



National  
Defence

Défense  
nationale

Chief Review Services Chef - Service d'examen

CRS  CS Ex

## Audit of NATO Contributions

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7050-19-2 (CRS)



Canada 

## SYNOPSIS

*Canada has been a member of the North Atlantic Treaty Organisation (NATO) since it was created in 1949. Over the years, Canada has contributed both militarily and financially to the success of NATO activities. Recent military involvement includes participation in the NATO-led missions to Bosnia and Kosovo as well as the current mission to establish security in Afghanistan. In addition to the military personnel and equipment that Canada contributes to NATO-led missions, yearly financial contributions to NATO approximate one percent of the annual budget of the Department of National Defence (DND).*

*The Treasury Board Secretariat Policy on Transfer Payments requires all federal departments to audit their respective grants and contributions on a cyclical basis. The \$126M DND contributed to NATO in fiscal year 2001-02 represents about 30 per cent of the Department's total grants and contributions. The objective of this audit was to examine the contribution management processes in place for the two largest NATO contributions (Military Budgets and the NATO Security Investment Program, or NSIP), which total \$102 million, or, approximately 24 per cent of total DND grants and contributions.*

*The audit did not identify significant deficiencies. This we attribute to the reliance DND is able to place on a number of processes and controls, including:*

- *The terms of agreement for Canada's contributions to NATO are set out in the Treaty of 1949 and in individual contribution call letters. Call letters are approved both within DND and within the NATO governance framework, in which Canada's representatives to NATO are active participants.*
- *The budgeting and financial management processes that allow DND to plan for, approve and make payments to NATO for agreed upon contributions in a controlled manner.*
- *The performance management processes in place over NATO contributions, including the performance monitoring activities of Canada's representatives to NATO and the International Board of Auditors for NATO, which audits Military Budget and NSIP performance on behalf of all member nations.*

*Five recommendations were made to enhance the management processes already in place. They include: formally documenting decisions; encouraging involvement by Canada on the International Board of Auditors for NATO; succession planning; segregation of duties; and considering opportunities to apply for NATO funding of military infrastructure projects.*



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## RESULTS IN BRIEF

The objective of this engagement was to assess the contribution management processes with respect to NATO Security Investment Program (NSIP) and Military Budget contributions made by the Department of National Defence (DND) within the context of Treasury Board Policy on Transfer Payments and within the context of the goals and objectives of the North Atlantic Treaty Organisation (NATO or the “Alliance”). The audit procedures consisted primarily of interviews, process mapping, a review of documents and transaction verification.

We did not find any significant deficiencies as a result of our audit work. The skilled, experienced staff responsible for managing NATO contributions operate a controlled management process. Key processes and controls that contribute to the effectiveness of the management processes in place include:

Audit Area Examined	Key Controls Observed
<i>Forming Agreement</i>	<ul style="list-style-type: none"> <li>▪ <i>The terms of the NATO agreement and Canada’s participation therein are documented in the Treaty of 1949. Specific details related to individual funding calls are documented in call letters, which are agreed to by Canada as part of the NATO Committee process.</i></li> <li>▪ <i>Canada’s NATO contributions are approved in accordance with an established accountability framework by members of Canada’s delegation to NATO and by financial staff in DND HQ. NATO contributions are also separately identified in parliamentary estimates.</i></li> </ul>
<i>Budgeting and Financial Management</i>	<ul style="list-style-type: none"> <li>▪ <i>Budgets for all Military Budget and NSIP contributions are established and approved by the NATO budget approval process and by the DND budget approval process.</i></li> <li>▪ <i>Budgets and financial records with respect to NATO contributions are maintained by DND staff in Ottawa and reflected in DND’s financial systems.</i></li> <li>▪ <i>Payments for NATO contributions are approved by both Canada’s representatives to NATO and by DND financial staff.</i></li> <li>▪ <i>DND staff regularly monitor budget versus actual results.</i></li> </ul>



Audit Area Examined	Key Controls Observed
<i>Performance and Outcome Measurement</i>	<ul style="list-style-type: none"> <li>▪ <i>Accountability for monitoring performance and outcomes with respect to Canada's contributions to NATO resides with Canada's representatives to NATO.</i></li> <li>▪ <i>Canada's representatives to NATO review regular performance reports prepared by NATO international staff for Military Budget and NSIP projects.</i></li> <li>▪ <i>IBAN (NATO's auditor), performs audits of individual NSIP projects and the annual NATO Military Budget and reports the results of these audits to the Canadian representatives to NATO.</i></li> <li>▪ <i>The Canadian representatives to NATO also receive outcome information from Canadian Forces staff assigned to NATO operations.</i></li> </ul>

The audit work performed resulted in the following five recommendations that we believe will enhance the effectiveness of the management processes in place:

- Improve the documentation of significant decisions made by Canadian representatives to NATO;
- Encourage involvement by Canada on the International Board of Auditors for NATO;
- Ensure proper succession planning for Canadian representatives to NATO;
- Ensure effective segregation of duties is maintained by monitoring personnel turnover; and
- Encourage the use of NATO-NSIP funding for eligible Canadian military infrastructure projects. For example, the organizational unit that applies for NSIP funding could be given credit in their budget for any resultant funding.



## MANAGEMENT ACTION PLAN

Ser	CRS Recommendation	OPI	Management Action	Estimated Completion Date
1	The documentation of significant decisions should be improved	DG Fin Mgt/ Director NATO Defence Support	<p>The Director NATO Defence Support staff have instituted new procedures for documenting specific Canadian decisions. These procedures will be further enhanced in accordance with the recommendations presented by the audit team, with specific recognition of the need to note:</p> <ul style="list-style-type: none"> <li>a. The analysis which supports the Canadian position;</li> <li>b. A description with rationale for the position taken;</li> <li>c. Reference to minutes and decision sheets from appropriate committee meetings; and</li> <li>d. Reference, as applicable, to final disposition of the issue.</li> </ul>	Actioned/ Ongoing
2	Increase Canadian participation in the International board of auditors for NATO (IBAN)	DG Fin Mgt/ Director NATO Defence Support	<p>Director NATO Defence Support staff continues to work in cooperation with other like-minded nations to strengthen the audit function by providing the IBAN with greater support from the existing financial committee structure. The Advisory Group of Financial Counsellors has taken on a role similar to that of an audit committee and carefully reviews and comments upon audit reports being submitted for North Atlantic Council (NAC) approval. The NAC, for the first time in several years, formally discussed the most recent IBAN Annual Report. The IBAN's freedom to conduct performance audits of all aspects of NATO organizations has also been reinforced as a result of an ongoing review of NATO Agencies.</p>	Ongoing



