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INTERNATIONAL TRADE ADMINISTRATION

US&FCS Japan
Should be Restructured to Better Meet the Needs of U.S. Exporters

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EXECUTIVE SUMMARY

The explosive growth in the Asia-Pacific region has created significant business opportunities for U.S. companies. The United States stands to gain from these opportunities by increasing exports to the region. Japan, with a 1995 Gross Domestic Product of $5 trillion, is the United States' largest overseas trading partner. Although its economic growth has been slower than that of some other Asian countries, Japan represents 75 percent of the entire Asian economy. Consequently, the U.S. and Foreign Commercial Service (US&FCS) has dedicated more resources to Japan than to any other nation.

The United States has long viewed Japan as an important, yet challenging market. In the 1980s, the United States placed great emphasis on opening up the Japanese market as a way of both balancing the trade deficit and giving U.S. companies the opportunity to compete fairly in Japan. Besides the important work that it does for the Department of Commerce, US&FCS Japan played an important role in this effort by assisting many government agencies, such as the Office of the United States Trade Representative, Department of the Treasury, and Department of State, in trade negotiations and trade policy formulation. As a result, US&FCS Japan tended to focus on policy at the expense of assisting individual U.S. exporters.

More recently, the United States has continued its efforts to gain access to the Japanese market but has also placed greater emphasis on increasing exports through trade promotion activities. US&FCS is responsible for carrying out these trade promotion activities, as mandated by the Omnibus Trade and Competitiveness Act of 1988.

The Office of Inspector General conducted a performance audit of US&FCS operations in Japan, conducting its fieldwork during September 1-12, 1997. Our audit focused on the general management and organization of US&FCS's operations throughout Japan, the effectiveness of US&FCS's program activities in serving the needs of U.S. exporters, and the integrity of the overall internal control environment.

We found that US&FCS Japan is staffed with capable, dedicated, and knowledgeable foreign service officers and foreign service nationals who have contributed greatly to the Department's progress in the Japanese market. During the six years preceding our audit, US&FCS Japan has done an exemplary job in the areas of deregulation, market access, major projects, government procurement, and advocacy under the direction of the post's senior management team and the Deputy Assistant Secretary for the Office of Japan. The Deputy Assistant Secretary has taken the lead in directing the Department's priorities and initiatives for opening this market, which continues to be closed in many respects. Despite these accomplishments, our audit identified a series of issues that warrant management's attention.

General Management and Organization

Improvements are needed in US&FCS Japan's management and organizational environment. Current resource allocation, the heavy concentration of staff in Tokyo, and the personnel structure appear to reflect the Department's priorities of years ago, when the United States focused extensively on gaining market share in a relatively closed market. We believe that US&FCS should consider reducing resources in Tokyo and Osaka and increasing them in Sapporo, Fukuoka and Nagoya to more fully take advantage of the exporting opportunities. (See page 6.)

Program Activities and Performance Measurement

In the six years preceding our audit, the post made considerable progress on the policy front at the direction of senior management and the Deputy Assistant Secretary for the Office of Japan. US&FCS Japan brought down trade barriers and opened markets through its advocacy efforts. The post also had success in deregulation, government procurement, and with major projects such as the Osaka airport project, vitamin industry changes, and the enormous housing market in Japan. However, trade promotion responsibilities have suffered. The post has reduced its contact with some sections of the business community, particularly small and medium-size exporters, by contracting out some of its core products and services to allow it to focus on policy initiatives. (See page 10.)

We believe that US&FCS Japan needs to be reoriented to better serve U.S. businesses. Core products and services need to be reintroduced so that staff will maintain close contact with the U.S. business community. The post should also change its focus from old-to-market and local-country firms to new-to-market and new-to-export firms. (See page 11.)

As discussed in the General Management and Organizational Issues section of this report, management needs to develop a Strategic Commercial Plan that includes a countrywide marketing plan. Utilization of the Tokyo Trade Center should be incorporated into this plan. If the Center is not incorporated, management should assess the cost benefit of operating the Center and whether the subsidy from the Government of Japan has the potential to influence trade event activity. (See page 12.)

Internal Control Environment

After reviewing the administrative and financial operations at post and conducting interviews with US&FCS and embassy staff, we concluded that US&FCS Japan's internal controls should be improved. Specifically, we observed significant redundancies (see page 18) within the administrative units and a lack of coordinated oversight by management. Additionally, there is not an effective internal control structure to separate critical administrative functions (see page

19). Account balances were also not fully reconcilable between the ITA, State Department, and Treasury Department records (see page 21). Moreover, in a matter affecting reporting requirements under the Chief Financial Officers Act, US&FCS Japan had accumulated over $2.3 million in unfunded personnel benefit liability for its employees. (See page 27).

Recommendations for addressing our concerns appear at the end of each report section, on pages 9, 16, and 28-29.

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In its response to our draft report, ITA did not expressly disagree with any of the report findings or recommendations. However, the agency response did question several conclusions and some of the data in the report. Most specifically, the response questions whether the audit team requested, obtained, or reviewed all of the pertinent documentation regarding the report findings.

In fact, the team interviewed all US&FCS Japan personnel and reviewed all available documentation with respect to the matters discussed in this report. Where ITA made a comment directly related to a specific finding or recommendation, we have inserted the response and the OIG analysis of the response in the body of the report. In all cases, we quoted ITA's response verbatim.

INTRODUCTION

Under the authority of the Inspector General Act of 1978, as amended, and the requirements of the Omnibus Trade and Competitiveness Act of 1988 and the Export Enhancement Act of 1992, the Office of Inspector General conducted a performance audit of the U.S. and Foreign Commercial Service (US&FCS) operations in Japan. We conducted our fieldwork during September 1-12, 1997.

Performance audits are objective, systematic examinations of evidence conducted to provide an independent assessment of an organization, program, activity, or function as a basis to improve accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. By identifying systemic strengths and weaknesses, the OIG will help the Department's managers, in this case the International Trade Administration (ITA) and US&FCS, implement more efficient and effective operations to better serve the Department's customers.

ITA, the parent organization of US&FCS, directs a variety of programs and activities designed to increase U.S. exports. In addition to its headquarters operations, ITA maintains a worldwide network of offices throughout the United States and in 75 foreign countries.

The goal of the domestic network is to deliver export counseling along with a variety of products and services that help U.S. companies increase international sales. In the United States, US&FCS operates 97 domestic offices, including 19 regional export assistance centers that offer services from export marketing counseling to trade finance assistance. The regional centers are a result of a cooperative effort among US&FCS, the Small Business Administration, and the Export-Import Bank. The other domestic offices are primarily staffed by US&FCS personnel.

Overseas, the foreign commercial offices are expected to perform activities that are directed at improving the trade position of the United States. Among other things, these offices identify trade and investment opportunities, identify potential distributors and agents, provide business counseling to U.S. companies, implement trade agreement practices and regulations, and develop information products for distribution to U.S. companies.

We discussed our observations with the U.S. Embassy's Chargé d' Affaires and held an exit conference with the Senior Commercial Officer (SCO) and the Deputy Assistant Secretary for International Operations on September 11, 1997. During this conference, the SCO generally agreed with our findings and recommendations. Subsequently, we also held discussions with cognizant US&FCS officials and personnel at US&FCS headquarters in Washington, D.C.

PURPOSE AND SCOPE OF AUDIT

The OIG is committed to the pursuit of operational effectiveness throughout the Department, challenging management to achieve excellence with respect to programmatic, administrative, and financial operations. The purpose of this performance audit was to evaluate the effectiveness of the Department's operations in Japan, which are carried out primarily through US&FCS.[1]

In accordance with General Accounting Office's *Standards for Internal Controls in the Federal Government*, we reviewed the agency's internal control environment relating to administrative and financial management. Our assessment indicates that controls are not properly designed and implemented; therefore, we could not rely on them in designing our audit approach. However, we conducted more extensive testing to achieve our objective of determining the effectiveness of administrative and financial management controls.

We tested US&FCS Japan's operations for compliance with GAO *Title II* and the Federal Manager's Financial Integrity Act requirements. In order to achieve our audit objectives, we relied extensively on computer-generated data contained in the State Department Financial Management System, ITA's accounting system, and the Treasury Department's accounting system. The report findings and recommendations draw upon significant tests of records; physical evidence; documentary evidence, including accounting records and memorandums; and analytical evidence based on the data obtained. As appropriate, we also conducted interviews with Department personnel, clients, and representatives of other organizations involved in trade promotion. The audit involved an extensive review of programmatic, management, administrative, and financial issues.

We reviewed the policies, procedures, and practices being implemented by US&FCS Japan to determine if it is effectively and efficiently meeting its mission: to assist U.S. companies, particularly small and medium-size enterprises, with export assistance. We also sought to determine whether US&FCS Japan's goals and objectives are being achieved, and are in line with agency objectives. In addition, we evaluated the effectiveness and efficiency of operations and assessed their compliance with applicable laws, regulations, and procedures.

In conducting our audit, we placed primary emphasis on the following areas:

- General Management and Organizational Issues.
- Program Activities and Performance Measurement.
- Internal Control Environment and Processes.

[1] The OIG discloses that audit team members formerly worked for ITA; however, they had no material involvement with US&FCS Japan operations.

In addition, the audit examined relevant ITA's headquarters and domestic office activities that involve or are coordinated with US&FCS Japan.

The audit was conducted in accordance with generally accepted government auditing standards and was performed under the authority of the Inspector General Act of 1978, as amended, and Department of Commerce Organization Order 10-13, dated May 22, 1980, as amended.

BACKGROUND

JAPANESE MARKET

The explosive growth in the Asian-Pacific economies has been sustained through unilateral trade and investment liberalization within the region as a whole. U.S. companies stand to gain from stable and growing economic engagement in the region. Japan, the United States' largest overseas trading partner, is the world's second largest economy with a 1995 Gross Domestic Product of $5 trillion, roughly 70 percent of the U.S. GDP for the same year. Japan's economy is larger than the combined economies of Germany, France, and the United Kingdom; 10 times the size of China's; and 17 times the size of India's. Japan represents 75 percent of the entire Asian economy.

Having expressed a public commitment to economic deregulation, the Japanese government has taken some steps toward loosening restrictions in certain industries, including energy, transportation, real estate, finance, retail, health care, and transportation. While these steps have helped increase opportunities for U.S. firms, there is wide recognition that more comprehensive deregulation is needed to ensure economic expansion and market access over the long term.

