Rentals payable under lease contracts are recognised as an expense in the Statement of Financial Performance on a straight line basis over the term of the lease.

The NDC is not party to any financial lease contracts and therefore is not reporting any assets or liabilities related to financial leases.

1.10. Cash and cash equivalents

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

1.11. Receivables

Receivables are stated at net realizable value, after provision for doubtful and uncollectible debts. Contributions receivable are recognized when a call for contribution has been issued to the member nations. No allowance for loss is recorded with respect to member countries' assessed contributions receivable, except for exceptional and agreed technical reasons.

1.12. Prepayments

Prepayments and deposits are payments to suppliers, employees and other NATO entities in advance of the period to which they pertain.

1.13. Property, plant and equipment

Property, plant and equipment (PPE) with finite useful lives that are acquired separately are carried at initial cost less accumulated depreciation and any recognized impairment losses. Depreciation is recognized on a straight-line basis over their estimated useful lives. Full depreciation is charged in the month of acquisition and nil in the month of disposal. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period with the effect of any changes in estimate accounted for on a prospective basis. PPE is derecognized upon disposal or when no future economic benefit is expected from the use of the asset. The cost and any related accumulated depreciation are removed from the accounting records.

In accordance with IPSAS 17 as adapted by the NAF, all assets qualified as PPE and under the control of the NDC at the reporting date have been capitalised if exceeding the set capitalisation thresholds, and recognised as non-current assets in the statement of financial position. Land and buildings are offered for use to the NDC by the MOD Italy. The values of land and building represent the historic cost as provided by the MOD Italy.

1.14. Impairment of tangible assets

The carrying values of non-current assets are reviewed for impairment when events or changes in circumstances indicate that they may be not recoverable. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Any provision for impairment is charged against the statement of financial performance in the year concerned.

1.15. Payables

Payables (including amounts due to other NATO entities) are initially recognized at their fair value and subsequently measured at amortized cost. This includes estimates of accrued obligations for goods and services received but not yet invoiced.

1.16. Deferred revenue and advances

Deferred revenue represents contributions from nations and/or third parties that have been called for current or prior years budgets but that have not yet been recognized as revenue. Funds are called in advance of their need because the entity has no capital that would allow it to pre-finance any of its activities. Advances are contributions called or received related to future budgets.

1.17. Employee benefits

The NDC civilian employees either participate in the Defined Contribution Pension Scheme (DCPS) or the Coordinated Pension Scheme (NATO Defined Benefit Plan).

The assets and liability for all NATO post-employment benefit schemes are accounted for centrally at NATO Headquarters by the International Staff and therefore are not recognized in these financial statements.

Defined Contribution plan:

The assets of the plan are held separately from those of NDC in funds under the control of independent trustees or an Administrator. The NDC is required to contribute a specified percentage of payroll costs to the DCPS to fund the benefits. Payments to the DCPS are recognized as an expense when employees have rendered service entitling them to the contributions. The only obligation of NDC with respect to the DCPS is to make the specified contributions.

Defined Benefit plan:

Employees who have joined NATO before 1 July 2005 are members of the NATO Coordinated Pension Scheme which is a funded defined benefit plan. Under the plan and upon completion of 10 years of 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. Staff members whose length of service is not sufficient to entitle them to a retirement pension are eligible for a leaving allowance.

Continued Medical Coverage: Some qualifying retirees may also benefit from Continued Medical Coverage (CMC).

1.18. Revenue recognition

Revenue comprises contributions from member nations and other customers to fund the entity's budgets. It is recognized as revenue in the Statement of Financial Performance in the year for which the contributions are used for their intended purpose as envisioned by the budgets. The balance of unspent contributions and other revenues that relate to future periods are deferred accordingly. 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.

Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the entity recognizes a liability until the condition is fulfilled.

1.19. Financial result

The financial result represents the net of bank interest earned, bank charges incurred and exchange rate gains and losses due to transactions in foreign currency. It is recognized as a payable to nations in order to return it to the nations.

2. Cash and cash equivalents

(in EUR)	2020	2019
Cash Accounts	49,595	19,193
Petty Cash and Advances	2,500	1,500
Current Bank Accounts in Euros	5,532,300	3,173,642
Cash Equivalent	100,133	-
Total	5,684,528	3,194,335

Cash and cash equivalents are short-term liquid assets. Deposit accounts are held in interest bearing bank accounts in immediately available funds. Cash holdings are largely determined by the timing of receipts from the nations, which arrive in two instalments, generally in April and December.

Cash equivalents are held in euros and are funds invested on a short term deposit or business account.

During the year, cash transfers amounting to 400,000 EUR were received from other entities in the IMS Budget Group in order to cover temporary shortfalls related to the calls for contributions. At 31 of December 2020 all of these cash transfers had been repaid.

3. Receivables

(in EUR)	2020	2019
Receivables from NATO Entities	4,362	50,902
Receivables from Governments / Gov. Agencies	5,224	696
Receivable from Staff Members	6,800	-
Accrued Revenue	51	-
Total	16,437	51,598

Receivables include outstanding reimbursements from different kinds of debtors, to include other NATO entities, NATO nations, third parties and staff members. The main balance refers to a salary advance to a NDC staff member. Accrued revenue consists of bank interests earned in 2020, but for which the cash was received in 2021. All of the balances are current.

4. Prepayments and Advances

(in EUR)	2020	2019
Advances – Non Assigned Expenditures	-	15,385
Advances – Vendors	1,725	-
Total	1,725	15,385

Advances relate to a credit with a hotel due to cancellation of a subsidized event and advance payment of complementary insurance for interpreters.

5. Property, Plant and Equipment

	Land	Buildings	Installed Equipment	Machinery	Furniture	Automated information systems	Totals
Cost							
Balance at 1 January 2019	7,718,220	7,119,426	2,399,093	83,438	26,961	152,512	17,499,649
Additions	-	-	224,367	-	-	65,206	289,572
Disposals/deletions	-	-	(74,990)	-	(26,961)	(56,880)	(158,830)
Balance at 31 December 2019	7,718,220	7,119,426	2,548,470	83,438	-	160,838	17,630,391
Additions	-	-	5,733	-	-	-	5,733
Disposals/deletions	-	-	-	-	-	-	-
Balance at 31 December 2020	7,718,220	7,119,426	2,554,203	83,438	-	160,838	17,636,124
Accumulated depreciation							
Balance at 1 January 2019	-	(3,271,325)	(1,001,629)	(46,258)	(26,961)	(104,174)	(4,450,347)
Depreciation expense	-	(177,986)	(239,340)	(8,199)	-	(37,110)	(462,635)
Disposals/deletions	-	-	74,990	-	26,961	56,880	158,830
Balance at 31 December 2019	-	(3,449,311)	(1,165,979)	(54,457)	-	(84,404)	(4,754,151)
Depreciation expense	-	(177,986)	(250,004)	(7,764)	-	(39,453)	(475,207)
Disposals/deletions	-	-	-	-	-	-	-
Balance at 31 December 2020	-	(3,627,297)	(1,415,983)	(62,220)	-	(123,858)	(5,229,358)
Net book value							
Balance at 31 December 2019	7,718,220	3,670,115	1,382,490	28,981	-	76,433	12,876,240
Balance at 31 December 2020	7,718,220	3,492,129	1,138,219	21,217	-	36,980	12,406,766

The following thresholds and useful lives are used in the calculation of depreciation:

Category	Threshold – per item (no grouping)	Depreciation life
Land	€ 200,000	N/A
Buildings	€ 200,000	40 years
Installed equipment	€ 5,000	10 years
Machinery	€ 5,000	10 years
Furniture	€ 5,000	10 years
Automated information systems	€ 5,000	3 years

The depreciation charge for the year was 475,207 EUR (2019: 462,635 EUR).

In 2020, there are no write-offs or disposals of property (other than the furniture shown in the table below) that meet the disclosure criteria in the NATO Financial Regulations.

Items (Quantity)	Purchased in	Net Book value	Total cost	Report of Survey	Reason for write-off
Furniture (18)	1987 → 1999	0	4,907	01-2020, 03-2020	Beyond state of repair. No longer serviceable
Total		0	4,907		

6. Payables

(in EUR)	2020	(restated) 2019
Payables to suppliers	138,870	160,808
Accruals	221,090	287,515
Payables to nations	520,377	362,996
Other Payable	37	-
Total	880,374	811,319

Payables are short-term liabilities to third parties directly related to the activities and operations of the NDC. Payables to suppliers include invoices from commercial vendors not yet settled, and goods and services received and accrued as invoices were not received by the reporting date.

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

Within payables, presentational changes have been made. As of 2020 liabilities from operational results, from financial results and from lapses have been moved out of deferred revenue and included under payables to nations. The comparative balances for 2019 have been restated accordingly. Payables to nations will be offset in the 2nd assessment call for 2021.

Other payables include the balance of untaken leave at the end of the reporting period. The untaken leave at the end of 2020 was 668.5 days (2019: 505 days). The associated cost of 119,680 EUR is considered material and has therefore been recognized as an accrual.

7. Deferred revenue and advances

(in EUR)	(restated 2019)	
Deferred Revenue – carry forwards	657,317	200,000
Advance Contributions for next year	4,165,000	2,250,000
Total current deferred revenue	4,822,317	2,450,000
Investment in PPE	12,406,766	12,876,240
Total non-current deferred revenue	12,406,766	12,876,240
Total deferred revenue	17,229,083	15,326,240

Current deferred revenue consists mostly of budget deferred revenue or advanced contributions for the next financial year, but for which corresponding expenses will be incurred after the reporting date. Exceptionally, nations have decided to convert 1.56MEUR of the 2.0MEUR lapses shown on the budget execution statement in Annex 1, to advances from the nations for 2021. Advance contributions will be deducted from the 1st assessment call for 2021.