Ser	CRS Recommendation	OPI	Management Action	Estimated Completion Date
2	Increase Canadian participation in the International board of auditors for NATO (IBAN) (cont'd)	DG Fin Mgt/ Director NATO Defence Support	The lead for Canadian participation on IBAN is the Office of the Auditor General (OAG). This issue has been discussed extensively with senior representatives from the OAG during two recent visits by OAG staff to Brussels. In principle, Canadian participation is supported by the OAG; however, issues of staffing and funding have to be coordinated and resolved among the responsible agencies. Meanwhile, the Director NATO Defence Support will continue to encourage Canadian participation in IBAN through periodic discussions with the OAG.	Ongoing
3	Succession Planning for positions should be ongoing and new staff should continue to get the training and support that is required from DND	DG Fin Mgt/ Director NATO Defence Support	<p>Succession planning for the three civilian posts in Director NATO Defence Support has been difficult for a number of reasons, including the small size of the Directorate, the overseas location, the unique mix of skills, and other employment options. All of these features have played a role in problems experienced with some recent assignments to Brussels.</p> <p>The current incumbent of the Director position was selected, in early 2003, utilizing a competitive process.</p> <p>For the most recent staffing action, in early 2004, the Director instituted an open, transparent and timely process to ensure the selection of a well-qualified candidate who would be available for a normal handover. Approximately eight months before the effective transfer date, an invitation for a lateral transfer was widely distributed throughout NDHQ to individuals currently filling FI-04, or equivalent, posts. Candidates self-identified and after interviews and reference checks, candidates were rated, and an offer was made to the top candidate. The new staff member reported for duty on time.</p>	Actioned/ Ongoing



Ser	CRS Recommendation	OPI	Management Action	Estimated Completion Date
3	Succession Planning for positions should be ongoing and new staff should continue to get the training and support that is required from DND) (cont'd)	DG Fin Mgt/ Director NATO Defence Support	Succession planning for the Director of NATO Defence Support positions will ensure that timely decisions are made to permit competitive staffing of the three civilian posts.	Actioned/ Ongoing
4	Segregation of Duties Control should be monitored	DG Fin Mgt/ Director NATO Defence Support	In those cases where succession planning has failed to ensure that all Director NATO Defence Support posts are staffed, particular attention will be addressed to the question of segregation of duties. Where appropriate, officers in NDHQ or elsewhere in the Canadian Joint delegation to NATO, could be called upon to fill specific roles. This issue will be monitored carefully during periods of staff turnover.	Actioned/ Ongoing
5	Access NSIP funding	DG Fin Mgt/ Director NATO Defence Support and VCDS/ DGSP/DDA	<p>In recognition of the need for improved Canadian participation in NATO programs such as the NATO Security Investment Program (NSIP), the VCDS has established a small cell, under DGSP/DDA, to deal with this issue. This cell will help to ensure that during the early stages of development of military requirements, opportunities for Canadian participation are not missed.</p> <p>When NATO funding is provided to a nation hosting an NSIP project, an allocation, for National Administrative Expenses (NAE) of three percent, is automatically included. The disposition of any such funding that Canada might receive, would be the subject of the normal business planning process.</p>	Actioned





Ser	CRS Recommendation	OPI	Management Action	Estimated Completion Date
5	Access NSIP funding (cont'd)	DG Fin Mgt/ Director NATO Defence Support and VCDS/ DGSP/DDA	<p>Canadian participation will not, however, necessarily mean significant sums of NATO common funding would be spent in Canada. The requirement for NATO infrastructure to be “over and above” the needs of the host nation will mean that, in most cases, only limited re-imbursement to Canada will be forthcoming.</p> <p>The Director NATO Defence Support staff are also actively encouraging Canadian industry to participate in the bidding for contracts issued under common funding programs.</p>	Actioned



## INTRODUCTION

### BACKGROUND

The North Atlantic Treaty Organisation (NATO) is an alliance of 19 countries from North America and Europe committed to fulfilling the goals of the North Atlantic Treaty of 1949. In accordance with the Treaty, the fundamental role of NATO is to safeguard the freedom and security of its member countries by political and military means. During the last fifteen years, NATO has also played an increasingly important role in crisis management and peacekeeping. Several Eastern European countries have sought membership in NATO, and the alliance will soon be expanded to 26 countries. This enlargement not only makes Europe more stable, but also encourages prospective members to resolve conflicts and make democratic reforms thereby contributing to the overall security of all member countries.<sup>1</sup>

One of the keys to success of NATO is the consensual decision-making process.<sup>2</sup> Each member country has a representative on the various NATO committees, and discussions among these representatives take place off-line before decisions can be made during formal committee meetings. All decisions are unanimous. With consensus, sovereignty and independence are respected, and each decision has the commitment of all member countries.

Canada is one of the original twelve members of the Alliance and has historically contributed both financially and militarily. There are key benefits to Canada from membership in NATO.<sup>3</sup> These pertain to influence, interaction with allies and collective defence. This is expanded in Annex A. More information on the role and programs of NATO is available on the NATO website at <http://www.nato.int/>.

### CONTEXT TO THE AUDIT

#### Treasury Board Policy

This audit was conducted in accordance with Treasury Board Policy on Transfer Payments and guidance on auditing grants and contributions. In this audit, management processes were assessed against the following criteria:

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<sup>1</sup> NATO in the 21<sup>st</sup> Century (NATO21EN0601), How NATO Works, Page 12.

<sup>2</sup> NATO in the 21<sup>st</sup> Century (NATO21EN0601), NATO Enlargement, Page 8.

<sup>3</sup> As documented by Defence Scientist group in ADM(Pol).



- Forming agreement;
- Budgeting and financial management; and
- Performance and outcome measurement.

The detailed audit criteria and results are listed in Annex B. More information on the Treasury Board Policy on Transfer Payments can be found at [http://www.tbs-sct.gc.ca/pubs\\_pol/dcgpubs/tbm\\_142/ptp\\_e.asp](http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/tbm_142/ptp_e.asp).