In July 1993, President Clinton and then Prime Minister Miyazawa signed the *U.S.-Japan Framework for a New Partnership*, a new vehicle for addressing the many barriers that foreign companies face when doing business in Japan. Under the framework, Japan is especially committed to address major barriers in five sectoral and structural areas:

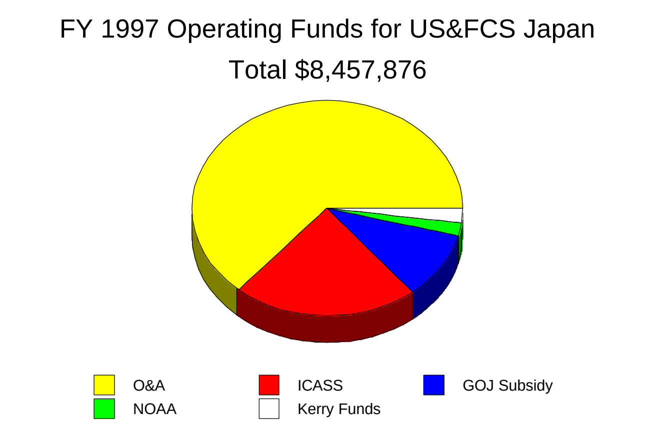
- Government procurement.
- Regulatory reform and competitiveness.
- Economic harmonization.
- Other major sectors.
- Implementation of existing arrangements and measures.

In addition, Japan agreed to make adjustments to the fundamental economic asymmetries that have affected its international economic relations, such as reducing its current account surplus as a percentage of its Gross National Product. Since 1992, in the areas covered by the framework, U.S. exports have grown by more than 80 percent. The combination of stable economic growth and liberalization has made the Japanese market much more competitive and dynamic than in the past. At the consumer level, imports and foreign brands produced in Japan are increasingly popular. Foreign investment in consumer goods and services industries has also increased significantly. As a result, Japanese consumers now enjoy a larger selection of imported products than they did before. However, it has proven more difficult to increase the foreign share of Japan's non-consumer market. To stimulate more competition in that market, vigorous antitrust enforcement, standards harmonization, bidding procedure transparency, and further deregulation are needed.

US&FCS JAPAN

Largely because of the significant long-range opportunities for U.S. exports to the Japanese market, Japan ranks first on the US&FCS Overseas Resource Allocation Matrix, a US&FCS management tool to help guide overseas resource allocation decision-making.

US&FCS dedicates significant resources, both personnel and financial, to its operations in Japan. US&FCS Japan employs 60 people at offices in five cities: Tokyo, Osaka, Nagoya, Fukuoka, and Sapporo. The $8.4 million operating funds come from five sources: the operating and administrative (O&A) budget, the International Cooperative Administrative Support Services funding for financial and administrative services, a subsidy from the Japanese government, the National Oceanic and Atmospheric Administration (NOAA), and Kerry funds provided by the Congress to facilitate American business access to the Japanese market and to increase exports.[2] The FY 1997 O&A budget of $5.4 million consumes approximately six percent of US&FCS's total overseas budget.



O&A			$5,378,150
ICASS			1,899,264
GOJ Subsidy			829,562
NOAA			179,900
Kerry Funds			171,000

[2]Note: NOAA and US&FCS signed a reimbursable agreement to hire an FSN to handle National Marine Fisheries Service issues in Japan. NOAA reimburses US&FCS for the cost of the FSN, travel, and procurements. Kerry fund data is estimated based on personal services contract and annual expenditures; the post does not track Kerry funds by fiscal year. Please see page 24 for additional information on Kerry funds.

US&FCS Japan operates in two facilities in Tokyo: the U.S. Embassy and the U.S. Trade Center. The Embassy location is the focal point for the country's commercial operations. US&FCS Japan houses 46 of its 60 personnel in the Embassy, including 12 of its 15 foreign commercial officers (FCOs). The SCO and the Commercial Counselor have their offices in the Embassy, as do 10 other officers who are organized largely by industry sectors. This is the largest concentration of FCOs at any site in the world.

The U.S. Trade Center, located in Ikebukuro, a suburb of Tokyo, is available for U.S. companies to use for trade and product promotion, technical seminars, training programs, and hospitality events. In addition, US&FCS holds from 10 to 12 trade events annually at the Center. The Center's director (whose primary office is in the Embassy) and three local hires[3] operate the Center.

To address market opportunities throughout the rest of the country, there are US&FCS-managed commercial offices in Osaka and Nagoya, and State Department-managed offices in Fukuoka and Sapporo. The staff of the Osaka office, which addresses commercial operations in a region of Japan that has a GNP equaling that of Germany, consists of two FCOs and seven local hires. The Nagoya office, established in 1993 to fill the expanding markets between Osaka and Tokyo, is managed by one FCO with support from two local hires. The Sapporo and Fukuoka offices each have one local hire.

[3]Local hires include either foreign service national or personal service contract employees.

FINDINGS AND RECOMMENDATIONS

We have categorized our audit findings and recommendations into three broad areas:

- General Management and Organizational Issues.
- Program Activities and Performance Measurement.
- Internal Control Environment.

While we found strengths in some areas, we identified weaknesses in all three areas, many of which we consider serious. For instance, in the six years preceding our audit, the post made considerable progress on the policy front by bringing down trade barriers, opening markets, and succeeding in major projects. However, the successes achieved in trade policy and market access issues have detracted from the trade promotion mission of US&FCS.

I. GENERAL MANAGEMENT AND ORGANIZATION

A. US&FCS Japan's Staffing Allocation and Distribution Should Be Reassessed

Improvements are needed in US&FCS Japan's management and organizational environment. In our view, the post's clients and other U.S. exporters are not being provided with the maximum available market opportunities because US&FCS Japan is not functioning as efficiently and effectively as it could. Resource allocation and the personnel structure appears to reflect the Department's priorities of years ago, when the United States primarily focused on gaining market share in a relatively closed market. As of September 1997, the 15 FCOs in Japan represented 7.1 percent of the US&FCS officer positions overseas. The 60 staff in Japan represent about five percent of the US&FCS worldwide full-time equivalents (FTE). The table below identifies the number of staff in each location within Japan:

LOCATION	FCOs	LOCAL HIRES	TOTAL
Tokyo- Embassy	11[4]	31	42
Tokyo- Trade Center	1	3	4
Osaka	2	7	9
Nagoya	1	2	3
Fukuoka	0	1	1
Sapporo	0	1	1
TOTAL	15	45	60

[4] Of the 12 positions, one is designated as a secretary/administrative assistant.

As shown in the table, Tokyo and Osaka have large staffs in comparison to the other locations. Under this arrangement, resources are not being used effectively (i.e., some FSNs do not have enough work). In Tokyo, for example, duties have been shifted from the secretary to a newly appointed FCO because there was not enough work for the incoming officer. Also, the high resource allocation to Tokyo and Osaka has allowed individuals to work on policy issues supporting the Ambassador, the Office of the United States Trade Representative, and ITA's Office of Japan rather than on promotion activities.

By contrast, personnel interviewed at Nagoya, Fukuoka, and Sapporo state that these offices lack sufficient resources to pursue all opportunities for U.S. exports. As a result, some opportunities for American firms and U.S. exports are forgone. We believe that Nagoya, Fukuoka, and Sapporo could better serve the needs of their clients if some of the resources supporting policy issues in Tokyo and Osaka were shifted to promotion activities at these three sites.

B. Organizational Structure and Work Environment Have Problems

We believe that the organizational structure of US&FCS Japan needs reassessment and the general management environment needs strengthening. This problem has been exacerbated in the past by a lack of direction from US&FCS Washington and a lack of coordination and communication with ITA's Trade Development unit and US&FCS domestic offices. One example of poor coordination and communication that we witnessed first-hand was the Tokyo International Gift Trade Show we visited while in Tokyo. At this show, ITA had three separate exhibit booths promoting U.S. firms. Adjacent booths representing the California US&FCS domestic offices, ITA's Trade Development consumer goods unit, and the US&FCS Japan Embassy operation were promoting products for various U.S. companies. Prior to the trade show, reportedly, there was not an effort among the three organizations to unify and coordinate their promotion activities. Such coordination would have resulted in a cost savings to the Department and more effective promotion for U.S. firms.

<u>Organizational structure should be reevaluated</u>

The large number of Foreign Commercial Officers (FCOs) in Japan compared to other US&FCS posts is attributable to the priorities of the Department during the late 1980s, before implementation of the current Big Emerging Market strategy. Moreover, because both Tokyo and Osaka are structured by industry units, the FSNs have become industry specialists rather than generalists, and US&FCS has become heavily dependent on FSNs for their industry contacts. The FCOs who manage the FSNs, in essence, have become "specialists managing specialists," a situation that can hinder career enhancement opportunities. Management has tried to accommodate the more general needs of the FCOs by rotating units and industries, but according to FSNs and clients, it is very time consuming to bring an FCO up to speed with an industry. We believe this organizational arrangement should be reevaluated.

US&FCS management has provided insufficient direction

US&FCS Japan has the most resources of any US&FCS operation worldwide, but according to local staff, the post does not receive adequate leadership or guidance from Washington. In fact, the local staff believe that US&FCS Japan has been largely neglected by US&FCS headquarters during the Big Emerging Market and Showcase Europe focus. Not being a part of either initiative, US&FCS Japan has increased its interaction with organizations outside US&FCS. For example, the Office of Japan, under the direction of ITA's Market Access and Compliance unit,[5] has contributed to successes in the policy arena, but at the expense of trade promotion activities.

Communication and direction from Tokyo to constituent posts should be improved

During our audit, we noted that constituent posts outside Tokyo have tended to operate independently. However, we believe the new SCO has the opportunity to take a more active role in the activities of the constituent posts, thereby linking them more closely with the overall mission. As part of this, management should develop a new countrywide outreach plan that identifies specific goals and milestones for each post and industry sector in the Strategic Commercial Plan. The plan should be the basis for defining the program's annual goals and measuring its performance. We found the current plan too general and lacking the specific milestones for posts and industry sectors that other plans have.

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Summarized ITA Response to Draft Report

In responding to our draft report, ITA said:

1. US&FCS believes that increasing exports to Japan is an important way to mitigate destabilizing influences on world trade. US&FCS is currently reviewing staffing levels at all of its overseas posts and will consider the issues presented in the draft OIG report. US&FCS will also examine whether officers and local hires could be used more effectively in all of its overseas posts.

2. ITA asserts that many US&FCS posts report uneven support from Trade Development and US&FCS domestic offices and would like additional information to help assess this matter.