Non-current deferred revenue represents the net carrying amount of property, plant and equipment and intangible assets as at 31 December 2020. The revenue will be recognized in the year when the depreciation and amortization expense will be recognized.

Within deferred revenue, presentational changes have been made. As of 2020 liabilities from operational results, from financial results and from lapses have been moved under payables to nations. The comparative balances for 2019 have been restated accordingly.

8. Revenue

(in EUR)	2020	2019
Revenue from NDC budget 303	7,916,042	8,807,702
Revenue from other NATO budgets	358,362	998,438
Revenue from third party reimbursables	92	-
Other revenue	475,207	462,635
Total Revenue	8,749,703	10,268,775

In 2020 the NDC managed the following budgets:

- **NDC Budget (Military Budget code 303):** This revenue relates to the contributions received from the participating nations to exclusively cover the operating expenses of the College.
- **Other NATO budgets:** This revenue is the total from other NATO budgets. In 2020 the NDC managed a portion of the IMS Outreach Budget (budget code 501) in order to conduct Outreach/Cooperation activities with partner nations.
- **Third Party Reimbursables:** This revenue is the total of reimbursable activities conducted by the NDC.

Other revenue is revenue released from deferred revenue in respect of PPE depreciation.

9. Personnel

Employees are compensated for the service they provide in accordance with rules and amounts established by NATO. The compensation consists of basic salary, various allowances, health insurance, pension plan and other benefits as agreed with each host nation and the protocols of NATO.

The breakdown of personnel expenses is the following:

(in EUR)	2020	2019
Employment of Personnel	4,924,251	5,242,065
Recruitment and Separation	70,963	45,681
Clothing	1,467	1,491
Medical Examinations	26,112	10,202
Training	13,853	14,454
Post-Employment Benefits	238,854	221,702
Total	5,275,500	5,535,595

The balance of untaken leave at the end of 2020 was 668.5 days (2019: 505 days). The associated cost is recognized as an accrual.

Peacetime Establishment (PE):

	Authorized PE	Filled Positions
Civilians	53	50
Military (IMP)	52	46
National Manpower Overage	0	0
Voluntary National Contribution (VNC)	1	2
Host Nation	32	32
Partnership Posts	4	2
Total	142	132

10. Contractual Supplies and Services

Contractual Supplies and Services are expenses required for administrative support to the NDC and include expenses for general administrative overheads, and the maintenance costs of buildings/grounds, communications and information systems, transportation, travel expenses, representation/hospitality and miscellaneous expenses.

Operating Leases:

All leases of the NDC are operating leases as they do not transfer substantially all the risks and rewards incidental to ownership, they do not cover all of the assets' life, the ownership is not transferred by the end of the lease term and do not contain a bargain purchase option. Lease payments are recognized as an expense on a straight-line basis over the lease term.

In 2020 the NDC had only one non-cancellable operational lease contract related to the rental of copy machines for an amount of EUR 32,883 (2019: 28,750 EUR).

The future minimum lease payments are as follows:

- Aggregate: EUR 68,506
- One year: EUR 32,883
- Later than one year and up to lease term (01/2023): EUR 35,623

11. Related Parties Disclosure

The key management personnel includes: the Commandant, the Dean, the Director of Management, and the Head of Budget & Finance Branch. They are all rotated, typically every three years, and with the exception of the Head of Budget & Finance Branch, have only management oversight of routine operating and maintenance activities. The detailed work related to these tasks tends to be undertaken by staff officers.

The Financial Controller is also the Financial Controller of the International Military Staff and the Science and Technology Organization. The NDC, IMS and STO are therefore related parties under a common Financial Controller.

The other key management personnel of the entity have no significant known related party relationships that could affect the operation of this reporting entity. Key management is remunerated in accordance with the applicable national or NATO pay scales. They do not receive from NATO any additional remuneration for Board responsibilities or access to preferential benefits such as the entitlement to receive loans over and above those available to all NATO personnel under normal rules.

During the year, the NDC entered into non material transactions with other NATO entities outside the IMS Budget Group. The fees charged for these transactions were an appropriate allocation of the costs incurred.

12. Representation Allowance

Representation Allowance is allocated to certain designated high level officials whose position entails responsibility for maintaining relationships of value to NATO.

In 2020, one senior NDC official received representation allowance. The total entitlement was 4,317 EUR (2019: 4,317 EUR) and the actual expenses were 1,885 EUR (2019: 2,409 EUR) .

13. Events after reporting date

There have been no other material events between the reporting date and the date the financial statements are authorized for issue that would affect the amounts recognized in these financial statements.

14. Morale and Welfare Activities

The NDC carried out Morale and Welfare Activities (MWA) in 2020 for which a detailed annual special purpose report is presented to the Budget Committee. Morale and Welfare Activity is an activity of a NATO body that enhances the quality of life, promotes cohesion and integrity, and/or contributes to the physical and mental wellbeing of eligible individuals. At the NDC, the MWA mainly relate to petrol products, rationed items and a small shop offering mementoes and other few items.

The position of MWA at year-end is:

(in EUR)	2020
Cash and cash equivalents	62,741
Total liabilities including provisions and contingent liabilities	820

Two staff members support the MWA as a minor part of their duties. The total extent of their MWA responsibilities amounts to less than one part-time equivalent.

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ANNEX 1 - BUDGET EXECUTION STATEMENTS FOR THE YEAR ENDED 31/12/2020

A) NDC Budget (Military Budget Code 303)

Budget Currency EURO	Initial Budget BA-1	Transfers	BA-2	Transfers	BA-3	Transfers	Final Budget	Commitments	Expenses	Total Spent	Carry Forward	Lapsed
BUDGET 303 - 2020												
Chapter 1	6,078,067	-	6,078,067	-	6,078,067	(66,065)	6,012,002	-	5,245,976	5,245,976	-	766,026
Chapter 2	3,548,177	-	3,548,177	-	3,548,177	(29,713)	3,518,464	147,121	2,188,486	2,335,607	147,121	1,182,857
Chapter 3	753,410	-	753,410	-	753,410	95,778	849,188	510,196	287,312	797,508	510,196	51,680
TOTAL FY 2020	10,379,654	-	10,379,654	-	10,379,654	-	10,379,654	657,317	7,721,775	8,379,091	657,317	2,000,563
BUDGET 303 - 2019												
Chapter 1	-	-	-	-	-	-	-	-	-	-	-	-
Chapter 2	-	-	-	-	-	-	-	-	-	-	-	-
Chapter 3	200,000	-	200,000	-	200,000	-	200,000	-	200,000	200,000	-	-
TOTAL FY 2019	200,000	-	200,000	-	200,000	-	200,000	-	200,000	200,000	-	-
BUDGET 303 - ALL FYs												
Chapter 1	6,078,067	-	6,078,067	-	6,078,067	(66,065)	6,012,002	-	5,245,976	5,245,976	-	766,026
Chapter 2	3,548,177	-	3,548,177	-	3,548,177	(29,713)	3,518,464	147,121	2,188,486	2,335,607	147,121	1,182,857
Chapter 3	953,410	-	953,410	-	953,410	95,778	1,049,188	510,196	487,312	997,508	510,196	51,680
GRAND TOTAL BUDGET 303 ALL FYs	10,579,654	-	10,579,654	-	10,579,654	-	10,579,654	657,317	7,921,775	8,579,091	657,317	2,000,563

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B) Other NATO Budgets & Third Party Reimbursables

Budget Currency EURO	Initial Budget	Transfers Adjustments	Final Budget	Commitments	Expenses	Total Spent	Lapsed
REIMBURSABLE BUDGETS							
BUDGET 2020 ZNC (501/IMS - PIP)*	490,000	(337,625)	152,375	-	152,375	152,375	-
BUDGET 2020 ZNC (501/IMS - MD)*	300,000	(165,525)	134,475	-	134,475	134,475	-
BUDGET 2020 ZNC (501/IMS - ICI)*	50,000	(50,000)	-	-	-	-	-
BUDGET 2020 ZNC (501/IMS - OMC)*	210,000	(138,488)	71,512	-	71,512	71,512	-
TOTAL REIMBURSABLE BUDGETS	1,050,000	(691,638)	358,362	-	358,362	358,362	-
(*) According to the IMS Directives, since Budget 501 (Outreach PIP, MD, ICI and OMC) is reimbursable, the accrued and carried forward amounts are shown in both IMS and NDC books. Expenses are recognized / recorded on an accrual basis							
REIMBURSABLE EXPENSES							
BUDGET 2020 Z01 (REIMBURSABLE EXPENSES)	92	-	92	-	92	92	-
TOTAL REIMBURSABLE EXPENSES	92	-	92	-	92	92	-
TOTAL REIMBURSABLE BUDGETS & EXPENSES	1,050,092	(691,638)	358,454	-	358,454	358,454	-

In accordance with the NRFs, article 34.4, the NDC has included within its financial statements a budget execution report of its main budget (military budget code 303) that shows the initial budget allocations, the in-year changes as authorized under the authority of the Financial Controller or by the Budget Committee, the final approved budget and its execution status for the fiscal year 2020. Funds lapsed and carried forward are also included. In addition thereto, a budget execution statement for all reimbursable budgets managed by the NDC has also been included.

It is also worth recalling that the budgets and the financial statements are not prepared on the same basis. In the financial statements current year depreciation is recognized as an expense, while in the budgets all noncurrent assets are fully expensed during the year. The following table summarizes the differences:

	2020
Total Expenses, Statement of Financial Performance	8,749,703
Personnel	-
Contractual supplies and services	-
Capital and investments	5,733
Depreciation	(475,207)
Total expenses, Budget Execution Statement	8,280,229

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NORTH ATLANTIC TREATY ORGANIZATION
ORGANISATION DU TRAITÉ DE L'ATLANTIQUE NORD
INTERNATIONAL BOARD OF AUDITORS
COLLÈGE INTERNATIONAL DES AUDITEURS EXTERNES DE L'OTAN

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IBA-A(2021)0113
25 August 2021

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

Subject: ***International Board of Auditors for NATO (IBAN) Audit Report on the audit of the Science and Technology Organisation (STO) Restated Financial Statements for the year ended 31 December 2020 – IBA-AR(2021)0020***

IBAN submits herewith its approved Audit Report with a Summary Note for distribution to the Council.

