NORTH ATLANTIC TREATY ORGANIZATION

International Board of Auditors for NATO

ANNUAL ACTIVITIES REPORT 2007

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INTERNATIONAL BOARD OF AUDITORS FOR NATO

ANNUAL ACTIVITIES REPORT

FOR 2007

EXECUTIVE SUMMARY

The International Board of Auditors for NATO (Board) is an independent six-member audit body reporting to the North Atlantic Council. The Board is assisted in its work by twenty-one auditors and eight administrative support personnel who are members of the International Staff. The Board is responsible for financial and performance audits of NATO bodies and the NSIP. During 2007 the Board audited some EUR 9.5 billion, of which EUR 8.9 billion relates to NATO agencies and commands, and EUR 0.6 billion to NSIP expenditures.

In July 2002, the Council decided that all NATO financial statements should be accruals based and International Public Sector Accounting Standards (IPSAS) compliant starting in 2006. The audit of the 2006 financial statements confirmed that the NATO entities have achieved significant progress in increasing the consistency and transparency of financial reporting. As expected, however, a number of financial statements needed to be restated or received qualified opinions because of failure to comply with IPSAS. In 2007, the Board issued thirty Auditor's Opinions on the accounts of NATO bodies and associated organisations. It issued 18 unqualified opinions and eleven qualified opinions of which six related to IPSAS. It did not issue an audit opinion on the accounts of one agency. The Board takes the view that NATO governing bodies and management of NATO entities maintain momentum in pursuing a consistent application of IPSAS.

On the NSIP side, the Board audited expenditure totalling more than EUR 650 million. It certified about 600 projects with a total value of EUR 639 million. About 700 completed projects for over EUR 3.1 billion authorised between 1979 and 1994 are still not closed. In February 2007, the NSIP staff and the Board made a joint proposal to the Committee to enhance the accelerated closure procedure approved in 2004. The discussion is still ongoing A timely audit is important for the accountability in NSIP. However, no incentives or sanctions exist for presenting NSIP projects for inspection and audit within a reasonable time frame after completion of the project. The Board is exploring ways on how accountability in that area could be improved. Furthermore, the Board has discontinued issuing an audit opinion on the NSIP financial statements because it believes that it does not fit the IPSAS framework.

The Board undertook both performance audits and ad hoc studies in 2007. It finalised the Survey on Corporate Governance in the NATO agencies and completed the field work for the performance audits on the Customer Funding at the NC3A and on the NATO Logistics for Deployed Operations. It carried out ad hoc studies to provide advice to the NATO Committees or to improve its own efficiency and working methods. This included an internal review of the Board's NSIP audit practices implemented in the context of the 2004 review of the Board's audit practices.

The Board continued its efforts to improve accountability and transparency in NATO. It has conducted a benchmarking survey on key aspects of the Guidelines for Corporate Governance and has issued guidance to its staff for the evaluation of the management representation letters and statements of internal control. The Board intends to revisit the issue of the Council delegation of budgetary authority to a lower NATO committee on the evaluation of the arrangements in spring 2009. The Council's decision to authorise publication of the Board's Annual Activities Reports and the Annual NSIP Reports illustrates the increasing awareness of the importance of accountability and transparency in NATO.

The Board provides in this annual report detailed information on the size of the budgets and expenditure audited, the staff allocated as well as on the direct cost of these audits in 2007.

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INTRODUCTION

BACKGROUND

1.1 This report to the Council has been prepared in accordance with Article 17 of the Charter of the Board, which states:

> "The Board shall prepare each year:... a detailed report on the activities of the Board during the year, and on progress made in processing its reports."

1.2 The Board is an independent audit body. It is composed of six members appointed by the Council from among candidates nominated by the member countries. According to Article 3 of the Board's Charter, its members are responsible for their work only to the Council and shall neither seek nor receive instructions from other authorities than the Council.

1.3 The primary function of the Board is to enable the Council and, through their Permanent Representatives, the Governments of member countries to satisfy themselves that the common funds have been properly used for the settlement of authorised expenditure. The Board's mandate also includes checking that the operations of NATO bodies have been carried out not only in compliance with the regulations in force but also with efficiency and effectiveness.

1.4 The Board conducts financial audits of agencies and of the NSIP expenditure and also carries out performance audits. The Board's audit scope in 2007 covered EUR 9.5 billion, of which EUR 8.9 billion related to Agency audits and EUR 0.6 billion related to NSIP audits.

1.5 The accounts of NATO bodies may be expressed in several different currencies. To help readers, and to provide some consistency, this report uses the EURO equivalent of the currencies used.

1.6 The Board's 2005-2009 Strategic Plan identifies four major goals: strengthening financial management in NATO, improving accountability in the NATO Security Investment Programme (NSIP), encouraging effective and efficient operations in NATO and promoting the Board as a model international audit organisation. The Board pursued these goals in 2007, based upon the priorities and specific targets and measures of success set out in its 2007 annual performance plan. This annual report provides for each of the goals a brief summary of the achievements in 2007.

MAIN ISSUES IN THIS REPORT

International Public Sector Accounting Standards in NATO (IPSAS)

1.7 In July 2002, the Council decided that all NATO financial statements should be accruals based and IPSAS compliant starting in 2006. The audit of the 2006 financial statements confirmed that the NATO entities have achieved significant progress in increasing the consistency and transparency of financial reporting. As expected, however, a number of financial statements needed to be restated or received qualified opinions, because of failure to comply with IPSAS. The Board found recurring problems in the application of accrual principles to expenses and revenue and in the treatment and reporting of inventories. It also noted instances where there was a lack of consistency and co-ordination between entities and a general lack of attention for the detailed requirements of IPSAS, for example in relation with note disclosures, the preparation of cash flow statements and the booking of provisions and contingent liabilities. The Board acknowledges the efforts made by the NATO entities to implement IPSAS and encourages the entities to maintain the current momentum. The Board therefore would welcome that the Council reconfirm the importance of IPSAS as NATO accounting standards in support of the efforts of the NATO Financial Controllers for a consistent application of IPSAS NATO-wide (paras 2.3 - 2.6).

IPSAS and the preparation of NSIP financial statements

1.8 NSIP Management issued annual financial statements for the first time in 2003, as a result of its involvement in the Working Group on NATO Accounting Standards. It based these financial statements as much as possible upon formats that comply with IPSAS. The Board has discontinued issuing an audit opinion on these NSIP financial statements because it believes that it is not necessary for the NATO Office of Resources (NOR) to issue IPSAS compliant annual financial statements for the NSIP as a programme. The Board will nevertheless, as in the past, continue to review the NSIP programme based upon existing regulations and reporting procedures (paras 2.7 - 2.9).

IPSAS and reporting on NSIP expenditure by NATO entities

1.9 The Certificate of Final Financial Acceptance (COFFA) procedures of the NSIP audit for territorial host nations are designed to provide complete assurance and require that every invoice and expenditure be checked. In non territorial host nations (NATO entities), the Board applies a different approach based upon audit procedures that provide reasonable assurance (instead of absolute assurance), that the accounts are, in all material respects, fairly presented. With the implementation of IPSAS, all NATO entities should include their NSIP transactions in the annual financial statements. This allows the Board to apply a proper and more cost effective approach in NSIP funded NATO entities, even more since experience demonstrates that the risks for excess works and cost overrun are considerably lower in NATO entities than in territorial host nations. The Board will examine in future to what extent the double certification, one based on the project cost under NSIP procedures (COFFA), the other one based on the transactions reported in the annual financial statements (Auditor’s Report), could be consolidated into one single annual certification for NSIP funded NATO entities (paras 2.10 - 2.14).

Corporate Governance in NATO

1.10 The Board continued its efforts to improve accountability and transparency in NATO. It has conducted a benchmarking survey on key aspects of the Guidelines for Corporate Governance promulgated by the Council as a basis for future comparison. Most of the NATO entities issued the management representation letters and statements of internal control requested by the Board that has now issued guidance for the evaluation of these statements (paras 2.15 and 2.16).

Delegation of Budgetary Authority to a Subordinate Committee

1.11 In early 2007, the Council approved the revised terms of reference for the NATO military resource committees in the context of the NATO HQ Reform. These terms of reference devolve budget approval authority from the Council to the Military Budget Committee (MBC) which is a subordinate committee of the Senior Resource Board (SRB) that itself responds to the Council. The Board informed the Council that the budget is a prerogative of the highest authority of an organisation which should not be delegated to a lower committee. The Board intends to revisit the issue on the evaluation of the arrangements in spring 2009 (paras 2.17 - 2.19).

Publication of the Board's Reports

1.12 On 21 February 2007, the Council decided that the Board's Annual Activities Report be released to the public, beginning with the 2005 report. Similarly on 12 October 2007, the Council authorised the publication of the annual NSIP reports beginning with the 2006 report. The Board's annual reports are available on the NATO web site (paras 2.20 - 2.22).

Agency Financial Audits

1.13 In 2007, the Board issued thirty Auditor's Opinions on the accounts of NATO bodies and associated organisations. In some cases these opinions covered several entities, several sets of financial statements or several financial years. The Board issued eighteen unqualified opinions, eleven qualified opinions on the Allied Command Operations (ACO) 2005 and 2006, Allied Command Transformation (ACT) 2005 and 2006, Civil Military Cooperation Group South (CIMIC GS) 2004-2005, NATO Airborne Early Warning and Control Programme Management Organisation (NAPMO) 2006, International Staff (IS) 2006, Munitions Safety Information Centre (MSIAC) 2006, New NATO HQ 2006, NSIP 2005 and Retirees Medical Claims Fund (RMCF) 2006 financial statements. It did not issue an audit opinion on the 2005 accounts of the NATO CIS Services Agency (NCSA). Six of the qualified audit opinions related to International Public Sector Accounting Standards (IPSAS) compliance issues (paras 3.13 - 3.29).

NATO Security Investment Programme

1.14 The Board audited the expenditure presented by the nations and agencies in 2007 which totalled more than EUR 650 million compared to EUR 600 million in 2006. It certified approximately 600 projects with a total value of almost EUR 639 million, compared to 630 projects for EUR 660 million in 2006. The net credit to NATO resulting from the audit in 2007 was EUR 6.9 million. About 700 completed projects for over EUR 3.1 billion authorised between 1979 and 1994 are still not closed. At the end of 2004, the Infrastructure Committee agreed on an accelerated closure of about one thousand projects authorised between 1979 and 1994. A new proposal in February 2007 to enhance the accelerated closure procedure is still pending in the committee. Timely audit is important for the accountability in NSIP. However, no incentives or sanctions exist for presenting NSIP projects for inspection and audit within a reasonable time frame after completion of the project. The Board is exploring ways on how accountability in that area could be improved (paras 4.1- 4.14).

Performance Audits and Ad Hoc Studies

1.15 The Board undertook both performance audits and ad hoc studies in 2007. It finalised the Survey on Corporate Governance in NATO agencies and completed the field work for the performance audits on Customer Funding at the NATO C3 Agency (NC3A) and on NATO Logistics for Deployed Operations. It carried out ad hoc studies to provide advice to the NATO Committees or to improve its own efficiency and working methods, on the audit of NSIP, IPSAS and TeamMate. The Board successfully completed the targets set in its annual performance plan for 2007 by presenting only performance reports that contain recommendations and/or options (paras 5.1 - 5.7).

Matters relating to the Board

1.16 The Board had its full complement of six serving Members for the whole of 2007. Since 2006 the Board has an authorised establishment of twenty-one auditors. The auditor vacancy rate in 2007 was 1.9 staff years. At the end of 2007, four of the nineteen audit staff present and one of the Board Members were women. Board Members and Auditors came from thirteen nations (paras 6.1 -6.3).

1.17 In 2003 and 2004 the Board carried out a review of its agency audit practices. In 2006, the Board implemented the last of the twenty-three action points and carried out an internal review of its NSIP audit practices. The recommendations of that NSIP review were gradually implemented in the course of 2008 (paras 6.4 and 6.5).

1.18 The publication of the Board's reports is an opportunity to improve its external visibility. A new satisfaction survey among staff showed a status quo in areas of internal communication and training, however, with big variances between old and new staff and concluded that further work was needed in these areas (para 6.6).

1.19 The Board's Strategic Training Plan 2004-2007 foresees an average of two weeks' training for each auditor. In 2007 each auditor received on average 10.3 days of training. Common training covered the use of audit software, auditing IPSAS and accruals based accounting. Individual auditors participated in seminars organised by their professional organisations (paras 6.7 and 6.8).

1.20 The Board provides in this annual report detailed information on the size of the budgets and expenditure audited, the staff allocated as well as on the direct cost of these audits in 2007 (paras 6.9 - 6.11).

1.21 The Competent National Audit Bodies (CNABs) met on 7th May 2007 to discuss the Board's 2006 annual report. The Board presented that report to the Council on 11th July 2007 and received strong support from the Permanent Representatives. The Board continued to develop its contacts with the professional audit community. The Board's representatives briefed visitors from the Supreme Audit Institutions (SAIs) and several NATO bodies on its activities and led NSIP workshops in five nations that joined NATO in 2004 (paras 6.13 - 6.18).

CHAPTER 2

ISSUES OF ACCOUNTABILITY AND GOVERNANCE IMPORTANT TO THE BOARD

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS IN NATO

Introduction

2.1 In July 2002, the North Atlantic Council adopted the International Public Sector Accounting Standards (IPSAS), including the accrual and going concern assumptions, as the applicable accounting standards for NATO entities effective from the 2006 financial statements. The Ad Hoc Working Group of Financial Controllers prepared the transition to IPSAS and acts as a forum where NATO entities share knowledge and ensure the consistent implementation. The Board participates in these meetings.

2.2 The audit of the 2006 financial statements confirmed that the NATO entities have achieved significant progress in increasing the consistency and transparency of financial reporting, although further important aspects need to be addressed, such as the consistency of accounting treatments NATO-wide and the completeness, consistency and usefulness of the note disclosures in the financial statements.

The implementation of IPSAS

2.3 As expected in the first year of implementation, a large number of financial statements needed to be reissued (restated) or received qualified audit opinions, due to the failure to comply with IPSAS. Anticipating such problems, the Board had put into place a policy in which, if certain conditions were met, it would issue the audit opinion based on restated or corrected financial statements. All nine of the financial statements that were restated received unqualified audit opinions as a result of the restatement. If the conditions of the policy were not met or the entity preferred not to restate, the Board issued its audit opinion on the original financial statements. This resulted in IPSAS related qualifications on the financial statements of six entities in 2007 (ACO, ACT, IS, MSIAC, the New NATO Headquarters and RMCF). Such flexibility by the Board was a practical approach to address the transition to IPSAS. The restatements, though, caused significant delays in financial reporting that also directly affected the timeliness of the audit reports. The Board will therefore apply in future a restrictive policy to auditing restated statements.

2.4 Recurring problems identified as a result of the Board's audit of the 2006 financial statements are the following:

a) Improper and inconsistent application of recording expenses and revenue on the accrual basis;

b) Incorrect and inconsistent treatment and presentation of inventories, particularly in regards to pricing, valuation and classification;

c) Lack of consistency and weak co-ordination between NATO entities in the following areas:

- expenses incurred against advances received from another NATO entity;
- inventories managed by one entity on behalf of another NATO entity;
- expenses and revenues related to reimbursable activities and delegated budgets.

d) A general lack of attention to the detailed requirements of IPSAS, particularly in relation to the completeness of note disclosures, but also to the preparation of the cash flow statement, the booking of provisions and contingent liabilities, and others.