[5] There are four units within ITA: US&FCS, Market Access and Compliance, Trade Development, and Import Administration. Market Access and Compliance is primarily responsible for providing trade policy support for the Department.

OIG Analysis of ITA's Response

1. The OIG is encouraged that US&FCS is reassessing its worldwide resource allocation of personnel. In its assessment, US&FCS should consider the heavy concentration of personnel in Tokyo, as well as the total personnel dedicated to US&FCS Japan operations.

2. The OIG found that most of the management direction and guidance over the last several years has flowed from ITA's Office of Japan, within Market Access and Compliance. The MAC direction focused the efforts of post management on policy development, not trade promotion. Additionally, US&FCS Japan and the domestic US&FCS offices have not regularly referred client to one another. While ITA asserts that US&FCS posts report uneven support and coordination, the OIG has several examples, one of which pertaining to a trade show visited by the audit team (page 7), that indicates a lack of program coordination throughout ITA.

Recommendations

We recommend that the Assistant Secretary and Director General of US&FCS:

1. Reassess the allocation of resources to US&FCS Japan's five offices, giving special attention to the merits of reducing resources in Tokyo and Osaka and increasing them in Sapporo, Fukuoka, and Nagoya.

2. Realign the organizational structure of US&FCS Japan to improve communication and overall operations.

3. Develop a countrywide strategic plan that incorporates the functions and activities of all five locations and focuses on trade promotion activities. The plan should identify milestones for each office and industry and should also serve as a benchmark to measure the post's performance.

II. PROGRAM ACTIVITIES AND PERFORMANCE MEASUREMENT

Clearly, the program activities of US&FCS Japan have been successful in certain areas, but lacking in others. In the six years preceding our audit, the post made considerable progress on the policy front at the direction of senior management and the Deputy Assistant Secretary for the Office of Japan. US&FCS Japan brought down trade barriers and opened markets through its advocacy efforts. The post also had success in deregulation, government procurement, and with major projects such as the Osaka airport project, vitamin industry changes, and with the enormous housing market in Japan. However, trade promotion responsibilities have suffered. The post has reduced its contact with some sections of the business community, particularly small and medium-size exporters, by contracting out some of its core products and focusing on policy initiatives.

We believe that US&FCS Japan needs to be reoriented to better serve U.S. businesses. Core products and services need to be reintroduced so that staff will maintain close contact with the U.S. business community. The post should also change its focus from old-to-market (OTM) and local-country firms to new-to-market (NTM) and new-to-export (NTE) firms.

As discussed in the General Management and Organization section of this report, management needs to develop a Strategic Commercial Plan that includes a countrywide marketing plan. Utilization of the Tokyo Trade Center should be incorporated into this plan. If the Center is not incorporated, management should assess the cost benefit of operating the Center and whether the subsidy from the government of Japan is influencing trade event activity. Management must also track its performance as required under the Government Performance and Results Act of 1993.

A. Significant Progress in Trade Policy Has Been Achieved but Trade Promotion Needs Greater Emphasis

In the 1980s, the United States attempted to reduce its large trade deficit with Japan through negotiated agreements centered on market access. As a result, many government agencies relied on US&FCS Japan for industry expertise, policy formulation, assistance in trade negotiations, monitoring of trade agreements, and information gathering. The post became accustomed to serving the needs of United States Trade Representative and ITA’s Office of Japan. This focus continues today. The Office of Japan and, to a lesser extent, the United States Trade Representative depend on US&FCS Japan for assistance.

Through interviews and questionnaires, we discovered that various US&FCS units in Tokyo spend significant time performing policy functions, thereby reducing the amount of time available for trade promotion. When we asked why the post appears to be so policy-oriented, one explanation given was that the post has a large number of FCOs, who believe that they can better enhance their professional reputation by performing policy functions. We were also told that senior FSNs tend to view trade promotion responsibilities as administrative work. In fact, some

FSNs viewed their role mainly as a policy advisor to top post management. In addition, we observed that some FSNs lacked sufficient knowledge of the products and services to assist effectively with promoting U.S. exports. We recognize the difficulty U.S. firms face when trying to enter the Japanese market due to the existence of non-tariff trade barriers. We also recognize (1) the linkage between trade policy and trade promotion and (2) ITA's role in both. However, we believe that the United States Trade Representative and the State Department are primarily responsible for dealing with these trade policy issues. Under the Omnibus Trade and Competitiveness Act of 1988 and the Export Enhancement Act, US&FCS's primary role is to carry out the Department's major trade promotion functions. With the significant progress that ITA and other U.S. government organizations have made in trade policy, we believe that it is now time for US&FCS Japan to focus its energies, efforts, and resources on its primary responsibility of trade promotion.

B. Post Contracts Out Some of its Core Products and Focuses Too Much on Old-to-Market and Local-Country Firms

US&FCS contracts out the work that supports some of its core trade promotion products and services, including the popular Gold Key Service, which matches U.S. exporters with potential representatives and distributors. While we recognize that contracting out certain tasks frees up resources to concentrate on other responsibilities, it seems that these resources currently are dedicated disproportionately to policy rather than promotion. Furthermore, by contracting out certain specific tasks, US&FCS removes itself further from performing some of the core US&FCS activities that best meet the needs of small and medium-size firms, as well as those that are more likely to be NTM and NTE firms.

We observed that US&FCS Japan focuses more on counseling OTM firms than NTM and NTE firms. Our analysis of the 1997 first, second, and third quarter statistics on the number of NTM, NTE, and OTM firms counseled by each office shows the following percentages of total firms counseled that are OTM:

Percentage of Counseling Services Used For OTM Firms

	1st QTR	2ND QTR	3RD QTR
Tokyo	55%	67%	57%
Osaka	77	82	69
Nagoya	28	67	63
Fukuoka	64	74	N/A
Sapporo	78	79	75

In the same period, we observed that Tokyo, Osaka, and Fukuoka facilitated over half of their trade sessions with local country firms.

Percentage of Counseling Services Used For Local Country Firms

	1st QTR	2ND QTR	3RD QTR
Tokyo	60%	61%	65%
Osaka	60	59	64
Fukuoka	50	70	N/A

We question whether each post should, on average, be spending more than half its time on OTM and local country firms. OTM firms should already have the knowledge of exporting to Japan, while NTM and NTE firms are in great need of counseling when entering the Japanese market. Although holding trade facilitation sessions with local country firms is acceptable, we question the value added given US&FCS' primary mission is to assist NTM, small, and medium-size firms.

C. Effectiveness of the U.S. Trade Center in Tokyo Is Questionable

The Tokyo Trade Center provides space for U.S. companies to use for trade and product promotion, technical seminars, training programs, and hospitality events. Although the Center has been useful for some smaller companies because of the low cost of its services, its overall effectiveness is questionable. US&FCS Tokyo tends to focus its efforts on activities other than trade events, and when it organizes such events, they are often held away from the Center. On average, US&FCS holds 10 to 12 trade events annually at the Center, although the Center's staff will assist events at other sites.

In the last two years, the Trade Center director has made extensive efforts to demonstrate the Center's usefulness, but has reportedly received little assistance from senior management, FCOs, and the domestic offices in improving the Center's viability. According to staff, because the Center is not located in the Tokyo business district, it is not a convenient location for events. Furthermore, because of the numerous events held each year at other locations throughout Japan, some staff members have difficulty devising events that are especially attractive.

D. Trade Center Cost Recovery Is Based on Subsidy from the Japanese Government

The Japanese government subsidizes the Trade Center in Tokyo through the Manufactured Imports Promotion Organization (MIPRO), an agency that promotes the import of manufactured products. Since MIPRO provides a rent subsidy for the Trade Center's present location, US&FCS Japan has decided not to relocate its facility to a more desirable business section of Tokyo.

In FY 1997, MIPRO subsidized approximately 53 percent of the Trade Center's events. Because the Japanese government decides which trade events to subsidize, there is at least the appearance that it influences some aspects of the trade promotion effort. Furthermore, to obtain the event subsidies, the Trade Center Director must submit annually to MIPRO a proposed event schedule. MIPRO then decides which events will receive the subsidies, and how much.

Our audit disclosed that the Trade Center is receiving more than $800,000 in subsidies from the Japanese government. The annual subsidy comes in three forms:

- Free building space valued at $427,350.
- Below-market rent for 400 square meters, valued at $209,904.
- A financial benefit (referred to as "trade enhancement funds") of $192,307 used by MIPRO to pay selected trade event expenses. Once the amount per event is established, US&FCS sends associated bills to MIPRO for payment.

The trade event subsidy is provided through offsets. The Trade Center identifies event-related expenses to be paid for by MIPRO. However, these costs are not identified in trade event fiscal plans or any Washington records. Once approved by MIPRO, these costs are passed directly to and paid for by MIPRO. According to post management, US&FCS Japan attempts to select events that have greater potential for MIPRO approval.

The Trade Center will run a surplus of approximately $26,000 for FY 1997 due to a subsidy of $829,562. Without the subsidy, the Center would not have been able to recover its costs.

Trade Center Cost Recovery

	With Subsidy	Without Subsidy
Collections	$655,369	$655,369
Expenses	410,279	602,587
Overhead	218,360	855,614
Surplus	26,730	(802,832)

When we asked for documents associated with the subsidy, we were informed that US&FCS does not have a memorandum of understanding or contract with MIPRO discussing the nature of and approval process for the subsidy expenses or collections. Thus, there is no convenient way of tracing the source or uses of these funds.

D. Performance Measurements Should Be Tracked More Accurately

The Government Performance and Results Act (GPRA) was enacted to improve federal management and accountability processes and practices by requiring agencies to set strategic goals, link them to budgets, measure performance, and report on the results. Under GPRA, agency strategic plans will define annual goals for programs and measure the programs' performance in meeting their goals. By March 31, 2000, each agency will be required to submit to the President and its congressional authorization and appropriations committees an annual report of program performance for the previous fiscal year.

US&FCS has established a procedure to track its performance in large part through "success stories" and statistics on products and services provided. Success stories attempt to measure export actions through the assistance and involvement of US&FCS. A success story identifies the company seeking assistance from US&FCS, the type of success (advocacy vs. non-advocacy, such as trade events, counseling, etc.), the size of the company, and whether the company is NTM, NTE, or OTM. The success story also identifies the dollar value of sales the company made, although not all companies divulge this data. While success stories are a form of measurement, they have limitations as performance measures.