IBAN's report sets out an unqualified opinion on the Restated Financial Statements of the Science and Technology Organisation (STO) and on compliance for financial year 2020.

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 Restated Financial Statements of the
Science and Technology Organisation (STO)
for the year ended 31 December 2020**

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 2020.

IBAN made two observations and recommendations.

These findings are listed below and do not impact the audit opinion on the financial statements and on compliance:

1. Fair presentation of conversion of lapsed appropriations into advanced contributions.
2. Improvement needed in the internal control process for the preparation of financial statements and budget execution statement.

IBAN followed up on the status of observations and recommendations from the previous years' audits and found that four remain in-progress and four were closed.

The Audit Report was issued to STO whose comments have been included, with the IBAN's position on those comments where necessary.

The observations and recommendations and the follow-up of the previous years' observations and recommendations that are not in the Audit Report 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 executive responsibility.

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IBA-AR(2021)0020

25 August 2021

INTERNATIONAL BOARD OF AUDITORS FOR NATO

AUDIT REPORT ON THE RESTATED FINANCIAL STATEMENTS OF THE

SCIENCE AND TECHNOLOGY ORGANISATION

(STO)

FOR THE YEAR ENDED 31 DECEMBER 2020

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

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

The International Board of Auditors for NATO (IBAN) has audited the Restated Financial Statements of Science and Technology Organisation, for the 12 month period ended 31 December 2020, issued under document reference STO-OCS(2021)0044, and submitted to IBAN on 25 June 2021. These Restated Financial Statements comprise the Statement of Financial Position as at 31 December 2020, 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 2020, including a summary of significant accounting policies and other explanatory notes. In addition, the Restated Financial Statements include a Budget Execution Statement for the 12 month period ended 31 December 2020.

In our opinion, the Restated Financial Statements give a true and fair view of the financial position of Science and Technology Organisation as at 31 December 2020, and of its financial performance, its cash flows and budget execution for the 12 month period ended 31 December 2020, in accordance with accounting requirements and reporting standards consistent with the NATO Accounting Framework (NAF).

Basis for Opinion on the Restated 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 2200-2899) 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 Science and Technology Organisation 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 31st 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.

Compliance

Opinion on Compliance

Based on the procedures we performed, nothing has come to our attention, as part of our audit of the Restated 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, 25 August 2021



Daniela Morgante
Chair

OBSERVATIONS AND RECOMMENDATIONS

IBAN made two observations and recommendations. These observations do not impact the audit opinion on the financial statements and on compliance:

1. Fair presentation of conversion of lapsed appropriations into advanced contributions.
2. Improvement needed in the internal control process for the preparation of financial statements and budget execution statement.

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

The Audit Report was issued to STO whose comments have been included, with the IBAN's position on those comments where necessary.

The observations and recommendations and the follow-up of the previous years' observations and recommendations that are not in the Audit Report are included in a Management Letter addressed to Science and Technology Organisation (STO) management. This is because IBAN considers that these matters are to be addressed by Management and therefore fall under STO executive responsibility.

1. FAIR PRESENTATION OF CONVERSION OF LAPSED APPROPRIATIONS INTO ADVANCED CONTRIBUTIONS**Reasoning**

1.1 In accordance with Article 34.1 of NATO Financial Regulations (NFRs), NATO bodies shall adhere to the accounting requirements and reporting standards consistent with the NATO Accounting Framework as approved by the North Atlantic Council (NAC). The NATO Accounting Framework is an adapted version of International Public Sector Accounting Standards (IPSAS) as issued by the International Public Sector Accounting Standards.

1.2 Furthermore, the NFRs require the Financial Controller 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 NATO Accounting Framework.

1.3 According to Financial Rules and Procedures (FRP) XXIX 11): *All lapsed appropriations have to be returned to the Nations. Such refunds shall be effected by deduction from the first call following submission of the financial statements.*

1.4 According to Section 1 – General Provisions, Preamble of the NFRs: *The Budget Committee may grant on specific and temporary exemption from provisions of the present FRP.*

1.5 In accordance with paragraph 27 of IPSAS 1, financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in IPSASs. The application of IPSASs, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.

1.6 According to paragraph 29 of IPSAS 1, in addition to compliance with applicable IPSAS, a fair presentation also requires an entity to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

Observations

1.7 In December 2020, due to the difficulties and uncertainties created by the COVID-19 pandemic, Nations decided to convert a portion of the 2020 lapsed budget appropriations into advanced contributions, for the approved NATO Command Structure Entities and Programmes (NCSEP) budget of 2021 (Ref. BC-D(2020)0176-FINAL). This decision affected the presentation of lapses and advances in the financial statements of multiple NCSEP budget holders at 31 December 2020.

1.8 IBAN noted that the presentation and disclosure of the accounting treatment of this decision differs between the 2020 financial statements of the different NCSEP budget holders. This is not consistent and may create difficulties for the users of the financial statements to compare between the financial statements of the NATO Reporting Entities concerned as prescribed by IPSAS 1.

1.9 STO disclosed the following information in Note 8 on Advances of the 2020 STO Financial Statements in relation to the above: *“Contributions are cash called or received related to future year’s budgets (applicable to CSO and OCS) [...] Exceptionally, nations have decided to convert EUR 720,000 of the EUR 955,977 for CSO and OCS lapses shown on the budget execution statement in Annex 1, to advances from the nations for 2021.”*

1.10 The audit revealed that STO did not disclose the decision described above in Note 9, Other current liabilities. This note only stated that *“Other current liabilities are mainly lapses from budget authorizations unspent during the financial year and miscellaneous income to be returned to the nations. These include lapses, miscellaneous income from operational results, financial results and any budget- over and under-calls”*. We consider this information as imperfect as it does not assert the specific circumstances and pronouncement thereto for the 2020 financial year in respect of the treatment of lapsed credits.

1.11 While STO disclosed the conversion of EUR 720,000 out of EUR 955,977 of lapsed budget appropriations into an advance from the Nations for the approved budget for 2021 in Note 8 on Advances, the information is also relevant for users of the financial statements that read Note 9 on Other current liabilities as this note contains information on the lapsed budget appropriations that have to be returned to Nations.

Recommendations

1.12 IBAN recommends that STO ensures when Nations in the future decide to convert lapses directly into advanced contributions, that sufficient relevant information is disclosed in the notes to the financial statements on accounts impacted by this, such as Payables and Deferred Revenue.

2. IMPROVEMENT NEEDED IN THE INTERNAL CONTROL PROCESS FOR THE PREPARATION OF FINANCIAL STATEMENTS AND BUDGET EXECUTION STATEMENT

Reasoning

2.1 Article 6 of the NFRs requires the Financial Controller to exercise the responsibility of budgeting, accounting and reporting activities of the NATO entity. This includes being responsible for the financial internal control system established and for the preparation of the financial statements in accordance with NATO accounting Framework.

2.2 In addition, Article 12.3 of the NFRs states that *“Internal control activities shall include,[...] adequate audit trails and data confidentiality, integrity and availability in information systems;”*

2.3 Financial Statements shall be free of misstatements, mathematical errors, non-reconciling items, or any other errors or omissions caused by lack of control during preparation. Entities should have proper internal controls, including reviews and reconciliations in place to ensure the consistency and the accuracy of information presented in the Financial Statements.

2.4 A key part of the system of internal control is to ensure adequate processes are in place for the preparation, review and reporting of the Financial Statements. Adequate review procedures are necessary to provide a reasonable basis for obtaining assurance that financial statements are in compliance with the applicable financial reporting framework.

Observations

2.5 We found material omissions and errors in the budget execution statements (BES) of STO/CSO and STO/OCS annexed to the financial statements. We also found

errors in the cash flow statement. These misstatements were corrected in the Restated Financial Statements for 2020 communicated to IBAN on 25 June 2021. The issues identified that led STO to request a restatement of the financial statements were the following:

2.6 We found that the total amount of commitments presented in the STO/CSO BES was understated by EUR 300,000, due to an omission. This amount corresponds to a special carry-forward authorisation in 2019 for the replacement of the bulletproof windows at the STO/CSO site, for which the contract was signed in mid-2020.

2.7 We also found that the total amount of the first revised budget (BA2) for 2020 shown in the BES of STO/OCS was materially overstated by an amount of EUR 900,000 compared to the one approved as per the 2020 International Military Budgets – Revised Authorisations (BC-BA(2020)0002). The BA2 amounted to EUR 2,018,323 in the BES compared to EUR 1,118,323 approved. This was due to a typing error, which also led to a wrong presentation of the transfers in the BES.

2.8 Finally we found that the 2019 restated cash flow statement did not show the restated 2019 depreciation charge of EUR 1,052,441 but an incorrect amount of EUR 718,242. The difference of EUR 334,200 corresponds to the retroactive restatement, which resulted from a change in accounting policy adopted by STO/CMRE regarding the starting point for the calculation of depreciation. This mistake also resulted in the presentation of a net cash decrease of EUR - 1,326,020 instead of EUR - 991,820.

2.9 IBAN highlights that management takes responsibility for the preparation and presentation of the entity's financial statements. Review procedures are necessary to provide a reasonable basis for obtaining assurance that financial statements are in compliance with the applicable financial reporting framework as well as prevent and detect errors before their issuance. This also contributes to a necessary improvement in the quality of the financial information presented.

Recommendations

2.10 IBAN recommends that STO strengthens its internal control over the preparation of the financial statements, in particular to ensure that the preparation, review and reporting process of the financial statements, including the budget execution statement and the cash flow statement, is fully documented and implemented.

FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS

IBAN followed up on the status of observations from the previous years' audit. The observations and recommendations, the 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>(1) STO FY 2019 IBA-AR(2020)0010, paragraph 1</p> <p>RECOGNITION OF THE FAIR VALUE OF STO'S VESSELS</p> <p>IBAN's Recommendation IBAN recommends that STO improves the reliability of information presented in the Financial Statements, by:</p> <p>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.</p>	<p>a. No fair value for the vessels is disclosed in the 2020 Financial Statements.</p> <p>On 25 June 2021, the Resource Policy and Planning Board (RPPB) approved (AC/335-D(2021)0009-AS1) the Budget Committee (BC) Report (BC-D(2021)0077) dated 16 June 2021, and agreed to recommend to Council to note the IBAN Audit Report on the STO 2019 Financial Statements. According to the BC Report, <i>"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</i></p>	<p>Observation In-Progress.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
<p>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.</p> <p>c. Reviewing the accounting treatment and disclosure of the Vessel upkeep and dismantling costs in the Financial Statements, in accordance with IPSAS 17.</p>	<p><i>BC proposes that STO continues to capitalise enhancements and upgrades to the Vessels."</i></p> <p>IBAN will re-examine this observation during the course of the audit of the 2021 STO Financial Statements, following notation by Council of the above Budget Committee Report and RPPB Action Sheet. In-progress.</p> <p>b. Further disclosure, better highlighting the status, roles and responsibilities of NATO, the Centre for Maritime Research and Experimentation (CMRE) and the Italian Navy was included in the notes to the 2020 Financial Statements while at the same time correcting the error in the disclosure note on custody. Closed.</p> <p>c. No accounting treatment and disclosure of the Vessel upkeep and dismantling costs in the Financial Statements in accordance with IPSAS 17 was added. IBAN will re-examine this observation during the course of the audit of the 2021 STO Financial Statements, following notation by Council of the above Budget Committee Report and RPPB Action Sheet. In-progress.</p>	
<p>(2) STO FY 2019 IBA-AR(2020)0010, paragraph 2</p> <p>SIGNIFICANT ERRORS IN NOTE 13 REGARDING PERSONNEL EXPENSES</p> <p>IBAN's Recommendation 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</p>	<p>STO revised the note on personnel expenses and the amount of personnel expenses in the notes now reconciles to the amount on the face of the Statement of Financial Performance.</p>	<p>Observation Closed.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
controls over the preparation of financial statements are effective.		
<p>(3) STO FY 2019 IBA-AR(2020)0010, paragraph 3</p> <p>TEMPORARY LOANS BETWEEN NATO REPORTING ENTITIES</p> <p>IBAN's Recommendation 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.</p>	<p>Updated procedures are still in preparation. To be reviewed during next year's audit.</p>	<p>Observation Open.</p>
<p>(4) STO FY 2019 IBA-AR(2020)0010, paragraph 4</p> <p>CONSISTENT ACCOUNTING POLICIES IN STO FINANCIAL STATEMENTS</p> <p>IBAN's Recommendation IBAN recommends that STO prepares financial statements using consistent accounting policies and methods for its three executive entities in accordance with IPSAS 3.</p>	<p>STO prepared its 2020 Financial Statements using consistent accounting policies and methods for its three executive entities in accordance with IPSAS 3.</p>	<p>Observation Closed.</p>
<p>(5) STO FY 2019 IBA-AR(2020)0010, paragraph 5</p> <p>IMPROVEMENTS TO THE PRESENTATION OF THE BUDGET EXECUTION STATEMENTS OF OCS AND CSO</p> <p>IBAN's Recommendation 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.</p>	<p>STO improved the presentation of the Budget Execution Statement for OCS and CSO and the note disclosures and addressed all related audit findings.</p>	<p>Observation Closed.</p>
<p>(6) STO FY 2017 IBA- AR(2018)0017, paragraph 3</p> <p>CMRE IMPROVEMENT NEEDED IN COMPLIANCE WITH CIVILIAN PERSONNEL REGULATIONS (CPR) ON</p>		<p>Observation Closed.</p>

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
<p>THE DURATION OF EMPLOYMENT OF CONSULTANTS</p> <p>IBAN's Recommendation 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>STO Human Resources took relevant measures for the matter to be closed, implementing an updated workflow in compliance with the NATO CPRs.</p>	
<p>(7) STO FY 2017 IBA- AR(2018)0017, paragraph 4</p> <p>FURTHER IMPROVEMENTS REQUIRED IN THE AREA OF RISK MANAGEMENT, INTERNAL CONTROL, AND INTERNAL AUDIT.</p> <p>IBAN's Recommendation 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>STO is implementing the work related to documenting and assessing internal controls. STO did not disclose any deadline for the completion of the work. No significant decision was approved via the Steering Board this financial year. To be reviewed during next year's onsite audit.</p>	<p>Observation: In-Progress.</p>
<p>(8) STO FY 2014 IBA-AR(2015)36, paragraph 1.1</p> <p>CENTRE FOR MARITIME RESEARCH AND EXPERIMENTATION (CMRE) – IMPROVEMENTS NEEDED IN ACCOUNTING TO RECOGNIZE ITS CUSTOMER FUNDED STATUS / IMPROVEMENTS NEEDED TO MANAGEMENT ACCOUNTING BY PROJECT</p> <p>IBAN's Recommendation 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 progressed during the last year. However, it is not yet embedded in a coherent integrated system using formalised and traceable processes to reconcile the assessment of project progress with financial data. In particular, the reconciliation between Time Accounting</p>	<p>Observation: In-Progress.</p>

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IBA-AR(2021)0020

OBSERVATION / RECOMMENDATION	ACTION TAKEN BY AUDITEE	STATUS
	(Replicon) and Project Budgets needs to be implemented.	

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

SCIENCE AND TECHNOLOGY ORGANISATION (STO) FORMAL COMMENTS ON THE AUDIT REPORT AND THE INTERNATIONAL BOARD OF AUDITORS (IBAN) POSITIONS**OBSERVATION 1:
FAIR PRESENTATION OF CONVERSION OF LAPSED APPROPRIATIONS INTO ADVANCED CONTRIBUTIONS*****STO's Formal Comments***

Do not fully concur.

Sufficient, relevant information to explain the conversion of lapses into advanced contributions was included in note 8 on deferred revenue to the financial statements. The notes to the Financial Statements are to be seen as a whole and as such, we deemed there was no need to disclose the same information twice, in note 7 on payables and in note 8 where it was more relevant.

IBAN's Position

IBAN considers that the information to explain the conversion of lapses into advanced contributions included in the notes to the STO 2020 Financial Statements is not sufficient, as the impact of this decision may be inaccurately interpreted by users of the financial statements. This is because Note 7 does not specify that lapses converted into advanced contributions in 2020 based on BC-D(2020)0176-FINAL were not included in Payables. IBAN therefore maintains its recommendation.

**OBSERVATION 2:
IMPROVEMENT NEEDED IN THE INTERNAL CONTROL PROCESS FOR THE PREPARATION OF FINANCIAL STATEMENTS AND BUDGET EXECUTION STATEMENT*****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.

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.
- 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.

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25 June 2021

STO-OCS(2021)0044

Chair, International Board of Auditors for NATO (IBAN)

Subject: The Science and Technology Organization consolidated Financial Statements for the Year ended 31 December 2020

Reference: IBA-A(2021)0071, IBAN audit of 2020 STO Financial Statements – Request for issuing restated financial statements, 24 June 2021

1. Please find attached the restated 2020 Science and Technology Organization (STO) Financial Statements, submitted in accordance with your agreement as per Reference.
2. As per the previous submission, 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 31st August 2021 (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 & STB Chairman

Action Officer: Ms A. Mueffke, Principal Administrator (Finance) to IMS-FC (4593)

Annex 1: STO Financial Statements FY 2020

Cc: STO Financial Controller,
CSO Director, CSO Deputy Director, CSO Head of Budget and Finance
CMRE Director, CMRE Deputy Director, CMRE Head of Budget and Finance

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Financial Statements of the
NATO SCIENCE AND TECHNOLOGY ORGANIZATION

31 December 2020



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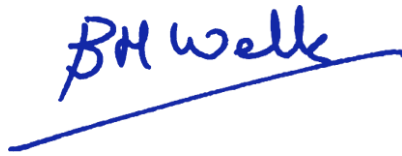
Introduction

1. The NATO Science and Technology Organization (STO) is a NATO body. The mission of the NATO STO is to help position the Nations' and NATO's S&T investments as a strategic enabler of the knowledge and technology advantage for the defense and security posture of NATO Nations and partner Nations by:
 - a. Conducting and promoting S&T activities that augment and leverage the S&T capabilities and programmes of Nations and NATO in support of Alliance objectives;
 - b. Contributing to NATO's ability to influence security and defense related capability development and threat mitigation in NATO and partner Nations;
 - c. Delivering targeted and timely evidence-based advice in support of decision-making in NATO Nations and NATO.
2. According to the STO Charter¹, the STO comprises the Science and Technology Board (STB) and three separate executive bodies, each one with a Head of NATO Body, budget or revenue stream, supported by the STO Financial Controller:
 - a. Office of the Chief Scientist (OCS), located in the NATO Headquarters, Brussels, Belgium;
 - b. Collaboration Support Office (CSO), located in Neuilly-sur-Seine, France ; and
 - c. Centre for Maritime Research & Experimentation (CMRE), located in La Spezia, Italy.
3. The OCS and CSO are NATO common-funded entities and their budgets part of the Military Budget. CMRE is customer funded and its revenue recognized based on goods and services delivered to its customers.
4. The STO 2020 Financial Statements have been prepared in accordance with the NATO Accounting Framework (NAF), based on International Public Sector Accounting Standards (IPSAS) as adapted by NATO and the NATO Financial Regulations (NFRs). They are presented in a commonly adopted layout.
5. The IMS Budget Group covers a number of budgets and entities linked together for financial management purposes by a Financial Controller. The Financial Controller is the Financial Controller of the International Military Staff, the NATO Defense College and the Science and Technology Organization (STO). These entities are therefore related parties under a common Financial Controller.
6. Throughout 2020, the STO experienced and shared in the impact of the COVID-19 pandemic as it took effect in Europe and around the world. The spread of the virus on a pandemic scale, and the related response measures necessary for the STO to implement, not only caused deviations from the planned activities but also affected the modus operandi of the Organization. While the successful achievement of core objectives remained a priority, special emphasis was placed on ensuring business continuity and protecting the health of staff and contractors at all times. The effects of such

¹ C-M(2012)0046

unpredictable event and consequent changes in plans are visible in these Financial Statements in terms of both budget execution and net operating results on the customer-funded activities.