2.5 Finally, the transitional period of five years for the implementation of IPSAS 17 on Property, Plant and Equipment ends in 2010. The application of that standard will present challenges for many entities and raise issues in commands, NATO Production and Logistics Organisations (NPLOs) and crisis response operations about the definition of assets, ownership of the assets and about what entity will account for them and how. These and similar issues should be dealt with before the transitional period expires.

Conclusion

2.6 The primary objective of IPSAS implementation "was to harmonise accounting standards and reporting formalities across NATO, taking into account the Alliance's heterogeneous structure." (Council document PO(2002)109). The Board acknowledges the efforts made by the NATO entities to implement IPSAS and it notes that, as a result, the consistency and transparency of financial reporting within NATO is starting to improve. That momentum should be maintained. The Board therefore would welcome that the Council reconfirm the importance of IPSAS as NATO accounting standards in support of the efforts of the NATO Financial Controllers for a consistent application of IPSAS NATO-wide.

IPSAS AND THE PREPARATION OF NSIP FINANCIAL STATEMENTS

2.7 NSIP Management issued annual financial statements for the first time in 2003. It had taken that initiative as a result of its participation in the Working Group on NATO Accounting Standards. These financial statements are, as much as possible, based upon IPSAS compliant formats. The statements are based on semi-annual financial reports that provide information on the financial status of the programme and form the basis for its funding through the system of multilateral compensation.

2.8 The Board does not believe that there is a requirement for separate IPSAS compliant financial statements for the NSIP as a programme. There is a significant and unavoidable time lag between the nations' expenditure reported in the financial statements and the final determination by the Board of what is eligible expenditure. It is therefore impossible to audit the funding and incurrence of NSIP expenditures in the context of an annual financial statement. The NSIP financial statements should consequently not be described as complying with IPSAS. The Board has therefore discontinued issuing an audit opinion on the financial statements of the NSIP with effect from the 2006 statements and informed the IC of this decision. However, this Board decision does not affect NATO entities that receive NSIP funding and that, under IPSAS must continue to report on these transactions in their financial statements.

2.9 As in the past, the Board will nevertheless continue to review the NSIP financial activities in order to provide sufficient assurance to the nations.

IPSAS AND REPORTING ON NSIP EXPENDITURE BY NATO ENTITIES

2.10 NSIP projects in territorial host nations are in principle audited when the projects are fully expended and formally accepted by the Infrastructure Committee, and prepared and presented for audit by the nation. The Board issues a Certificate of Final Financial Acceptance (COFFA) on the expenditure to be charged to NATO common funds, after all observations have been satisfactorily resolved. Certification of expenditure implies that in principle every invoice and expenditure amount should be checked. The certification process is designed to provide full assurance.

2.11 In NATO entities acting as a NSIP Host Nation, the Board is able to use a different audit approach based upon the annual financial statements. Several NATO entities that receive NSIP funding include the related transactions in their annual financial statements, parallel to the separate ad hoc semi-annual NSIP financial reporting. In fact, with the implementation of IPSAS, all agencies and commands that receive NSIP funding should include such operations in their annual statements.

2.12 In the financial statements audit, the auditor designs procedures to provide reasonable assurance -not absolute assurance- that the accounts are, in all material respects, fairly presented. Auditing standards prescribe procedures to achieve that assurance including evaluation of risks and controls and of accounting policies and reviewing records and documentation on a sample basis. The Auditor's Report ("Audit Opinion") issued by the Board on annual financial statements formulates that assurance.

2.13 The Board views this as a proper and cost effective approach in NSIP funded NATO entities, the more since experience and analyses demonstrate that the risks for excess works, cost overrun and overestimated advance claims from the programme are considerably lower in agencies than in territorial host nations. It therefore intends to generalise the annual financial statements based audit approach to all NATO entities that receive NSIP funding and, in accordance with IPSAS, need to include it in their annual financial statements.

2.14 The Board will also examine in future to what extent the double certification, one based on the project cost under NSIP procedures (COFFA), the other one based on the transactions reported in the annual financial statements (Auditor's Report) could be consolidated into one single annual certification.

CORPORATE GOVERNANCE IN NATO

2.15 In 2007, the Board continued its efforts to promote accountability and transparency in NATO. It conducted a survey to obtain preliminary indications of how NATO agencies are implementing key aspects of the "Guidelines for Corporate Governance of NATO Organisations", adopted by the Council on 20 September 2005. In that survey the Board established benchmarks for future comparison in the areas of Organisational Structure and Processes, Standards of Behaviour, Control and External Reporting. The details of that survey and the recommendations formulated are attached at Annex B, Para 32**.**

2.16 In a similar context of good governance, the Board requested in early 2005 that senior managers of NATO bodies recognise their responsibility for the fair presentation of the financial statements and the establishment and maintenance of an effective system of internal control. This is done in the management representation letter and the statement on internal control. All entities are now providing these letters and the Board has issued guidance to its audit staff on how to evaluate the assurance provided in accordance with IFAC International Standard on Auditing 580 and the INTOSAI Guidelines for internal control standards for the public sector.

DELEGATION OF BUDGETARY AUTHORITY TO A SUBORDINATE COMMITTEE

2.17 On 14 February 2007, the Council approved C-M(2007)0010 - "Revised Terms of Reference (TOR) for the Senior Resource Board, the Infrastructure Committee and the Military

Budget Committee". The revision is a result of the NATO Headquarters Reform that comprises a number of initiatives to improve NATO's working practices and business procedures, inter-alia in the area of resource management that was previously dissipated over various committees.

2.18 Some of the provisions of these revised TOR affected the working practices and the mandate of the finance committees and still require final resolution. Other provisions delegate budget authority that previously was a Council prerogative, to the MBC, a subordinate committee of SRB. These provisions constitute a significant exception to the NATO financial regulations. They also violate the principles of Corporate Governance approved previously by the Council itself on 28 September 2005 with C-M(2005)0087. More detail on this issue is provided in the Annual Report 2006 in paras 5.6 to 5.9.

2.19 As announced at the time of the approval of the TOR, a review of the new arrangements is scheduled to take place in spring 2009. The Board remains of the opinion that the budget is a prerogative of the highest authority of the organisation. It intends to revisit the issue on the evaluation of the current arrangements.

PUBLICATION OF THE BOARD'S REPORTS

2.20 The question of public access to the Board's reports as a means to increase transparency and accountability has been raised several times in the past in the context of the Board's annual report, by SAIs and in the Advisory Group of Financial Counsellors (AGFC). Following a recommendation by the AGFC formulated during its review of the Board's annual report on 2005, the Council on 21 February 2007 agreed to the publication of the annual reports beginning with the 2005 report.

2.21 Similarly, on recommendation of the Infrastructure Committee, the Council agreed on 12 October 2007 that the annual reports on the audit of NSIP may be released to the public, beginning with the report on 2006.

2.22 The 2005 and 2006 annual reports of the Board and the 2006 annual report on the audit of NSIP are available on the NATO web site.

CHAPTER 3

AGENCY FINANCIAL AUDITS

BACKGROUND

3.1 The Board audits civilian and military headquarters and other entities established pursuant to the North Atlantic Treaty. The Board also audits other activities or operations in which NATO has a particular interest such as the multi-nationally funded Commands and the NATO Parliamentary Assembly. The Board refers to all these audits as agency audits. In 2007 there were 83 such agencies that come under the Board's mandate. They include 48 military headquarters (HQ) of which 24 HQ are common funded by a NATO budget and 24 HQ are multi-nationally funded by the participating nations; 15 NATO Production and Logistics Organisations (NPLOs) plus 4 national divisions attached to these NPLOs with a budget approved by their respective finance committees or governing bodies; and 16 military, civilian and other bodies of which 4 entities have a multi-national status. The audited entities are listed in Annex C. These bodies are funded through the civil and military budgets approved by the Council, budgets approved by the governing bodies of NPLOs, or budgets approved by the nations participating in a multinational entity or activity. Some NATO bodies also implement NSIP projects and receive funding from that programme. The Board is also mandated to audit non-appropriated funds covering morale and welfare activities for NATO staff. In 2007, the agency accounts to be audited by the Board amounted to EUR 8,881 million (see details in Annex D to this report).

3.2 NATO bodies have a varying degree of autonomy in managing their operations. All NATO bodies are subject to the NATO Financial Regulations (NFR) that are approved by the Council and that provide a high level financial and budgetary framework. These NFR also apply to most of the multinational entities via an explicit provision in their memoranda of understanding.

3.3 Although some entities group or consolidate financial information at varying levels, there is no NATO-wide financial reporting. The result is that in many cases the financial statements of the different NATO bodies are not homogeneous and difficult to compare. The implementation of IPSAS in the NATO funded entities, with effect from the 2006 financial statements, is an opportunity to harmonise and improve accounting and financial reporting.

AUDIT MANDATE

3.4 According to the Board's Charter, the primary function of the Board is, by its audit, to enable the Council and, through their Permanent Representatives, the Governments of member countries to satisfy themselves that common funds have been properly used for the settlement of authorised expenditure. The Board is responsible for checking that expenditure incurred by NATO bodies is within the physical and financial authorisations granted and that it is in compliance with applicable rules and regulations. The Board provides a similar assurance to the participating nations and the governing bodies of the multinational entities. The Board's financial audits result in an audit opinion on the financial statements of NATO bodies issued in accordance with the NFR and international standards on auditing.

PERFORMANCE IN 2007

3.5 One of the goals of the Board's 2005-2009 Strategic Plan aims at reinforcing financial management in the NATO bodies. The Annual Performance Plan for 2007 identified two criteria to measure successful achievement: (1) timeliness of the audit reports and (2) the amount of recommendations implemented.

3.6 Target for the first objective (timeliness) was to have 40% of the audit reports approved within 6 months after the publication of the financial statements. The Board approved only nine of the thirty reports on time (30%), mainly because many entities took a long time to restate their accounts after audit as a result of IPSAS related audit observations or incurred significant delays in responding to IPSAS related observations. In normal circumstances the rate of success would have been as high as 61%.

3.7 The Board achieved its second target of 80% of the recommendations implemented, within a three-year period of the audit report date. Of the 110 observations formulated in 2004, 96 observations (87.3%) were resolved by 2007.

AUDIT METHODOLOGY AND CONDUCT OF AUDITS

3.8 The objective of the audit of financial statements is to provide assurance that these statements present fairly in all material respects, the financial position of the NATO body and the results of its operations, on a basis consistent with the previous year; and that the underlying transactions are in compliance with budgetary authorisations and relevant regulations. The Board's audit methodology distinguishes the usual phases of Planning (including mid-term strategic and annual planning), Audit Execution, Reporting and Follow-up and is compliant with the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI), complemented, as and when required, by the International Standards on Auditing issued by the International Federation of Accountants (IFAC). The audit process is fully integrated in the TeamMate audit software.

3.9 Audits are conducted on the agency site by auditors, under the supervision of a Board Member. The more significant agencies and those with a higher risk are audited every year. A few agencies posing only a small audit risk are audited every two or three years. In that case a minimal review of the financial statements is nevertheless undertaken during the years not covered by a full audit. The Council endorsed this policy of cyclical auditing in 1990. Annex C shows the cyclical basis on which the Board plans and carries out the audits of agencies and commands. Nineteen entities were not scheduled for audit in 2007 and will be audited over the next two years. They represent about EUR 75 million in annual budget, which is less than 1% of the Board's audit scope for 2007.

ALLOCATION OF RESOURCES

3.10 The Board is responsible for the audit of some 83 different agencies and commands, some of which consolidate their accounts. Amounts audited range from less than EUR 0.5 million to over EUR 5 billion. The Board also audits the expenditure of over 30 NSIP host nations (NATO bodies and nations), with an audited scope of EUR 650 million in 2007.

3.11 Agency audits are resourced on the basis of risk and available staff. The risk assessment takes into account elements such as the entity's *size* in budgetary and staff terms, its *organisational complexity* in terms of the number of locations, programmes and budgets, the *complexity of the transactions* (number, variety), the *time expired between* two audits. It also covers the qualitative elements such as *external visibility* and *sensitivity* of the activities, and the risks for overall *accountability and control*. Issues that may affect the allocation of resources include a qualified or adverse audit opinion, the creation of a new NATO body, the implementation of new activities, a reorganisation or change in management, problems with the implementation of an accounting system or any other event that creates an additional risk for the agency's activities. Elements such as these explain for example why the Board uses proportionally more resources on military commands than it does on NPLOs, or why the audit effort is not necessarily proportional to the size of the entities' activities.

3.12 Throughout the process, the Board maintains a high degree of flexibility, which allows it to make optimal use of its resources. The Board considers that, through its position in NATO and the inputs from the audit teams, it has a good overview on where the risks lie and on the resources needed to cover them.

SUMMARY OF AGENCY AUDIT WORK IN 2007

3.13 In 2007, the Board issued thirty Auditor's Opinions on the accounts of some 63 NATO bodies and assimilated organisations, using 10.5 staff years. In several cases the opinions covered several entities, several sets of financial statements or several financial years.

3.14 Table 3.1 below summarises the amounts audited and resources used for the three types of agency audits during 2007 and 2006.

TABLE 3.1
AGENCY EXPENDITURE AND AUDIT EFFORT (2007-2006)

	Audit Scope (EUR Million)		Audit Effort In staff years		Audited per Staff year (EUR Million)	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
NPLOs	7,586	8,450	4.6	3.8	1,649	2,224
Commands	836	857	3.6	3.7	232	231
Civ. & Mil. Agencies	459	364	2.3	2.3	200	158
Global Average	**8,881**	**9,671**	**10.5**	**9.8**	**900**	**987**

3.15 Resources allocated to agency financial audits increased by 7%, from 9.8 to 10.5 staff years. This increase illustrates an overall improved staff situation, and a significant improvement in the audit effort devoted to NPLOs. The disparity between amounts audited per staff year in NPLOs and other agencies is explained by the differences in size and by different risk factors mentioned in the previous section on allocation of resources.

SIGNIFICANT AUDIT OPINIONS

3.16 In 2007 the Board issued thirty Auditor's Opinions comprising eighteen unqualified opinions, eleven qualified opinions on the ACO 2005 and 2006, ACT 2005 and 2006, CIMIC Group South 2004-2005, NAPMO 2006, IS 2006, MSIAC 2006, New NATO HQ 2006, NSIP 2005 and RMCF 2006 financial statements. It did not issue an audit opinion on the 2005 accounts of NCSA. Six of the qualified audit opinions resulted from IPSAS related observations. An explanatory note on the different types of audit opinions is provided on page 3 of Annex B.

3.17 This section provides a summary of the modified opinions issued in 2007. It follows up on previous modified opinions as required.