We question the value of sales as a measurement of performance because in not all cases does the service provided by US&FCS (i.e., briefing papers, ambassador support, policy initiatives) account for sales being made. Also there is an inequity in assigning values to successes. The amount of time spent assisting one exporter may not contribute to a sale, while the same amount of time assisting another exporter may contribute to a large dollar-value transaction. However, they are all counted as success stories for performance measurement purposes.

In addition, we noted that many projects are difficult to measure. Long-term market access, deregulation, and government procurement projects are all advantageous to the United States, but are often not captured by the performance measurement process. Moreover, the significant services provided to other agencies, such as the United States Trade Representative and ITA's Office of Japan, sometimes go unmeasured.

Furthermore, there is no centralized, consistent format for quarterly performance reporting by US&FCS Japan's constituent posts. A centralized, consistent reporting system is necessary to track performance and keep management abreast of output. While some FCOs and FSNs keep detailed logs on their daily functions, such as providing counseling or answering inquiries, other employees do not keep track of their functions. This raises questions as to the accuracy of some of the statistics reported.

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Summarized ITA Response to Draft Report

In responding to our draft report, ITA said:

1. US&FCS sees trade policy and trade promotion as a continuum. US&FCS believes that both are important components of the U.S. government's efforts to help U.S. exporters. US&FCS management relies on the SCO for Japan and his staff to recognize the right mix of policy and promotion activities.

2. US&FCS agrees that more NTM clients are needed and asserts that the agency has been implementing programs to try to increase the number of NTM firms doing business in Japan. However, US&FCS states that many expert observers advise that difficult markets, like Japan, are not the appropriate place for the new-to-export to begin. Moreover, US&FCS does not believe that the draft OIG report adequately recognizes that Japan is characterized by highly protectionist administrative barriers that require US&FCS Japan to "go to bat" for OTM clients. US&FCS further states that the agency must be constantly vigilant to expose Japanese bureaucratic regulators who interpret vague rules to restrict competition by U.S. industry. US&FCS concludes this point by stating, "If US&FCS Japan is not fighting in the trenches for a 'level playing field' in Japan, who will?"

3. ITA's response pertaining to the U.S. Trade Center in Tokyo questions the figures presented by the OIG and states that they are not accurate. In addition, US&FCS believes it is inaccurate to state that US&FCS management has not supported the United States Trade Center. US&FCS does agree with the OIG that the viability of the Trade Center is an issue that must be assessed.

OIG Analysis of ITA's Response

1. While acknowledging that US&FCS Japan will have some trade policy responsibilities, our concern has been, and continues to be, the extent to which the policy work competes and interferes with trade promotion work. According to the US&FCS mission statement, trade promotion is the most important aspect of what US&FCS has to offer to the U.S. business community. This would include the core products and services: information products and market research, counseling, trade promotion events, contact information, Gold Keys, and advocacy. While these services are offered to the U.S. business community by US&FCS Japan (or contractors), they could be offered in greater magnitude and quality if the post reduced its trade policy activities.

For a clearer definition of trade promotion and the mission of US&FCS, we refer to the testimony of the US&FCS Deputy Assistant Secretary for International Operations before the Senate

Foreign Relations Committee in the Fall of 1997. She testified that the "principal mission" of US&FCS is to "assist U.S. exporters," and she further testified, "Our most fundamental commitment to the business community is export counseling." At no time did the Deputy Assistant Secretary discuss trade policy development as a key or significant part of the US&FCS mission or one of its objectives.

2. The OIG is aware of the barriers to U.S. firms attempting to conduct business in Japan. However, we believe that U.S. government efforts to reduce these barriers is the primary responsibility of the economic section at the State Department and the U.S. Trade Representative. While US&FCS must contribute to these efforts, its primary responsibility should be on trade promotion activities. The OIG believes that too many US&FCS Japan resources are dedicated to trade policy efforts.

3. The OIG evaluation of the Trade Center focused solely on the events taking place at the Trade Center. Therefore, the figures presented in the draft report are accurate. In assessing the long-term viability of the United States Trade Center, US&FCS should not consider events that take place outside the physical confines of the Trade Center. US&FCS will still be able to participate, coordinate, and co-sponsor such events without the existence of the Center.

Recommendations

We recommend that the Assistant Secretary and Director General of US&FCS:

1. Redirect US&FCS Japan's attention toward trade promotion activities. In some cases, it will be necessary to provide trade promotion training for personnel. This would also include encouraging FSNs to constantly interact with the American business community and market the products and services offered by US&FCS.

2. Focus more on assisting NTM and NTE firms rather than OTM and local country firms.

3. Assess whether the Trade Center subsidy from the Japanese government:

   a. Influences the trade promotion effort and
   b. Should be continued.

   If it is continued, documents should be maintained to track it.

4. Assess the cost-effectiveness of operating the Trade Center. If management decides to continue operating the Center, it should be utilized more productively. If management determines it is not cost effective to operate the facility, it should be closed and the resources reallocated.

5. Develop a better system to track US&FCS's performance against its goals and objectives as outlined in the Strategic Commercial Plan in accordance with Government Performance Results Act. Specifically, such services as counseling, advocacy, information gathering, and assisting other government agencies should be accounted for.

III. INTERNAL CONTROL ENVIRONMENT

After reviewing the administrative and financial operations at post and conducting interviews with US&FCS and embassy staff, we concluded that US&FCS Japan's internal controls should be improved. Specifically, we observed significant redundancies within the administrative units and a lack of coordinated oversight by management. Additionally, there is not an effective internal control structure to separate critical administrative functions. Account balances were also not fully reconcilable between the ITA, State Department, and Treasury Department records. Moreover, in a matter affecting reporting requirements under the Chief Financial Officers Act, US&FCS Japan had accumulated over $2.3 million in unfunded personnel benefit liability for its employees.

A. Post Administrative Structure Needs Realigning

US&FCS Tokyo management has developed two administrative units, resulting in significant redundancies. The administrative units consist of FSNs and several officers doing similar work and transactions, none of which is coordinated or managed by the administrative officer.

US&FCS Tokyo has redundant administrative and financial structures in support of the two major sources of funds at post (Operating and Administrative and International Cooperative Administrative Support Services). The functional segregation between O&A programs and trade event activity has created two duplicative administrative units (see Appendix II, Present Alignment). This duplication has resulted in the inefficient use of personnel resources, and overly complicates the SCO's management of administrative and financial operations. Moreover, the post's administrative officer does not have responsibility over the full spectrum of administrative functions. Three FCOs are involved in administrative and financial matters (administrative officer, Trade Center director, and American secretary). Among these officers, there appears to be little coordination of financial and administrative matters.

US&FCS Tokyo needs to realign its administrative structure to more effectively manage its responsibilities. Specifically, it needs to streamline the human resources dedicated to the administrative and financial process. Establishing a single administrative section will properly align all administrative and financial personnel under the administrative officer (see Appendix II, Proposed Realignment). Realignment would consolidate work efforts and house all US&FCS Japan administrative and financial operations in one area, thus leveraging the available resources to effectively handle the post's increasing administrative requirements.

US&FCS Japan needs to separate critical administrative functions to ensure proper internal controls are established

Trade Event Funds Management: The US&FCS Tokyo Trade Center has a budget analyst/imprest fund cashier who is the sole controller of funds, including collections, expenditures, and reconciliations. Most importantly, this person controls all elements of the $10,000 imprest fund.

The Trade Center also has a receiving clerk, but since the analyst/cashier manages the electronic fund transfers, the cashier is performing the core duties of the receiving clerk and there is no separation of duties with the Center's analyst/cashier. The weakness is compounded by the absence of other tracking mechanisms (such as logbooks) and reconciliations between the two employees.

O&A Funds Management: Similarly, Tokyo's O&A division has a budget specialist/petty cashier who controls all financial tracking systems for collections, procurements, disbursements, and reconciliations. These functions are managed by two supervisors (the administrative officer and the American secretary) who do not coordinate their separate functions. For example, both supervisors have oversight responsibilities for petty cash. The administrative officer controls the signing authority and the secretary controls the reconciliation of funds, but neither formally communicates issues or concerns. These functions should be brought together, or a more formal communication process should be established.

Although reconciliations are supposed to be conducted regularly, unannounced cash reconciliations are rarely performed. For example, there were none between April 1996 and June 1997. As signing official, the administrative officer needs this important information to ensure proper administrative procedures are followed.

ICASS management needs strengthening

ICASS, the international cooperative administrative support system, is proposed to replace the existing administrative and financial system. ICASS (1) is a customer-driven, voluntary interagency system for managing and funding administrative support services abroad; (2) gives posts the authority to determine how services are delivered, at what cost, and by whom; (3) has customer service standards established by the post, with the service provider formally accountable to the customer; and (4) incorporates a full-cost recovery system through a no-year working capital fund.

Each post has both a council and working group to address and resolve financial and administrative issues. Each agency assigns its senior officer to the council and a junior officer or FSN to the working group. During our audit, we observed the following:

US&FCS: US&FCS Tokyo is represented on both the ICAAS council and the working group. Moreover, US&FCS Japan has reduced its level of representation in ICASS by removing the SCO from the ICASS council. Originally, the SCO and the administrative officer were the key representatives on ICASS. After a new SCO and a new administrative officer came on board, the administrative officer was reassigned to the working group, and the American secretary to the council. We believe that these roles should be reversed and would be more effective if the senior officer in charge of post administrative issues were assigned to the ICASS council and the junior officer assigned to the working group. Because the ICASS council consists of heads-of-agency representatives from each involved agency, US&FCS Japan should have a high-level representative who can work effectively with his or her colleagues in the Embassy.

State Department: As the old Foreign Affairs Administrative Support System evolved into the new ICASS system, State Department FSNs were shifted to all foreign service agencies who participate in ICASS. Unfortunately, the State Department did not shift funding to cover the liability associated with the years of service that these employees worked for the State Department. Therefore, this liability is expected to be funded by other foreign service agencies and could result in significant costs.

Furthermore, the personnel officer noted that State is committed to reducing its overhead cost by encouraging retirement through a downgrading of its FSN positions. At the time of our review, the Embassy administrative section did not have a specific strategy to implement its downgrading plan. Therefore, the potential financial cost to US&FCS Japan was not identified. However, any cost associated with a voluntary or involuntary separation would be shared across all ICASS agencies. In Japan, US&FCS pays approximately 9 percent of total ICASS costs and would most likely incur a similar share of separation costs. Based on post records, total ICASS personnel costs were estimated at $18.5 million. The estimated unfunded personnel liability is approximately $11.1 million, of which more than $1 million could be directly attributed to US&FCS Japan.