7. The International Board of Auditors for NATO (IBAN) issued² 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 raised a Key Audit Matter, which does not impact the audit opinion on the financial statements and on compliance, related 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. Agreeing that further disclosure is needed and while applying NAFs, the Organization corrected and enhanced the relevant disclosure notes better highlighting the history, accounting treatment, status, roles and responsibilities of NATO, the CMRE and the Italian Navy concerning these vessels.



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



Rui M.M. da Silva
PRTCV - Financial Controller

² IBA-A(2020)0122

Statement on Internal Control

The NATO 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 STO Risk Management and Internal Control systems, 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 12.2).

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 2020 and up to the date of these Financial Statements.

The systems of Risk Management and Internal Financial Control are designed to manage and minimize rather than entirely eliminate 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

The culture and ethical values of the overall control environment are established by senior management. 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.

Oversight is provided by the Science and Technology Board (STB), supported by various sub-groups, who routinely scrutinize STO Senior Management reports on strategic operational matters.

On Financial matters, interim Budgetary Execution Reports are presented to and reviewed by the NATO Budget Committee two 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 at various oversight fora. 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).

The overall structure of the STO incorporates clearly defined responsibilities and authorities in the pursuit of operational objectives. In this regard, the Finance and Audit Sub-Group (FASG) mission is to prepare the decision making process of the STB, pertaining to the financial and audit governance of the STO and the STO's Executive Bodies. The scope of the FASG activities covers all financial, audit and financial risk aspects of the STB's Governance.

Risk Assessment

The STO continues to develop internal risk management policies and procedures, adapting existing risk management frameworks, to better identify those events that if occurring may affect the achievement of its objectives.

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 and Technology Board (STB) is routinely informed about risks affecting the STO, via the work of the STB Finance and Audit Sub-Group (FASG).

Although in the course of 2020 some of the planned efforts were adversely affected by the limitations imposed by COVID-19, it is anticipated that in the course of 2021 the STO and its executive bodies will deploy relevant initiatives to further enhance the understanding of the risks which are implied in the set strategy, in order to anticipate adverse events and take the necessary corrective measures.

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 in order 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 executive management boards who meet on a routine basis to review internal processes and to inform decision-making.

Information and Communication

STO internal communications are enhanced by strong reporting lines. The STO has extensive guidance on the management of information and communications. This promotes effective communications in pursuit of operational objectives. Communication also provides for the effective functioning of internal control. The FASG, for example, reports to the STB.

The STO communicates externally on matters affecting the functioning of internal control mechanisms including the Statement on Internal Control, which is included in the financial statements. External Audits include examinations of internal controls and compliance. The results of these audits are reviewed by various oversight authorities and made available to the general public along with the financial statements.

Monitoring

An outsourced Internal Audit service provider is engaged on a periodic basis, to undertake internal audit assignments. The STO is also subject to annual external audit from the International Board of Auditors for NATO (IBAN).

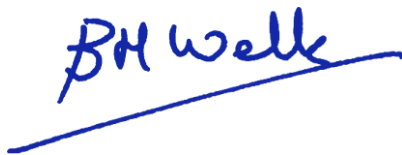
Recommendations and observations arising from audits are assessed by the FASG, which vets the remediation actions, reporting the results to the STB.

The Chairman of the STB, the Heads of NATO body of CSO and CMRE and the 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-groups reporting to the STB, including the Finance and Audit Sub-Group (FASG).

The IBAN audit of the STO 2019 Financial Statements resulted in an unqualified opinion. In it the IBAN raised a Key Audit Matter, which does not impact the audit opinion, related 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. The IBAN also observed on the need for strengthening of risk management procedures and clarification of the internal control process related to the temporary shortfall of funds in IMS Budget Group entities.

The STO is taking the necessary measures to address all outstanding observations, including the Key Audit Matter, by continuously implementing improvements to risk management practices specifically tailored to each of the executive bodies, clarifying with the support of the IMS the principles underpinning the temporary transfer of cash between entities within the same budget group and, while applying NAFs, enhancing the information provided in the disclosure notes.

Overall, while continuing to develop further application guidance within the framework of the STO Risk Management Policy, we are satisfied that the Risk Management and Internal Financial Control systems in operation across the STO during the year 2020 were reasonably adequate and effective.



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



Rui M.M. da Silva
PRTCV - Financial Controller

STO Consolidated Statement of Financial Position

as at 31 December 2020

(in EUR)

		<u>2020</u>	<u>2019*</u>	<u>2019</u>
	Notes			
Assets				
Current assets				
Cash and cash equivalents	2	8,286,156	8,291,897	8,291,897
Receivables	3	4,949,228	5,477,925	5,477,925
Prepayments	4	460,987	271,824	271,824
		<u>13,696,371</u>	<u>14,041,646</u>	<u>14,041,646</u>
Non-current assets				
Property, plant & equipment	5	3,791,339	4,796,919	4,043,983
		<u>3,791,339</u>	<u>4,796,919</u>	<u>4,043,983</u>
Total assets		<u>17,487,710</u>	<u>18,838,565</u>	<u>18,085,629</u>
Liabilities				
Current liabilities				
Payables	6	2,952,119	3,102,932	3,102,932
Deferred revenue	7	627,544	406,678	406,678
Advances	8	3,728,508	2,775,130	2,775,130
Other current liabilities	9	240,596	291,734	291,734
		<u>7,548,767</u>	<u>6,576,474</u>	<u>6,576,474</u>
Non-current liabilities				
Deferred revenue	10	347,075	399,226	399,226
		<u>347,075</u>	<u>399,226</u>	<u>399,226</u>
Total liabilities		<u>7,895,842</u>	<u>6,975,700</u>	<u>6,975,700</u>
Surplus/Deficit		(2,270,996)	(1,892,872)	(2,311,608)
Retained earnings	11	12,197,064	13,755,737	13,421,537
Total net assets		<u>9,591,868</u>	<u>11,862,865</u>	<u>11,109,929</u>
Total net assets and liabilities		<u>17,487,710</u>	<u>18,838,565</u>	<u>18,085,629</u>

*Restated



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



Rui M.M. da Silva
PRTCV - Financial Controller

The notes on pages 11 to 27 form an integral part of these financial statements.

The financial statements were originally issued to the International Board of Auditors for NATO on 31 March 2021 and resubmitted, upon agreement from IBAN (IBA-A(2021)0071), on 24 June 2021.

STO Consolidated Statement of Financial Performance

for the year ended 31 December 2020
(in EUR)

	<u>2020</u>	<u>2019*</u>	<u>2019</u>
Notes			
Revenue	12		
Revenue	31,845,422	30,775,055	30,775,055
Financial revenue	19,311	228,763	228,763
Total revenue	<u>31,864,733</u>	<u>31,003,818</u>	<u>31,003,818</u>
Expense			
Personnel	13	19,288,294	19,288,294
Contractual supplies and services	14	12,516,873	12,516,873
Depreciation	5	1,052,441	1,471,177
Finance costs		39,082	39,082
Total expense		<u>32,896,690</u>	<u>33,315,426</u>
Surplus/(Deficit) for the period		<u>(2,270,996)</u>	<u>(2,311,608)</u>

*Restated

STO Consolidated Cash Flow Statement

for the year ended 31 December 2020
(in EUR)

		<u>2020</u>	<u>2019*</u>	<u>2019</u>
Cash flow from operating activities	Notes			
Surplus/(Deficit)		-2,270,995	-1,892,872	-2,311,608
Non-cash movements				
Depreciation/ Amortization	5	1,600,413	1,052,441	1,471,177
Increase in payables and provision		- 150,814	-1,997,994	-1,997,994
Increase / (decrease) in other current liabilities		1,123,106	- 227,672	- 227,672
Increase / (decrease) in deferred revenue		- 52,151	125,510	125,510
Decrease / (Increase) in other current assets		- 189,163	89,709	89,709
(Increase) / Decrease in receivables		<u>528,697</u>	<u>3,020,634</u>	<u>3,020,634</u>
Net cash flow from operating activities		<u>589,093</u>	<u>169,756</u>	<u>169,756</u>
Cash flow from investing activities				
Purchase of property plant and equipment / Intangible assets	5	- 594,833	-1,161,576	-1,161,576
Net cash flow from investing activities		<u>- 594,833</u>	<u>-1,161,576</u>	<u>-1,161,576</u>
Cash flow from financing activities				
Cash in from IMS BG transfer			500,000	
Cash out from IMS BG transfer			- 500,000	
Net cash flow from financing activities		<u>-</u>	<u>-</u>	<u>-</u>
Net increase/(decrease) in cash and cash equivalents		<u>- 5,740</u>	<u>- 991,820</u>	<u>- 991,820</u>
Cash and cash equivalent at the beginning of the period		<u>8,291,897</u>	<u>9,283,716</u>	<u>9,283,716</u>
Cash and cash equivalent at the end of the period	2	<u>8,286,157</u>	<u>8,291,896</u>	<u>8,291,896</u>