3.18 **Qualified opinion on the ACO 2005 accounts.** The ACO 2005 financial statements received a qualified opinion for two reasons: (1) a scope limitation relating to all ISAF-related financial transactions, that were not adequately documented and were inflicted by significant breaches of internal control and, (2) because the ACO financial position and financial performance were materially affected by financial data pertaining to another agency, NCSA that was established as a separate NATO entity in 2004 (see Annex B para 1).

3.19 **Qualified opinion on the ACO 2006 accounts.** The Board issued a qualified opinion on the 2006 financial statements based upon the following IPSAS related observations: ACO has not made an assessment of the adjustments that might have been necessary to comply with IPSAS. Furthermore, in the transition to IPSAS, ACO has made incorrect adjustments that resulted in a EUR 30 million overstatement of revenue and a EUR 109 million understatement of assets (receivables) and liabilities (unearned revenues). The Board also found significant weaknesses in the management and reporting of inventory, casting doubt about the reliability of the inventory balance. A fourth weakness related to the incorrect or inconsistent assessment of accruals within ACO. Finally, the ACO financial statements did not include the revenues and expenses of approximately EUR 18.5 million funded by the NSIP program (see Annex B para 2).

3.20 **Qualified opinion on the ACT 2005 accounts.** The Board qualified the ACT 2005 consolidated financial statements of the ACT Group as a result of unclear budget transfers that resulted in an unsupportable increase of the ACT budgets (see Annex B para 3).

3.21 **Qualified opinion on the ACT 2006 accounts.** The audit qualification on the 2006 ACT consolidated financial statements resulted from a scope limitation because the command had not performed an assessment to determine whether expenditures accurately reflected goods or services received during 2006 as required under the accruals based IPSAS (see Annex B para 4).

3.22 **Qualified opinion on the CIMIC GS 2004-2005 accounts.** The Board qualified the CIMIC GS 2004 and 2005 financial statements for three reasons. The first qualification relates to the presentation of the financial statements and results from the absence of statements of Financial Position and of Cash Flow. Two other qualifications relate to significant deviations from the financial regulations on budgetary transfer and carry forward of budget credits (see Annex B para 6).

3.23 **Qualified opinion on the NAPMO 2006 accounts.** The Board issued a qualified opinion on NAPMO's 2006 financial statements because of a scope limitation resulting from insufficiently documented expenditures claimed by member nations on the organisation. According to the NAPMO Charter "the authority of the Board of Auditors does not extend to auditing internal records of Member States; however, member states will make vouchers available to that Board in support of expenditure claimed by them on the NAPMO". That statutory provision was not fully complied with because the provided documentation was not considered by the Board as sufficiently supporting the transactions (see Annex B para 13).

3.24 **Qualified opinion on the International Staff (IS) 2006 accounts.** The Board qualified the 2006 financial statements of the IS because they deviated in a number of instances significantly from the requirements of accruals based accounting and IPSAS. Expenditures on the statement of Financial Performance were based on budgetary commitments, which cannot be assimilated to expenses under accruals based IPSAS; Contributions were recorded as revenue when called and not when expended; Liabilities were improperly offset against receivables; and the recording of fixed assets and depreciation expenses was not in accordance with IPSAS (see Annex B para 20).

3.25 **Qualified opinion on the MSIAC 2006 accounts.** The Board qualified the 2006 financial statements of MSIAC because contributions were recorded as revenue when called and not when expended (see Annex B para 21).

3.26 **Qualified opinion on the New NATO Headquarters 2006 accounts.** There are several IPSAS related observations that lead to a qualified opinion on the 2006 accounts of the new NATO Headquarters. As the IS disclosed that they chose not to take advantage of the five-year transition period for Property, Plant and Equipment offered by IPSAS 17, all costs incurred for the project should have been capitalised as a “Construction in Progress” asset and not expensed. Furthermore, the expenses recorded in 2006 did not reflect the actual construction activity during the period and were understated by EUR 2.7 million; Contributions were recorded as revenue when called and not when expended; Assets and liabilities were understated by EUR 13 million as a result of improperly recording a temporary transfer of funds from a nation’s account to another NATO entity (see Annex B para 26).

3.27 **Qualified opinion on the NSIP 2005 accounts.** The Board qualified the NSIP 2005 financial statements because of a limitation on the scope of the audit arising from regulatory constraints. As a result of the way the programme is designed, it is impossible for the Board to audit the expenditures within territorial host nations at the time they are reported in the financial statements. These statements should consequently not be described as IPSAS-compliant and the Board has decided to refrain from issuing an audit opinion on the NSIP with effect from the 2006 financial statements. It will nevertheless continue as in the past to audit the programme based upon existing regulations, documentation and ad hoc reports (see Annex B para 27).

3.28 **Qualified opinion on the RMCF 2006 accounts.** The Board qualified the audit opinion on the 2006 statements of the RMCF because they do not disclose the defined benefit liability resulting from NATO’s obligation to provide continued medical coverage for qualifying retired staff (See Annex B para 30).

3.29 **No audit opinion on the NCSA 2005 accounts.** The Board did not issue an audit opinion on the 2005 financial statements of NCSA because it did not obtain audit assurance with respect to the assets and liabilities of NCSA as a stand alone entity. One year after the establishment of NCSA as a separate agency from ACO, material amounts of assets and liabilities pertaining to NCSA continued to be reported in the context of the ACO accounts. The Board therefore decided not to issue a separate audit opinion on the NCSA 2005 financial statements (see Annex B para 15).

FOLLOW-UP ON PRIOR YEARS’ QUALIFIED OPINIONS

3.30 **Unqualified opinion on the AFNORTH International School 2006 accounts.** The Board had previously issued a disclaimer of opinion on the accounts of the AFNORTH International School for the years 2002, 2003 and 2004 because the accounting records of the School were inadequate and no reliable financial statements were available. The Board had issued an unqualified opinion on the 2005 financial statements of the School, as corrected during the audit. The school again received an unqualified opinion on the 2006 financial statements, illustrating the soundness of measures taken to improve the accounts (see Annex B para 16).

CHAPTER 4

NATO SECURITY INVESTMENT PROGRAMME AUDITS

BACKGROUND

4.1 The Annual Activity Report gives a brief outline of the Board's activities and concerns in respect of the NATO Security Investment Programme (NSIP). Under Article 17 of its Charter, the Board also prepares a separate report to the Council summarising the result of the audit of NSIP expenditure. The report will be issued later in the year, after all NSIP expenditure made in 2007 has been reported by nations and NATO agencies.

4.2 NATO established the Infrastructure Programme in 1951 to build facilities to meet its military requirements. The nations share the cost of the Programme based on agreed percentages. The "Host Nation" is normally responsible for the planning and execution of the project. The Council made some major changes to the Programme in 1994 and renamed it the NATO Security Investment Programme. The Programme is overseen by the Infrastructure Committee (IC).

OBJECTIVES OF THE NSIP AUDITS

4.3 Under Articles 13, 14 and 16 of its Charter, the Board verifies that common funds have been properly used for the settlement of authorised expenditure, in particular within the physical and financial authorisation granted. It has to check whether all payments for which reimbursement is claimed have actually been invoiced and paid and to detect any item that is non-eligible for NATO funding. The audit results in a Certificate of Final Financial Acceptance (COFFA). The Board certifies for each project it has audited an amount as a charge to NATO common funds. In principle, this requires that every invoice needs to be checked.

4.4 It should be noted that this is different to the Agency financial audit. There the Board's responsibility is to express an opinion as to whether the financial statements are fairly presented. The objective is to obtain reasonable assurance whether the financial statements are free of material misstatements. This allows checking the supporting documentation on a test basis.

AMOUNTS AUDITED AND CERTIFIED IN 2007

4.5 The Board audited the expenditure presented for audit by the nations and agencies in 2007. It conducted 28 audit missions in 12 nations and 4 agencies. These audits covered nearly 200 projects totalling more than EUR 650 million, compared to 250 projects for EUR 600 million in 2006. The Board issued about 600 COFFAs in 2007 with a total value of EUR 639 million, compared to 630 COFFAs for EUR 660 million in 2006. As a result of the audit of NSIP projects in 2007 the net credit in favour of NATO was EUR 6.9 million.

PERFORMANCE IN 2007

4.6 In 2007, the Board spent 2.3 staff years on the audit of NSIP. The Board continued implementing its 2005-2009 Strategic Plan. One of the goals is to improve accountability in the NSIP. In its Annual Performance Plan, the Board developed measures of success and set targets for 2007. One target was to reduce by 30 the audited projects still open, awaiting final audit or a technical inspection. Only 10 such projects were closed in 2007, illustrating that a hard core of projects are difficult to resolve. A second target to reduce the percentage of the uncertified portion for nations by 2% was achieved. The Board exceeded a third target of auditing at least EUR 350 million in territorial host nations by EUR 90 million (25%). These achievements illustrate the efforts of the Board to close NSIP projects.

THE BOARD'S 2006 NSIP REPORT

4.7 The Board issued its report on the 2006 audit of NSIP on 29th June 2007. The report formulated a number of comments and proposals directed towards improving the accountability and transparency of the programme. The Infrastructure Committee (IC) supported these comments in its report to the Council including its publication, and invited the staff and the nations in the committee to initiate the appropriate action and or discussion. The Council noted the report and the recommendations of the IC on 12th October 2007.

ACCELERATED CLOSURE OF PROJECTS IN SLICES 21 TO 45

4.8 About 700 completed NSIP projects, (with a value of over 3.1 billion EUR), authorised between 1979 and 1994 are still not technically inspected and/or not presented for audit or not closed for other reasons, such as outstanding audit observations.

4.9 In the end of 2004, the IC agreed on an accelerated closure of about one thousand projects authorised between 1979 and 1994. The Board raised concern about the slow process in 2005 to the IC. However, all participants in the accelerated closure process have gained some understanding of the process and the speed has considerably increased. More than 300 projects were closed this way in 2006, and about 200 in 2007.

4.10 In February 2007, the International NSIP Staff and the Board made a joint proposal to the IC to enhance the accelerated closure procedure. Currently, projects up to a ceiling of EUR 0.5 million and fulfilling certain other criteria are subject to a simplified technical inspection and are authorised as a lump sum with no audit required. It was proposed to increase the ceiling to EUR 2 million without materially increasing the audit risk. Increasing the ceiling from EUR 2 to 10 million would materially increase the risk and reduce the potential savings resulting from audit. Therefore, the Board recommended to the IC a "payback" of 1.8% of the expended amounts before they are converted into lump sums and certified. The 1.8% was calculated from statistical analysis of audit savings data for the years 2002 to 2004. The proposal is still under discussion in the IC. The Board expresses its concern, and expects the IC to actively pursue this issue.

ACCOUNTABILITY IN THE NSIP PROGRAMME

4.11 The main objective of the NSIP audit is the achievement of accountability. The Board noted, however, that Nations have no financial incentive to offer reported expenditure for early audit, except in cases of cost overruns. Furthermore, currently no sanctions exist that would discourage late presentation for Joint Final Acceptance Inspection (JFAI) and for audit. In its 2003 report, the Board suggested that in the future, part of the authorised funds could be withheld until a project has been subject to JFAI and final audit.

4.12 In its NSIP report for the year 2006 the Board recommended that the IC discuss this issue. The aim should be to provide an incentive for nations to present projects within the agreed milestone periods for JFAI and final audit and this way, to improve accountability in the NSIP.

4.13 In an informal IC meeting, a number of nations made clear that, for legal and accounting reasons, they would be unable to agree to any withholding of a portion of the full amount of funds when a project was authorised; however, nations were keen to explore the possibility of addressing the Board’s concerns as regards accountability in other ways.

4.14 Finally, the Board is concerned that the NATO Office of Resources, in spite of requests for JFAI by nations, is not able to organise and perform the JFAI for a large number of projects, thus preventing their final audit by the Board.

CHAPTER 5

PERFORMANCE AUDITS AND AD HOC STUDIES

INTRODUCTION

5.1 The Board's Charter mandates it to assess efficiency and effectiveness of NATO operations. It refers to these as performance audits. The Board occasionally provides advice to NATO committees and agencies and undertakes initiatives to improve its own efficiency and working methods. These activities are referred to as ad-hoc studies.

BACKGROUND

Performance audits

5.2 The Board is committed to carry out at least one substantial performance audit per year. To support that commitment, it has developed performance auditing guidance, requiring regular consideration by the Board of new audit topics, a systematic follow up of the progress in ongoing performance audits and the involvement of Board Members and financial auditors in the identification of potential topics in the agencies audited by them. A core of three auditors mainly carry out performance audits and follow up on NATO-wide performance risks and issues, assisted as required by financial auditors. The Board also decided to enhance its performance audit capabilities by increasing the resources dedicated to performance audits, ad-hoc performance audit training and investigating the possibility of involving SAI experts in certain phases of conducted performance audits. The Board is working on the development of a TeamMate module for performance audits that incorporates the related procedures.

5.3 In 2007 the Board spent 2.2 staff years on performance audits, corresponding to 11% of its resources (compared to 1.6 staff years or 8% in 2006). It developed benchmarks for Corporate Governance against which it will measure progress in future in the various NATO entities. It carried out performance audits on the NATO Logistics of Deployed Operations and on the system of Customer Funding at the NC3A, on which it spent respectively 1.2 and 1 staff years in 2007. The field work for both audits is completed. One audit was at report drafting stage; the other one was being factually cleared at the time this annual report was prepared (March 2008). The Board also started to prepare a survey for a NATO-wide study on fraud prevention and detection and the NSIP programme as potential topics for audit in 2008.

Ad hoc studies

5.4 As in the past, the Board responded to requests for advice from NATO bodies and committees. It was involved in meetings and workshops to prepare the introduction of IPSAS. It advised NATO committees on the revision of terms of reference for the main finance committees in NATO HQ and participated in meetings to prepare the update of the NATO Financial Regulations. Board representatives participate as observer in the Independent Advisory Team that oversees the new review of the NATO Command Structure. Further internal study work related to the full implementation of TeamMate and the review of the Board's NSIP audit practices. In 2007 the Board used 1.3 staff years (7%) on such study work and advice to NATO bodies and committees (2.1 staff years or 11% in 2006).

PERFORMANCE IN 2007

5.5 One of the goals of the Board's 2005-2009 Strategic Plan is to encourage effective and efficient operations in NATO bodies. Success is measured through the proportion of reports presenting recommendations and/or options (target 100%) and the percentage of recommendations implemented over a three-year period (target 70%).

5.6 The Corporate Governance audit report issued in 2007 contained recommendations and consequently met the first target. Successful achievement of the second target of 70% implementation will be checked during a follow-up audit to be scheduled two years after approval of the audit report, which allows the audited organisation to take action on the report and the recommendations. In order to complete the ongoing performance audits within the shortest possible time frame, the Board has decided to delay the follow up of the previous NATO Airborne Early Warning and Control (NAEW&C) performance audit, initially scheduled for autumn 2007 and for the ACO Financial Organisation and Management performance audit, initially scheduled for early 2008, until after summer 2008.

5.7 In its Survey on Corporate Governance, the Board has reviewed the way NATO bodies are implementing key aspects of the Guidelines on Corporate Governance adopted by the Council in September 2005. The review focused on areas such as Organisational Structures and Processes, Standards of Behaviour, Control, and External Reporting and its aim was twofold, setting benchmarks for future comparison and recommending action for improvement. Although the Council guidelines in principle apply to NPLOs, the Board also surveyed NATO military commands and civil and military agencies that have a different governance structure from NPLOs, and concluded that these entities would face problems similar to those in the NPLOs if they had to implement the Council guidelines (see Annex B para 32).