## NATO Goals

Consistent with section 7.14 of the Treasury Board Policy on Transfer Payments, which requires departments to respect the obligations made by Canada as a signatory to international multilateral agreements to prevent inappropriate trade barriers, the Department of National Defence (DND) must respect the obligations made by Canada as a signatory to the North Atlantic Treaty of 1949.

On this basis, work conducted and recommendations made in this report are within the context of Canada's commitment to NATO and the NATO governance structure and management framework within which Canada must work. An explanation of Canada's participation in NATO was provided by ADM(Pol) staff, and is included in Annex A of this report.

## International Board of Auditors for NATO (IBAN)

The various NATO organizations and projects under NATO's Security Investment Program are audited by the International Board of Auditors for NATO ("IBAN"). The Board is composed of government officials from auditing bodies in member countries. They have independent status and are selected and remunerated by their respective countries. They are appointed by and are responsible to the North Atlantic Council.<sup>4</sup>

Based on conversations with Canada's representative to the Competent National Audit Bodies, which is a group of financial counsellors that reviews the annual report of IBAN activities, Canada last had a representative to IBAN approximately six years ago.

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<sup>4</sup> NATO Handbook, Chapter 10, Civilian Organization and Structures.

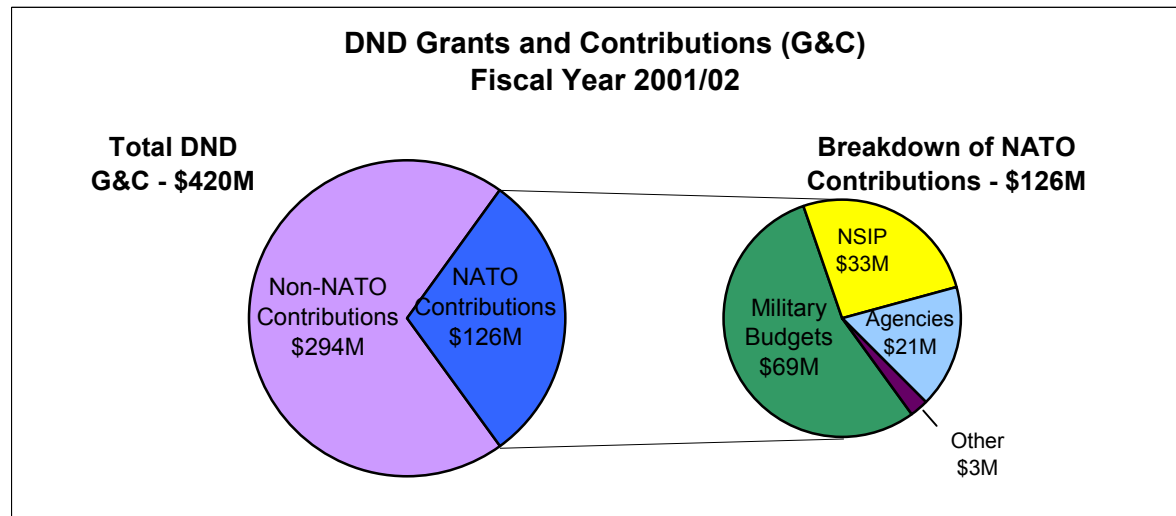


## Approval process for Canada's Contributions to NATO

Canada has developed an approval process for approving budgets and payments to NATO that is reflected in Annex E of this report.

## Canada's Contributions to NATO

Canada's contributions to NATO were 30 per cent of total DND grants and contributions in 2002, and two specific budgetary items (Military Budgets and the NATO Security Investment Program, or NSIP) comprised 81 per cent of the NATO contributions (24 per cent of total DND grants and contributions), as reflected in the following graph:

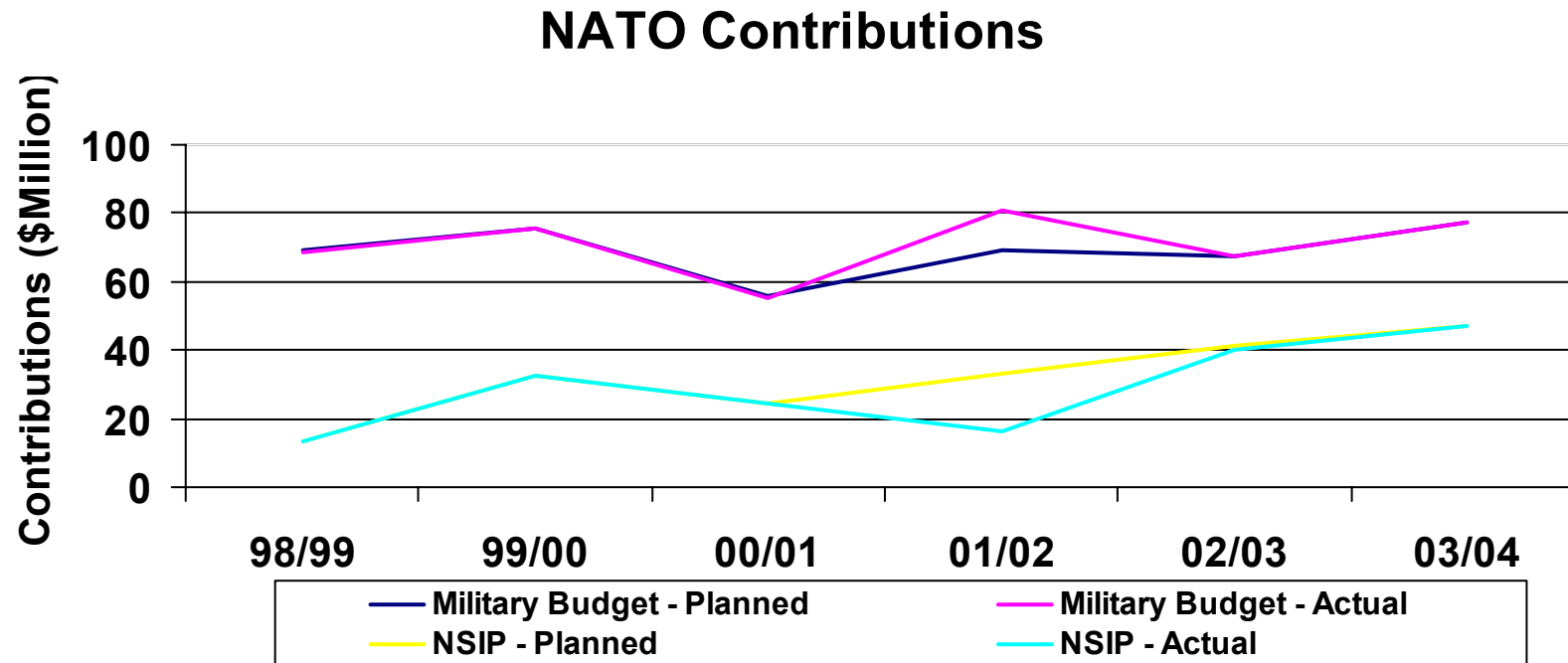


The two budgetary items included in the scope of this audit are both budgets to which all NATO members contribute and that are managed by the NATO international staff to accomplish approved NATO objectives. The two budgetary items are:

