United Nations Development Programme
The Associate Administrator

1 June 2007

Dear Mr. Saha,

I am pleased to provide you, for your consideration, a copy of the United Nations Development Programme's management response to the Special Audit of the United Nations Operations in the Democratic People's Republic of Korea.

UNDP stands ready to clarify any questions that the Advisory Committee on Budgetary and Administrative Questions (ACABQ) may have.

Yours sincerely,

Ad Melkert

Mr. Rajat Saha
Chairman
ACABQ

cc: H.E Mr. Ban Ki-Moon
Secretary-General
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UNDP management response to the Special Audit of the United Nations Operations in the Democratic People's Republic of Korea

1 June 2007

Introduction

UNDP has implemented the Democratic People's Republic of Korea (DPRK) programme in accordance with the decisions of the Executive Board and UNDP Financial Regulations and Rules. The conditions under which UNDP has had to operate in DPRK were unusual and in the last 27 years a variety of practices were adopted to meet the expectations of the Government without which the Programme would not have been delivered.

UNDP wishes to emphasize that the flow/exchange of hard currency made available for the DPRK Programme as mandated by the Board for implementation and cooperation with the Government of DPRK is inevitable. This reality has to be seen in the context of the modest UNDP Programme in DPRK.

In this respect, the UNBOA has confirmed, in the Report of the Board of Auditors on the Special Audit of DPRK, that UNDP, from 2002-2006, had an average Programme expenditure per annum of $2.6M.

For many years UNDP took the lead in requesting the DPRK Government to conform to international practices, however the DPRK Government was not willing to comply with these practices. In January 2007 the Executive Board imposed a number of conditionalities on the DPRK Programme which were not accepted by the Government of DPRK resulting in the suspension of the Programme on 1 March 2007.

UNDP has taken full note of the Report of the Board of Auditors on the Special Audit of DPRK and its findings. UNDP will continue to improve and strengthen its controls and management practices and hence will undertake the following management actions:

- As part of the ongoing harmonization of the Financial Regulations and Rules of the UN Secretariat and the Ex-Com Agencies, UNDP will propose strengthening the Financial Regulations and Rules regarding the utilization of currencies.
- In respect of the services arrangement with the Government for provision of personnel, UNDP has stopped this practice globally.
- In late 2006 the current management changed the practice of making local payments in hard currency.

General Context:

Whilst we address each audit comment individually, in this section of the management response we are providing the general context regarding UNDP's operations in DPRK relating to personnel, UNDP's financial framework and project site visits.

The status of the **local personnel** in DPRK has always been of an exceptional nature. The Country Office (CO) has been functioning under the same basic rules in DPRK since the establishment of the office in 1980. In 1980/81 there was an attempt to reach agreement on a service contract. The service arrangement was never formally concluded because DPRK authorities sought to introduce additional terms which were not acceptable to the Organization, thus on the advice of the United Nations Office of Legal Affairs (OLA), the Country Office continued to use the ad hoc practice already in place. UNDP did not employ local staff. On the basis of the services arrangement with the Government, the Government provided services to the office through the provision of personnel.

The Executive Board at its Second Regular Session in 2001 formally took note of the findings of the Country Review Report in document DP/CRR/DRK/1, which referred to the particular arrangements used to undertake operations in DPRK and highlighted the fact that "staff" do not have contracts and that UNDP has few options in its "staff" selection.

The regulatory framework of UNDP (that governs utilization of currencies) is embedded in the Financial Regulations, Rules, procedures and practice and not the Agreement between the Democratic People's Republic of Korea and UNDP related to UNDP's assistance to the country (SBAA), concluded on 8th November 1979. The SBAA is the overall treaty based on a global model text that provides the basic conditions under which UNDP and its executing agencies assist the Government in carrying out its development projects. The authority to approve Financial Regulations is vested solely in the Executive Board of UNDP. The UNDP Financial Regulations and Rules do not contain a stipulation on the utilization of currencies. Indeed, this is consistent with the United Nations Financial Regulations and Rules which also do not contain any such stipulation.