CHAPTER 6

MATTERS RELATING TO THE BOARD

PERSONNEL MATTERS

6.1 The Board had its full complement of six serving members: France, Poland, Turkey and the United States were represented on the Board for the whole of 2007. Germany and Spain sent a Board Member when Denmark and the Netherlands left on 31 July 2007.

6.2 In 2006, the Council approved two new auditor positions, augmenting the authorised establishment to 21 auditor posts, including one Principal Auditor, two Senior Auditors and 18 Auditors. Three auditors joined and two auditors left the Board in the course of 2007. Of the two remaining vacancies at 31 December 2007, one was filled on 1st March 2008. The second vacancy, reserved for a performance auditor is expected to be filled in autumn 2008. Throughout 2007, the Board had an auditor vacancy of 1.9 staff years. In its recruitment, the Board strives for a proper geographical and gender balance. At the end of 2007, four of the nineteen audit staff present and one of the six Board Members were women. Board Members and Auditors come from thirteen nations.

6.3 The Board has 1 Administrative Officer and 7 Administrative Support Staff who perform a wide range of functions in support of the audits.

REVIEW OF BOARD AUDIT PRACTICES

6.4 In 2003 and 2004 the Board carried out a review of its agency audit practices. The results of that review were shared with the SAIs, NATO stakeholders, and the staff of the Board. In 2006 the Board implemented the last of the twenty-three recommendations and carried out an internal review of its own NSIP audit practices. This lead to a number of recommendations that are being implemented on: (1) the co-ordination of all Board NSIP audit policy in one single document; (2) the implementation of a new planning approach to NSIP audits by scheduling these audits twice a year in a fixed time frame agreed with the nations and by assigning all audits in a nation or group of nations to one Board Member/Auditor; together with (3) the preparation of nation specific files describing the administration and execution of NSIP projects and the related control environment in each host nation.

6.5 For some issues identified in the review, such as the Board's mandate for NSIP, axing policy and the annual file review the review team and the Board concluded that the current status was satisfactory and did not require action for the time being. Other recommendations on the application of a sampling approach for auditing NSIP and the clearance of the backlog projects are being worked on. A final recommendation on the implementation of a performance audit on the management of the NSIP is scheduled for mid 2008.

PERFORMANCE IN 2007 - THE BOARD AS A MODEL AUDIT ORGANISATION

6.6 The fourth goal of the Board's 2005-2009 Strategic Plan aims at promoting the Board as a model international audit organisation. The publication of the Board's annual reports on the internet is an opportunity for improving the external visibility of the Board. The Board carried out a new survey in 2007 on the issue of staff satisfaction with the work environment. That survey showed a status quo in the areas of internal communication and training but revealed significant variances between old and new staff and between auditors and administrative staff. Further work is needed in these areas. The Board will also continue its monthly staff meetings and intends to develop and approve a new training strategy and plan and to step up its performance audit capacity.

TRAINING AND PROFESSIONAL DEVELOPMENT

6.7 In accordance with the auditing standards of INTOSAI and IFAC, the Board ensures that its audit and administrative staff receive adequate on-the-job training. The Board's Strategic Training Plan 2004-2007 stresses the importance of continuous professional development. The plan foresees an average of two weeks training for each auditor (one week shared training and one week individual training). It also draws on a detailed analysis of the individual training needs of the staff that are now updated annually as "personal development objectives" in NATO's Performance Management system.

6.8 During 2007 the Board provided on average about 10.3 days of training per auditor. The annual common training in January covered advanced use of spreadsheet software for audit, downloading and importing data with the IDEA software. The use of TeamMate in NSIP and modifications to the financial statements module. Other subjects related to IPSAS and accrual accounting at the European Commission (EC), brought by staff from the EC accounting service and the European Court of Auditors. This included a discussion on the IPSAS implementation status at NATO. NATO staff briefed the Board about the new IT support organisation. The Board's staff attended user group sessions and seminars on TeamMate, IT audit and project evaluation, and participated in seminars and courses organised by their professional organisations or specialised training institutes.

RESOURCE ALLOCATION

6.9 Table 6.1 below shows the use of the Board's audit resources in 2007 and 2006.

TABLE 6.1
ALLOCATION OF AUDIT RESOURCES
IN STAFF YEARS FOR 2007 and 2006

	Actual 2007	**Actual 2006**
NSIP Financial Audits	2.3	2.5
Agency Financial	10.5	9.8
Performance Audits	2.2	1.6
Studies	1.3	2.1
Training	0.9	0.9
Administration (1)	0.6	0.8
Board Support (2)	1.3	2.0
Sub-total	**19.1**	**19.7**
Vacant positions	1.9	1.3
Total authorised establishment	**21.0**	**21.0**

(1) The item "Administration" includes activities such as preparing travel, handling personnel matters, management reporting, performance management and tasks that cannot be assigned to a specific audit.
(2) The item "Board Support" covers the preparation of the Board's Activities Report, the Annual NSIP Report, and the Strategic Plan, attendance at Board Meetings and at meetings of NATO committees.

DIRECT COST OF THE AUDIT

6.10 Table 6.2 below shows the allocation of the Board's audit resources and their cost in 2007.

TABLE 6.2
DIRECT COST OF THE AUDIT IN 2007

Activity	Time Allocated (Staff days)	Direct Audit Cost (EUR million)
Agency financial audit	2,193	1.7
NSIP financial audit	473	0.4
Performance audit	461	0.3
Other (Training, Board, studies)	849	0.6
Total	**3,976**	**3.0**

6.11 The table at Annex D provides complete details of the audited amount, allocated resources and cost of the audit. This information on the size and the cost of the Board's audits has been compiled from different sources, including the Board's time recording system, and financial data on remuneration and travel provided by IS personnel and accounting services. It is important to note that the cost of the audit to NATO in 2007, EUR 3 million, constitutes less than half of the net return to NATO in pure monetary terms in the area of NSIP audits alone. Independent from the improvement in procedures and the assurance on the financial statements in the field of its agency audits, the Board's audits of NSIP projects in 2007 generated 6.9 million net adjustments in favour of NATO.

NEW ENTITIES REQUESTING AUDIT BY THE BOARD

6.12 In 2007, two new multinational entities, the Centre of Excellence Defence against Terrorism (COE-DAT) and the Intelligence Fusion Centre (IFC) requested to be audited by the Board. Requests by two other new multi-national entities are pending. In accordance with the provisions of the Charter, a Council decision is required for the Board to accept these audits. Some nations raised the point that there would be no impact on the civil budget, or that the Advisory Group of Financial Counsellors design a method to recuperate the cost of the audit. Although the Board will try to restrict the impact of these new tasks as much as possible, it cannot exclude resource implications.

ANNUAL MEETING WITH NATIONAL AUDIT BODIES

6.13 In accordance with the Council decision C-M(90)46, the competent national audit bodies have the opportunity to discuss the content of this annual report with the Board of Auditors. Para A.7. of the same document states that "the AGFC will take these comments into account, as appropriate, when reporting to the Council".

6.14 The 17th meeting to discuss the 2006 Annual Activity Report took place on 10th May 2007 under the chairmanship of the United States. Representatives of twenty-five nations participated in the meeting, which was also attended by the Chairman and several national representatives of the AGFC.

6.15 On 11 July 2007, the Board presented its 2006 annual report in the Council. The Chairman of the Board introduced the report and summarised the main achievements. The Chairman requested the Council's attention for four issues: the continued qualified audit opinions at the military commands; the Board's efforts to close old (pre-1994) NSIP projects; concerns about the implementation of IPSAS, and the Board's involvement in the promotion of Corporate Governance. In the latter context, the Chairman expressed concern that the Council, contrary to the principles of Corporate Governance, had delegated budget approval authority to a lower committee. The Permanent Representatives in the Council expressed strong appreciation for the Board's audit work, particularly in the field of performance audit. Coming back to the issue of delegated budget authority, the Council noted that the arrangements would be reviewed in two years' time and that in the meantime, any issues of concern could always be raised.

INTERNATIONAL CO-OPERATION

6.16 In line with Article 14 of its Charter, the Board continued to collaborate with the national audit bodies. In 2007, Board representatives contributed to a meeting with the external auditors of Western-European international organisations on standards applicable to the audit of international organisations and IPSAS.

6.17 The Board met with the NATO governing bodies and managers to introduce them to the Board's mandate, activities and concerns and to report on the conclusions of its Survey on Corporate Governance. It held NSIP workshops for audit and Ministry of Defence staff in two of the seven nations which joined NATO in 2004 and carried out first NSIP audits in these nations. The Board also briefed representatives from national authorities when they stay with the International NSIP Staff as trainees.

6.18 The Board attempts through the activities such as described above to stay within the mainstream of the professional audit community. The Board believes that professional contact and interchange with other audit bodies are important for maintaining a "state-of-the-art" international audit organisation, which is one of the aims of its 2005-2009 Strategic Plan.

LIST OF REPORTS

RESULTING FROM THE AGENCY AUDITS

LIST OF REPORTS RESULTING FROM THE AGENCY AUDITS

	Subject	Budget year	Reference of document and date
MILITARY COMMANDS			
1.	**ACO Group**	**2005**	IBA-AR(2007)05, dated 28.02.2007 C-M(2007)0039
2.	**ACO Group**	**2006**	IBA-AR(2008)07, dated 17.03.2008
3.	**ACT Group**	**2005**	IBA-AR(2006)37, dated 28.02.2007 C-M(2007)0034
4.	**ACT Group**	**2006**	IBA-AR(2007)23, dated 25.01.2008
5.	**CAOC Southern Region & Financial Administration**	**2005-2006**	IBA-AR(2007)21, dated 25.01.2008
6.	**CIMIC Group South**	**2004-2005**	IBA-AR(2007)07, dated 29.06.2007
7.	**NRDC GNL**	**2003-2005**	IBA-AR(2007)09, dated 29.06.2007
NPLOs			
8.	**CEPMO**	**2005**	IBA-AR(2007)02, dated 27.04.2007 C-M(2007)0063
9.	**NACMO**	**2006**	IBA-AR(2007)17, dated 28.09.2007 C-M(2007)0107
10.	**NAHEMO**	**2005**	IBA-AR(2006)17, dated 24.05.2007 C-M(2007)0105
11.	**NAMEADSMO**	**2006**	IBA-AR(2007)18, dated 28.09.2007 C-M(2007)0121
12.	**NAMSO**	**2006**	IBA-AR(2007)20, dated 7.09.2007 C-M(2008)0001
13.	**NAPMO**	**2006**	IBA-AR(2007)16, dated 7.09.2007
14.	**NC3A**	**2005**	IBA-AR(2007)01, dated 30.03.2007 C-M(2007)0064
15.	**NCSA**	**2005**	IBA-AR(2007)03, dated 28.02.2007 C-M(2007)0040

LIST OF REPORTS RESULTING FROM THE AGENCY AUDITS			
Subject		Budget year	Reference of document and date
CIVIL-MILITARY AGENCIES AND OTHER ORGANISATIONS			
16.	**AFNORTH International School**	**2006**	IBA-AR(2007)08, dated 28.09.2007
17.	**AGS3**	**2004-2005**	IBA-AR(2006)34, dated 24.05.2007 C-M(2007)0031
18.	**AGS RRS**	**2005**	IBA-AR(2006)35, dated 24.05.2007 C-M(2007)0032
19.	**INTERNATIONAL STAFF**	**2005**	IBA-AR(2006)27, dated 30.03.2007 C-M(2007)0072
20.	**INTERNATIONAL STAFF**	**2006**	IBA-AR(2007)15, dated 28.09.2007 C-M(2008)0015
21.	**MSIAC**	**2006**	IBA-AR(2007)26, dated 17.03.2008
22.	**NATO P.A.**	**2006**	IBA-AR(2007)11, dated 27.04.2007
23.	**NATO PENSION SCHEME**	**2005**	IBA-AR(2006)31, dated 28.02.2007 C-M(2007)0028
24.	**NATO PROVIDENT FUND**	**2005**	IBA-AR(2007)14, dated 26.10.2007
25.	**NEW NATO HQ**	**2005**	IBA-AR(2006)32, dated 26.01.2007 C-M(2007)0073
26.	**NEW NATO HQ**	**2006**	IBA-AR(2007)22, dated 29.02.2008
27.	**NSIP**	**2005**	IBA-AR(2006)36, dated 28.02.2007 C-M(2007)0041
28.	**PERSONNEL MANAGEMENT INFORMATION SYSTEM (PMIS)**	**2001-2005**	IBA-AR(2006)24, dated 27.04.2007 C-M(2007)0047
29.	**REPRESENTATION ALLOWANCES**	**2006**	IBA-AR(2007)12, dated 29.06.2007
30.	**RETIREES MEDICAL CLAIMS FUND (RMCF)**	**2006**	IBA-AR(2007)32, dated 29.02.2008
31.	**SHAPE INTERNATIONAL SCHOOL**	**2004-2006**	IBA-AR(2007)25, dated 30.11.2007

LIST OF REPORTS RESULTING FROM THE AGENCY AUDITS			
Subject		**Budget year**	**Reference of document and date**
PERFORMANCE AUDITS & SPECIAL STUDIES			
32.	**SURVEY OF CORPORATE GOVERNANCE IN THE NATO AGENCIES**		IBA-AR(2007)10, dated 26.03.2007 C-M(2007)0025

SUMMARY OF THE FINDINGS

IN THE AGENCY AUDIT REPORT

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PERFORMANCE AUDITS AND SPECIAL STUDIES

INTRODUCTION

After each audit, the Board issues an opinion on the financial statements. The phrase “the Board issued an "unqualified" opinion” is used whenever the Board issues an opinion that the financial statements are stated fairly and that the underlying transactions conform to the rules and regulations. A "qualified" opinion means that the Board 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 that the underlying transactions were not in conformity with budgetary authorisations and regulations. A "disclaimer" is issued when the audit scope is severely limited and the Board cannot express an opinion, or when there are material uncertainties affecting the financial statements. An "adverse" opinion is issued when the effect of an error or disagreement is so pervasive and material to the financial statements that the Board concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

In July 2002, the North Atlantic Council (NAC) adopted the International Public Sector Accounting Standards (IPSAS), including the accrual and going concern assumptions, as the applicable accounting standards for NATO entities with effect from the 2006 financial statements. For the first time the Board has audited against IPSAS and accruals based accounting principles. This has in many cases lead to IPSAS related observations and restatement of financial statements as observed in the summaries below.