- NSIP, which is used to pay for a portion of security infrastructure of NATO member nations that is useful to NATO in accomplishing its mandate, as approved by the Infrastructure Committee and the Senior Resource Board; and
- Military Budgets, which is an operational budget used to fund the international staff, international military staff, major NATO commands and the airborne early warning force.



Canada's Military Budgets and NSIP contributions to NATO between 1998/99 and 2003/04 (both budget and actual) are reflected in the following graph.



Canada's contributions to NATO are dependent on the NATO budgets approved by the North Atlantic Council. A breakdown of the dollars included in NATO contributions for fiscal year 2002 is included in Annex C.

## AUDIT OBJECTIVE

The objective of this engagement was to assess the contribution management processes with respect to NATO Security Investment Program (NSIP) and Military Budget contributions made by DND within the context of the Treasury Board Policy on Transfer Payments and within the context of the goals and objectives of NATO.



## Audit Scope

The audit focused on only the common-funded NATO programs, NSIP (\$33M) and Military Budgets (\$69M), which are also Canada's two largest contributions to NATO. Common-funded programs are those where some or all member countries of NATO contribute to an eligible expenditure. See Annex C for more information.

## Contribution Audit Methodology

The audit methodology, which did not have the rigor of an assurance engagement, is detailed in Annex D and included the following key elements:

- Process mapping and risk assessment;
- Examination of financial transactions;
- Interviews with representatives of the Canadian delegation to NATO, NDHQ finance personnel responsible for managing NATO contributions, NATO International Staff, and International Board of Auditors for NATO (IBAN);
- Observation of NSIP and Military Budget Committee meetings at NATO Headquarters;
- Review of records and documentation; and
- Interview-based information gathering from other similar organizations to confirm the appropriateness of the recommendations identified herein as good management practices for NATO contributions.



## OBSERVATIONS AND FINDINGS

Key controls related to the management of NSIP and Military Budget contributions to NATO are documented in Annex B. Our observations are:

### The Consensus Nature of NATO

NATO requires the consensus of all members before it can take action or approve any project. In the event that one member decides to “break silence” (vote against a NATO resolution) that action cannot be taken by NATO. Consequently, each and every member of NATO has the equal ability to block an action from happening. This structure allows Canada to effect some authority over the direction and actions of NATO, and use the analysis performed by other nations with similar interests on specific issues. Canada is able to ally itself with other countries with similar positions on issues to ensure that the depth of analysis and consideration is sufficient. For example, Canada is one of several countries attempting to limit the spending growth of NATO. The Canadian delegation shares the responsibility for reviewing various NATO proposals with the other delegations to save resources.

While the consensus nature does allow an opportunity to influence NATO, the threat of breaking silence is a politically sensitive tactic that must be used thoughtfully. The breaking of silence can draw significant political pressure from other members of NATO, to both the delegation and the nation’s capital.

*Recommendation #1: The documentation of significant decisions should be improved.  
Office of Primary Interest (OPI) – DG Fin Mgt*

The members of the Canadian delegation currently maintain a significant amount of documentation on their decisions to approve budgets or to break silence, but there is no formal policy in place providing guidance on what should be retained or for how long. Decisions on what documentation to retain are currently made based on the staff members’ assessment of the sensitivity of the issue and can include the minutes of meetings, personal notes, financial analyses completed by the individual or by the NATO staff. There is currently no policy specifying what documentation to retain. We recommend that:



1. A formal documentation policy be established; and
2. All budget-related decisions and any significant or contentious issue where Canada has taken a stand should be formally documented and contain explanations of:
  - The issue;
  - The reason for taking the position; and
  - The conclusion or resolution.

The documentation policy established should reflect both the NATO classified document policies and DND's existing documentation policies, and should specify:

- Identified responsibility for maintaining documentation;
- The scope and type of documentation that should be retained;
- The retention period for retained documentation; and
- The filing system and location for organizing and storing documents.

The documentation retained should at a minimum include:

- Analyses of specific issues prepared by the Canadian delegation or the NATO International Staff;
- Description of the position taken and the rationale for taking that position based on the analyses performed;
- References to the minutes of the committee meetings where the issues were discussed; and
- References to the final disposition of the issue.

The implementation of this recommendation will not require additional resources nor should it have a significant impact on the members of the Canadian delegation as they are already preparing this information informally.

#### *Comparison to other organizations*

The consensus nature of NATO is common to all NATO participating countries. In our interviews with other NATO organizations, we were told of varying levels of documentation policies, with one organization already having formal documentation policies in place.





## International Board of Auditors for NATO (IBAN)

IBAN is an independent, six-member audit body composed of representatives from national audit institutions, such as the Office of the Auditor General of Canada (OAG). There are 19 auditors and nine support personnel on the International Staff that supports the Board. IBAN performs financial statement audits of all NATO agencies on an annual basis and contract-cost audits of all contributions made under NSIP.

IBAN's primary role in auditing the NATO agencies is to determine if the financial statements have been prepared in accordance with NATO accounting principles. IBAN also ensures that the spending is being completed in accordance with the approved budget and that a proper financial control system is operating within the agency.

IBAN audits all NSIP contributions once the projects are finished and the technical inspection completed. Upon completion of the audit, a report with outstanding items and questions is issued to the host country. Once these have been resolved, usually through a combination of negotiation and receiving additional documentation from the host, a final certification is issued and the contribution audit process is complete.

DND staff responsible for monitoring the performance and outcome measurement of NATO contributions place significant reliance on IBAN as a key control.