With respect to **project site visits**, UNDP provided detailed documentary evidence to the Board of Auditors testifying to 38 field visits to project sites that were carried out between 2002 and the present. The visits verified that project funds were being used for the purposes intended and no instance was found of shortcomings in this respect. All requests by UNDP to visit project sites were agreed to by the Government. Visits were carried out by international staff, headquarters staff and project review teams. Based on the UNBOA initial review, there is no evidence that funds have been misused; the monitoring reports confirm that funds were used for the purposes intended and results achieved.

In the context of UNDP activities in DPRK, it is also important to note that implementation of internal audit recommendations between 1999 and 2004 noticeably improved, with a substantial decrease in the recommendations in 2004 as opposed to 1999 and 2001. This underscores the serious effort made to improve oversight despite a less than conducive environment. Indeed, the overall OAPR audit rating improved.

Specific Comments:

Comment #13:

UNDP did not in any way limit the scope of work of the current phase of the UNBOA audit. All documentation requested by the audit team was provided to them on a timely basis. Furthermore, the audit team had access to all UNDP staff members, including staff members located in the DPRK office.

With reference to #13 (b), UNDP does not prepare country by country financial statements but rather prepares financial statements at the corporate (global) level. However, we have provided a complete set of records, requested by UNBOA, from our accounting systems for the period under review.

UNDP will welcome and fully cooperate if a decision is taken to proceed with the second phase of the audit in DPRK Pyongyang, where supporting documentation required for the UNBOA to complete their work is available.

Comment #17:

Concerning local personnel, the provisions mentioned in the UNBOA report under comment 17 are not applicable. These individuals were provided under the service arrangement with the Government. Although efforts were made to harmonize the arrangements with UNDP local staff practices in other countries, this was not possible because the Government did not agree. The Executive Board at its Second Regular Session in 2001 formally took note of the findings of the Country Review Report in document DP/CRR/DRK/1, which referred to the particular arrangements used to undertake operations in DPRK and highlighted the fact that "staff" do not have contracts and that UNDP has few options in its "staff" selection. The Executive Board requested UNDP to discontinue this practice on 1st March 2007 but the Government of DPRK disagreed. This and other factors resulted in the suspension of the Programme.

Article 6 of the SBAA does not govern local or foreign currency payments made by UNDP. Furthermore, UNDP's Financial Regulations and Rules do not contain a stipulation on the utilization of currencies. Indeed, this is consistent with the United Nations Financial Regulations and Rules which also do not contain any such stipulation.

In the 1992 UNDP Finance Manual, Country Offices were encouraged to utilize local currencies to the extent possible, thereby ensuring adequate use of accumulated local currencies and furthermore mitigating risks of devaluation. In the same Manual the decision regarding the choice of currencies utilized was delegated to all UNDP Resident Representatives. **The scope of this audit is the period 2002-2006. During this period, the 1992 UNDP Finance Manual was not applicable**. The Manual revised in 2000 does not contain any guidance on the utilization of currencies.

Given that the 2000 UNDP Finance Manual did not contain any guidance on this issue, and given the restricted commercial environment in DPRK, in order to sustain the UNDP programme and ensure that local suppliers provided services and goods, the DPRK Country Office had to make certain payments in foreign currency. This practice was also followed by other UN Agencies and Foreign Missions present in DPRK.

Concerning project visits, UNDP was able to monitor all field projects. Evidence of this was presented to the UNBOA. These visits were in the presence of DPRK Government counterparts, as would be the practice elsewhere, and hence the term "supervision" is not appropriate. There is no evidence that any attempt was made by the Government to influence the conclusions reached by those international staff monitoring projects.

It should be noted that UNDP is the only UN Agency that, to date, has suspended its operations in DPRK.