RESULTS OF AUDITS RELATING TO MILITARY COMMANDS

1. Allied Command Operations (ACO) – 2005
2. Allied Command Operations (ACO) – 2006

Introduction

In 2003, the NATO Command Structure was split in two at the strategic level: the Allied Command Operations (ACO) in Mons (BE), which has all operational responsibility and the Allied Command Transformation (ACT) in Norfolk (US) which has the responsibility to lead the military transformation of Alliance forces and capabilities. There are three main headquarters under ACO, Joint Force Command (JFC) Brunssum-NL, JFC Naples-IT and Joint Command Lisbon-PO, and a number of subordinate commands and standing forces such as the NATO Airborne Early Warning Force (NAEWF). ACO presents consolidated financial statements incorporating the accounts and operations of these commands. The 2006 MBC funded budgets of ACO including credits carried forward from previous years amounted to EUR 950.8 million of which 935.9 million was committed and 722.8 million spent in 2006 (respectively EUR 945.7, 924.3 and 678.8 million in 2005).

Audit Highlights 2005

The Board issued an audit opinion with two qualifications on the 2005 ACO financial statements: (1) a scope limitation covering all ISAF-related financial transactions, that were not adequately documented and inflicted by several material breaches of internal controls; and (2) because ACO included in its statements material financial data pertaining to NCSA, established as a separate NATO agency in 2004, which materially affects the reporting of ACO financial position and financial performance.

The Board also noted that the consolidated 2005 financial statements include data from consolidated and non consolidated entities and commingle consolidation entries together with other accounting adjustments in many different sets of books and recommended that ACO clearly define and explain the consolidation process and dedicate appropriate resources to it. Furthermore, ACO should develop and enforce consistent financial policies command-wide to resolve inconsistencies in the accounting treatment of nation borne costs, the reporting of year-end closure data by the subordinate commands and the financial reporting of NSIP funded activities. A third group of observations related to weak control environment at ACO, illustrated by internal control weaknesses, insufficient internal audit and internal review activity ACO wide and a lack of action on identified internal control and internal audit weaknesses. Finally, a number of persistent technical and design weaknesses in the NAFS accounting system should be addressed as soon as possible with the system provider.

Audit Highlights 2006

The Board issued a qualified opinion on the 2006 financial statements based upon the following IPSAS related observations:

Because ACO was late in transitioning to IPSAS and made no assessment of the adjustments that might have been necessary to comply with IPSAS, the Board was not able to provide assurance that 2006 expenses, revenues, and cash flows are recorded and presented in accordance with IPSAS. Furthermore, in the process of transitioning to IPSAS, incorrect adjustments were made that resulted in a EUR 30 million overstatement of revenue and a EUR 109 million understatement of assets (receivables) and liabilities (unearned revenues). In addition, because of significant weaknesses in the management and reporting of inventory, the Board has not been able to provide assurance as to the reliability of the inventory balance. A fourth issue for qualification related to the incorrect or inconsistent assessment of accruals within ACO. Finally, the ACO financial statements did not include the revenues and expenses of approximately EUR 18.5 million funded by the NSIP program.

Despite such instances of non-compliance, the Board recognises the current efforts being made by ACO in regard to IPSAS implementation. However, the Board also observed that the future years will continue to present significant challenges for ACO due to continued organisation and staffing weaknesses that had been previously identified by the Board in its related performance audit.

The Board raised additional observations concerning the long-standing issue of an unfunded contribution cost share of EUR 31 million as of 31 December 2006; Issues of reporting; Segment information not being prepared in conformity with the accounting principles adopted for the consolidated entity; Payments of EUR 4.6 million without budgetary coverage at NHQSa; Lack of support and audit trail for nations' cost shares at NHQSa; Unclear responsibilities for the management of the airlift contract at JFC Brunssum; and Weaknesses in the HQ ISAF Kabul Accounting Software at JFC Brunssum.

3. Allied Command Transformation (ACT) – 2005
4. Allied Command Transformation (ACT) – 2006

Introduction

The audit covered the 2005 and 2006 financial statements of the Allied Command Transformation (ACT) group which comprises HQ ACT in Norfolk (US), the NATO Undersea Research Centre in La Spezia (IT) (NURC), the Joint Warfare Centre in Stavanger (NO), the Joint Force Training Centre in Bydgoszcz (PL) and the Joint Analysis and Lessons Learned Centre in Lisbon (PO). In June 2003, the revised NATO military command structure came into effect. ACT became responsible for the transformation of NATO's military structures and capabilities to improve the military effectiveness of the Alliance. The 2005 budgets of ACT, including credits brought forward from previous years, amounted to EUR 126.3 million of which 124.6 million was committed and 97.4 million spent in 2005. The 2006 budgets of ACT, including credits brought forward, amounted to EUR 143.2 million of which 141.3 million was committed and 115.3 million spent in 2006.

Audit Highlights 2005

The Board qualified the ACT 2005 consolidated financial statements of the ACT Group as a result of unclear budget transfers after the mid-year review that resulted in an unsupportable increase of the ACT budgets.

The Board made observations concerning instances of non-compliance with budgetary and financial provisions, such as funding the NAFS accounting system implementation from an inappropriate budget and carrying forward commitments without a legal liability. The audit revealed problems with internal control, illustrated by inadequate management review of financial procedures, reconciliation problems with bank accounts and with accounts receivable and payable, a lack of internal audit activity and the late submission of the financial statements. In addition, there were errors in the presentation of Equity and Budget Execution by cost-share, inconsistent or incomplete reporting on reimbursable budgets, the NURC ship chartering activities were not included in the consolidated financial statements and the ACO Interest in the ACT Equity was not properly reflected as a liability. Finally, the Board recommended that ACT take initiative to resolve a long standing dispute between the IC and the MBC on the funding of an ACT NSIP project.

Audit Highlights 2006

The Board issued a qualified opinion on the 2006 ACT consolidated financial statements because of a scope limitation resulting from the fact that ACT did not perform an assessment to determine whether expenditures accurately reflected goods or services received during 2006 as required by the adoption of accruals based IPSAS.

The Board noted inconsistent accounting treatment throughout the financial statements of Revenue, Unearned Revenue, Net Assets and Inventories and reimbursable revenues and expenses, and recommended corrective action. It also recommended that NURC in future request details from the Alliance management contractor for each transaction not actually paid at 31 December and investigate the origin of errors in booking expenses as commitments carried forward. Finally it recommended that the command improve the overall presentation of the financial statements, by including a reconciliation between expenses recorded in the Budget Execution statements and those in the Statement of Financial Performance; by providing information on NSIP Advances, Footnote Disclosures, and an IPSAS compliant and useful Cash Flow Statement.

5. Combined Air Operations Centres Southern Region & Financial Administration (CAOCs SR and SRFA) – 2005-2006

Introduction

The 11 Combined Air Operations Centres (CAOCs) were established to support NATO air operations. They are multi-nationally manned and funded except when deployed for NATO operations. The Financial Controllers of JFC HQ Naples and CC Air HQ Ramstein provide financial administrative support to the CAOCs. The CAOCs Secretariat and the two support units each have their own budget and issue separate financial statements. The Southern Region CAOCs are: CAOC 5, CAOC 6, CAOC 7, CAOC 8 and CAOC 10. They are located in Italy, Turkey, Greece, Spain and Portugal. The Southern Region Financial Administrator is based in JFC HQ Naples up to 2007 and provides the administrative support and accounting for all the Southern Region CAOCs. The CAOCs and their support organisations are subject to cyclical audit in view of their small size in budgetary terms and the lower risk involved. The 2006 Budget of the SR CAOCs and the SRFA including brought forward credits amounted to EUR 3.7 million. Commitments were EUR 3.4 million and payments 2.7 million (respectively EUR 3.6, 3.4 and 2.6 million in 2005.

Audit Highlights

The Board issued an unqualified opinion on the CAOCs 5, 6, 7, 8 and 10 and the SR Financial Administration financial statements for the years 2005 and 2006. The Board raised no new observations. It also followed up on previous audit observations and is satisfied with the corrective actions taken.

6. Civil-Military Cooperation Group South Headquarters (CIMIC GS) – 2004-2005

Introduction

CIMIC GS was established in February 2004 by Greece, Hungary, Italy and Portugal and SHAPE. It is located in Motta di Livenza (IT) and is intended to provide NATO and the participants with civil-military capabilities in support of military missions by providing a framework for cooperation between the military commander and civil structures, organisations and agencies. CIMIC GS is multi-nationally manned and funded. It is composed of 150 military staff made available by the participating nations. Budget authorisation in 2005 including brought forward credits amounted to EUR 0.6 million. Commitments were EUR 0.6 million and payments EUR 0.3 million (respectively EUR 0.1, 0.1 and nil in 2004).

Audit Highlights

The Board's audit opinion on the CIMIC GS HQ 2004 and 2005 financial statements comprises three qualifications. The first qualification is related to the completeness and fair presentation of the statements and results from the absence of statements of Financial Position and of Cash Flow, and the fact that equivalent information was not available in any other part of the statements. Two other qualifications concern the lack of compliance with budgetary and financial rules and result from unauthorised carry forwards and budgetary transfers.

The Board recommended in addition that the command credit the surplus of prior years to the nations as required by the Memorandum of Understanding. CIMIC GS should also invoke its tax exemption status on transactions with its bank and effectively apply the requirement of double signature on payment orders, agreed with the bank. Basic internal spot checks and key controls should be introduced in the budget and finance department and the cash situation monitored to avoid excessive cash holdings. Finally, the Board also recommended that the audit section in the Memorandum of Understanding be revised to properly reflect the audit authority and mandate of the International Board of Auditors for NATO.

7. NATO Rapid Deployable Corps Germany – The Netherlands – NRDC GNL 2003-2005

Introduction

The HQ NRDC-GNL is a multi-national command responsible for establishing and maintaining a rapid deployment capability in support of the Council approved operations. It is part of the NATO Force Structure subordinate to Supreme Headquarters Allied Powers Europe (SHAPE) and is located in Münster (GE). The NRDC-GNL was established in 2002 and the related memorandum of understanding was signed by nine NATO member nations, SHAPE and ACT. Three additional NATO nations joined in 2004-2006. The framework nations Germany and The Netherlands bear the costs of operating and maintaining the Headquarter. Expenditure not funded by the framework nations, by individual participants or by NATO is shared by the member countries according to a pre-defined cost sharing formula based on the share of national officer establishment. The 2005 Budget including brought forward credits amounted to EUR 1.8 million; 2005 commitments were EUR 1.8 million and payments EUR 1.8 million (respectively EUR 2.2, 2.2 and 2.1 million in 2004 and EUR 1.2, 1.1 and 0.6 million in 2003).

Audit Highlights

The Board issued an unqualified opinion on the NRDC-GNL financial statements for the years ended 31 December 2003, 2004 and 2005.

The Board recommended that the command present duly signed and dated financial statements including a formal statement of financial position and a statement on internal control. The NRDC GNL should also apply proper budget control procedures to avoid commitments exceeding authorisations. It should also revise the audit provisions in its MOU and the financial procedures to properly reflect the audit authority and mandate of the International Board of Auditors for NATO.

RESULTS OF AUDITS RELATING TO THE NATO PRODUCTION AND LOGISTICS ORGANISATIONS

8. Central Europe Pipeline Management Organisation (CEPMO) – 2005

Introduction

CEPMO is mandated to manage the transport, storage, and delivery of petroleum products in Central Europe for military and non-military clients. For that purpose, CEPMO operates and maintains the Central Europe Pipeline System (CEPS), a system of pipelines, pump stations, input and delivery points, and depots. The CEPMO Board of Directors defines the general policy, missions, objectives and resources of the system. Tariffs, contracts and procedures to be applied are the joint responsibility of the Central Europe Pipeline Management Agency (CEPMA) and the National Organisations, within the guidelines provided by the CEPMO Board of Directors. The National Organisations are established by the Host Nations which include Belgium, France, Germany, The Netherlands and Luxembourg. The United States and Canada are User Nations. The CEPMO budget for 2005 including commitments carried forward amounted to EUR 117.3 million, commitments amounted to EUR 115.5 million and payments EUR 90.5 million (respectively EUR 120.8, 116.4 and 94.6 million in 2004).

Audit Highlights

The Board issued an unqualified opinion on the CEPMO financial statements, including CEPMA and the National Organisations, for the year 2005.

The Board noted that the personnel cost information provided by one nation for consolidation into the CEPMO financial statements, due to problems with the IT systems within that nation, were provisional estimates rather than actuals. The Board recommended that the nation concerned ensure timely production of its payroll data in future.

9. NATO Air Command and Control System Management Organisation (NACMO) – 2006

Introduction

The Air Command and Control System Management Organisation (NACMO) has been established to plan, develop, co-ordinate and execute the programme for the implementation of the Air Command and Control System (ACCS). NACMA is the procurement and implementing agency and acts as host nation for the NATO Security Investment Programme (NSIP) projects assigned to it. NACMA reports to a Board of Directors representing the nations. It is located in Brussels and has an establishment of 113 posts. The NACMA 2006 financial statements consolidate the operations from both the administrative budget and NSIP accounts. The 2006 NSIP funded (operational) expenditures of NACMA amounted to EUR 19.5 million. The administrative budget including credits brought forward amounted to EUR 20.3 million, commitments to EUR 20.0 million and expenses (accrual based) to EUR 17.1 million. The NACMA 2006 expenditure (accruals basis under IPSAS) amounted to EUR 36.7 million.

Audit Highlights

The Board issued an unqualified opinion on the NACMA 2006 financial statements. It noted that the information concerning the scope authorisation and commitments for one of the NSIP projects in the 2006 financial statements was incorrect. Following the audit, NACMA issued a corrigendum to its 2006 financial statements.

The Board also audited the expenditure for NSIP projects authorised for NACMA and will issue the Certificates of Final Financial Acceptance for the audited projects for which technical inspections are completed and accepted.

10. NATO Helicopter D&D Production and Logistics Management Organisation (NAHEMO) –2005

Introduction

NAHEMO is the NATO Organisation responsible for the design, development, production and logistics support of a Tactical Transport Helicopter and a NATO Frigate Helicopter. The organisation was established by France, Germany, Italy and the Netherlands. Portugal joined in 2001. NAHEMO consists of a Steering Committee and an agency NAHEMA, responsible for the daily management of the programme. It has an authorised staff of 51. In June 2000, the Participating Nations signed a Production Investment & Production Contract (PI&P) for the 1st Batch of 243 helicopters. NAHEMA's operational expenditure for 2005 amounted to EUR 409.2 million. Administrative and NAMSA expenditures were EUR 9.1 million.

Audit Highlights

The Board issued an unqualified opinion on NAHEMA's restated financial statements for 2005. As a result of observations made during the audit, the agency had reissued its statements to correct an overstatement of expenses caused by the inclusion of the value of goods/services invoiced but not yet delivered. Furthermore, the agency had carried forward into 2006 admin budget commitments of EUR 42,650 for which no legal liability existed. The Board recommended that NAHEMA review its budget control procedures to ensure it adheres to its financial regulations in future.

11. NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Organisation (NAMEADSMO) – 2006

Introduction

NAMEADSMO was established in 1996 by Germany, Italy and the United States to manage the design and development of a Medium Extended Air Defence System (MEADS). MEADS is envisioned to be a tactical mobile and transportable air and missile defence system capable of countering air threats including cruise missiles and tactical ballistic missiles. The MEADS project will be designed, developed and built by private industry. The system is expected to be in service by 2012 with the first unit scheduled to be equipped in 2014. NAMEADSMA is based in Huntsville, Alabama, USA and has an authorised staff of 91 (including 49 staff made available by the United States, 21 from Germany, 16 from Italy and 5 local hires). It provides NATO oversight and mangement on the day-to-day implementation of the programme. Although it continues to fund and manage its operational and administrative budgets separately, NAMEADSMO provided one set of financial statements covering the Organisation as a single entity, but with separate financial information about the two budget segments. Total accruals based expenses in 2006 amounted to USD 297 million (EUR 223.4 million at year-end rates). 2006 authorisations including brought forwards were USD 365 million and commitments USD 351.6 million (EUR 264.4 million at year-end rates).