The following areas of concern were expressed with respect to IBAN:

- NSIP contribution audits are not performed on a timely basis and do not reflect a value-for-money focus.
- ..... While IBAN has been able to audit 81 per cent .....  
..... of the total NSIP expenditures to the end of 2002 ..... only 62 per cent .....  
had received final certification. This trend is improving – in 2002 IBAN audited ..... followed up on previous  
audits, and certified ..... The IBAN report notes that most of the difference was because either the projects had  
not received final technical inspection or .....
- DND staff responsible for monitoring the performance and outcomes of NATO contributions have expressed concern with respect to Canadian contributions to projects in countries where audits are slow or the audit trails are not solid. This trend is likely to increase as the focus of NATO stretches into countries with less robust accounting and control structures.



- IBAN recommendations are typically slow to be implemented.
- IBAN cannot “force” the audit of a project. It is incumbent on the host nation to seek a Joint Final Acceptance and Inspection (JFAI) or formal technical acceptance from NATO prior to the IBAN financial verification.

Canada has an opportunity to provide a member to the Board of IBAN. This has not been done in recent years because of cost considerations and a lack of clarity over which federal department should pay the cost.

*Recommendation #2: Increase Canadian participation in IBAN*

OPI: DG Fin Mgt

We recommend that DND work with other relevant parties such as the Department of Foreign Affairs and the Office of the Auditor General to demonstrate Canada’s commitment to improving the strength of IBAN. This could include cost-sharing arrangements. IBAN is one of the key controls available to monitor the performance and outcome measurement of Canada’s contributions to NATO and, as such, DND staff should have sufficient knowledge of how effective this control is to place the required reliance on IBAN. Some potential actions to increase the strength of, and knowledge of the reliance that can be placed on, IBAN include:

- Emphasizing within NATO the importance of IBAN; and
- Based on a cost-benefit analysis, nominating a Canadian member to the board of IBAN will help Canada influence the strength of IBAN and adopt practices consistent with Canadian auditing methodologies.

This will provide Canada with further input into ensuring that IBAN is able to fulfill its mandate and additional comfort that the Canadian funding of NATO is being spent appropriately.

*Comparison to other organizations*

As the designated auditor for the NATO Military Budget and NSIP contributions, IBAN functions as the key control within NATO to provide audit assurance to all nations. Interviewees stated that they rely on IBAN as a key control with respect to monitoring the performance and outcome measurement of NSIP funding and the accuracy of financial reporting with respect to the NATO Military Budget.



## Succession Planning for Canadian Delegation Staff

A strong controls environment requires staff that have appropriate skills and experience to participate effectively in various NATO committees. It is important that the staff have the ability to interpret the financial information being put forth to them by the NATO staff and be politically astute enough to function in NATO's extremely political environment. The Canadian staff must also be able to work with a fair amount of autonomy due to the volume of issues and decisions they are required to make. For example, if a country is breaking silence at a committee meeting when a NATO Organization is requesting additional funds, the Canadian staff member must be able to assess the underlying cause for that country breaking silence, and the impact that has on Canada's position. The country breaking silence could be doing so for a wide variety of reasons, such as the adequacy of the financial presentation of the NATO staff, a general objection to any increase in NATO funding, or that the beneficiary of the increase is another NATO member that the country breaking silence is having issues with in another committee, or even outside of NATO. The Canadian staff member must decide either to remain silent or support the country breaking silence, understanding the long-term ramifications of each alternative.

The postings for Canadian staff require a minimum of a two-year commitment, and DND has had difficulty in recruiting qualified personnel with all of the necessary skill sets to fill postings. During the year prior to fieldwork for this audit, one of the three positions within the Canadian delegation was vacant and efforts to find a replacement for one long-serving staff member due for rotation had been unsuccessful. Recruiting and succession planning efforts, including training of replacement staff, had not been able to fill the existing vacancies.

*Recommendation #3: Succession planning*  
*OPI: DG Fin Mgt*

Succession planning for positions should be ongoing and new staff should continue to get the training and support that is required from DND. Having competent, properly trained personnel in the Canadian delegation will contribute to a strong control environment.

### *Comparison to other organizations*

The two international funding organizations that provided information with respect to succession planning stated that succession planning processes are in place within their organizations.



## Effective Segregation of Duties

Effective segregation of duties is a key control in all organizations. Segregation of duties among those responsible for NATO contributions ensures that no payments or budgets are approved autonomously. NATO Headquarters ensures that Canada is not making unplanned commitments or payments and protects all of the individuals in the process. The positions at NDHQ and NATO Headquarters tend to have a significant amount of turnover, as they are either regular military postings or fixed-term public service assignments. This can lead to inappropriate segregation of duties if positions are left vacant.

For example, in 2003 there were two Canadian staff members in Brussels filling three positions, with a vacancy in the position of the senior member of the Canadian delegation. One staff member was responsible for participating in the Military Budget Committee meetings, and the other participated in both the Infrastructure Committee (NSIP) and the Senior Resource Board, which oversees the work of the Infrastructure Committee. This meant that negotiations conducted and decisions made by the Infrastructure Committee were not subject to review and approval by a separate member of the Canadian delegation on the Senior Resource Board.

*Recommendation #4: The control should continue to be monitored*

*OPI: DG Fin Mgt*

We recommend that this control continue to be monitored as the individuals or their respective roles change within the organization.

### *Comparison to other organizations*

The audit team confirmed with three international granting organizations that they monitor staff turnover and its impact on segregation of duties to ensure that appropriate controls are in place and operating.

## Cost recovery Opportunity

NSIP funding is available to all members of NATO for projects that fit within the NATO Capability Requirements and which are in excess of the military requirements of the country. DND does not currently attempt to access the funding that is available under NSIP. One reason that has been given for the lack of DND applications for NSIP funding is that the administrative effort required to apply for the funding is significant, and the project team that undertakes the required work to apply for funding may not receive the budgetary credit for the additional NSIP funding as any funding received would flow into general DND budgets instead of back to the organizational unit that processed the NATO request for funding. Canada last applied for NSIP funding in 1984, for construction of a fuel handling facility in Bedford, Nova Scotia.



While the documentation and other requirements are significant, there is an opportunity to recover some of the contributions that Canada is paying to NATO. This would defray some of the expense of NATO to Canada and would subsidize the improvement of Canada's military infrastructure.