LAN management should be improved

There is no clear management structure to effectively address local area network (LAN) operations because of the division of responsibilities between the Embassy and the Trade Center. US&FCS Japan has created a redundant structure by designating two officers and two FSNs to separately manage overall LAN operations in Japan and LAN operations for the Trade Center. These two divisions do not coordinate or assist each other on LAN issues. This results in a significant difference in the quality of service and amount of attention to LAN matters since the qualified LAN specialist does not work with the Trade Center. Specifically, with the Center located outside the Embassy, its LAN requirements are often not met or addressed by the US&FCS administrative officer. The Center operates on a less than adequate system that needs to be upgraded. The Center's LAN system is sometimes inoperable, occasionally for long periods, a problem that occurred while we were in Tokyo. This problem was compounded by the lack of responsiveness to a request for headquarters assistance.

Implementation of CAMS may have a significant negative impact on commercial work at post

The Department is developing a single administrative and financial management system known as the Commerce Administrative Management System (CAMS). CAMS consists of three components: (1) the core financial system (CFS), (2) a bankcard module, and (3) a small purchases procurement module. CFS, the primary focus of CAMS, is intended to streamline financial and administrative procedures and improve timeliness. At the time of our fieldwork, ITA's projected date for deploying CFS overseas was December 1998, which has since been pushed back to October 1999. We believe the current deployment strategy has not been thoroughly reviewed to address the unique administrative and resource environment of overseas posts. Furthermore, CFS implementation would require US&FCS overseas staff to become administrative managers as well as commercial officers if the deployment plan proceeds as outlined.

The overseas internal control environment would be weakened under ITA's current plans. Commercial officers and FSNs have not been trained in critical functions, such as financial management (which includes accounting and disbursing). Moreover, ITA has not conducted a thorough assessment of the impact CAMS may have on ICASS services at post. ITA has also not addressed matters surrounding the disbursement or certification of funds and how CAMS may change State's role in providing services or internal controls.

B. Management Controls Need to Be Strengthened

Upon reviewing management controls over its administrative and financial responsibilities, we determined that the post did not maintain adequate management controls to protect against waste, fraud, or abuse. During our audit, we identified several problems, as detailed in the findings section below.

Account balances differ

Our review of official records disclosed unreconciled account balances between State, Treasury, ITA, and US&FCS Washington. During our review of account balances, we identified the following:

- A more than $61,000 difference in expenditures between State Department and ITA official records for FY 1997 Operating and Administrative accounts.
- A $144,152 difference in collection balances between State and Treasury records and a $127,711 difference between State and ITA records.

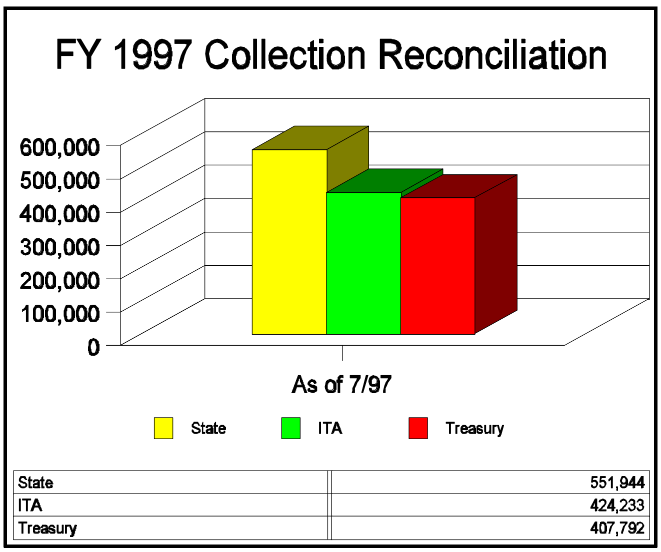
- More than $191,000 in prior-year unliquidated obligations.
- Differences totaling $1.7 million between FY 1996 State and ITA accounting data for expenditures.

In examining the $1.7 million difference, we compared State and ITA FY 1996 report balances, which produced the following breakdown by account:

FY 96 Reconciliation of State and ITA Accounting Data

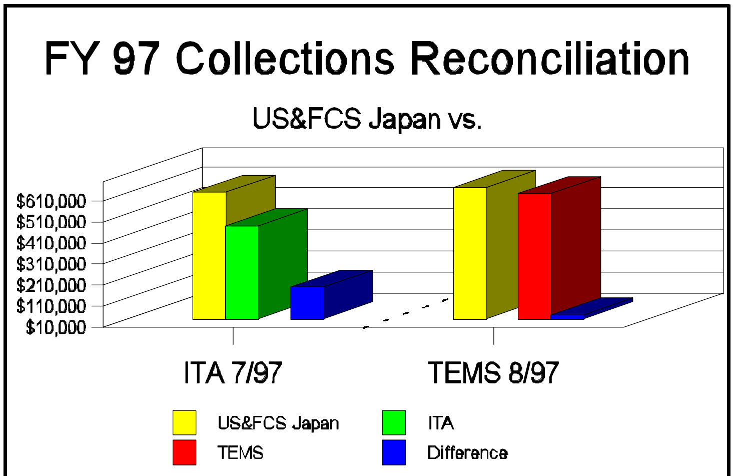
Category	State	ITA	Difference
O&A	$4,765,410	$6,233,105	$1,467,695
Overhead	173,595	432,250	258,655
Other Reimbursable	150,112	150,525	413

The comparison of collection balances in the State Department report to the ITA and Treasury reports for the period ending July 31, 1997, revealed a $144,152 difference with the Treasury balance and a $127,711 difference with the ITA balance (see graph below).



In comparing the ITA accounting report to US&FCS's Trade Event Management System's (TEMS) collection report, we found that in FY 1997, the Trade Center, ITA accounting, and TEMS reported trade event collection balances that differed significantly. The difference with ITA amounted to $160,747 for the reporting period ending July 31, 1997. We were unable to identify the reasons for the differences because ITA does not track collections on an individual or project code basis. We believe that the difference may have resulted from timing differences or from funds being improperly credited to an agency other than ITA.

Also, the difference may have resulted from the way in which ITA and the Trade Center account for collections. ITA accounts for collections in the fiscal year that the collection is received, whereas the Trade Center reports total collections by trade event. The difference between TEMS and US&FCS Japan amounted to $28,667 for the reporting period ending September 2, 1997. We believe that this difference occurred because TEMS had numerous posting errors, such as collection amounts posted to the wrong trade event accounts (see diagram below).



US&FCS Japan	$610,696	$632,846
ITA	449,949	
TEMS		604,179
Difference	160,747	28,667

Note: Available accounting reports were not consistent in reporting periods; thus, US&FCS Japan data was compared separately against ITA and TEMS.

<u>Prior year unliquidated obligations and unobligated authorizations exist</u>

The State Department's Financial Management Center (FMC) in Tokyo and US&FCS Japan have failed to determine if prior year unliquidated obligations and funds available (unobligated) are still valid.

Prior year obligated funds totaling $191,425 have not been disbursed for accounts dating back to FY 1994 (see breakdown in table below).

Prior Year Unliquidated Obligations			
Category	FY 1994	FY 1995	FY 1996
O&A	$473	$10,705	$1,320
Trust Fund	0	569	7,347
Kerry Funds	0	171,011	0

Prior year funds totaling $167,182 have not been obligated, nor have these funds been returned to Washington (see breakdown in table below).

Prior Year Unobligated Authorizations		
Category	FY 1995	FY 1996
O&A	$2,661	$100,628
Trust Funds	2,034	53,034
Kerry Funds	8,412	0

US&FCS Japan has not reconciled or managed the account balances at post. The official State Department monthly accounting reports clearly identify these prior year funds. These funds could be put to better use either in Japan or by US&FCS Washington. US&FCS Japan should determine if these balances can be returned to the Treasury and reconcile the accounts properly.

FY 1995 Kerry funds are being drawn down improperly

In 1995, Senator John Kerry of Massachusetts sponsored a one-time appropriation of nearly $500,000 to ITA's Market Access and Compliance division, known at that time as International Economic Policy. These funds were appropriated to create an export center in Tokyo to facilitate American business access to the Japanese market and to increase U.S. exports to Japan. In FY 1995, ITA's Office of Japan authorized the full amount of "Kerry funds" to post in support of the program. At the instruction of the Office of Japan and with ITA support, US&FCS Tokyo obligated the full amount of the single year funds, thus avoiding losing the funds at the end of the year. To date, US&FCS Tokyo maintains approximately $171,000 of Kerry funds still on the books under the FY 1995 account. The account is currently being drawn down on an as-needed basis to fund personal service contracts (PSCs), travel, and supplies.

We observed that US&FCS Japan is funding current year PSCs from the FY 1995 account. The US&FCS is authorized PSC authority through its appropriation language, which allows for only one-year authority. Furthermore, ITA's policy is that all contract positions are to be funded out of current year accounts, not multiple or prior year accounts. Using Kerry Funds to continue paying for PSCs appears to violate this policy. As the Department's expert on legal and legislative matters, the Office of General Counsel should be consulted for a determination of the proper use and disposition of these funds.

Collection process is inadequate

We reviewed the process by which US&FCS Japan collects funds. We found no apparent misuse of collections; however, the State Department collection balance differed from ITA and Treasury reports by $127,711 and $144,152, respectively. In the absence of adequate reconciliation, we are unable to determine the causes of the discrepancy. Furthermore, because the post has consolidated incompatible functions under a few employees, it cannot ensure that collections are properly handled. Additionally, key reconciliation systems and processes, such as collection logbooks and reconciliations of account balances between ITA, State, and Treasury reports, do not exist. As shown earlier, there were differences in the final balances of official accounting records.

Our fieldwork indicated that improvements are needed in US&FCS Japan's financial management practices to properly account for collections, reconciliations, and cash management. The current collection process at post does not ensure accountability of funds. Most collections for trade events in Japan are executed through electronic fund transfers. Such collections are received, verified, and reconciled through computer dial-up software provided by the Bank of America. Because this software does not track the deposits by agency, all transfers for the embassy are executed within one account. This requires daily reviews and reconciliations by the Trade Center budget analyst/cashier. Collections are not coded to the agency until they are processed with a deposit form, Official Form (OF)-158, *Deposit*. As a result, some deposits have not been identified because the electronic fund transfer was overlooked during a daily review of the account. These mistakes were eventually corrected.