Comment #22:

No DPRK local personnel were ever employed by UNDP or the UN system in DPRK. On the basis of the service arrangement imposed by the Government, the Government provided services to the office through the provision of personnel as is the case for all Foreign Missions and International Organizations and therefore all UN Agencies follow the same practice.

As noted in paragraph 24, the Executive Board at its Second Regular Session in 2001 formally took note of the findings of the Country Review Report in document DP/CRR/DRK/1, which referred to the particular arrangements used to undertake operations in DPRK and highlighted the fact that "staff" do not have contracts and that UNDP has few options in its "staff" selection.

In January 2007 the Executive Board asked UNDP to follow normal competitive recruitment practices to hire personnel from 1 March 2007. This was not accepted by the DPRK Government.

Comments #25 to #28 and #32 to #35:

The SBAA is the overall treaty that governs UNDP's assistance to the Government and is based on a global model text.

No DPRK local personnel were ever employed by UNDP or the UN System. Moreover local personnel were not seconded (because the Government would not allow its staff to sign contracts). As the Board has noted in paragraphs 25 through 28 on the basis of the service arrangement imposed by the Government, the Government provided services to the office through the provision of personnel as is the case for all Foreign Missions and International Organizations. Therefore all references to the UNDP Personnel Manual as referred to in paragraphs 32 through 35 are not valid.

The UNBOA report states in paragraph 28 that no signed copy of the agreement was provided to the Board. The draft agreement was not signed by either party in 1981 because the Government of DPRK sought to introduce additional terms which were not acceptable to the organization, thus on the advice of the OLA the Country Office continued to use the ad hoc practice already in place.

Comments #36 to #40:

Pursuant to the services arrangement between UNDP and the Government payments were made directly to the Government. Supporting documentation relating to these payments is available in Pyongyang.

As reflected in the UNBOA report, the payment in EUROS was a standard practice among UN Agencies operating in DPRK.

The request for advice mentioned in paragraph 40 referred to monthly payments for local personnel. All of the local personnel providing services to the Country Office were provided by the Government and hence were not local staff. Therefore, the UN Staff Rules on currency of payment only apply to UN staff members. In 2004, guidance was provided by an Expert Adviser on Compensation to BOM/OHR that "...payments by 'private' employers or other embassies would in all likelihood be hard currency denominated...", and hence on the basis of this, Treasury/OFA had no objection on the usage of Euro.

Comments #41 to #43:

On the basis of the services arrangement with the Government, the Government provided personnel to the office, and thus they were not local staff. Hence the UN Salary Survey methodology does not apply.

These increments were determined by the Ministry of Foreign Affairs and communicated by the attached Note Verbale and implemented by all International Organizations and Foreign Missions.

Increments with respect to payments for services were insignificant considering that such increments were only $13 over a twelve-month period.

Comments #45:

The individuals were not staff. Meal allowances have been paid to personnel for many years, and the practice is common to Foreign Missions and International Organizations including UN Agencies in DPRK. The internal audit report of 2004 found no objection to this arrangement.

Comment #46:

No personnel were seconded from the Government, and thus the reference to the UNDP Personnel Manual made in the UNBOA report is not valid.

Comment #50:

No personnel were seconded from the Government. An understanding was reached with the Government on the provision of services for the office, which was the basis for operations for the last 27 years. The SBAA is the overall treaty that governs UNDP's assistance to the Government and is based on a global model text. In 1980/81 there was an attempt to reach agreement on a service contract. The service arrangement was never formally concluded because DPRK authorities sought to impose additional terms which were not acceptable to the Organization, thus on the advice of the OLA, the Country Office continued to use the ad hoc practice already in place. Very modest increases were levied by the Government for these services. These charges were paid in response to periodic formal Notes Verbales issued by the Ministry of Foreign Affairs to all Foreign Missions and International Organizations.

