Internal Audit of the Democratic People’s Republic of Korea Country Office

July 2018

Office of Internal Audit and Investigations (OIAI)
Report 2018/02
Summary

The Office of Internal Audit and Investigations (OIAI) has conducted an audit of the Democratic People’s Republic of Korea (DPRK) Country Office. OIAI’s internal audit sought in particular to assess the effective management of risks to programme implementation, including implementation of the programme activities managed under the funding agreement with the Global Fund to Fight Aids, Tuberculosis and Malaria. The audit was conducted between 21 November and 8 December 2017, and covered the period from 1 May 2016 to 30 November 2017. This audit did not include a field visit to DPRK.

2017 was the start of the 2017-2021 country programme (CP), which consists of four programme components: Health, Nutrition, WASH, and Programme Monitoring and Evaluation, supported by a cross-cutting Programme Effectiveness component. The CP was approved in September 2016 with a total budget of US$ 71.3 million, comprising US$ 12.7 million in Regular Resources (RR) and US$ 58.6 million in Other Resources (OR). RR are core resources that are not earmarked for a specific purpose. OR are contributions that may have been made for a specific purpose, and may not always be used for other purposes without the donor’s agreement.

Since 2010, UNICEF has been the Principal Recipient (PR) of funds from the Global Fund. During this period, UNICEF has signed grant agreements with the Global Fund totalling over US$ 81 million. Since 1993, the United Nations Security Council (UNSC) has adopted a number of resolutions imposing sanctions on the DPRK. There were five UN resolutions signed between 30 November 2016 and 11 September 2017 that introduced further restrictions, affecting UNICEF-supported programme implementation and making operations in DPRK more challenging and unpredictable.

The audit team noted a number of areas of good practice within a challenging and fast-moving operating environment. For example, the office had rigorously identified risks, updated country-specific risk profiles and developed mitigating action plans. It had also commissioned a risk management review for its main Health programme to assess the implementation risks and suggest mitigation measures given the specific context. This proactive approach was supplemented by good collaboration within the UN Country Team which helped UNICEF and the other UN agencies to leverage each other’s strengths.

Action agreed following the audit

The audit identified a number of areas where further action was needed to better manage risks to UNICEF’s activities. In discussion with the audit team, the country office has agreed to take a number of measures to address these risks and issues.

Three actions are being implemented as a high priority; that is, to address issues requiring immediate management attention. These relate to ensuring that all exceptions to UNICEF’s regulatory framework are approved at an appropriate level, that there is appropriate documentation of the donor’s formal acceptance of any variations from the terms of a grant agreement, and that the office implements the findings of a review to strengthen logistics management in the face of a rapidly-deteriorating supply situation.
Conclusion

Based on the audit work performed, OIAI concluded at the end of the audit that, subject to implementation of the agreed actions, the office’s governance, risk management and internal controls, as described above, were generally established and functioning during the period under audit.

The DPRK Country Office, the East Asia and the Pacific Regional Office (EAPRO) and OIAI will work together to monitor implementation of these measures.

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Objectives

The objective of the country office audit is to provide assurance as to whether there are adequate and effective controls, risk-management and governance processes over a number of key areas in the office. In the case of DPRK, the internal audit’s focus was in particular on assessing the effective management of risks to programme implementation, including the delivery of programme activities managed under the funding agreement with the Global Fund.

This report presents the more important risks and issues found by the audit, the measures agreed with the client to address them, and the timeline and accountabilities for their implementation. It does not include lower-level risks, which have been communicated to the client in the process of the audit.

Audit observations

Risk management

The UNICEF Office in the Democratic People’s Republic of Korea is operating in a unique and challenging environment; this impacts UNICEF’s ability to deliver life-saving programmes, and accordingly requires a particular focus on effective risk management.

In May 2016, the office received technical support from the regional office to conduct a detailed risk assessment; it developed a comprehensive risk profile, which included the mapping of contextual, institutional, programmatic and operational risks, together with an action plan to mitigate identified risks.

In July 2017, the office commissioned a further risk management review of its Tuberculosis (TB) and Malaria programmes. This review was conducted by a team of experts from the regional office, New York Headquarters and Supply Division, and helped the office to adjust its mitigation actions and work processes taking into account the impact of the changing operating environment on the implementation of the TB and Malaria programme.

The 2017 Situation Analysis (SitAn) of Children and Women in the Democratic People’s Republic of Korea was developed in close collaboration with Government ministries and departments. The SitAn serves as a comprehensive reference on the situation of children and women in DPR Korea, and provides a source for advocacy and for resource mobilization. Although limited availability and analysis of survey data made it difficult to fully assess performance related to the Millennium Development Goals (MDGs) or to establish a baseline for the Sustainable Development Goals (SDGs), the 2017 SitAn is nonetheless helping inform surveys and studies such as MICS 2017 and the planned census in 2018.