Audit Highlights

The Board issued an unqualified opinion on the NAMEADSMA restated 2006 financial statements.

The Board observed that NAMEADSMO's initially presented cash flow statement did not comply with IPSAS requirements for (1) converting foreign currency (EUR) cash flows into the reporting currency (USD) using exchange rates prevailing at the dates of the transactions, and (2) reporting the effect of exchange rate changes on cash and cash equivalents. Following the audit, NAMEADSMO issued restated 2006 financial statements with an accordingly amended Cash Flow Statement. The Board also noted that NAMEADSMO had not assessed whether a performance incentive fee should either have been recognized as a provision in the Statement of Financial Position, or disclosed in the Notes to the financial statements as a contingent liability. The Board recommended that the organisation implement a process to conduct such an assessment, and to disclose more information about the structure of the incentive fee in future financial statements.

12. NATO Maintenance and Supply Organisation (NAMSO) – 2006

Introduction

The mission of the NATO Maintenance and Supply Organisation (NAMSO) and its executing agency, the NATO Maintenance and Supply Agency (NAMSA) is to provide logistic support services to NATO or to its member states individually or collectively. The objective of this mission is to maximise in peacetime and in wartime the effectiveness of logistics support to the armed forces of the NATO States and to minimise costs. In 2006, the agency's support and services extended to 19 Weapon System Partnerships, 5 Support Conferences, and several Sales Agreements and other partnership or subscription arrangements. NAMSA's activities take place at three main locations: Capellen (Luxemburg) for most of the storage and maintenance works, Rueil-Malmaison (France) for the HAWK Logistics management, and Taranto (Italy) for the Southern Operational Centre. There are approximately 940 permanent staff. The total expenses in 2006 amounted to EUR 843 million (accrual basis under IPSAS).

Audit Highlights

The Board issued an unqualified opinion on NAMSA's 2006 restated financial statements. The Board also issued an unqualified opinion on the separate audit certificate covering NAMSA's administrative costs charged to the Military Budget Committee (MBC) funded programmes. Auditing that cost allocation is a special purpose assignment requested by the MBC.

The Board observed inconsistencies in the presentation of the change in net equity amount in the statement of financial position. NAMSA subsequently restated the related accounts. In addition, NAMSA had posted Project Management Costs for the administration of NSIP into the administrative budget intended to cover such costs, and also for project control purposes, in the operational budget, resulting in an overstatement of revenue and expenditure by EUR 4.6 million on the statement of financial performance. The Board recommended that NAMSA take action to eliminate the effect of that double recognition. Furthermore, the audit revealed inconsistencies in the accounting treatment of MBC-funded stocks, not part of any Weapon System Partnership, leading to overstatement of expenses and revenues on the statement of financial performance by EUR 19.5 million and discrepancies on the statement of financial position of EUR 28.6 million, consolidated in other reserve accounts on the financial statements. The Board also noted that two similarly MBC funded inventories in one case (Air Defence Ground and Communications inventories) were reported as asset by NAMSA, whereas in another case (AWACS Programme inventories) they were not, and recommended that NAMSA review historical arrangements in this respect to ensure that they are still valid and consistent with IPSAS.

13. NATO Airborne Early Warning and Control Programme Management Organisation (NAPMO) – 2006

Introduction

NAPMO is responsible for the direction, co-ordination, and execution of the co-ordinated acquisition programme of the NATO Airborne Early Warning and Control (NAEW&C) system. The agency NAPMA oversees the execution of the programme for NAPMO. The US System Project Office (SPO) administers the main contract with Boeing on behalf of NAPMA. The NAPMA agency has an authorised Peacetime Establishment of 135 personnel and is located in Brunssum (NL). The NAPMA expenditures in 2006 totalled the equivalent of USD 250 million (at fixed contract exchange rates), equalling EUR 188 million at NATO 2006 year-end rates.

Audit Highlights

The Board issued a qualified opinion on NAPMO's financial statements because of a scope limitation on the audit. The NAPMO Charter states that the Board's "audit shall cover all the accounts of NAPMO, operational as well as administrative". It also states that "the authority of the Board of Auditors does not extend to auditing internal records of Member States; however, member states will make vouchers available to that Board in support of expenditure claimed by them on the NAPMO". This statutory provision was not fully complied with by the management because the provided documentation was not considered by the Board as sufficiently supporting the transactions hence could not be accepted as vouchers in the spirit of the Charter's provisions in that respect. This adversely affected the evidence to support the value of the work undertaken by the main contractor, Boeing, who is contracted to report directly to the US System Program Office, rather than NAPMA. The value of its work in 2006 was USD 140 million, about 56% of NAPMA expenditure.

The Board noted that NAPMA had used the year-end rate for reporting on foreign currency transactions and recommended that the rate of the date of transaction be used as required by IPSAS 4. By choosing an early cut-off for identifying 2006 payables, the agency had understated closing payables by about USD 1 million that were incorrectly reported as 2007 expenditure. The Board recommended that NAPMA design a procedure for identifying payables and accruals to ensure that expenses are allocated to the correct period. Finally, NAPMA had requested credits for the same support personnel cost in the admin budget and additionally in a project budget. The intention was to reduce the admin budget authorisations if the project budget was approved. That reduction did not take place and both budgets were approved. However, only one budget (the admin budget) and the transactions against that budget were included in the accounting and financial statements. The Board recommended that the agency ensure that budgetary requests and authorisations do not cover expenditure more than once and that the financial statements disclose all authorisations granted.

14. NATO Consultation, Command and Control Agency (NC3A) – 2005

Introduction

The NC3A supports NATO with advice, research and development of consultation, command and control systems. As from 1 January 2000, the NC3A has been operating under a customer-funding regime. Under this regime the major NATO commands request in their budget funds for NC3A services and directly pay NC3A for those services. The Infrastructure Committee pays NC3A directly for host nation services whether for projects (100% funded) or for the administration of projects (project service costs negotiated with NC3A on a fixed price basis). External customers also pay for services on a price negotiated with NC3A and for acquisitions on a 100% refundable basis. In 2005, NC3A expenditure amounted to EUR 185 million, of which 38% was for NSIP projects, 15% for acquisitions for third parties (100% reimbursable) and 47% on customer funding i.e. the administration of projects, acquisitions and scientific work for NATO bodies and external customers.

Audit Highlights

The Board issued an unqualified opinion on the NC3A 2005 financial statements.

These statements were derived from the new Integrated Management Information System (IMIS) financial system and the opening balances migrated from the legacy BUDCOM (customer funding transactions) and IFAS systems (NSIP and third party transactions). However, the Board noted that the new IMIS was not being fully used to process transactions throughout the year for NSIP and third party activities (ex-IFAS) requiring parallel accounting and manual reconciliations leading to increased risk. It recommended that NC3A complete migration of all historical financial data for NSIP and third party transactions to the IMIS, to ensure efficient implementation of the new system. The Board also audited the controls within IMIS to ensure integrity of the agency's financial processes and data and formulated a number of concerns relating to access and security, more specifically with regard to security policies that have not yet been configured in IMIS, the large number of inactive users that have access and the fact that for a number of users the roles and permissions had not yet been documented and approved. The Board recommended that the agency review and take action to address these risks.

The agency needs to treat interest and miscellaneous income differently on whether they relate to customer funding or NSIP projects. Surplus/deficit related to NSIP must be offset against nations' contributions, whereas other interest and miscellaneous income is to be transferred to the operating fund. The Board recommended that NC3A separate the interest and miscellaneous income belonging to third party transactions from those belonging to NSIP so that the third party surplus/deficit can be transferred to the operating fund.

15. NATO CIS Services Agency (NCSA) – 2005

Introduction

The implementation of the new NATO Military Command Structure included the transformation of the NATO Communication and Information System (CIS) Operating and Support Agency (NACOSA) into the new NATO CIS Services Agency (NCSA). NCSA was activated in November 2004 along with the new Peacetime Establishment implementation and the transfer of staff from NACOSA to NCSA.

Audit Highlights

Delays in the approval of the NCSA Charter affected the agency's ability to enter into contracts and to set up a bank account in order to receive contributions and execute payments. In addition, delays in providing the agency with the necessary budget and finance resources, particularly staffing, had affected NCSA's ability to take over many of the accounting functions that continued to be performed by ACO staff. NCSA did not issue separate financial statements for 2004.Rather, its 2004 activities continued to be fully embedded within the Allied Command Organisation (ACO) financial statements. The 2005 financial statements were the first statements issued by NCSA and the first statements to be audited by the Board. NCSA noted in the financial statements that the unusual circumstances of creating a new agency from an existing structure (NACOSA), which had previously been financially embedded within ACO, made the task of fully separating the financial records from those of ACO infeasible. More specifically, it reported that the asset and liability accounts, including the cash that had been called and received by ACO Central Treasury on behalf of NCSA, could not be fully separated from the ACO accounting records.

The Board noted that an unknown, but material, amount of NCSA's assets and liabilities as of 31 December 2005 were not reported in the NCSA 2005 financial statements but continued to be reported in the ACO financial statements. Therefore, The Board could only audit the NCSA transactions and balances as part of the audit of the ACO financial statements. It cannot therefore provide separate audit assurance with respect to NCSA as a stand alone entity.

As no separate audit assurance with respect to NCSA as a stand alone entity can be obtained, the Board has decided not to issue a separate audit opinion on the NCSA 2005 financial statements.

RESULTS OF AUDITS RELATING TO THE CIVIL AND MILITARY AGENCIES AND OTHER ORGANISATIONS

16. AFNORTH International School – 2006

Introduction

The AFNORTH International School (Brunssum, NL) provides schooling for the children of staff from Canada, Germany, the United Kingdom and the United States who work at the Joint Force Command Headquarters in Brunssum and at other military bases in Belgium, Germany and the Netherlands. Each nation finances and audits its own education unit. The School's General Services are financed by the four participating nations on the basis of the student population. The Board's audit mandate only covers the General Services unit. The financial year is the school year, which extends from 1 August to 31 July. For the years audited, the average of the General Service's budget was EUR 4.1 million. As of 1 June 2006 the School had 1,081 students.

Audit Highlights

The Board issued an unqualified opinion on the AFNORTH School's financial statements for the year ended 31 July 2006.

The Board formulated a number of observations relating to formal compliance with general principles and the NATO Financial Regulations, recognising nevertheless the considerable improvement noted in the School's accounting practices and records, compared to the previous audit of 2002-2005 accounts. It recommended that the School should correct persisting weaknesses in the recording and approval of official budget documents and financial statements. It also observed that the statement of budget execution should include information on credits brought forward. Finally, the School should avoid deviations from the NFR, which it has adopted on a voluntary basis; waivers from the NFR should result from an explicit decision of the Board of Governors.

17. Alliance Ground Surveillance Programme (AGS3) – 2004-2005
18. Alliance Ground Surveillance Risk Reduction Study (AGS RRS) – 2005

Introduction

The objective of the Alliance Ground Surveillance (AGS) Programme is to provide the Alliance with a NATO owned and operated AGS core capability. The AGS Steering Committee is supported by the AGS Support Staff (AGS3) and monitors the programme. The Financial Controller, International Staff, is responsible for the financial administration of the AGS programme. The programme is still at its Definition Phase. Should the D&D contract be awarded in 2007 as planned, the Production Phase is envisioned to start in 2014. The cost of the procurement programme is estimated in the range of EUR 3.3 billion. The 2005 budget for the programme including credits brought forward amounted to EUR 2.1 million, commitments and payments were EUR 1.4 million (in 2004 respectively EUR 2.5 and 0.7 million).

Before entering into the contract for the Design and Development phase of the programme, the nations decided to carry out a Risk Reduction Study which was subject to a separate budget of EUR 25 million. Commitments and expenditures for this project amounted to EUR 23.5 million. All related payments took place during 2005, and the RRS was closed in 2006.

Audit Highlights AGS Programme

The Board issued an unqualified opinion on the 2004 and 2005 financial statements of the AGS Programme and recommended that AGS3 management issue a letter of management representation in the context of the financial statements. AGS3 subsequently issued that document for the matters under its responsibility.

Audit Highlights AGS – RRS

The Board issued an unqualified opinion on the 2005 financial statements presented for the Risk Reduction Study. The Board reviewed the final disposition of the AGS RRS assets subsequent to the closure of the project and requested to be informed on the disposition of EUR 1,570,204.36 that remained for distribution to 23 participating nations. It also observed some inconsistency in the financial statements, between the statement of financial position and the notes. The agency subsequently amended its statements for the project accordingly.

19. International Staff (IS) – 2005
20. International Staff (IS) – 2006

Introduction

The International Staff (IS) supports the work of the North Atlantic Council and its committees. The IS is headed by the NATO Secretary General supported by the Private Office of the Secretary General. The IS comprises five operational divisions: an Executive Management Division, and three independent office including the Office of Financial Controller. The IS staff establishment was almost 1,250 at the end of 2006. The total 2006 budgetary authorisations including credits brought forward from previous years amounted to EUR 221million; 2006 commitments were EUR 218 million and payments EUR 168 million (respectively EUR 208, 203 and 154 million in 2005).

Audit Highlights 2005

The Board issued an unqualified audit opinion on the restated financial statements of the IS for the year ended 31st December 2005. The Board reported weaknesses in the IS "accounting system" that relies on different software packages for budget management, financial control, purchasing and contracting and personnel management creating the need for interface and requiring significant manual intervention. The Board recommended a comprehensive review of the IS accounting system.

The IS had also, for the first time, prepared a statement of financial performance, which contained a number of deficiencies in the classification of revenue and the computation of expenses. The Board recommended that the IS continue its efforts to prepare the transition to IPSAS compliant statements in 2006. The audit revealed several discrepancies and errors in the financial statements and recommended that the IS implement a set of control activities in support of reliable financial reporting. In addition, the Board also recommended that the Personnel Management Information System (PMIS) financial statements be incorporated in the IS accounts. Up to now, the IS reported the activities in support of that NATO-wide HR management system in separate financial statements.

Finally the Board also audited the NATO-Russia Resettlement Centre that receives funding from the NATO civil budget (EUR 0.5 million in 2006), and formulated observations and recommendations on the Centre's financial and administrative management. These recommendations have subsequently been taken account of in the preparation of the new contract between the Centre and the Russian partner implementing the project.