Cash collections are generally received by trade specialists and are passed on to the receiving clerk or cashier. There is no record of receipts issued for cash collections, no collection logbook, no reconciliation of cash deposit reports, and no officially designated money handlers.

ABIC operations need to account for and secure collections

US&FCS Japan has established the American Business Information Center (ABIC) as an information center for market research and as the central coordinating office for US&FCS market research products sold to post clients. Our fieldwork indicates that ABIC has not adequately reconciled collections and deposits. ABIC maintains a tracking spreadsheet for collections and receipts issued, but not OF-158 numbers. The spreadsheet does not track the official numbers of the receipt sub-voucher. However, when the OF-158 is generated, it records the associated official receipt numbers. Information needed for reconciliations is available, but ABIC has not organized its accounting system to use it effectively. In the absence of a comprehensive tracking system, ABIC is unable to reconcile the collections and receipts issued to the OF-158s or Regional Administrative Management Center (RAMC) reports. As the regional financial management center for all embassy operations, RAMC manages the financial system that tracks all transactions from the embassies within its region.

Additionally, ABIC does not adequately account for collections maintained before deposit. Because of the low number of collections, amounts are held for long periods. ABIC does not have a cash lockbox for collections, so they are secured by the petty cashier. However, ABIC does not track how much cash has been collected and turned over to the cashier. Each staff member of ABIC is allowed to receive cash and issue receipts because US&FCS Japan has not identified a specific cash handler for ABIC collections. Although there is a supervisor to coordinate the collection process, it is a significant internal control weakness to have multiple employees responsible for the collection process. We observed a similar weakness in Osaka.

<u>US&FCS Washington does not adequately manage the NOAA account in Japan</u>

In 1982, NOAA and US&FCS signed a reimbursable agreement to hire an FSN to handle National Marine Fisheries Service issues in Japan. NOAA reimburses US&FCS for the cost of the FSN, travel, and procurements. In addition, NOAA pays a percentage of the costs associated with US&FCS administrative support personnel and the International Cooperative Administration Support Service (ICASS), a new administrative support program and cost distribution method. However, the post does not get reimbursed for some of NOAA’s costs.

Each year, US&FCS Tokyo loses money authorized to post due to its inability to obligate funds for NOAA’s costs associated with support personnel and ICAAS. At the end of each year, the State Department remits funds remaining at the post back to the Treasury Department. The administrative support costs are already funded through post O&A funds, and ICAAS funds are maintained and paid in Washington. Therefore, US&FCS Tokyo is unable to obligate authorizations sent to post for these line items. Last year, US&FCS Japan lost approximately $30,000 authorized for administrative support and NOAA-related ICASS charges. These funds should not be authorized to post.

Furthermore, there is no financial oversight of these funds from either Washington or Japan. NOAA has never received from US&FCS Washington (1) any unused funds or (2) a report that accounts for how the funds were expended or if they were used appropriately.

Our fieldwork indicated that US&FCS Japan and US&FCS Washington are not communicating effectively on these matters. These funds can be easily tracked and reconciled. Authorizations for support personnel and ICASS can easily be sent back to Washington to be applied against the account (the East Asia Pacific regional budget for US&FCS) where the funds originate.

US&FCS needs to fund its unfunded personnel liability

The Federal Managers' Financial Integrity Act and the CFO Act require that US&FCS Washington maintain an account on the growing personnel liabilities for payment of benefits upon separation, whether voluntary or involuntary, for FSNs eligible for severance.

We met with the embassy personnel division to assess the agency's unfunded liability. As of the end of FY 1997, the total unfunded liability for US&FCS Japan is $2.3 million. Of this, over $400,000 will be used in FY 1998 for the expected retirements of highly paid FSNs. During our review we were advised by post management that these funds were not included in the FY 1998 budget request for the post.

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Summarized ITA Response to Draft Report

In responding to our draft report, ITA said:

1. ITA has informed the OIG that the audit team reviewed US&FCS Japan's administrative structure in a time of transition. It is presently being unified under the direction of the Commercial Counselor and American Secretary. Nonetheless, ITA does not believe that it has redundant accounting processes and believes it is imperative that the two funding accounts remain separate.

2. According to US&FCS the OIG team has made inaccurate assumptions and did not ask to review US&FCS Tokyo's documentation of the Kerry Fund and its use. US&FCS states that if the OIG team had seen the documents, they would have found that every disbursement from Kerry Funds is fully documented and in accordance with instructions from Washington. Moreover, the IG report failed to note that Kerry funds enabled US&FCS to expand its reporting on the Kobe Earthquake, open the Virtual Trade Center, create a popular home page on U.S./Japan trade and start new programs in housing, government procurement, safety and security and oil spill response — all of which, according to ITA, meet the Senator's objective of greater visibility and outreach to the U.S. business community.

3. With regard to the unfunded personnel liability for ICASS, according to ITA, US&FCS indicates that it has discussed this issue at post, and most recently with the ICASS Council. However, the issue ultimately must be decided in Washington and is not resolvable at post. It is being addressed by ITA's Office of Financial Management.

OIG Analysis of ITA's Response

1. The OIG agrees that these two referenced accounts need to remain separate. In fact, we believe that all accounts need to be tracked and managed individually. We also agree that the processes for managing O&A and Trust Funds are unique.

However, the OIG finding is directed toward the fact that US&FCS Japan has multiple staff doing similar work and does not separate critical financial duties (collection, expenditure, reconciliation, petty cash/cashiering, and ICASS management). It is often appropriate for one employee to manage two or more accounts. That is a management issue that can be resolved by managing information databases and tracking mechanisms. Our proposed organizational structure adequately addresses the need to separate both accounts and key financial functions.

2. The OIG agrees that there have been valuable results from utilizing the Kerry Funds for the past several fiscal years. However, our audit finding is not directed to the individual expenses of these funds compared to Senator Kerry's objectives, rather to the management of the account.

The OIG interviewed all officials at post with responsibility for managing Kerry Fund activities and reviewed pertinent documents. The funds were obligated in FY 1995 to avoid a withdrawal of authorization at the end of the fiscal year. US&FCS Japan obligated the full amount of these funds against no contracts, agreements, or known costs.

The report finding did not question the expenditures as they related to Senator Kerry's intent. Instead, the finding questions the management practice of spending prior year funding against current year expenses. The report does specifically question the personal services contract that was established using these prior year funds. According to ITA administration, this violates management guidance provided to US&FCS.

3. Officials at post who are knowledgeable about the unfunded liability issue told the OIG that they had not raised it with the State Department. We agree that this is not solely a US&FCS Japan matter. However, ICASS is a post-driven program, and US&FCS Japan has the ability to determine its potential ICASS costs and should do so expeditiously. We are encouraged that US&FCS and ITA are addressing this matter.

Recommendations

We recommend that the Assistant Secretary and Director General of US&FCS:

1. Ensure that the Commerce Administrative Management System will address the administrative and resource environment of the overseas posts prior to its deployment. In addition, assess the impact the system may have on ICASS services at posts and State's role in providing services or internal controls.

2. Develop internal control structures that provide proper, accountable cash management and account reconciliation processes at US&FCS Japan; conduct thorough reconciliations of present and prior year expenditure and receivable accounts to ensure that post and State Department reports reconcile; and resolve unliquidated and unobligated prior year balances.

3. Continue working with ITA and the State Department to address the requirements of the CFO Act in regard to overseas financial assets and liabilities. Accurately report the status of total unfunded personnel liability to ITA and budget for expected FY 1998 separations.

4. Consult with the Office of General Counsel to determine whether FY 1995 Kerry funds are being properly used and whether they need to be remitted to the Treasury.

5. Realign US&FCS Japan's administrative structure to effectively manage responsibilities at post. This would include (a) streamlining the human resources dedicated to the administrative and financial process, (b) separating critical administrative and financial functions at post, and (c) assigning administrative officer supervision over all administrative and financial transactions.

6. Assess representation assignments to the ICASS council and working group to ensure that assignments coincide with management responsibilities at post.

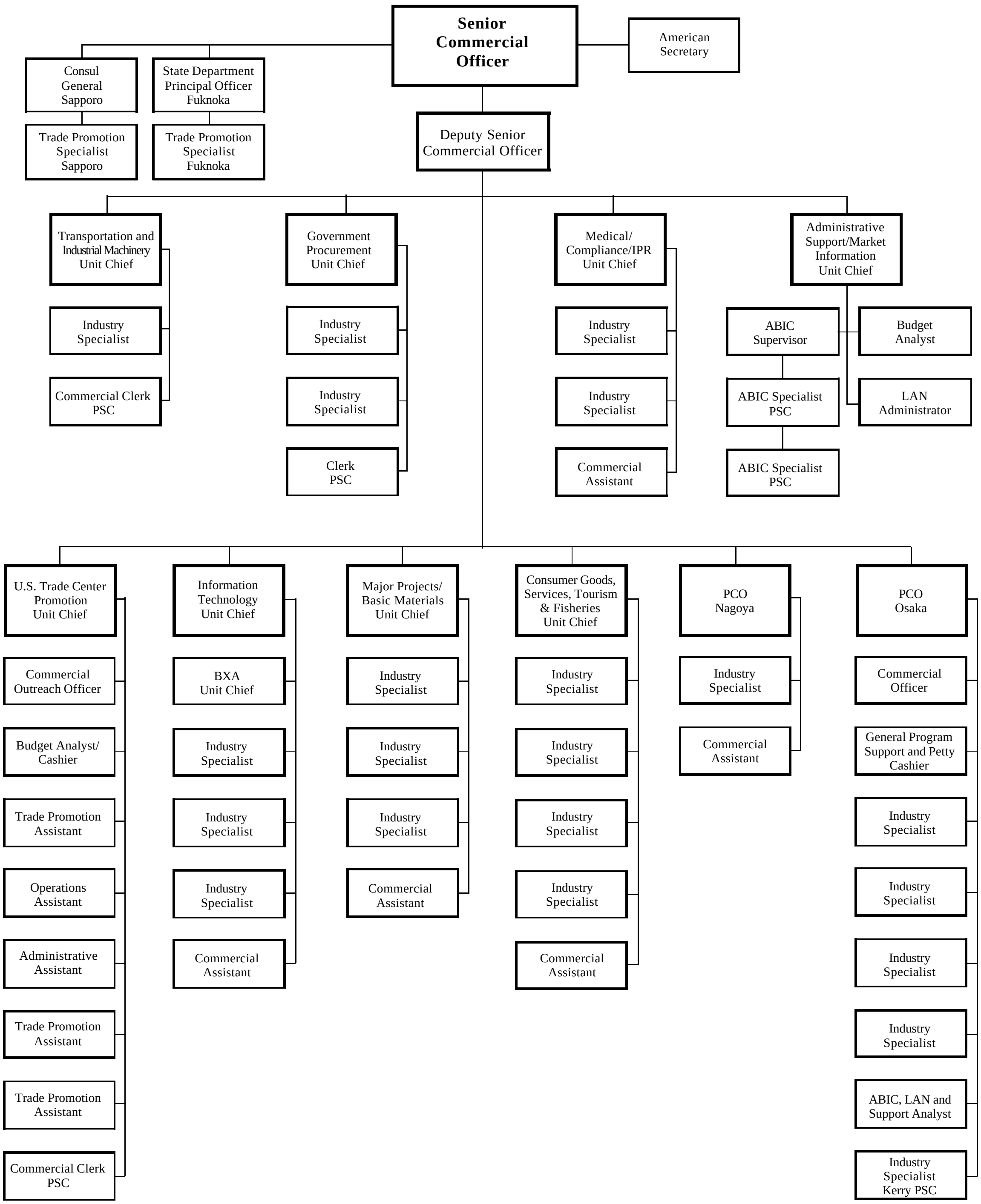
7. Ensure proper oversight for post's imprest fund and petty cash authorization.