*Recommendation #5: Access NSIP Funding*  
*OPI: DG Fin Mgt*

We recommend that DND actively consider opportunities to access NSIP funding for projects that have potential NATO benefits. DND should determine if there are cost-effective opportunities to access NSIP funding to expand Canada's defence infrastructure and ensure the appropriate incentives are in place to encourage DND staff to apply. For example, providing budgetary credit to the organizational unit that applies for NSIP funding removes the current requirement that the organizational unit applying absorb the administrative costs of preparing the application without realizing the budgetary benefits.

#### *Comparison to other organizations*

Most NATO countries have processes in place to draw on NATO NSIP funding. For example, one NATO organization interviewed stated that they encourage groups within their Defence Department to apply for NSIP funding by passing the NSIP funding received back to the group that requested it.

### **Summary of Recommendations**

We did not find any significant deficiencies in the contribution management processes applied to the NATO NSIP and Military Budgets. Key controls related to managing these two contributions are documented in Annex B, and a summary of our recommendations with respect to contribution management is reflected in the Management Action Plan at the front of this report.



## **ANNEX A – Canada’s Membership in NATO**

According to defence scientists within ADM(Pol), there are four main ways that Canada benefits from membership in NATO:

- “Seat at the Table” argument;
- “United States” argument;
- “European argument”; and
- “Collective Defence” argument.

### **Seat at the Table Argument**

Membership in NATO offers Canada access to a venue where it sits as an equal with other influential states. Membership gives Canada benefits such as diplomatic access, political influence, and intelligence at a reduced cost compared to that which it would otherwise have to bear.

### **United States Argument**

An important Canadian foreign policy interest is to maintain the best possible relationship with the United States as our security and standard of living are related to maintaining this relationship.

### **European Argument**

Canadian membership means that the Alliance is more than a security pact between the United States and an increasingly integrated Europe. Canada can and does play a balancing role within NATO.

### **Collective Defence Argument**

NATO is a proven defence alliance. Canadian membership allows Ottawa to encourage the transformation of this organization to make it more effective in countering new and evolving threats common to all NATO members. Enhancing the effectiveness of NATO will also support Canadian interests by discouraging the formation of smaller security pacts among NATO members.



## ANNEX B – Audit Results

### FORMING AGREEMENT

Audit Criteria	Key Controls	Criteria Met	Could be Improved	Recommendation
The terms and conditions of the agreement are set out and clearly documented.	<ul style="list-style-type: none"> <li>➤ The terms of the NATO agreement and Canada's participation are documented in the Treaty of 1949.</li> <li>➤ Specific details related to individual funding calls are documented in call letters, which are agreed to by Canada as part of the NATO Committee process.</li> </ul>	✓		
The outcome expectations related to the contributions are clearly understood and documented.	<ul style="list-style-type: none"> <li>➤ DND representatives to BNATO participate in NATO oversight committees where NSIP project proposals and NATO military budgets are approved. This includes consideration of both contribution costs and outcome expectations.</li> <li>➤ Budget documents for all NATO contributions are approved by NATO international staff, and Canada's representatives to NATO.</li> <li>➤ The NATO medium term resource plan documents the medium term outcome expectations.</li> </ul>	✓		
There is an appropriate approval framework in place and accountability assigned for selecting and approving contributions.	<ul style="list-style-type: none"> <li>➤ There is an agreed upon, documented and understood approval framework in place for approving NATO contributions.</li> <li>➤ The Canadian delegation to BNATO is staffed with personnel that have appropriate finance background.</li> <li>➤ There is ongoing communication with respect to NATO contributions between Canada's representatives to NATO and Ottawa-based DND staff.</li> </ul>		✓	#1



## ANNEX B

## FORMING AGREEMENT (Cont'd)

Audit Criteria	Key Controls	Criteria Met	Could be Improved	Recommendation
	<ul style="list-style-type: none"> <li>➤ NATO International staff plays an oversight role with respect to all NATO expenditures, and the North Atlantic Committee functions in a governance role with respect to NATO activities and funding requirements/contributions.</li> <li>➤ There is designated accountability for FAA Section 32, 33 &amp; 34 signoffs with respect to NATO contributions.</li> </ul>			
Appropriate records are maintained to provide documentary evidence of agreements.	<ul style="list-style-type: none"> <li>➤ Documentation of all NATO meetings and decisions are maintained at NATO Headquarters</li> <li>➤ Documentation of all NATO financial requests is maintained at DND Ottawa.</li> </ul>		✓	#1
NATO contributions are identified and approved in Parliamentary estimates.	<ul style="list-style-type: none"> <li>➤ NATO contributions are specified in parliamentary approved estimates.</li> </ul>	✓		





## ANNEX B

## BUDGETING AND FINANCIAL MANAGEMENT

Audit Criteria	Key Controls	Criteria Met	Could be Improved	Recommendation
There is an appropriate approval framework in place and accountability assigned for budgeting and financial management of contributions.	<ul style="list-style-type: none"> <li>➤ Budgets for NATO contributions are established with FMAS.</li> <li>➤ All NATO contributions are compared to budgets and approved by both BNATO representatives and DND Ottawa staff prior to payment.</li> <li>➤ There is designated accountability for FAA Section 32, 33 &amp; 34 signoffs with respect to NATO contributions.</li> </ul>	✓		
Appropriate financial control processes are in place.	<ul style="list-style-type: none"> <li>➤ All NATO payments are processed through the normal DND payment process and recorded in FMAS.</li> <li>➤ There is designated accountability for FAA Section 32, 33 &amp; 34 signoffs with respect to NATO contributions.</li> <li>➤ Staff involved in both BNATO and DND Ottawa are aware of the need to conform with financial controls.</li> <li>➤ There is segregation of duties between BNATO staff (who participate in the decision making process) and DND Ottawa staff (who maintain financial records and process payments).</li> </ul>	✓		
The budget processes are adequate to meet planning requirements.	<ul style="list-style-type: none"> <li>➤ NATO contributions are subject to the budgeting processes of both DND and NATO, and are separately disclosed in parliamentary estimates.</li> </ul>	✓		