The country office has developed a country programme management plan (CPMP) that reviewed the management and staffing implications of, and potential resources available for,
the new country programme (CP). The plan specifically recognises the need for flexibility and for adjusting to changing risks. The office conducted a business continuity plan (BCP) simulation in August 2017, and updated its BCP in September 2017.

The audit team reviewed the performance metrics for DPRK that were produced by UNICEF Global Shared Services Centre (GSSC) for the first three quarters of the 2017 calendar year. The GSSC report did not identify any problems in the areas of invoice processing, master data management, payments or payroll related to the office. The audit team reviewed a sample of payments, and found that the transactions selected were adequately supported.

Management of exceptions
The UNICEF procedure issued in June 2016 sets out the regulatory framework governing the organization’s operations and activities, and defines the mechanisms for approving exceptions to these policies and procedures. Given that it would be impracticable to promulgate a single set of rules that fits every situation and operating environment, UNICEF offices are allowed to seek approval for any exceptions that are required in response, for instance, to an unexpected change in the local programming or operating environment. However, these exceptions should be documented and justified, with compensating measures identified and taken to mitigate any related risks and reported to the relevant Business Owner. They should also be approved at an appropriate level within the organization. This helps protect UNICEF from exposure to risks which have not been properly accepted, as well as protecting individual managers and staff members where they are validly departing from normal policies and procedures.

The 2017-2021 country programme document (CPD) for DPRK states that accountabilities of managers at the country, regional and headquarters levels are as prescribed in the organization’s programme and operations policies and procedures. The CPD acknowledged that there were programme and operational challenges in a number of areas that could not be managed through existing policies and procedures: examples included how to manage the recruitment of personnel who are seconded by the Government to work in the UNICEF country office, and how to mitigate the cash-flow impact of periodic interruptions to banking channels.

The office had properly obtained advice and guidance from the regional office, and from the Division of Human Resources (DHR) and Division of Financial & Administrative Management (DFAM), on how to manage risks in these areas. Risk assessments, mitigations plans, and standard operating procedures (SOPs) were developed or were being developed to reflect the exceptions required from UNICEF’s standard policies and procedures, but the audit team noted that these exceptions were not formally approved. Exceptions need to be approved by the responsible Business Owner (in this case either DHR or DFAM) upon written request from the UNICEF Representative. Where variations might involve acceptance of a significant degree of risk to UNICEF, the approval may need to be at a higher level than the Business Owner. The internal audit also made an observation around the Harmonized Approach to Cash Transfers (HACT). UNICEF country offices are normally required to implement HACT, under
which the office relies on its implementing partners (IPs) to manage and report on the use of funds provided to them for agreed activities; this reduces the amount of supporting documentation UNICEF demands from the partner, thus cutting bureaucracy and transaction costs. In certain cases, however, the HACT procedure accepts that HACT is not an appropriate approach, and there are defined steps for authorizing exceptions from the normal policy.

In 2015, the country office had properly requested and obtained approval for an exception under HACT. In 2016 and 2017, however, whilst the office had submitted exception requests, the audit team noted there was no evidence of the required approval having been provided by UNICEF’s Field Results Group (FRG) as is required under the HACT policy. Both the office and FRG told the auditors that approval had in fact been given informally, but that the continuing departure from HACT had not been formally signed-off for 2016 and 2017.

**Agreed action 1 (high priority):** The country office agrees, with support from relevant headquarters functions and the regional office, to ensure that all exceptions to UNICEF’s policies and procedures are properly documented and approved at the appropriate level.

**Responsible staff members:** Deputy Representative and Chief of Operations

**Target date for completion:** The office reports action as completed

The audit team observed that the framework agreement with the Global Fund specifically mentions the key oversight role of Local Fund Agent (LFA) as a core control within the Global Fund’s normal operating model. In the case of DPRK, however, the Global Fund had subsequently agreed that there would not be an LFA put in place and, as with programme monitoring more generally, had indicated to the UNICEF country office that it would accept UNICEF’s normal risk management practices instead of requiring an LFA to provide verification.

The country office was able to show that the Global Fund had accepted this departure from the terms of the grant agreement, with reliance being placed on UNICEF’s own monitoring systems rather than on an LFA. However, the audit team noted that communication with the Global Fund on this issue had been through an exchange of emails at country level, and that there was no formal variation of the terms and requirements set out in the framework agreement. There was therefore increased risk of misunderstandings as to what conditions are currently in place, and so a greater acceptance of risk by UNICEF as there would be no independent oversight mechanism in place as envisaged under the grant agreement.