*Restated

STO Consolidated Statement of Changes in Net Assets

for the year ended 31 December 2020

(in EUR)

	Commitments / Legal Obligations	Depreciation Reserve*	Vessels Reserve	Net Equity Fund	General Reserve	Total
Balance at the end of the period 2018	1,320,684	4,079,868	615,000	3,500,000	3,905,984	13,421,536
Restated of net book value	-	334,199				334,199
Restated balance at 1-Jan-2019	1,320,684	4,414,067	615,000	3,500,000	3,905,984	13,755,735
Surplus/(deficit) for the period	138,804	(16,374)	-	-	(2,015,302)	(1,892,872)
Change in net assets/equity for the year ended 2019	138,804	(16,374)	-	-	(2,015,302)	(1,892,872)
Balance at the end of the period 2019	1,459,488	4,397,693	615,000	3,500,000	1,890,682	11,862,863
Opening balance 2020	1,459,488	4,397,693	615,000	3,500,000	1,890,682	11,862,863
Surplus/(deficit) for the period	(204,181)	(953,428)	191,537	-	(1,304,924)	(2,270,996)
Change in net assets/equity for the year ended 2020	(204,181)	(953,428)	191,537	-	(1,304,924)	(2,270,996)
Balance at the end of the period 2020	1,255,307	3,444,265	806,537	3,500,000	585,758	9,591,867

Notes to the STO Consolidated Financial Statements

1. Significant accounting policies

1.1. Basis of preparation

The STO financial statements 2020 have been prepared in accordance with the NATO Accounting Framework (NAF). The NAF is based on International Public Sector Accounting Standards (IPSAS), as adopted by NATO. 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.

In accordance with Article 2 of the NFRs, the financial year covered by these financial statements is 1 January to 31 December 2020. 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.

1.2. 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.

Change in accounting estimates

Following IBAN's recommendation in their Letter of observations and recommendations for the STO for the year ended 31 December 2019, the STO entities decided to align their accounting estimates for the 2020 financial statements on the two following accounting areas:

- Depreciation of property, plant and equipment (PP&E):

STO has aligned their accounting policy across the three entities regarding the starting date of the straight-line depreciation of their property, plant and equipment. This adjustment has been accounted for as a restatement of the opening balance for the 2020 financial statements. Applying this depreciation policy retroactively, this resulted in a change of net book value at 1 January 2019. The net book value of all property, plant and equipment was increased from 4,043,983 EUR to 4,796,920 EUR. In addition, the effect of decreased depreciation expense for the year ended 31 December 2019 of 752,935 EUR is recognized in the Statement of Changes in Net Assets as well as in the restated PP&E table. A further presentational change was made regarding the 2019 transfer of work in progress to relevant asset categories. These transfers were not shown on the adjustment line but were previously included within additions (see note 5).

- STO Consolidated Statement of Cash Flow:

Within the consolidated cash flow statement, a presentational change has been made to show cash transfers within the IMS Budget Group, which have a net effect of zero.

1.3. Changes in pronouncements

At the date of authorization of these financial statements, the STO has not applied the following new and revised IPSAS that have been issued but are not yet effective. The effective dates of the following have been deferred due to COVID-19:

- IPSAS 41 Financial Instruments
- IPSAS 42 Social Benefits
- Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)
- Collective and Individual Services (Amendments to IPSAS 19)
- Improvements to IPSAS, 2019.

It is not expected that the adoption of these standards will have a material impact on the financial statements of the STO in future periods.

1.4. Foreign currency transactions

These financial statements are presented in euro (EUR), which is the STO functional and reporting currency. Foreign currency transactions are accounted for at the NATO exchange rates prevailing at the date of the transaction. Monetary assets and liabilities which were denominated in foreign currencies at year-end are assessed for materiality and if material are converted into euro using the applicable NATO exchange rates as at 31 December 2020. Realized and unrealized gains and losses resulting from the settlement of such transactions and from the revaluation at the reporting dates of monetary assets and liabilities denominated in foreign currencies are recognized in the Statement of Financial Performance.

1.5. Consolidation

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

Name	Location
Office of the Chief Scientist (OCS)	Brussels – Belgium
Collaboration Support Office (CSO)	Neuilly-sur-Seine – France
Centre for Maritime Research and Experimentation (CMRE)	La Spezia – Italy

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

The three bodies each 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 - paragraphs 18-22. CSO and OCS are common funded entities and CMRE is customer funded.

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 departure

from IPSAS 6, these activities are not consolidated into the respective financial statements of NATO reporting entities. More information on MWA is disclosed in note 19.

1.6. Services in-kind

The STO received services in-kind in the form of military personnel provided by the NATO nations. Such personnel are assigned to specific military positions on the Personnel Establishment (CMRE) and Peacetime Establishments (CSO and OCS) 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.

1.7. Financial instruments disclosure/presentation

STO uses only non-derivative financial instruments as part of its normal operations. These financial instruments include cash, bank accounts, deposit accounts, accounts receivable, provisions and cash transfers 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 2020 is equal to the total amount of bank balances, short-term deposits, and receivables disclosed in the Statement of Financial Position. Receivables considered uncollectible are adequately accounted for. There is a very limited credit risk associated with the realization of these instruments.

Currency risk: The STO's exposure to foreign currency exchange risk is very 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 of whether the organization will encounter difficulties in meeting its obligations associated with financial liabilities.

For CSO and 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 accuracy of forecasting cash requirements as well as the delay in payment represent the main liquidity risk. For CMRE, liquidity risk is minimized by the cash available in the Net Equity Fund (NEF) and by the policy of requiring pre-payments and milestone payments from customers.

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

1.8. Cash and cash equivalents

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

1.9. Receivables

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

Contributions receivable are recognized when a call for contribution has been issued to the member nations. No allowance for loss is recorded with respect to member countries' assessed contributions receivable except for exceptional and agreed technical reasons.

1.10. Prepayments

Prepayments and deposits are payments to suppliers, employees and other NATO entities in advance of the period to which they pertain.

1.11. Property, plant and equipment (PP&E)

Property, plant and equipment with finite useful lives that are acquired separately are carried at initial cost less accumulated depreciation and any recognized impairment losses.

Depreciation is recognized on a straight-line basis over their estimated useful lives. Monthly depreciation is charged in the month of acquisition and nil in the month of disposal. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period with the effect of any changes in estimate accounted for on a prospective basis. Property, plant and equipment is derecognized when no future economic benefit is expected. The cost and any related accumulated depreciation are removed from the accounting records.

Assets purchased prior to the implementation of the NATO Accounting Framework

In accordance with the NATO Accounting Framework adaptation of IPSAS 17, PP&E acquired prior to 1 January 2013 has been fully expensed and the STO does not foresee any grouping of assets. STO owns or controls approximately 100 assets purchased before 1 January 2013, amongst them the NATO Research Vessel Alliance and the Coastal Research Vessel Leonardo. In accordance with the NATO Accounting Framework, the STO capitalizes within the relevant equipment category, improvements made to the assets on or after 1 January 2013.

1.12. Impairment of tangible and intangible assets

The carrying values of non-current assets are reviewed for impairment when events or changes in circumstances indicate that they may be not recoverable. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Any provision for impairment is charged against the statement of financial performance in the year concerned.

1.13. Payables

Payables (including amounts due to other NATO entities) are recognized at their fair value. This includes estimates of accrued obligations for goods and services received but not yet invoiced.

1.14. Deferred revenue

For CSO and OCS, deferred revenue represents contributions from nations and/or third parties that have been called for current or prior year budgets but that have not yet been recognized as revenue.

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.

1.15. Advances

For CSO and OCS, advances are income or contributions from member nations or third parties called or received, that are related to future budgets. Funds are called in advance of their need because the entity has no capital that would allow it to pre-finance any of its activities.

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.

1.16. Employee benefits – Post-employment benefits

STO employees participate either in the Defined Contribution Pension Scheme (DCPS) or in the Coordinated Pension Scheme.

The assets and liabilities for all of NATO's post-employment benefit schemes are accounted for centrally at NATO Headquarters by the International Staff (NATO IS) and therefore are not recognized in these financial statements.

Defined Contributions Pension Scheme: The assets of the plan are held separately from those of STO in funds under the control of an independent Administrator. The STO is required to contribute a specified percentage of payroll costs to the DCPS to fund the benefits. Payments to the DCPS are recognized as an expense when employees have rendered service entitling them to the contributions. The only obligation of STO with respect to the DCPS is to make the specified contributions.

Coordinated Pension Scheme: Employees who joined NATO before 1 July 2005 are members of the NATO Coordinated Pension Scheme, which is a funded defined benefit plan. Under the plan and 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.

Continued Medical Coverage: Some qualifying retirees may also benefit from Continued Medical Coverage (CMC).

1.17. 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 realization of an operating surplus or deficit in the financial reporting period.

1.18. Revenue

Revenue comprises contributions from member nations and other customers to fund STO activities. 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.

For CSO and OCS, revenue is recognized in the Statement of Financial Performance in the year for which the contributions are used for their intended purpose as envisioned by the budgets. The balance

of unspent contributions and other revenues that relate to future periods are deferred accordingly. Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the entity recognizes a liability until the condition is fulfilled.

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.

Exchange rate revenue due to transactions in foreign currency, in accordance with IPSAS 4 – Effect of the foreign exchange rate, is recognized as financial revenue.

2. Cash and cash equivalents

	(in EUR)	
	2020	2019
Petty cash	846	2,954
Current accounts	8,285,310	8,288,943
Total	8,286,156	8,291,897

Cash and cash equivalents are short-term liquid assets, held in EUR, GBP and USD. Deposits are held in interest bearing bank accounts in immediately available funds. For CSO and OCS, cash holdings are largely determined by the timing of receipts from the nations, which arrive in two instalments, generally in April and December.