Audit Highlights 2006

The Board issued a qualified opinion on the 2006 financial statements. That opinion is based upon the following IPSAS related observations:

- Expenditures shown in the Statement of Financial Performance were based on budgetary commitments and do not represent an expense in accordance with IPSAS;

- Contributions were recorded as revenue when the calls were made, which is not in accordance with IPSAS. Budgetary transfers from the nations are revenues from non-exchange transactions and should be recorded as a liability until the receiver has complied with the conditions attached to those transfers, i.e. when the budget is expended, not when it is called;

- Liabilities of approximately EUR 20 million were improperly offset against Outstanding Contribution Receivables and other receivables;

- The recording of fixed assets and depreciation expenses was not in accordance with IPSAS. The depreciation of EUR 12.4 million on the Statement of Financial Performance was incorrectly based on accumulated depreciation; equipment or work not yet delivered had been included as fixed assets; and the fixed asset database did not properly calculate the net value of depreciated assets.

In addition to these qualification observations, the Board raised observations concerning inaccurate descriptions in the statement of financial position and the insufficient disclosure of contingent liabilities.

21. Munitions Safety Information Analysis Centre (MSIAC) – 2006

Introduction

The Munitions Safety Information Analysis Centre (MSIAC) provides a focal point within NATO to assist national and NATO Munitions development and logistics programmes in addressing the problems associated with achieving Munitions Safety. At the end of 2006 there were 12 MSIAC member countries including three non-NATO members. The staff was composed of 9 persons. The MSIAC 2006 budget authorisations including credits brought forward were EUR 1.7 million, commitments were 1.3 million and payments 1.2 million (respectively EUR 1.7, 1.4, and 1.1 million in 2005). The International Staff Financial Controller provides the accounting services and issues the financial statements for MSIAC.

Audit Highlights

The Board issued a qualified opinion on the MSIAC 2006 financial statements because the contributions were not accounted for in compliance with IPSAS. Contributions were recorded as revenue when received. Contributions from nations are revenues from non-exchange transactions and should be recorded as a liability until the receiver has complied with the conditions attached to those transfers, i.e. when the budget is expended, not when it is called. The Board further observed that Expenditures shown in the statement of Financial Performance were based on budgetary commitments and do not represent an expense in accordance with accruals based IPSAS.

22. NATO Parliamentary Assembly (NATO PA) – 2006

Introduction

Since 1955, the NATO PA, formerly the North Atlantic Assembly (NAA), has been a forum for legislators from member countries of the North Atlantic Alliance. The work of the NATO PA is mainly financed by contributions from member countries, based on the sharing key used for the NATO civil budget. NATO and other organisations also provide the Assembly with additional subsidies that may be designated to be spent on specific activities. The NATO PA is independent of NATO and the Board carries out the audit with the authorisation of the Council. It has a staff of some 30 employees. The NATO PA 2006 budget expenditure amounted to EUR 3.6 million (EUR 3.6 million in 2005). The assets of the NATO PA Provident Fund as at 31 December 2006 amounted to EUR 4.3 million (EUR 3.9 million in 2005).

Audit Highlights

The Board issued unqualified opinions on the financial statements of the NATO PA and the NATO PA Provident Fund for 2006. The Board raised one observation regarding the lack of formal policy for access rights to the computer network of the Assembly.

23. NATO Pension Scheme – 2005

Introduction

The NATO Pension Scheme applies to all staff recruited between 1st July 1974 and 30th June 2005. The Scheme is a ‘defined benefit plan’. The Scheme defines rights to either a leaving allowance or a pension. It includes provisions for invalidity, survivor’s, orphan’s and dependant’s pensions. The Scheme is unfunded. Benefits are paid from annual budgets financed by the nations and by a contribution from staff of 8.3% of their salary. In 2005, The Pension Scheme supported 2,352 pensioners, and over 4,800 staff paid into the scheme. Over 90 per cent of all NATO civilian staff are members of the Scheme. The members of staff recruited prior to July 1974 are members of the Provident Fund. The remaining staff members recruited after 1st July 2005 are members of the new (defined contribution) Pension Scheme. Total payments made under the Scheme for 2005 amounted to EUR 84.6 million (EUR 79.4 million in 2004).

Audit Highlights

The Board issued an unqualified opinion on the financial statements of the Pension Scheme for the year ended 31 December 2005.

The Board noted that there is no consistency between NATO bodies concerning the application of a contract notice period (and indemnity) in case of contract termination on medical grounds. The Board recommended that the administration analyse the Appeals Board decision in that respect and propose amendments to the Civilian Personnel Regulations as appropriate. The Board also recommended that the agency provide the Letter of Representation and Statement on Internal Control.

24. NATO Provident Fund – 2005

Introduction

The NATO Provident Fund provides retirement benefits to civilian staff who joined NATO before 1 July 1974, and who are not members of the NATO Pension Scheme. The Fund invests the retirement contributions (7% of the basic salary from members and 14% from NATO) using the services of an investment banker. ACO Treasury carried out the day to day accounting of the Fund and transferred that responsibility to the International Staff starting as from 2005. The value of the Fund's assets at 31 December 2005 was EUR 98 million (EUR 114 million in 2004). As at 31 December 2005, there were 263 members contributing to the Fund, (308 members in 2004).

Audit Highlights

The Board issued an unqualified opinion on the Provident Fund 2004 restated financial statements. The restatement was required to correct a number of material errors, omissions and minor discrepancies in the Statement of Financial Position, the Income and Expenditure Account, the Summary of Accruals and in the annexes to the financial statements that detail the Bonds Portfolio and the Bonds Sold and Bought in 2004. The Board also noted that the one outstanding observation had been satisfactorily resolved in 2004.

The Board issued an unqualified opinion on the amended financial statements of the Provident Fund for the year ending 31 December 2005. The amendments were required to correct material errors in the initially presented "Summary of Accruals"-statement. The Board also commented on the late publication of the financial statements that were provided six months after the 30th April deadline and the need to follow up on changes in the calculation of the management fee charged by the fund manager.

25. New NATO Headquarters – 2005
26. New NATO Headquarters – 2006

Introduction

At the Washington Summit, in April 1999, the Heads of State and Governments of NATO countries formally decided to build a new Headquarters in Brussels to meet the Alliance's needs in the twenty-first century. The North Atlantic Council, upon recommendation of the Civil Budget Committee, approves the budget for the new NATO Headquarters which is funded from national contributions based on a specific cost-share agreement among the 26 NATO nations. Belgium is responsible for the management of the project and acts as host nation under the principles of the NATO Security Investment Programme. The budget for 2006 including brought forward credits was EUR 21.8 million; commitments in 2006 were EUR 21.6 million and payments EUR 16.7 million (respectively EUR 11.6, 11.1 and 8.6 in 2005).

Audit Highlights 2005

The Board issued an unqualified opinion on the new NATO Headquarters financial statements for the year ended 31 December 2005. The Board noted that the cash advances paid to the host nation Belgium in the accounting and the statements are treated as final expenses, not as advances. It recommended that in future, the financial statements properly recognise and disclose the amounts advanced to the Host nation and the expenditures incurred by the Host nation against these advance. The administration also issued a corrigendum to New HQ financial statements to amend some minor inconsistencies noted during the audit.

Audit Highlights 2006

The Board issued a qualified opinion on the 2006 financial statements of the new NATO Headquarters. That opinion is based upon the following IPSAS related observations:

- NATO did not utilise the five-year transition period for Property, Plant and Equipment offered by IPSAS 17. As a result, the costs incurred to date relating to the construction of the new headquarters have been incorrectly expensed rather than capitalized as a “Construction in Progress” asset;
- The recording of Expenses in 2006 did not reflect the actual construction activity during the period and is understated by EUR 2,7 million;
- The recognition of Revenue when contributions from the nations are called rather than being deferred until earned;
- The understatement of Assets and Liabilities by EUR 13 million, resulting from .the improper recording of a temporary transfer of funds from a nation’s escrow account to another NATO entity.

The Board also noted transfers between budget chapters authorised by the Financial Controller and recommended that such transfers in future be approved by the finance committee as prescribed by the NATO Financial Regulations.

27. NATO Security Investment Programme (NSIP) – 2005

Introduction

The NSIP is a key element of NATO common funding. The NSIP provides an established mechanism for implementing capital investments in response to identified operational requirements. It finances the provision of capabilities recognised as exceeding the national defence requirements of individual member nations. The NSIP is implemented under the supervision and management of the Infrastructure Committee within annual contribution ceilings approved by the North Atlantic Council. The Security Investment Directorate (currently NATO Office of Resources) provides technical and administrative support to the programme. Cash outflows of the programme, consisting of expenditure reported by host nations were EUR 607 million in 2005 (EUR 653 million in 2004).

The programme issued annual financial statements for the first time for the year ended 31 December 2003. The initiative to prepare annual NSIP financial statements was started by management as a result of its participation in the Working Group on NATO Accounting Standards. Management prepares these statements as much as possible, based upon formats that comply with International Public Sector Accounting Standards (IPSAS). However, it is impossible for the Board to audit the funding and incurrence of expenditures within territorial host nations at the time of issuance of the financial statements. Therefore, the NSIP financial statements should not be described as complying with IPSAS.

For that reason, the Board has decided to refrain from issuing an audit opinion on the NSIP with effect from the 2006 financial statements. It will nevertheless continue as in the past to review the programme based upon existing documentation and reports that provide sufficient assurance to the nations on the management and operations of the Programme.

Audit Highlights

The Board's audit report includes a scope limitation arising from regulatory constraints. More specifically, it occurs because supporting documentation for some project expenditure, mostly incurred by territorial Host Nations, will not be audited until subsequent financial years. On an annual basis, the NSIP financial statements are essentially based upon a "self-reporting" system for expenditure as detailed in the approved semi-annual Financial Reports of the member nations. The Board cannot finally audit the expenditure on NSIP projects until the projects are technically inspected and financially completed. Consequently, there is an unavoidable time lag between the audit of the financial statements and the final audit determinations as to what constitutes eligible project expenditure. Within the context of this scope limitation, the Board's audit did not identify any material accounting errors or omissions. The Board had no other observations on the 2005 financial statements.

28. Personnel Management Information System (PMIS) – 2001-2005

Introduction

In December 2000, the Civil Budget Committee agreed a funding mechanism for the establishment and operation of an Integrated Personnel Management Information System (PMIS). The purpose was to extend the existing payroll information system used by IS to other interested NATO bodies. This should lead to economies of scale and less duplication of effort and resources NATO-wide. The project is administered by the International Staff and its cost is shared between the participating NATO entities on the basis of the number of established posts. The participating entities provide for this cost in their budget. Annually about EUR 200,000 are needed for system support, maintenance and licensing. The main cost is for manpower (an external consultant) to carry out software development and maintenance.

Audit Highlights

The Board issued an unqualified opinion on the PMIS financial statements for the years ended 31 December 2001 to 31 December 2005. The Board recommended that the administration in future incorporate the PMIS transactions into the International Staff's financial statements.

29. Representation Allowances – 2006

Introduction

The Board audits the Representation Allowance expenditures of senior NATO officials in accordance with the provisions set out by the Permanent Representatives in 1980 and further guidance established in 1998. The Board's report is submitted to the Secretary General for onward transmission to the Permanent Representatives. The total 2006 allowances amounted to EUR 0.2 million.

Audit Highlights

The Board found that for 2006, most of the recipients of the allowance complied with the accountability requirements. In a few cases, recipients spent less than the allowance received. Such under spends are to be reimbursed in accordance with the Secretary General's instructions. The Board further found instances of insufficient justification and recommended that the administration remind the recipients of the related provisions.

30. Retirees Medical Claims Fund (RMCF) – 2006

Introduction

The qualifying NATO retirees are permanently entitled to the reimbursement of certain medical expenses. The reimbursements are provided via private medical insurance. The Retirees Medical Claims Fund (RMCF) was established in 2001 as a reserve to finance future medical insurance premiums for NATO retirees who reached the age of 65 after 1 January 2001. The fund is managed by a private investment company, Fortis Investment Management. Each month, the fund receives an amount equal to 4.5% of the salaries of serving staff. In addition, some retirees are required to make a contribution. Two-thirds of these amounts are paid by NATO bodies; one-third is deducted from salaries or pensions. The fund has a Supervisory Committee which oversees the management of the fund. In 2006, receipts from NATO bodies and staff were some EUR 18.46 million and insurance premiums paid out these receipts were EUR 5.19 million (respectively EUR 17.5 and 3.9 million in 2005). At the end of 2006 the fund manager held EUR 91.75 million on behalf of NATO (EUR 77 million in 2005).

Audit Highlights

The Board qualified the 2006 financial statements of the RMCF because of a limitation to the scope of its audit. NATO has the obligation to provide Continued Medical Coverage for qualifying staff in retirement. This is a defined benefit for employees. Under International Accounting Standard (IAS) 19, Employee Benefits, which the Board believes is relevant, the value of the defined benefit obligation should be disclosed as a liability. The 2006 financial statements of the RMCF do not disclose the defined benefit liability, and are therefore not in compliance with IAS 19.

The Board recommended that an actuary should be engaged to make periodic valuations of the defined benefit, and that the valuation is recognised as a liability in the RMCF financial statements. It also recommended that NATO discuss with the insurance company the terms of the contract to avoid overlap of premiums due when a staff member retires. It recommended in addition that NATO include in future disclosure notes to the financial statements as required by IPSAS 1.

31. SHAPE International School (SIS) – 2004-2006

Introduction

The SHAPE International School provides schooling for dependants of the SHAPE community, from Kindergarten through to the secondary levels. The school comprises nine national curricula, 6 curricula languages and students from 41 nations. Nations determine the curricula of their national units, pay their own teachers, and provide supplies. That expenditure is accounted for and audited nationally. The school's General Services Unit is funded internationally by contributions of member countries. These contributions mainly depend on the number of Nationals attending the school. The Board only audits the General Services unit. The school General Services budget in 2006 amounted to EUR 5 million; commitments were EUR 5.0 million and payments EUR 3.8 million (respectively EUR 4.8, 4.7 and 3.5 million in 2004). The School has about 2,500 students.

Audit Highlights

The Board issued an unqualified audit opinion on the financial statements of the SHAPE International School for the years 2004, 2005 and 2006. The Board noted different hourly salary rates for temporary teachers in the contract submitted by the school and by the SHAPE Community Service Facility (SCSF) that provides the payroll services. The difference was explained by an agreement which recognises the time teachers spend in preparing the lessons. The school agreed to prepare consistent contract documentation in future. The Board also noted that, although it did not identify any mistakes, the school has limited internal control procedures on the payroll amounts calculated by two different SHAPE offices, and recommended that the school develop procedures of control. As to the limited amount of unpaid school fees each year, for which there is no prospect of recovery, the Board recommended that the School Budget Committee decide how best to allocate the cost of the bad debt. That school agreed and announced to put this as a proposal on the agenda of the committee meeting.

PERFORMANCE AUDITS AND SPECIAL STUDIES

32. Survey of Corporate Governance in NATO Agencies

Introduction

The Council adopted the Guidelines for the Corporate Governance of NATO Organisations in September 2005 (C-M(2005)0087) in the context of the Review of Roles and Requirements for NATO Agencies (C-M(2004)0106). The review examined how NATO agencies could contribute in more efficient ways to NATO's strategic goals, priorities, and objectives, within the context of NATO's Transformation efforts.

Corporate governance refers to the structures and processes by which organisations are directed, controlled, and held to account, particularly through their Boards of Directors and Executive Management.