The country office had also not obtained the written agreement of the Business Owner, the Public Partnerships Division (PPD), who are responsible for the overall relationship with Global Fund and who sign grant agreements on UNICEF’s behalf; this increased the risk of confusion between different parts of UNICEF.

**Agreed action 2 (high priority):** The country office, with support from the regional office and from the Public Partnerships Division, agrees to ensure that any material variations that are agreed from the terms of a grant agreement with a donor are appropriately formalized, for
instance through an exchange of letters at headquarters level or, if necessary, through an amendment to the grant agreement itself.

Responsible staff members: Deputy Representative and Chief of Operations
Target date for completion: The office reports action as completed

Programme implementation strategy
Programme coverage: The 2017-2021 country programme document (CPD) acknowledged the need to demonstrate synergies between sectors in nine provinces and nine convergent counties. The CPD noted that the Health and Nutrition programmes were reaching 50 counties with life-saving interventions. The Tuberculosis grant under the Health Programme focused on 190 counties in 10 provinces, whilst the Malaria grant focused on 123 counties in nine provinces. The CPD included some components with national coverage, delivery of immunization services and distribution of Vitamin A, deworming and multi-micronutrient supplementation.

Convergence of and better synergy between programmes could help maximize the resilience and sustainability of UNICEF’s and its partners’ efforts overall. The 2017-2021 CP Strategy Note mentioned ten counties (one county each in 10 provinces) in which UNICEF will increase convergence of its Health, Nutrition and WASH (Water, Sanitation and Hygiene) programmes. The document also mentioned a multi-sectoral convergence in 11 counties, although it was unclear as to how these counties were selected and why they differed from the nine counties in the CPD.

The audit team also noted that the strategy note did not define how convergence would be operationalised. The CP result matrix included in the strategy note showed that the WASH programme had output statements that referred to 10 convergence counties. For example, ‘1.1.2 Output Statement: By 2021, selected cooperative farms, households, schools and health facilities in 10 convergence counties apply knowledge and skills to practise hygiene behaviours and safe use of faecal matter in agriculture.’ ‘1.1.4 Output Statement: By 2021, people's committees in 10 convergence counties have the capacity to assess WASH needs, plan, manage and monitor WASH services’. For the Nutrition and Health programmes, however, the approach was different: convergence counties were not mentioned at output level but instead under the geographic coverage section of the workplan, and there were no output results related to the convergent counties.

The audit team reviewed the minutes from the Health programme mid-year meetings which mentioned a discussion on the convergence approach. In November 2017, a concept note of convergence counties was shared with Government partners; this identified nine counties that will need to be integrated in the workplans, but did not define convergence indicators.

Effectiveness of service delivery: UNICEF’s comparative advantage in service delivery comes largely from its experience in supporting the provision of quality services for children,
developing approaches that can be taken to scale, and facilitating the identification and adoption of relevant policy options.

The 2017-2021 CPD indicated the need to strengthen cross-sectoral linkages, and to balance the urgent supply component of the humanitarian programme with the required technical assistance to support partners with hands-on training, policy work and programme communications. However, the audit team noted that the key strategic documents (strategy notes, CPMP and annual management plan) did not clearly articulate how the country office will maximize the effectiveness of its service delivery. There were no indicators or other tools in place to measure the office’s progress toward improving effectiveness of service delivery.

**Agreed action 3 (medium priority):** The country office agrees to clearly define:

i. Indicators for convergence and what the expected results will look like;

ii. How the convergent counties approach will be integrated into the office’s programming overall;

iii. Indicators to measure improvements in programme efficiency, including how to leverage service delivery to help strengthen resilience and partner capacity.

Responsible staff members: Representative and Deputy Representative

Target date for completion: 30 June 2018

**Programme monitoring**

Monitoring helps managers to determine how effectively and efficiently programme interventions are progressing towards their stated goals, providing an opportunity to track the implementation of activities and the results being achieved, to take corrective action as necessary, and to report on progress.

In 2016 and 2017, the country office conducted mid-year and annual programme reviews jointly with its Government counterparts. These reviews assessed progress achieved, and identified constraints and lessons learned. The office had developed an annual monitoring plan, together with standard field visit reporting formats to record findings, recommendations and follow up actions. The annual management plan (AMP) included field trip performance indicators. Each international staff member was to spend an average of 20 days in the field for monitoring.

The audit noted the following.