3. Receivables

	(in EUR)	
	2020	2019
Receivable from non consolidated NATO entities	63,749	2,575,341
Receivable from governments	18,800	48,903
Other receivables	4,866,679	1,746,816
Insurance	-	1,106,866
Total	4,949,228	5,477,925

Other receivables are mainly invoices to be established for services that have been provided to CMRE customers, including NATO HQ SACT, but not invoiced at the end of the reporting period.

The insurance reimbursable for NRV alliance repairs was received in 2020.

4. Prepayments

	(in EUR)	
	2020	2019
Prepaid expenses	231,547	209,475
Advance to vendors	229,440	62,349
Total Prepayments	460,987	271,824

Prepaid expenses are amounts paid for expenses incurred or services rendered, but for which the benefits continue to flow in the following financial years. The figure relates, for the most part, to CMRE prepaid insurance for the two vessels and software licenses.

Advance to vendors is payment for which goods have not been received, or services have not been rendered. The advances relate, for the most part, to the payment made for the replacement of bulletproof windows in the CSO premises (173,288 EUR).

5. Property, plant and equipment

(in EUR)

	Mission equipment	AIS equipment	Vehicles	Installed equipment	Work in progress	Total
Gross Book Value (1 Jan 2019)	2,583,391	509,415	55,608	2,601,763	1,738,789	7,488,966
Accumulated depreciation	(1,726,487)	(351,951)	(6,184)	(716,562)		(2,801,184)
Net Book Value (1 Jan 2019)	856,904	157,464	49,424	1,885,201	1,738,789	4,687,782
Additions in 2019	338,701	-	-	170,448	652,427	1,161,576
Adjustments in 2019	1,658,407			80,382	(1,738,789)	-
Depreciation in 2019	(691,841)	(74,593)	(11,117)	(274,887)		(1,052,439)
Net Book Value (31 Dec 2019)	2,162,171	82,871	38,307	1,861,143	652,427	4,796,919
Gross Book Value (31 Dec 2019)	4,580,499	509,415	55,608	2,852,593	652,427	8,650,542
Accumulated depreciation (31 Dec 2019)	(2,418,328)	(426,544)	(17,301)	(991,450)	-	(3,853,622)
Net Book Value (31 Dec 2019)	2,162,171	82,871	38,307	1,861,143	652,427	4,796,919

*Restated

(in EUR)

	Mission equipment	AIS equipment	Vehicles	Installed equipment	Work in progress	Total
Gross Book Value (1 Jan 2020)	4,580,499	509,415	55,608	2,852,593	652,427	8,650,542
Accumulated Depreciation	(2,418,328)	(426,544)	(17,301)	(991,450)	-	(3,853,622)
Net Book Value (1 Jan 2020)	2,162,171	82,871	38,307	1,861,143	652,427	4,796,920
Additions in 2020	369,516	222,295	-	-	3,022	594,833
Adjustments in 2020	-	652,427	-	-	(652,427)	-
Depreciation in 2020	(1,061,142)	(242,370)	(11,141)	(285,760)	-	(1,600,413)
Net Book Value (31 Dec 2020)	1,470,545	715,223	27,166	1,575,383	3,022	(1,600,413)
Gross Book Value (31 Dec 2020)	4,950,015	1,384,137	55,608	2,852,593	3,022	9,245,375
Accumulated Depreciation (31 Dec 2020)	(3,479,470)	(668,914)	(28,442)	(1,277,210)	-	(5,454,036)
Net Book Value (31 Dec 2020)	1,470,545	715,223	27,166	1,575,383	3,022	3,791,339

The impact of the alignment of the depreciation policy resulted in a decrease of the depreciation expense by 418,737 EUR. At the same time, the net book value of all property, plant and equipment at 1 Jan 2019 was increased from 4,353,583 to 4,687,782. This two effects lead to a restated NBV at 31 Dec 2019 of 4,796,920 EUR.

A further presentational change was made regarding the 2019 transfer of work in progress to relevant asset categories. These transfers (1,658,407 EUR) are now shown on the adjustment line but were previously included within additions.

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

Category	Useful life	Threshold
Mission equipment	3	50,000
Automated information systems equipment	3	50,000
Vehicles	5	10,000
Installed equipment	10	30,000

Depreciation is recognized on a straight-line basis over their estimated useful lives. Monthly depreciation is charged in the month of acquisition and nil in the month of disposal. The depreciation charge for the year was 1,600,413 EUR (2019 restated: 1,052,439 EUR).

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

STO – Assets purchased prior to the implementation of the NATO Accounting Framework

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.

CSO owns one staff car purchased before 1 January 2013.

CMRE owns approximately 100 assets purchased before 1 January 2013.

- *Vessels*
 - *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*

NATO Research Vessels

The NATO vessels NRV Alliance and CRV Leonardo are used to carry out the CMRE programme of work for its customers. The CMRE and its predecessor organizations acquired full operational control and beneficial ownership of these two NATO vessels in 1988 and 2002 respectively. Following a North Atlantic Council decision on 21 December 2015, custody of both vessels (on behalf of NATO) was

transferred from the Supreme Allied Commander Transformation, to the STO Centre for Maritime Research and Experimentation (CMRE) with effect from 1 January 2016.

The vessels are operated by the Italian Navy under Italian flagging and Italian military crew as agreed in a memorandum of understanding between the CMRE and Italy.

Notwithstanding the formal transfer in custody effective 1 January 2016, both vessels have been under the full operational control of the CMRE since their introduction into service in 1988 and 2002. The transfer of custody on behalf of NATO was a non-adjusting event. The acquisition date of both vessels remains unchanged. In accordance with the NATO Accounting Framework, the STO considers Property, Plant and Equipment (PP&E) acquired prior to 2013 as fully expensed. Therefore, consistent with the accounting treatment in prior years, these assets are not capitalized as PP&E on the face of the STO Consolidated Statement of Financial Position.

In accordance with the NATO Accounting Framework, improvements made to the vessels on or after 1 January 2013 are capitalized within the relevant equipment category.

CMRE intends to operate the vessels for the foreseeable future. Costs related to a potential future divestment have therefore not been assessed nor accounted for. Any future divestment decision (sale, dismantling or donation) regarding these vessels requires formal approval from the North Atlantic Council upon recommendation from the Defence Policy and Planning Committee (Resources) and Resource Policy and Planning Board.

Write-offs

In 2020, no write-offs meet the disclosure criteria in the NFRs.

6. Payables

	(in EUR)	
	2020	2019
Payables to suppliers	1,443,961	1,299,842
Accruals	1,508,158	1,803,090
Total	2,952,119	3,102,932

Payables are short-term 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.

Accruals are mainly related to goods and services received before year-end and untaken leave. As from 31 December 2020, CSO has accrued untaken leave, which has increased expenses by 119,870 EUR. The CMRE untaken leave balance is 601,235 EUR.

7. Deferred revenue

The deferred revenue at year-end 2020 is related to Programme of Work activities (OCS and CSO) and associated commitments not fully delivered by suppliers (carried-forward) at 31 December 2020 due to delays from contractors unable to fulfil their deliveries as planned.

8. Advances

	(in EUR)	
	2020	2019
Advances from customers	1,186,495	1,022,710
Contributions	2,500,000	1,750,000
Other advances	42,013	2,420
Total	3,728,508	2,775,130

Contributions are cash called or received related to future years' budgets (applicable to CSO and OCS), and advances from customers (applicable to CMRE) for pre-financing of European Community projects. Exceptionally, Nations have decided to convert 720,000 EUR of the 955,977 EUR for CSO and OCS lapses shown on the budget execution statement in Annex 1, to advances from the nations for 2021.

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. These include lapses, miscellaneous income from operational results, financial results and any budget over- and under-calls.

	(in EUR)	
	2020	2019
Liabilities from lapsed budget authorization	235,977	237,151
Liabilities from operational result	4,623	6,217
Liabilities from financial result	(4)	(1,634)
Liabilities from budget decrease	-	50,000
Total	240,596	291,734

10. Deferred Revenue – Non-current liabilities

The deferred revenue for the capitalization of PP&E of CSO and OCS represents depreciation that has not been incurred. The revenue is recognized incrementally in the same year as the depreciation expense.

11. Net Assets

The deficit of the period (EUR 2,270,996) reduced the net assets, which are allocated as follows:

Reserve	Commitments / Legal Obligations	Depreciation Reserve*	Vessels Reserve	Net Equity Fund	General Reserve	Total
Net Equity 31st December 2019	1,459,488	4,397,694	615,000	3,500,000	1,890,682	11,862,864
Net change in Vessels Reserve			191,537			191,537
Net change in PPE		(953,429)				(953,429)
Net change in Commitment	(204,181)					(204,181)
Net change in General Reserve					(1,304,923)	(1,304,923)
Net Equity 31st December 2020	1,255,307	3,444,265	806,537	3,500,000	585,759	9,591,868
					Net result of the period	(2,270,996)

*Restated

Commitments/Legal Obligations

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 net book value of assets and a source of future depreciation expense. This amount has been restated for the NBV at 1 Jan 2019 and the depreciation charge for the year 2019 following the alignment of the PP&E depreciation policy (see also Note 5).

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. 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 the net accumulated earnings available for allocation in subsequent financial periods. In 2020, this reserve was reduced by 1,304,922 EUR reflecting the net operating loss from customer funded activities at CMRE recorded in the period. This was mostly due to the negative impact the COVID-19 pandemic had on the CMRE's revenue, with the customers postponement of projects, and the restrictions brought on the operation of the vessels, such as quarantine requirements for embarking personnel, which severely limited its use.

12. Revenue

	(in EUR)	
	2020	2019
Revenue from contributions	6,260,616	6,794,520
Revenue from services	25,584,806	23,980,535
Financial revenue	19,311	228,763
Total	31,864,733	31,003,818

Revenue from contributions is the revenue received from the member nations to cover the operational expenses of CSO and OCS.