Comment #52:

In the 1992 UNDP Finance Manual, Country Offices were encouraged to utilize local currencies to the extent possible, thereby ensuring adequate use of accumulated local currencies and furthermore mitigating risks of devaluation. In the same Manual the decision regarding the choice of currencies utilized was delegated to all UNDP Resident Representatives. The scope of this audit is the period 2002-2006. During this period, the

1992 UNDP Finance Manual was not applicable. The Manual revised in 2000 does not contain any guidance on the utilization of currencies.

Given that the 2000 UNDP Finance Manual did not contain any guidance on this issue, and given the restricted commercial environment in DPRK, in order to sustain the UNDP programme and ensure that local suppliers provided services and goods, the DPRK Country Office had to make payments in foreign currency. This practice was also followed by other UN Agencies and Foreign Missions present in DPRK.

Comment #55:

All the local personnel providing services to the Country Office were provided by the Government and hence were not local staff. The UN Staff Rules on currency of payment only apply to staff. In 2004, guidance was provided by an Expert Adviser on Compensation to BOM/OHR that "...payments by 'private' employers or other embassies would in all likelihood be hard currency denominated...", and hence on the basis of this, Treasury/OFA had no objection on the usage of Euro.

In order to sustain the UNDP programme and ensure that local suppliers provided services and goods, the DPRK Country Office had to make payments in foreign currency. This practice was also followed by other UN Agencies and Foreign Missions present in DPRK.

Comments #58 to #59:

References to the UNDP Manual on locally recruited staff are not relevant since they were not UN staff but personnel provided by the Government under the services arrangement.

The provision referred to in the audit findings is in the UNDP Finance Manual issued by the Assistant Administrator, Bureau of Management. There is no special treasury instruction on currency exchange rates. In the 1992 UNDP Finance Manual, Country Offices were encouraged to utilize local currencies to the extent possible, thereby ensuring adequate use of accumulated local currencies and furthermore mitigating risks of devaluation. In the same Manual the decision regarding the choice of currencies utilized was delegated to all UNDP Resident Representatives. The scope of this audit is the period 2002-2006. During this period, the 1992 UNDP Finance Manual was not applicable. The Manual revised in 2000 does not contain any guidance on the utilization of currencies.

The UNDP Headquarters Local Salary Steering Committee in the period under review only dealt with local salary payments but not any other form of local payments. As the local personnel were not staff the reference to the Local Salary Steering Committee is not relevant. The function of managing the National Salary Surveys for non-HQs Duty Stations has been transferred, effective 1 July 2006, from UNDP Headquarters to the UN Secretariat.

Comment #60:

The regulatory framework of UNDP (that governs utilization of currencies) is embedded in the Financial Regulations and Rules and not the SBAA. The SBAA is the overall treaty that provides the basic conditions under which UNDP and its executing agencies assist the Government in carrying out its development projects and under which any UNDP assisted projects may be executed.

With respect to the Board's conclusion relating to Article 6 of the SBAA, UNDP wishes to clarify that Article 6 relates to assessed programme costs and other items payable in local currency by the Government of DPRK to UNDP. This Article does not govern local or foreign currency payments made by UNDP.

Comment #61:

All of the local personnel providing services to the Country Office were provided by the Government and hence were not local staff. Therefore, the UN Staff Rules on currency of payment do not apply to local personnel provided by the Government under the services arrangement, as they are not UN staff members. In 2004, guidance was provided by an Expert Adviser on Compensation to BOM/OHR that "...payments by 'private' employers or other embassies would in all likelihood be hard currency denominated...", and hence on the basis of this, Treasury/OFA had no objection on the usage of Euro.

In order to sustain the UNDP programme and ensure that local suppliers provided services and goods, the DPRK Country Office had to make payments in foreign currency. This practice was also followed by other UN Agencies and Foreign Missions present in DPRK.