## ANNEX B

## BUDGETING AND FINANCIAL MANAGEMENT (Cont'd)

Audit Criteria	Key Controls	Criteria Met	Could be Improved	Recommendation
Financial results are compared to budget to assess performance and financial condition.	<ul style="list-style-type: none"> <li>➤ The results of NATO financial performance are compared to original budgets by the NATO international staff and this information is reviewed by the Canadian delegation to BNATO.</li> <li>➤ Budget and actual numbers for Canada's contributions to NATO are analyzed by DND Ottawa staff.</li> </ul>	✓		
Cash management processes are in place with respect to the contribution agreements.	<ul style="list-style-type: none"> <li>➤ Reconciliations are completed by both DND and NATO staff to ensure the completeness and accuracy of contribution payments.</li> </ul>	✓		
The payment processes in place to make contribution payments are appropriate.	<ul style="list-style-type: none"> <li>➤ NATO contributions are paid through the normal DND payment processing system.</li> </ul>	✓		
The accounting processes in place ensure contributions are appropriately accounted for.	<ul style="list-style-type: none"> <li>➤ Staff managing NATO contributions comply with accounting systems and control frameworks reflected in the DND accounting system.</li> <li>➤ There is financial information available to, and used by, DND staff in periodically reviewing NATO contributions.</li> </ul>	✓		
Appropriate budget and accounting records are maintained.	<ul style="list-style-type: none"> <li>➤ Filing system maintained at NDHQ reflects all necessary approvals prior to the release of funds.</li> </ul>	✓		



## ANNEX B

## PERFORMANCE AND OUTCOME MEASUREMENT

Audit Criteria	Key Controls	Criteria Met	Could be Improved	Recommendation
There is an appropriate approval framework in place and accountability assigned for performance and outcome measurement of the contributions.	<ul style="list-style-type: none"> <li>➤ Accountability for decision making and the monitoring of outcomes is clearly defined within the Canadian delegation.</li> <li>➤ Input on outcomes is solicited from relevant NATO and DND staff with respect to outcomes.</li> <li>➤ IBAN and NATO international staffs perform detailed audits of NATO Military Budgets and NSIP projects on behalf of all NATO nations.</li> </ul>		✓	#2 & #5
Outcomes related to the contributions are measured and the results are used appropriately.	<ul style="list-style-type: none"> <li>➤ Detailed outcome information is provided to the Canadian delegation by NATO international staff.</li> <li>➤ The Canadian delegation to NATO also solicits informal performance information from other Canadian Forces staff assigned to NATO projects.</li> <li>➤ IBAN and NATO international staffs perform detailed audits of NATO Military Budgets and NSIP projects on behalf of all NATO nations.</li> </ul>		✓	#2
Recipient reports are gathered and appropriately used within DND.	<ul style="list-style-type: none"> <li>➤ Summarized recipient reporting is provided to DND by NATO international staff on a regular basis.</li> <li>➤ DND representatives to BNATO review IBAN reports for Military Budget and NSIP project audits.</li> </ul>		✓	#2



## ANNEX B

## PERFORMANCE AND OUTCOME MEASUREMENT (Cont'd)

Audit Criteria	Key Controls	Criteria Met	Could be Improved	Recommendation
Understanding the monitoring processes in place (such as IBAN audits) over the contribution agreements.	<ul style="list-style-type: none"> <li>➤ DND representatives to BNATO participate in the oversight committees of NATO.</li> <li>➤ Canada has a representative to the Competent National Auditors committee which review IBAN reports.</li> <li>➤ NATO international staff and IBAN report to all NATO nations, including Canada, on a regular basis with respect to the status of the Military Budget and open NSIP projects.</li> </ul>		✓	#2
Appropriate records are maintained to provide documentary evidence of performance and outcome measurement.	<ul style="list-style-type: none"> <li>➤ Record of Military Budget expenditures and NSIP contributions are maintained by NATO international staff.</li> </ul>		✓	#1
Departmental capacity exists to effectively deliver and administer the program, including monitoring, learning and training.	<ul style="list-style-type: none"> <li>➤ There is a selection process in place to identify and select candidates for members of the Canadian Delegation.</li> </ul>		✓	#3 & #4



## ANNEX C – Canada's NATO Contributions

Planned expenditures on grants and contributions for fiscal year 2002 amounted to \$420M. Of this amount, \$126M (approximately 30 per cent) represented contributions to NATO, shown as follows in the DND 2001-2002 Report on Plans and Priorities:

	\$	\$
NATO Military Budgets and Agencies	69,000,000	
NATO Agencies	20,667,000	
NATO Security Investment Program (NSIP) (capital expenditures)	33,000,000	122,667,000
Mutual Aid	2,727,000	
NATO Allied Command Rapid Reaction Corp HQ	153,000	
Reaction Force Air Staff	48,000	
U.N. Standby Forces High Readiness Brigade	280,000	3,208,000
Total NATO Contributions		125,875,000

### Note to reader

The audit focused on the Military Budgets and NSIP budget items, which are common-funded. The principles of common funding, where NATO members share the costs of eligible expenditures, are described in Chapter 9 of the *NATO Handbook* available at <http://www.nato.int/docu/handbook/2001/hb0901.htm>.

Canada's contributions to NATO for Military Budgets and NSIP are reflected in the following table:

	98/99	99/00	00/01	01/02	02/03	03/04
Military Budgets (actual)	68,587,861	75,442,941	55,396,845	80,537,369	67,297,117	77,205,839
Military Budgets (budgeted)	69,408,643	75,446,100	55,590,000	69,000,000	67,464,798	77,234,400
NSIP (actual)	13,589,872	32,304,930	24,477,604	16,301,950	39,905,507	47,244,975
NSIP (budgeted)	13,590,000	32,305,000	24,545,000	33,000,000	41,465,154	47,104,916



## **ANNEX D – Contribution Audit Methodology**

The contribution audit methodology used involved examining the business processes in place to conform with the Treasury Board Policy on Transfer Payments and guidance on auditing grants and contributions. Two specific contributions (NSIP and Military Budgets) were selected and reviewed against the expectations set out by the existing policy and guidance information, summarized in the following three categories:

- Forming agreement;
- Budgeting and financial management; and
- Performance and outcome measurement.

Procedures conducted by the audit team to examine the business processes in place within each of the three categories include the following:

### **Business Process Documentation and Risk Assessment**

An understanding of the contribution management framework was developed and documented for the following NATO contribution processes:

- Budgeting;
- Budget amendments;
- Approval and decisions making; and
- Payments.

Based on this process documentation, specific risk areas were identified in each of the three categories examined, and the need for further testing was assessed based on the perceived risk levels in each category.