Data needed to establish an appropriate baseline against which to measure progress towards achieving program results were provided by the Government. Monitoring visits verified the actual implementation arrangements, and were an essential component of UNICEF’s work, enabling the country office to triangulate the data it collected. There were, however, specific challenges in undertaking effective and comprehensive monitoring: some restricted areas (yellow counties) were only accessible by national seconded personnel, whilst eight counties were not accessible at all. The 2017-2021 UN strategic framework notes that the Government has agreed a ‘no access, no assistance’ operating principle, under which assistance will only
be provided to areas that can be accessed by the UN’s international staff; as noted above, UNICEF’s signed 2017-2021 country programme document acknowledges programme components that by their nature need to have national coverage (for instances vaccinations against communicable diseases).

UNICEF as Principal Recipient was responsible for the overall coordination and monitoring of the Global Fund grant implementation to ensure that activities are implemented as planned in the Tuberculosis (TB) and Malaria work plans. The country office had implemented the Global Fund monitoring system which assessed achievements against the targets in the Performance Framework and developed minimum standards for programme monitoring. The TB and Malaria minimum visits standard identified two types of visits: a technical support visit with the main purpose of providing technical guidance, and an observational visit focusing on the verification of stock and assessing whether the supplies were in the right place as per the distribution plan. The office indicated that a minimum standard was defined and introduced in September 2017; this included counties judged critical to overall programme that were to be visited at least four times by International Staff. However, it is too early to assess its implementation.

The office’s monitoring report for 2017 stated that 112 observational visits were completed compared to 106 visits planned; this included completion of all 60 planned TB programme observational visits, whilst 52 Malaria programme observational visits were completed compared to 46 planned.

The audit team observed that none of the 67 technical support visits that were planned were reported as having been conducted, according to the October 2017 report provided. However, the field trip reports reviewed during the audit showed that the observational visits did include components which would normally fall under technical support visits. If the teams conducting this monitoring have the necessary mix of skills and expertise, it could validly be argued that a series of integrated visits is more efficient and effective than conducting separate observational visits and technical visits. In this case, however, the office would need to ensure that this was clearly agreed with the donor.

A review by the audit team of 16 field trip reports reinforced the need to strengthen the quality of the reports with specific follow-up actions. For example, a field trip report noted the absence of medicine and medical kits in two counties’ medical warehouse, one county hospital and one Ri hospital, but there were no follow-up actions raised. The office indicated that in order to prevent stock out of medicines at central level, some essential medicines had to be air shipped. The country office had itself identified the issue of strengthening the quality of recommendations, and this was noted in the programme coordination meeting minutes. The office indicated that a field trip database was being developed that will allow the office to monitor the implementation of recommendations and follow-up actions included in the report.

**Agreed action 4 (medium priority):** The country office agrees to strengthen its programme monitoring, including by:
i. Assessing risks relating to the UN strategic framework clause of *no access, no assistance*, and defining any necessary mitigation measures.

ii. Reviewing the targets for monitoring visits to ensure these remain appropriate, and taking the necessary action to ensure that the necessary quantity and quality of monitoring is performed. Where observational visits and technical support visits are combined (for instance, for reasons of efficiency), this approach should be formally agreed with the donor.

iii. Strengthening the quality of field visit reports, ensuring that actions are raised as necessary to address issues identified, and that these remedial actions are tracked and followed-up appropriately.

Responsible staff members: Deputy Representative

Target date for completion: The office reports action as completed

Supply and logistics

Programme supplies were a significant component of UNICEF DPRK’s life-saving interventions and represented over 70 percent of the country programme’s total throughput. The total value of supplies procured in 2016 amounted to US$ 35.2 million, with a further US$ 24 million procured during 2017 as at November. UNICEF’s Supply Division (SD) was the major channel for procurement, purchasing 84 percent of the total, with procurement made through UNICEF China accounting for less than 13 percent; supplies procured locally were approximately 3 percent of the total.

In 2016/17, the majority of the supplies (more than 90 percent) were for the country office’s Nutrition and Health programmes. Procurement of supplies was a large component of the Malaria and Tuberculosis programmes. Furthermore, as the Principal Recipient (PR) of the funding for the Malaria and TB programmes, UNICEF was responsible to ensure that efficient and effective supply chains were created and functioning so that life-saving commodities reached vulnerable people.

A review of a sample of 14 sales orders noted that Government requests received for supplies were linked to activities defined in the signed workplans. Distribution lists and goods receipts were provided.

However, the audit team noted delays in the procurement, distribution and issuance of supplies: in five out of eight instances reviewed, the supplies were actually received after the planned implementation period, and in June 2017 a Government partner had sent letters to UNICEF and to the donor raising concerns on delays in procurement for the Malaria programme that could prevent a timely response in advance of the Malaria season. A number of measures had been taken, including a pre-financing arrangement, to address the risk of delays.