Comments #65 to #67:

With respect to overtime and meal allowances paid to local personnel, the office's procedure was to issue a cheque in the name of the Administrative Officer, a payee entered as "Staff" in the Accounts Payable Voucher in Atlas, who had been authorized by all local personnel to receive the amounts on their behalf. The Administrative Officer would cash the cheque and then distribute the cash to the local personnel. This practice was to avoid preparing several vouchers of small amounts.

Supporting documentation, for additional controls, available at the office, includes:

- A breakdown of the amount by local personnel
- Formal acknowledgement of receipt of the cheque by the Administrative Officer
- Signed authorization by all local personnel for the Administrative Officer to receive the payment on their behalf.

There is no mandatory requirement to record, in Atlas, the payment description. The purpose and nature of the payment can be determined from the Chart of Accounts – most importantly the project, activity, and the account code. The account code describes the nature of the payment (i.e. travel, overtime, etc.). The supporting documentation attached to the vouchers provides additional information about the payment. The supporting documentation is available in Pyongyang.

Comment #68:

The office's procedure was to issue bank transfers or cheques. The office required vendors to formally acknowledge receipt of cheques.

Supporting documentation is retained by the DPRK Country Office and is available in Pyongyang. This includes a record of the payee and amount for all cheques issued by the office, formal acknowledgement of receipt of the cheque by the vendor and cheque stubs stamped by the bank as "paid".

Comment #69:

In the 1992 UNDP Finance Manual, Country Offices were encouraged to utilize local currencies to the extent possible, thereby ensuring adequate use of accumulated local currencies and furthermore mitigating risks of devaluation. In the same Manual the decision regarding the choice of currencies utilized was delegated to all UNDP Resident Representatives. The scope of this audit is the period 2002-2006. During this period, the 1992 UNDP Finance Manual was not applicable. The Manual revised in 2000 does not contain any guidance on the utilization of currencies.

Given that the 2000 UNDP Finance Manual did not contain any guidance on this issue, and given the restricted commercial environment in DPRK, in order to sustain the UNDP programme and ensure that local suppliers provided services and goods, the DPRK Country Office had to make payments in foreign currency. This practice was also followed by other UN Agencies and Foreign Missions present in DPRK.

Comments #70 to #71:

The balance for the non-convertible WON bank account as of the 31st of March is equivalent to $69,000. This balance includes non-convertible WON received from the Government on behalf of other UN Agencies which are funds received infrequently. Government Local Office Cost (GLOC) is paid periodically, but not on a fixed schedule, and hence the non-convertible WON bank balance fluctuates. This did not allow the Country Office to consistently make local rental payments out of the non-Convertible WON account. The balance of non-convertible bank account balance should be evaluated within the context of the average Imprest level authorized for the office which was $200,000 per month.

Comments #72:

The following explains the history of the cancelled counterfeit money. This money did not below to UNDP. On 9 December 1995, an Egyptian consultant, Mr. Hazen El-Tanbouli, was paid by the UNDP Country Office in DPRK via bank voucher, for the consultancy services he provided. Three weeks later, on 10 February 1995, Mr. El-Tanbouli sent a fax to the Resident Coordinator/Resident Representative (RC/RR) in DPRK, stating that to his surprise and sorrow, his bank (the National Bank of Egypt-Agouza branch) rejected the (35X100 US$) notes he received from the Foreign Trade Bank of the DPRK when he cashed his bank voucher received from UNDP. Mr. El-Tanbouli also stated in his fax that the Egyptian Bank returned the bills to him after marking them to ensure that the bills could not be re-used again. He concluded his fax message by asking the RC/RR to find a way to put this matter in order.

In early 1996, Dr. Yehia Abu Alam, at Mr. El- Tanbouli's request, delivered the counterfeit currency to the RC/RR in DPRK with a note from Mr. El-Tanbouli explaining the circumstances as described in his fax.