**ANNEX D****Financial Transaction Testing**

The purpose of the transaction examination was to verify the approval and payment process for NATO contributions. Procedures consisted of:

- Verifying that the call (request for funds) from NATO had been properly authorized;
- Examining the documentation kept on file at NDHQ to ensure it was comprehensive and supported the release of funds;
- Tracing the payment into the DND payment system; and
- Verifying the exchange rates applied to payments.

We did not test the controls surrounding the DND payment system as that was beyond the scope of this engagement.

Our sample was selected from NATO's 2002 fiscal year. We selected NATO's fiscal year to determine the population because the contribution levels are determined based on the NATO operating and budgetary cycle. NATO's year-end is December 31<sup>st</sup> whereas DND has a March 31<sup>st</sup> year-end. Consequently, the cash expended by DND on NATO contributions can fluctuate based on the timing of the funding requests.

The 2002 NATO fiscal year consisted of 30 calls with a total value of \$94.4 million. We judgementally selected and tested seven calls totalling \$69.5 million, which represented almost 74 per cent of the total value of 2002 calls. No exceptions were noted during the testing.

**Records and Documentation Review**

The audit team selected and reviewed representative samples of the following documents as a part of the audit:

- Minutes of NATO committee meetings including the Military Budget Committee, NSIP and Senior Resource Board;
- Various analyses and presentations prepared by NATO International Staff detailing samples of NSIP project acceptance, NSIP project monitoring, the review of submissions for Military Budget meetings, and documented processes and controls for both NSIP and Military Budget treasury functions;



**ANNEX D**

- Various analyses prepared by the Canadian delegation detailing the reasons for breaking silence on selected issues. The analysis included NATO staff analysis, copies of or references to other committee meetings and supplemental notes and analyses prepared by the Canadian staff;
- Various IBAN audit reports for projects and agencies prepared for fiscal years 2001 and 2002;
- The IBAN Charter;
- IBAN publications including “50 Years of Activity” and the “2002 Activity Report”; and
- The NATO Handbook.

**Interviews and Observation of NATO Meetings**

Interviews were conducted with representatives of the following organizations:

- DND BNATO (Brussels – NATO) staff participating in the Canadian delegation to NATO;
  - Colin Galigan
  - Michel Lepage
  - Claire Gauthier
- DND DFinOps (Financial Operations) staff responsible for processing the financial elements of NATO contributions;
  - Major Shelagh Stevens
  - Elizabeth Alexander
- DND ADM IE (Infrastructure and Environment) staff responsible for Canada’s last NSIP project
  - Major Higgs
- NATO International Staff involved in NATO operations in Brussels;
- IBAN (International Board of Auditors for NATO) with respect to the results and execution of audits conducted; and
- Office of the Auditor General with respect to their involvement in IBAN.

All interviews with NATO and IBAN staff were conducted on a confidential basis.





**ANNEX D****Interviews with Other International Granting Organizations**

In order to confirm that the recommendations made herein are appropriate, we identified a number of similar organizations that make and manage donations to internationally funded institutions such as NATO, and conducted interviews with representatives of those organizations to:

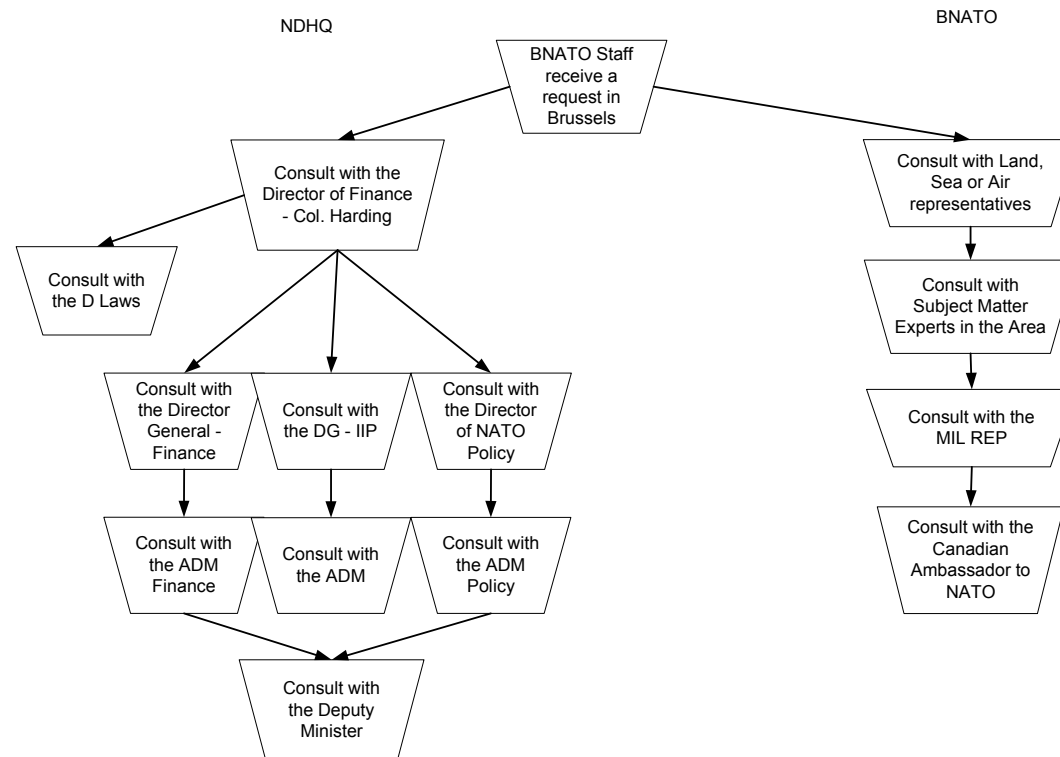
- Understand the overall process used by their organization to manage contributions; and
- Understand specifically how they managed issues related to recommendations identified in this report (such as documentation and succession planning).

The results of these best practice interviews have been incorporated into our recommendations.



## ANNEX E – NATO Approval Process

### DND APPROVAL PROCESS



This chart shows the progression of consultation through the different areas of DND. The consultations undertaken in NDHQ and BNATO (Brussels) and the level to which they would proceed vary according to the financial or political impact. Each individual issue would only go through the hierarchy to the level deemed necessary by that individual. For example, if the DG Finance reviews an issue and makes a decision within his authority, no consultation would be required with the ADM Finance. The level of approval is normally decided through the consensus of the individuals involved.