An analysis of lead times showed that Nutrition and WASH items were not being impacted by the new sanctions. The procurement lead time for these items, on average, from sales order release to delivery and goods was 3-6 months in 2016 and 2017. For Health supplies, however, including supplies for TB and Malaria, the lead time had increased significantly with
new sanctions - for instance increasing from 4-6 months up to 8-11 months delay for TB-related materials.

The office’s supply unit has a process to monitor the status of goods in transit (GIT). The GIT account reduced from US$ 5.9 million in December 2016 to US$ 1.6 million in November 2017. At the time of the audit, there were 65 aging GIT transactions that had not been cleared for more than three months, with 55 items that had not been cleared for between five and eight months. These were all individually low-value items that could not be released for various reasons, for instance items delayed outside DPRK’s borders due to an enhanced and longer physical inspection of goods. GITs not cleared were not being charged to the grant, and long-outstanding GIT could result in loss of funds as the funds would need to be returned to the donor as unused.

Unless the office is able to get the necessary supplies into DPRK on a timely basis, UNICEF’s ability to deliver life-saving interventions will be significantly reduced. The risk management review of Malaria and Tuberculosis programmes that was performed in July 2017 (see section on Risk management above) included a review of supply logistics. The review had made a number of recommendations to help the office address the current risks - albeit within the highly-constrained environment resulting from increasingly tightening international sanctions.

Agreed action 5 (high priority): The country office agrees to ensure that key recommendations included in the July 2017 risk management review are implemented, including to:

   i. Develop a longer-term supply plan, facilitating earlier procurement with staggered deliveries where this is possible;
   ii. Conduct a joint market analysis between DPRK Country Office, China Country Office and Supply Division to identify how to manage supply risk and how to decrease the procurement and delivery times;
   iii. Determine, working with Supply Division, how best to manage risks related to procured supplies that cannot be brought into DPRK for distribution.

Responsible staff members: Deputy Representative, Supply Monitoring and Programme Monitoring
Target date for completion: The office reports action as completed
Annex A: Methodology, and definitions of priorities and conclusions

The audit team used a combination of methods, including interviews, document reviews, testing samples of transactions. The audit compared actual controls, governance and risk management practices found in the office against UNICEF policies, procedures and contractual arrangements.

OIAI is firmly committed to working with its clients and helping them to strengthen their internal controls, governance and risk management practices in the way that is most practical for them. With support from the relevant regional office, the country office reviews and comments upon a draft report before the departure of the audit team. The Representative and their staff then work with the audit team on agreed action plans to address the observations. These plans are presented in the report together with the observations they address. OIAI follows up on these actions and reports quarterly to management on the extent to which they have been implemented. When appropriate, OIAI may agree an action with, or address a recommendation to, an office other than the client’s own (for example, a regional office or headquarters division).

The audit looks for areas where internal controls can be strengthened to reduce exposure to fraud or irregularities. It is not looking for fraud itself. This is consistent with normal practices. However, UNICEF’s auditors will consider any suspected fraud or mismanagement reported before or during an audit, and will ensure that the relevant bodies are informed. This may include asking the Investigations section to take action if appropriate.

The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors. OIAI also followed the reporting standards of International Organization of Supreme Audit Institutions.

Priorities attached to agreed actions

**High:** Action is considered imperative to ensure that the audited entity is not exposed to high risks. Failure to take action could result in major consequences and issues.

**Medium:** Action is considered necessary to avoid exposure to significant risks. Failure to take action could result in significant consequences.

**Low:** Action is considered desirable and should result in enhanced control or better value for money. Low-priority actions, if any, are agreed with the country-office management but are not included in the final report.

Conclusions

The conclusions presented in the report summary fall into four categories:

*Unqualified (satisfactory) conclusion*

Based on the audit work performed, OIAI concluded at the end of the audit that the office’s
governance, risk management and internal controls were generally established and functioning during the period under audit.

[Qualified conclusion, moderate]  
Based on the audit work performed, OIAI concluded at the end of the audit that, subject to implementation of the agreed actions, the office’s governance, risk management and internal controls were generally established and functioning during the period under audit.

[Qualified conclusion, strong]  
Based on the audit work performed, OIAI concluded that the office’s governance, risk management and internal controls needed improvement to be adequately established and functioning.

[Adverse conclusion]  
Based on the audit work performed, OIAI concluded that the office’s governance, risk management and internal controls needed significant improvement to be adequately established and functioning.