The RC/RR, other UNDP officials, as well as subsequent RCs/ RRs who were assigned to DPRK, attempted to address the issue for many years without success. On 29 May 1996, the RC/RR wrote a letter to the General Manager of the Foreign Trade Bank asking that the notes be replaced by genuine notes explaining that this had happened to staff members of Embassies such as Nigeria and Indonesia and asserting that the notes were replaced. The Bank refused to replace the notes. In June 1996, the RC/RR sent letters to the Ministry of Foreign Affairs and the Secretary-General NCC for UNDP. UNDP staff met with the Section Chief of the Bank's Foreign Exchange Department. The Foreign Minister was asked for his personal intervention and in August 1996, the RC/RR met the Foreign Minister on the issue. A number of formal and informal communications were conducted by UNDP office. Notwithstanding these efforts, the DPRK Bank rejected UNDP's request.

After the enormous effort made by the UNDP office in DPRK to have the false notes replaced, Mr. El-Tanbouli was informed of the outcome. The counterfeit notes -- marked by the Egyptian Bank so that they could not be used again -- remained in the UNDP safe.

Different individuals over the years within the UNDP Country Office sought guidance from Headquarters on what to do with the counterfeit notes and did not receive any direction. Several leadership changes took place in the Country Office and Headquarters without resolving the matter. As a result, the counterfeit bills stayed in the UNDP Country Office safe in Pyongyang for many years.

The matter was brought to the attention of the current senior management in New York in February 2007. In agreement with the US authorities, the suspected counterfeit dollars were handed over to the US authorities on 20 March 2007 in New York. Following the preliminary audit findings of the UNBOA and investigation by US authorities, UNDP is undertaking an internal review of the situation pertaining to the $3500 suspect currency.

Comment #73:

With respect to the Board's conclusion relating to Article 6 of the SBAA, UNDP wishes to clarify that Article 6 relates to assessed programme costs and other items payable in local currency by the Government of DPRK to UNDP. This Article does not govern local or foreign currency payments made by UNDP.

The provision referred to in the audit findings is in the UNDP Finance Manual issued by the Assistant Administrator, Bureau of Management. There is no special treasury instruction on currency exchange rates. In the 1992 UNDP Finance Manual, Country Offices were encouraged to utilize local currencies to the extent possible, thereby ensuring adequate use of accumulated local currencies and furthermore mitigating risks of devaluation. In the same Manual the decision regarding the choice of currencies utilized was delegated to all the Resident Representatives of each Country Office. The scope of this audit is the period 2002-2006. During this period, the 1992 UNDP Finance Manual was not applicable. The Manual revised in 2000 does not contain any guidance on the utilization of currencies.

References to the UNDP Manual on locally recruited staff are not relevant since they were not UN staff but personnel provided by the Government under the services arrangement. Hence no formal authorization was required.

Given that the 2000 UNDP Finance Manual did not contain any guidance on this issue, and given the restricted commercial environment in DPRK, in order to sustain the UNDP programme and ensure that local suppliers provided services and goods, the DPRK Country Office had to make payments in foreign currency. This practice was also followed by other UN Agencies and Foreign Missions present in DPRK.

As part of the ongoing harmonization of the Financial Regulations and Rules of the UN Secretariat and Ex-Com Agencies, UNDP will propose strengthening of the Financial Regulations and Rules on utilization of currencies.

Comments #74, #76, #79, #86, #87, #88 and #97:

With respect to project site visits, UNDP provided detailed documentary evidence to the Board of Auditors testifying to 38 field visits to project sites that were carried out between 2002 and the present. The visits verified that project funds were being used for the purposes intended and no instance was found of shortcomings in this respect. All requests by UNDP to visit project sites were agreed to by the Government. Visits were carried out by international staff, headquarters staff and project review teams. Based on the UNBOA initial review, there is no evidence that funds have been misused; the monitoring reports confirm that funds were used for the purposes intended and results achieved.

Comment #90:

The 1999 audit is outside the scope of the review. UNDP provided the UNBOA with subsequent audit reports and status of implementation. The subsequent audit reports indicated that audit recommendations relating to project site visits have been completely implemented.