8. Establish better internal controls and reconciliation systems in the collection process to ensure that collections are identified, recorded, and reconciled.

9. Reconcile the NOAA reimbursable account annually with the post and ITA, and provide a status report to NOAA. Ensure that NOAA-associated ICASS costs are being reimbursed to the US&FCS headquarters account and not authorized to post.

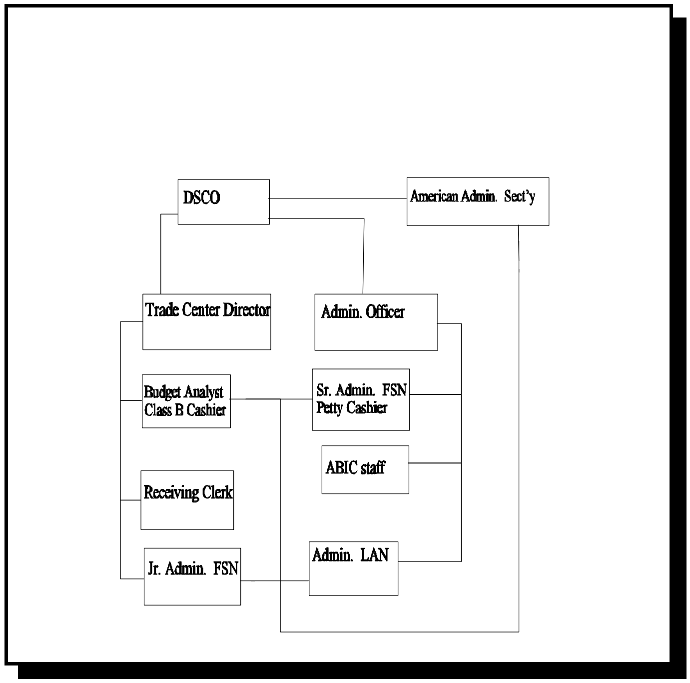
APPENDIX I

US&FCS Japan Organization Chart

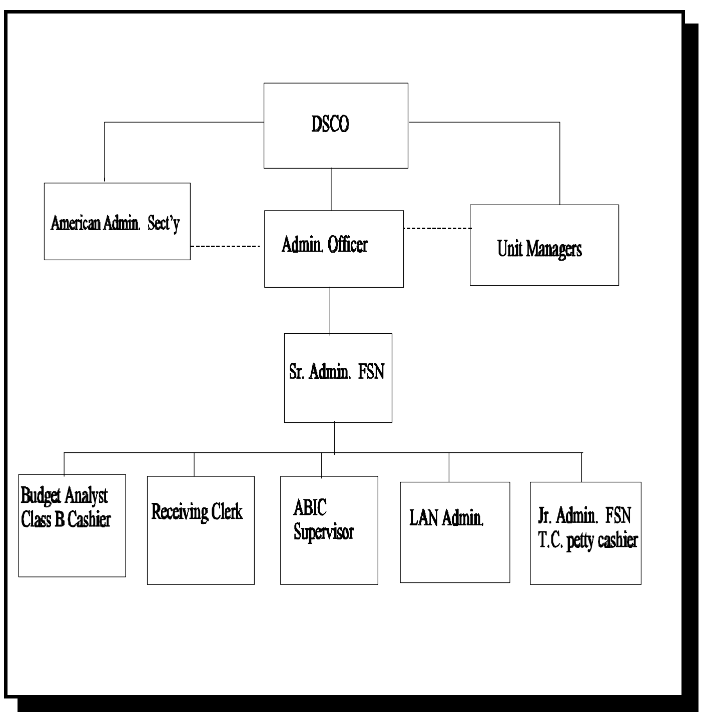


APPENDIX II
Administrative Structural Chart

PRESENT ALIGNMENT



PROPOSED REALIGNMENT



APPENDIX III

Acronyms

ABIC	American Business Information Center
CAMS	Commerce Administrative Management System
CFO Act	Chief Financial Officers Act of 1990
CFS	Core Financial System
FCO	foreign commercial officer
FMC	Financial Management Center
FSN	foreign service national
FTE	full-time equivalent
GDP	Gross Domestic Product
GNP	Gross National Product
GOJ	Government of Japan
GPRA	Government Performance and Results Act of 1993
ICASS	International Cooperative Administrative Support Service
ITA	International Trade Administration
LAN	local area network
MIPRO	Manufactured Imports Promotion Organization
NOAA	National Oceanic and Atomospheric Administration
NTE	new to export
NTM	new to market
O&A	Operating and Administrative
OIG	Office of Inspector General
OTM	old to market
PSC	personal services contract
RAMC	Regional Administrative Management Center
SCO	senior commercial officer
SCP	Strategic Commercial Plan
TEMS	Trade Event Management System
US&FCS	U.S. and Foreign Commercial Service
USTR	United States Trade Representative
USTTA	Unites States Travel and Tourism Administration

APPENDIX IV

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

MEMORANDUM FOR Johnnie E. Frazier
Acting Inspector General

FROM: David L. Aaron

SUBJECT: Comments on Draft Audit Report on ITA Operations in Japan

Thank you for the opportunity to review and comment on the draft report entitled "US&FCS Japan Should be Restructured to Better Meet the Needs of U.S. Exporters," produced by the Office of Audits, International Audits Division. I have attached some topic-specific commentary prepared by the US&FCS which addresses a number of the preliminary findings, and provides information and perspective the review team may not have incorporated in the drafting stage. US&FCS also requests additional information about several aspects of the IG report.

I hope that you will keep our comments in mind as you revise the report, and that you will incorporate them in the final version. In turn, we will study your final report and let you know how we propose to implement the recommendations.

As ITA moves ahead with realignments, reallocations, upgrades, and other improvements in our service to U.S. exporters, we are looking at additional ways in which to enhance our overseas operations. The Inspector General's recommendations will be valuable in this effort and we look forward to receiving your report.

Attachment

COMMENTS ON DRAFT IG AUDIT REPORT ON US&FCS OPERATIONS IN JAPAN

Introduction:

Following are ITA comments on Draft Audit Report # IAD-10218-8, entitled "US&FCS Japan Should be Restructured to Better Meet the Needs of U.S. Exporters". They respond to the request for review and comment in Assistant Inspector General for Audits Ross' memo to Under Secretary Aaron dated December 3, 1997.

We believe the preparation and the visit went well, and appreciate the hard work and professionalism of the members of the performance audit team. We have reviewed their draft report carefully.

Requests for additional information:

Although we are requesting additional information regarding certain aspects of this report, we note that we have already found several findings and recommendations quite useful. These findings are helping us fine-tune our strategic review of Japan operations, and complete our current program for restructuring of US&FCS Japan.

In its report, the team makes some broad recommendations on how we could improve our operations in service to U.S. exporters to Japan. However, many of these are couched in general terms such as "develop," or "assess." While constructive, they do not address the difficult trade-offs that would be necessary, and/or the resource constraints. We would appreciate additional guidance from the team to assist us in the decision-making process in those areas.

We would also be interested in learning more about the team's evaluation of our success in assisting U.S. companies. We understand that the team held discussions with our end users and multiplier organizations, and it would be helpful to know how the team rated post's effectiveness in assisting U.S. exporters. The team also acknowledges "significant...successes" in a few areas described generally as "trade policy," and it would be helpful to have more information about these, too.

More specifically, we ask that the team's final report provide more information about the following:

- "Significant progress in trade policy has always been achieved at the expense of trade promotion." (p. 11) To fully understand the IG team's recommendations here, it would be very helpful for us to have the OIG's definition of "policy." As we noted in our debriefing meeting with the IG team, US&FCS sees policy/promotion as a continuum, not a dichotomy. We believe that both are important components of our efforts to help U.S. exporters. The appropriate "mix" of trade policy and traditional trade promotion activities will vary with industry sector in Japan. For example, in the pharmaceutical sector, market access issues are still the major concern of U.S. companies. But in the consumer goods sector, where there are few market access issues, U.S. companies are primarily interested in finding agents and distributors, advertising their product effectively, participating in the "right" trade exhibit and so forth. We rely on our SCO and his highly experienced staff to know Japan's markets and to recognize the mix of policy and promotion activities which would be most helpful to U.S. exporters.

- "Lack of communication and low morale among the staff has resulted in the FCOs and...FSNs not working together effectively in a team environment." (p. 6) We realize that some IG team conversations with officers and FSNs may be confidential, but we would nevertheless appreciate additional guidance on what, exactly, the team felt was wrong with morale in Japan and how this affected job performance.

- "...the management from US&FCS senior management showed little interest in Japan. Furthermore, the management from US&FCS' Office of International Operations has not provided needed direction, and, in the last few years, has paid only one, one-day visit to Japan." Again, if we are to address management problems, it would help to have specific examples of ways US&FCS has failed to provide needed direction. (Minor correction: in early FY 1997, recognizing the importance of the Japan mission, the current Regional Director visited our Japan posts [her very first official visit to the EAP region] to hold consultations with the SCO and with the Osaka and Nagoya PCOs. During the trip, the RD was able to spend time at the Embassy and Trade Center in Tokyo and at our office in Nagoya.)