The Board conducted a survey to obtain preliminary indications of how NATO bodies are implementing key aspects of these guidelines. Although the Council decision in principle applies to NATO Production and Logistics Organisations (NPLOs), the Board also surveyed NATO military commands and civil and military agencies that have a different governance structure from NPLOs.

Audit Highlights

The survey focused on areas as: Organisational Structures and Processes, Standards of Behaviour, Control, and External Reporting. The Board recommended that the Council invite Boards of Directors and General Managers of NATO agencies to systematically review their agencies' adherence to the guidelines on corporate governance, and specify plans for improvement in their agencies' annual reports. In particular, they should ensure that:

- agencies clearly define the key roles and responsibilities of both Board Members and Chairmen, and delineate them from those of Executive Management;

- Boards and/or agencies provide some guidance to nations on the desired qualifications of candidates for Board members;

- Boards explicitly acknowledge responsibility for promoting openness, integrity, and accountability;

- Boards establish appropriate audit committees and internal audit bodies (as defined in the guidelines) if they do not already exist; and

- Boards systematically oversee risk management policies/procedures and internal control frameworks for their agencies.

The Board also recommended that the Council clarify how NATO agencies should develop and adopt codes of conduct, in light of existing provisions in NATO Civilian Personnel Regulations which also govern the professional behaviour of NATO staff.

AUDITED ENTITIES AND ACTIVITIES

AND AUDIT CYCLE

The Board audits 83 entities, of which 45 are audited on an annual basis, and 37 are audited on a cyclical basis, every two to three years.

MILITARY COMMANDS AND OPERATIONS

Annual

ACO Consolidated[1]
- ACO Treasury
- SHAPE
- Joint HQ Lisbon
- JFC HQ Brunssum
- JFC HQ Naples
- CC-Air HQ Ramstein
- CC-Land HQ Heidelberg
- CC-Air HQ Izmir
- CC-Land HQ Madrid
- CC HQ Northwood (incl. MEWSG)
- CRO (incl. JFC, KFOR, NHQSa, ISAF, NTMI, AMIS)
- E-3A Component
- NAEW FC
- NPC Glons

(+ associated budgets not linked to a specific location)

ACT consolidated
- SACT HQ
- JFTC Bydgoszcz
- NURC La Spezia
- JALLC Monsanto
- JWC Stavanger

(+ associated programme budgets)

Cyclical

ARRC[2]
CAOCS (11 commands)[2]
CIMIC Group North[2]
CIMIC Group South[2]
COE-DAT[2]
HQ RRC-FR[2]
IFC[2]
JAPCC[2]
JCBRN Defence COE[2]
NRDC (5 commands)[2]

[1] The Board audits the most important commands every year. Smaller commands are audited on a bi- or tri-annual basis. The audit of these commands also includes a number of programmes that are budgeted and reported separately from the command's budgets.
[2] Multi-nationally funded command(s).

NATO PRODUCTION AND LOGISTICS ORGANISATIONS

Annual

ALTBMDPMO
BICES
CEPMO
- CEPMA
- Belgian Division
- French Divisions
- German Divisions
- Netherlands Division

NACMO
NAGSMO
NAHEMO
NAMEADSMO
NAMSO
NC3A
NETMA
- NAMMO
- NEFMO

NAPMO
NHMO
NCSA (incl. NCISS)
NSA
RTO

MILITARY, CIVILIAN AND OTHER BODIES

Annual	Cyclical
AFNORTH International School[3]	FORACS
AGS3	MSIAC
Defined Contribution Pension Scheme	
IMS, PfP and MD	
IS	
NATO HQ Adaptation	
NAMFI[3]	
NDC	
NPA[3]	
Provident Fund	
Pension Scheme	
Retirees Medical Claims Fund	
Representation Allowances	
SHAPE International School[3]	

[3] Multi-nationally funded entity.

FINANCIAL AUDIT COVERAGE FOR AUDITED ENTITIES

		Last Audit		Next Audit	
		Done in year	**Covering year(s)**	**To be done in year**	**Covering year(s)**
MILITARY COMMANDS					
1.	ACO Group	2007	2006	2008	2007
2.	ACT Group	2007	2006	2008	2007
3.	ARRC	2004	2000/01/02/03	2008	2004/05/06/07
4.	JAPCC	2006	2005	2009	2006/07/08
5.	CAOCs (3 sites out of 11)	2007	2004/05/06	2008	2005/06/07
6.	Cimic (1 site out of 2)	2007	2004/05/06	2008	2005/06/07
7.	NRDC	2007	2004/05/06	2008	2005/06/07
NPLOs					
1.	NAMSO	2007	2006	2007	2007
2.	NETMA	2007	2006	2007	2007
3.	NAPMO	2007	2006	2007	2007
4.	NHMO	2007	2006	2007	2007
5.	CEPS	2007	2006	2007	2007
6.	NC3A	2007	2006	2007	2007
7.	NACMO	2007	2006	2007	2007
8.	NAHEMO	2007	2006	2007	2007
9.	NAMEADSMO	2007	2006	2007	2007
10.	BICES	2007	2006	2007	2007
11.	RTO	2007	2006	2007	2007
12.	NSA[4]	2007	2006	2007	2007
13.	NCSA	2007	2006	2007	2007
14.	NAGSMO	-	-	-	-
15.	ALTBMDPMO[5]	2007	2006	2008	2007

[4] The audit is combined with the audit of the IMS which prepared the consolidated IMS-NSA financial satements.
[5] Incorporated into the NC3A financial statements.

FINANCIAL AUDIT COVERAGE FOR AUDITED ENTITIES

		Last Audit		Next Audit	
		Done in year	**Covering year(s)**	**To be done in year**	**Covering year(s)**
MILITARY, CIVILIAN AND OTHER BODIES					
1.	IS	2007	2006	2008	2007
2.	NATO HQ Adaptation	2007	2006	2008	2007
3.	IMS	2007	2006	2008	2007
4.	NAMFI	2007	2006	2008	2007
5.	Provident Fund	2007	2006	2008	2007
6.	Pension Scheme Group	2007	2006	2008	2007
7.	Defined Contribution Pension Scheme	2007	2006	2008	2007
8.	Retirees Med. Claims Fund	2007	2006	2008	2007
9.	Representation Allowance	2007	2006	2008	2007
10.	NDC	2007	2006	2008	2007
11.	FORACS	2007	2000/01/02/03/04	2008	2005/06/07
12.	MSIAC	2007	2006	2008	2007
13.	AFNORTH School	2007	2006	2008	2007
14.	SHAPE School	2007	2004/05/06	2008	2007
15.	AGS3	2007	2006	2008	2007
16.	NPA	2007	2006	2008	2007

AUDIT UNIVERSE AND DIRECT COST OF THE AUDIT

IN 2007

AUDIT UNIVERSE AND DIRECT COST OF THE AUDIT IN 2007

BODIES	Audit Universe in 2007 Million EUR (1)	Auditor Time (days) (2)	Salary + Travel Cost 2007 EUR (3)
AGENCY FINANCIAL			
ACO Group (incl. PSO)	704.9	468	362,359
ACT Group	114.4	123	109,031
ARRC	1.1	5	3,173
JAPCC	1.2	-	-
CAOCs - 11 commands	5.9	43	37,995
CIMICs - 2 commands	1.6	42	31,781
NRDCs - 4 commands	6.9	77	60,880
Subtotal	**836**	**758**	**605,220**
ALTBMDPO	3.1	1	831
BICES	3.5	45	31,731
CEPMO	99.6	104	90,623
NACMO	38.0	47	32,940
NAHEMO	449.5	68	52,531
NAMEADSMO	198.1	44	41,937
NAMMO-NEFMO-NETMA	5,434.4	165	143,134
NAMSO	776.0	112	89,780
NAPMO	188.0	80	61,243
NC3A	244.1	181	131,129
NCSA	131.3	30	21,768
NHMO	14.9	50	38,666
RTO	5.8	27	21,894
Subtotal	**7,586**	**954**	**758,208**
AFNORTH SCHOOL	4.1	12	8,309
AGS3	2.8	12	8,537
DCPS (New Pension Scheme)	7.0	16	10,955
FORACS	1.3	-	-
IMS (Incl. NSA, PfP, MD)	21.8	25	17,679
IS	172.0	89	62,253
IS New HQ	19.3	42	29,389
MSIAC	1.5	9	6,346
NAMFI	14.9	43	36,916
NDC	5.7	26	23,370
NPA (c)	3.7	27	21,988
PENSION SCHEME	98.0	54	38,764
PROVIDENT FUND (a)	79.0	60	42,383
REP. ALLOWANCE	0.2	11	7,933
RMCF (b)	23.7	37	25,763
SHAPE SCHOOL	3.9	19	13,598
Subtotal	***459***	***482***	***354,182***
Total	***8,881***	***2,193***	***1,717,610***

AUDIT UNIVERSE AND DIRECT COST OF THE AUDIT IN 2007

BODIES	Audit Universe in 2007 Million EUR (1)	Auditor Time (days) (2)	Salary + Travel Cost 2007 EUR (3)
NSIP FINANCIAL			
Annual File Review		168	117,759
NSIP financial statements		9	6,043
ACO	29.6	13	12,822
BELGIUM	3.0	8	5,421
CEPMO	15.3	10	8,592
GERMANY	140.0	69	61,531
GREECE	10.8	16	16,416
ITALY	27.8	19	16,673
NACMO	19.6	10	7,021
NAMSA	32.6	13	9,973
NC3A	158.6	14	9,865
NORWAY	24.3	14	12,154
POLAND	11.3	17	17,728
PORTUGAL	7.5	6	5,739
The NETHERLANDS	12.1	10	8,480
TURKEY	9.3	33	28,851
UNITED KINGDOM	140.5	38	34,601
UNITED STATES	8.0	6	7,910
Subtotal	**650.3**	**472.8**	**387,580.9**
PERFORMANCE AUDITS			
Internal Audit		14	9,719
Logistics of Deployed Ops		243	186,000
NC3A Customer Funding		203	143,396
Fraud Study		0	286
Subtotal		***461***	***339,400***
STUDIES			-
IT reviews (ACO, NAMSA, NETMA)		69	53,345
IPSAS		105	74,454
NSIP Review		24	16,864
TeamMate		53	37,385
Various		17	12,076
Subtotal		***269***	***194,123***
BOARD		270	200,291
ADMINISTRATION		113	78,960
TRAINING		197	137,935
GENERAL TOTAL	***9,532***	***3,974***	***3,055,901***

Column (1)
Represents the budget authorised in 2006 audited in 2007 in the case of Agencies, or the NSIP amounts presented for audit during 2007.
Column (2)
Represents the time spent by the audit staff during 2007 on the assignment
Column (3)
Represents the cost of the audit to the NATO Civil Budget, including remuneration and a notional pension/leaving allowance amount of auditors and travel cost of auditors and Board Members. It does not contain the cost of support staff amounting to EUR 523,432 and the salaries and allowances of Board Members that are a national charge.

Footnotes

(a) Not including EUR 98 million assets spread over 263 individual members' accounts
(b) Not including EUR 91.8 million assets of the RMCF investment fund
(c) Not including EUR 4.3 million assets of the 30 members of the NPA Provident Fund

LIST OF ABBREVIATIONS

LIST OF ABBREVIATIONS

ACO	Allied Command Operations
ACT	Allied Command Transformation
AFNORTH	Allied Forces, Northern Europe
AGFC	Advisory Group of Financial Counsellors
ALTBMDPMO	Active Layered Theatre Ballistic Missile Defence Programme Management Organisation
AMIS	African Union Mission in Sudan
ARRC	Allied Rapid Reaction Corps
BAM	Balkans Air Mission
BICES	Battlefield Information Collection and Exploitation System
Board	International Board of Auditors for NATO
BoD	Board of Directors
CAOCs	Combined Air Operation Centres
CEPMA	Central Europe Pipeline Management Agency
CEPMO	Central Europe Pipeline Management Organisation
CEPS	Central Europe Pipeline System
CIMIC	Civil and Military Cooperation
CNABs	Competent National Audit Bodies
COFFA	Certificate of Final Financial Acceptance
CRO	Crisis Response Operations
EC	European Commission
EUR	Euro
FORACS	NATO Naval Forces Sensor and Weapons Accuracy Check Sites
HQ	Headquarters
IBAN	International Board of Auditors for NATO
IC	Infrastructure Committee
IFAC	International Federation of Accountants
IMS	International Military Staff
INTOSAI	International Organisation of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
IS	International Staff
ISAF	International Security Assistance Force [Afghanistan]
JALLC	Joint Analysis and Lessons Learnt Centre
JAPCC	Joint Airpower Competence Centre
JFAI	Joint Final Acceptance Inspection
JFC	Joint Force Command Balkans Operations
KFOR	KOSOVO Forces
MBC	Military Budget Committee
MD	Mediterranean Dialogue
MEADS	Medium Extended Air Defence System
MEWSG	Multiservice Electronic Warfare Support Group
MOU	Memorandum of Understanding
MSIAC	Munitions Safety Information Analysis Centre
NAFS	NATO Automated Financial System
NACMA	NATO ACCS Management Agency
NACMO	NATO ACCS Management Organisation
NAEW&C	NATO Airborne Early Warning and Control
NAEW&CS	NATO Airborne Early Warning and Control System
NAGSMO	NATO Alliance Ground Surveillance Management Organisation

NAHEMO	NATO Helicopter Design & Development Production and Logistics Management Organisation
NAMEADSMA	NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Agency
NAMEADSMO	NATO Medium Extended Air Defence System Design and Development, Production and Logistics Management Organisation
NAMFI	NATO Missile Firing Installation
NAMMO	NATO Multi-Role Combat Aircraft Development and In-Service Support Management Organisation
NAMSA	NATO Maintenance and Supply Agency
NAMSO	NATO Maintenance and Supply Organisation
NAPMA	NATO AEW&C Programme Management Agency
NAPMO	NATO AEW&C Programme Management Organisation
NC3A	NATO Consultation, Command and Control Agency
NCSA	NATO CIS Services Agency
NDC	NATO Defence College
NEFMO	NATO European Fighter Aircraft Development, Production and Logistics Management Organisation
NETMA	NATO Euro Fighter 2000 and Tornado Development Production and Logistics Management Agency
NFR	NATO Financial Regulations
NHMO	NATO HAWK Management Office
NHQSa	NATO HQ Sarajevo
NATO PA	NATO Parliamentary Assembly
NPC	NATO Programming Centre
NPLO	NATO Production and Logistics Organization
NRDC	NATO Rapid Deployment Corps
NRFA	Northern Region Financial Administration
NSA	NATO Standardization Agency
NSIP	NATO Security Investment Programme
NTM-I	NATO Training Mission Iraq
PfP	Partnership for Peace
PSO	Peace Support Operations
RFAS	Reaction Force Air Staff
RMCF	Retirees Medical Claims Fund
RTA	Research and Technology Agency
RTO	Research and Technology Organisation
SACLANT	Supreme Allied Commander Atlantic
SAIs	Supreme Audit Institutions
SHAPE	Supreme Headquarters Allied Powers Europe
SPO	System Project Office
SRB	Senior Resource Board
UNAC	User Nations Committee
USD	United States Dollar