Revenue from services is the revenue received from CMRE customers: HQ SACT, European Community and projects funded from industries and other public organizations.

Financial revenue is composed of bank interest and realized currency gains. For CSO and OCS, financial revenue is used to cover financial costs to the extent possible.

13. Personnel

Employees are compensated for the service they provide in accordance with rules and amounts established by NATO. The compensation consists of basic salary, various allowances, health insurance, pension plan and other benefits as agreed with each host nation and the protocols of NATO.

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	4	5	9	2	4	6
CMRE - Customer funded positions	9	-	9	7	-	7
International Manpower Ceiling	27	40	67	20	35	55
CMRE - Customer funded positions	-	169	169	-	151	151
Voluntary National Contributions	1	-	1	2	-	2
Total	28	209	237	22	186	208

The breakdown of salaries and other personnel related expenses is as follows:

	(in EUR)	
	2020	2019
Basic Salary	13,387,681	12,710,214
Allowances	2,087,500	2,137,322
Employer's contribution to post-employment benefits	1,081,728	968,114
Employer's contribution to insurance	1,684,834	1,477,671
Consultant	485,877	1,242,038
Other allowances	545,619	621,152
Medical examination	29,384	24,181
Training	55,958	107,603
Total personnel expenses	19,358,581	19,288,294

Untaken leave

The balance of untaken leave at the end of 2020 is 2,047.5 days (2019: 1,932 days). The associated cost is recognized as an accrual for 739,028 EUR. The breakdown by entity is shown below:

Entity	(in days)	
	2020	2019
OCS	41.0	4.0
CSO	398.5	171.0
CMRE	1,608.0	1,757.0
Total	2,047.5	1,932.0

14. Contractual supplies and services

	(in EUR)	
	2020	2019
General support	1,587,255	1,818,040
Mission support	10,654,771	8,820,759
Travel	222,715	1,042,814
Grants and subsidies	173,582	663,457
Miscellaneous	108,004	69,922
Capital and investments	163,051	101,881
Total Expenses	12,909,378	12,516,873

Contractual 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.

15. 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.

CMRE has recently become aware of an invoice issued in 2019 in the amount of 213,000 EUR for repairs made to the NRV Alliance. CMRE's position is that these repairs, conducted in 2019, were a direct consequence of the supplier's defective workmanship when carrying out prior repairs in 2018. There is a possibility that the supplier will initiate court action to recover the invoiced amount from CMRE in the future. Should that be the case, some or all of these costs may be reimbursed to CMRE by way of a future insurance claim.

16. Segment reporting

In accordance with IPSAS 18, the STO discloses segment information for its three executive bodies as provided in the STO Charter: CMRE, CSO and OCS. There are no inter-entity transactions that would be eliminated on consolidation.

	(in EUR)							
	CMRE		CSO		OCS		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
Segment revenue								
Revenue from contributions			5,383,078	5,914,229	877,538	880,290	6,260,616	6,794,519
Revenue from services	25,584,806	23,980,536					25,584,806	23,980,536
Financial revenue	18,164	225,535	1,147	3,228	-	-	19,311	228,763
Total segment revenue	25,602,970	24,206,071	5,384,225	5,917,457	877,538	880,290	31,864,733	31,003,818
Segment expenses								
Personnel costs	14,921,061	14,695,916	3,719,254	3,874,007	718,265	718,371	19,358,580	19,288,294
Contractual supplies and services	11,141,454	10,359,669	1,608,651	1,995,285	159,273	161,919	12,909,378	12,516,873
Depreciation and amortisation	1,545,240	1,007,503	55,173	44,937	-	-	1,600,413	1,052,440
Financial costs	266,210	35,854	1,147	3,228	-	-	267,357	39,082
Total segment expenses	27,873,965	26,098,942	5,384,225	5,917,457	877,538	880,290	34,135,728	32,896,689
Surplus/deficit for the year	(2,270,995)	(1,892,871)	-	-	-	-	(2,270,995)	(1,892,871)
Segment assets	13,399,766	15,631,375	3,540,383	2,689,093	547,561	518,097	17,487,710	18,838,565
Segment liabilities	3,807,898	3,768,510	3,540,383	2,689,093	547,561	518,097	7,895,842	6,975,700

17. 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 International Military Staff (IMS) and the NATO Defense College (NDC). The STO, IMS and NDC are therefore related parties.

During the year, the STO entered into transactions with NATO entities outside the IMS Budget Group. The fees charged for these transactions were an appropriate allocation of the costs incurred.

Key management personnel include the following officials:

Science and Technology Board	<ul style="list-style-type: none"> NATO National Representatives on STB
Office of the Chief Scientist	<ul style="list-style-type: none"> NATO Chief Scientist
Centre for Maritime Research and Experimentation	<ul style="list-style-type: none"> CMRE Director CMRE Deputy Director
Collaboration Support Office	<ul style="list-style-type: none"> CSO Director CSO Deputy Director

Remuneration of key management personnel

STO Board members do not receive 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 applicable national or NATO pay scales. They do not receive from NATO any additional remuneration for Board responsibilities or access to preferential benefits such as the entitlement to receive loans over and above those available to all NATO personnel under normal rules.

	(in EUR)	
	2020	2019
Basic salaries	556,720	422,027
Allowances	46,317	79,477
Post-employment benefits	66,806	50,643
Employer's contribution to Insurance	66,871	49,158
Total	736,714	601,305

18. Representation allowance

Representation allowance is available to certain designated NATO high officials whose position entails responsibility for maintaining relationships of value to NATO. In 2020, three senior STO officials were entitled to the representation allowance for the following expenses:

	(in EUR)	
	2020	2019
OCS	-	2,245
CSO	3,011	5,469
CMRE	1,509	2,650
Total	4,521	10,364

19. Morale and Welfare Activities

The STO carried out Morale and Welfare Activities (MWA) in 2020 for which a detailed annual special purpose report is presented to the relevant Financial Committee. Morale and Welfare Activity is an activity of a NATO body that enhances the quality of life, promotes cohesion and integrity, and/or contributes to the physical and mental wellbeing of eligible individuals. At the CMRE, the MWA mainly relate to common interest clubs, athletic and recreational activities.

The position of MWA at year-end is:

(in EUR)	2020
Cash and cash equivalents	78,626
Total liabilities including provisions and contingent liabilities	138,395

As of year-end, 0.5 full-time equivalent staff directly support the MWA.

20. Events after the reporting date

There have been no other material events between the reporting date and the date the financial statements are authorized for issue that would affect the amounts recognized in these statements.

Annex 1: Budget Execution Statements

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 recognized in the budget execution statement.

OFFICE OF THE CHIEF SCIENTIST

EURO	Initial Budget	Transfers	BA2	Transfers	BA3	Transfers	Final Budget	Commitments	Expenses	Total Spent	Carry-Forward	Lapsed
BUDGET 907 (OCS) 2020												
Chapter 71	937,118	-	937,118	(17,090)	920,028	-	920,028	-	718,265	718,265	-	201,763
Chapter 72	181,205	-	181,205	17,090	198,295	-	198,295	-	159,273	159,273	-	39,022
Chapter 73	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL	1,118,323	-	1,118,323	-	1,118,323	-	1,118,323	-	877,538	877,538	-	240,785

The significant lapses in 2020 are due to the understaffing in NATO International Civilians Peacetime Establishment positions as well as to the travel restrictions imposed by NATO governments in response to the COVID-19 pandemic.

There is no difference between the actual budget execution amounts as per the OCS budget execution statement and the actual expenses as per the OCS segment reporting.

COLLABORATION SUPPORT OFFICE

EURO	Initial Budget	Transfers	BA2	Transfers	BA3	Transfers	Final Budget	Commitments	Expenses	Total Spent	Carry-Forward	Lapsed
BUDGET 908 (CSO) 2020												
Chapter 71	4,080,775	(100,000)	3,980,775	-	3,980,775	-	3,980,775	2,205	3,719,255	3,721,460	2,205	259,315
Chapter 72	2,161,211	(155,990)	2,005,221	(1,700)	2,003,521	30,284	2,033,805	150,084	1,437,634	1,587,719	150,084	446,086
Chapter 73	25,000	255,990	280,990	1,700	282,690	(30,284)	252,406	175,255	67,361	242,616	175,255	9,790
TOTAL	6,266,986	-	6,266,986	-	6,266,986	-	6,266,986	327,544	5,224,250	5,551,794	327,544	715,192
BUDGET 908 (CSO) 2019												
Chapter 71	-	-	-	-	-	-	-	-	-	-	-	-
Chapter 72	106,678	-	106,678	-	106,678	-	106,678	-	106,678	106,678	-	-
Chapter 73	300,000	-	300,000	-	300,000	-	300,000	300,000	-	300,000	300,000	-
TOTAL	406,678	-	406,678	-	406,678	-	406,678	300,000	106,678	406,678	300,000	-
TOTAL BUDGET 908 (CSO)	6,673,664	-	6,673,664	-	6,673,664	-	6,673,664	627,544	5,330,927	5,958,472	627,544	715,192

The significant lapses in 2020 are a direct result from the protective measures taken by NATO governments in response to the evolving COVID-19 pandemic. The restrictions applied to international travel, meetings, exercises and scientific demonstrations of technologies directly impacted on the usual financial and personnel support of the CSO to S&T Board and Panel meetings and the scientific activities conducted within the framework of the annual S&T Collaborative Program of Work.

The following table is a reconciliation of actual budget execution amounts as per the CSO budget execution statement to actual expenses as per the CSO segment reporting.

	(in EUR)
Total Expenses - Budget Execution	5,330,927
Property Plant and Equipment capitalized (Recognition from Capital and Investments)	(3,022)
Depreciation	55,173
Financial Costs	1,147
Total Expenses - CSO Segment reporting	5,384,225