- "...various industry sectors within Trade Development have shown little interest in working with US&FCS Japan in exploring opportunities. Moreover, there has been insufficient continuity of client servicing between US&FCS Japan and the domestic offices." (p.10) Many US&FCS posts report uneven support from TD and domestic offices (i.e., some are very responsive and others are not). Therefore, to help ITA address this issue, it would be helpful to have more information.

Additional Information/Perspectives We Ask the Team to Consider:

We have noted below a few factual errors that we would like to have corrected. We would also like to respond to a number of points raised in the draft, and express our concern about selected preliminary findings and recommendations. These relate, inter alia, to "trade promotion," resource allocation, performance measurement, the USTTA office, Kerry funds, administration and finance, automation, and the U.S. Trade Center.

TRADE PROMOTION

1. As we noted in the first section, US&FCS views trade promotion and policy as a contiuum -- with USG trade policy initiatives serving as one additional way to help US companies in the Japanese market.

President Clinton and Prime Minister Hashimoto announced a four sector "Enhanced Deregulation Initiative" in November, 1997. Most of our trade promotion efforts fall within those designated sectors: housing, health care, automotive and telecommunications. We seek trade promotion opportunities outside of sensitive policy areas as well. However, there are already excellent trade shows in industries unrestricted by trade barriers. We often advise NTM and NTE exporters that their best option is to enter a pre-existing show. We support US companies at these events. We can not -- should not -- compete with well-organized private shows.

2. On page 7, the IG states that "we believe an FTE in a relatively closed market, such as Japan, could be utilized more effectively in other Asian countries."

As the report states, Japan comprises approximately 75 percent of Asia's total GDP. Yet US&FCS Japan receives less than 20% of the East Asia Pacific region's FTE and less than 30% of the budget. Japan (2 percent of the world's population) has 40 percent of total world savings. Moreover, Japanese companies utilize their domestic market as a "profit sanctuary" to "dump" products elsewhere in Asia and in the United States. As a result, our trade deficit with Japan makes up almost 50 percent of our total international trade imbalance, and is growing rapidly. If Japanese invested companies in Asia are included, Japan makes up for as much as 75 percent of America's multilateral trade deficit. American companies have immense strategic interests in Japan. House Speaker Gingrich summarized this situation concisely when he said that, "Japan is the most intelligent protectionist country in the world." US&FCS believes that increasing U.S. exports to Japan is an important way to mitigate destablizing influence on world trade.

US&FCS is currently reviewing FTE at all of its overseas posts. We will be considering these and other issues during the review process. Whether or not FTE could be used more effectively in other Asia countries will also be examined.

3. On page 9, the IG states that "US&FCS focuses more on counseling OTM firms than NTE and NTM firms."

Page 13 states that "we question each post spending at least half of its time on OTM and local country firms."

US&FCS agrees that we need more NTM clients and have been vigorously implementing programs to try to increase the number. We note, however, that many expert observers advise that difficult markets, like Japan, are not the appropriate place for the new-to-export to begin.

Moreover, we believe the IG report does not adequately recognize that Japan is characterized by highly protectionist administrative barriers that require US&FCS Japan to "go to bat" for OTM clients across a whole spectrum of industries. Most of the "host country firms" that we counsel are in fact agents for American manufacturers.

In US&FCS Japan's view: "We need constant feedback from invested American companies. We need to staunchly support those companies as they battle for an equal opportunity to make a sale. We need to be constantly vigilant to expose Japanese bureaucratic regulators who interpret vague rules to remove competition from American exports. We need to use the full weight of the U.S. government to fight for our OTM exporters. If US&FCS Japan is not fighting in the trenches for a 'level playing field' in Japan, who will?"

We believe that US&FCS Japan assists NTM and NTE exporters as well as OTM firms by identifying and fighting protectionist barriers to imports.

PERFORMANCE MEASUREMENT

> Page 15 states that "we question the value of sales as a measurement of performance because in not all cases does the service provided by US&FCS account for sales being made."

We agree with this statement. US&FCS Japan reports numerous non-sale based success stories. At the same time, we would note that most companies evaluate their success or failure on the basis of sales. US&FCS Japan has been scrupulous in maintaining strict criteria for its submitted success stories, whether dollar denominated or otherwise.

Nonetheless, the IG team's point is valid. We suggest that a more nuanced discussion is required that goes beyond the scope of this report. The issue of performance measurement is perhaps the single most important issue facing US&FCS on a worldwide basis.

USTTA OFFICE CLOSING

> USTTA documentation (p ii, p 21)

The IG team conclusions are based on the inaccurate assumption that US&FCS Japan had any control over the closure process. US&FCS Japan never had possession, control or authority over USTTA assets. From beginning to end, their disposition was under the control and supervision of the State Department's GSO, working directly with the Washington-based Closure Task Force. Therefore, any questions on the process will need to be fielded by our colleagues in the State Department.

THE "KERRY FUNDS" (p 25)

IG team conclusions here, too, are based on inaccurate assumptions. According to US&FCS Japan, the IG team did not ask to review US&FCS Tokyo's documentation on the Kerry Fund and its use. Had they seen the documents, they would have found that every disbursement from Kerry Funds is fully documented and in accordance with instructions from Washington. Moreover, the IG report failed to note that Kerry funds enabled us to expand our reporting on the Kobe Earthquake, open the Virtual Trade Center, create a popular home page on U.S./Japan trade and start new programs in housing, government procurement, safety and security and oil spill response -- all of which meet the Senator's objective of greater visibility and outreach to the U.S. business community. The team's comments on the Kerry Fund are inaccurate, and Post has forwarded copies of the documents that the IG did not request when the team was in Japan. All are available to team members at US&FCS headquarters if they wish to review.

ADMINISTRATION

Redundant administrative and financial structure --(p 17)

The IG team reviewed US&FCS Japan's administrative structure in a time of transition. It is presently being unified under the direction of the Commercial Counselor and American Secretary. Nonetheless, we do not understand the team's suggestion of redundant accounting. The IG seems not to be acknowledging the difference between O&A and event funding processes, systems, and procedures. It is imperative that the two remain separate. US&FCS Japan does have two fully employed staff responsible for the respective accounts. Both of these individuals are extremely busy with their own portfolios and do not engage in redundant administrative activities.

UNFUNDED LIABILITY

Unfunded personnel liability for ICASS -- (p 19)

The report states that US&FCS Japan has not raised this matter with the State Department. In fact, the issue has been discussed repeatedly at post, and most recently by the ICASS Council. However, the issue involved ultimately must be decided in Washington and is not resolvable at post. It is being addressed by ITA's Office of Financial Management. It is not a US&FCS Japan operational matter.

AUTOMATION

Lotus Notes -- (page 20)

The IG team neglects to note that utilization of Lotus Notes is dependent on the upgrade of equipment and software currently being scheduled at headquarters. Post is prepared to begin full utilization of the software as soon as available.

THE TRADE CENTER

1. Page ii, Para 4: ***To compound the trade promotion inadequacies, the U.S. Trade Center is not integrated into the overall promotional efforts of US&FCS Japan, and it is not viewed as an effective promotional vehicle. In addition, the large financial subsidy provided by the Government of Japan may be influencing U.S. trade promotion efforts.***

Despite the generalizations above, we believe the U.S. Trade Center *is* viewed as effective by those who use it: U.S. companies exhibiting as private shows or in one of our events. The exhibitor evaluations generated from events at the USTC are consistently and overwhelmingly positive. Trade Center events are productive for our clients as well, yielding more than 50,600 sales leads *as reported by exhibitors* in 37 events since FY 1996. The USTC is the birthplace of many documented success stories. Further, the steady stream of U.S. companies using the Center for individual, Business-sponsored Promotions (BSPs) attests to its "effectiveness" as a promotional "vehicle."

The IG Team noted that the U.S. Trade Center received a financial subsidy from MIPRO, an organization related to JETRO, in turn part of MITI, a Ministry of the GOJ. The IG Team did not try to determine whether this relationship affected US&FCS Japan's trade promotion program. The suggestion that it "may be influencing U.S. trade promotion efforts" is pure conjecture. The Recommendations section of the report tacitly admits this point by suggesting US&FCS Japan investigate this possibility in the future.

2. Page 5, Para 2: ***In addition, US&FCS holds anywhere from 10 to 12 trade events annually at the Center.***

These numbers are not accurate, and overlook entirely that one of the Center's important functions is as a platform for promotional events by individual U.S. companies. It seems possible that the Team counted only one type of event: SFO or Solo Fairs Organized Overseas. A summary of the events involving the Trade Center by category and fiscal year appears below.

Total Number of Events by Type, FY1996-1998 to date				
	FY1996	FY1997	FY1998 to date	**Total**
SFO	9	9	9	**27**
SFW	2	2	1	**5**
TFW	2	1	1	**4**
TFO		1	1	**2**
CERT	3	3	1	**7**
SEM	1	2	3	**6**
CTM	3	1		**4**
TM		3		**3**
BIO	1	1		**2**
BFC	2	1		**3**
RC	1			**1**
PLC		1		**1**
BSP	42	31	11	**84**
Total	**66**	**56**	**27**	
Total at USTC	59	50	26	135

In a few cases, such as a TFW (Trade Fair, Washington recruited) like JapanTex, the events took place outside of the U.S. Trade Center, but relied heavily upon the work of Trade Center staff. These events would not have been possible "but for" the existence and work of the Center. However, even the most conservative counting (the sum of BSPs, Trade Missions, Seminars and Solo Fairs; i.e., events that take place in the facility) exceeds the IG Team figures by a factor of three or four.

3. Page 12, Para 4: ***USFCS focuses more on counseling OTM firms than NTE and NTM firms.***

In recruiting exhibitors in USTC trade events we have made significant efforts to identify and encourage "new-to-market" firms, with some notable success. However, we should recognize that "new to market" companies become "old to market" by following our advice to secure a distributor or local representation in this market. The U.S. exporters prefer that we work with their representatives directly. Calling them "local country firms" obscures the fact that these are American companies' representatives.

4. Page 13, Paragraph 2: ***On average, USFCS holds about 10 to 12 events annually at the Center.***

Incorrect. This number is closer to 50 events per year. See Number 2 above.

5. Page 14, Para 1: ***Once the schedule is approved, MIPRO does not allow any changes or flexibility in which events receive subsidies.***

This is not correct. MIPRO *does* allow changes to the events it subsidizes, and has proven flexible in its support. Most recently we have reallocated money from environmental and medical related shows to building materials and apparel, with MIPRO's agreement.

6. Page 14, Para 3: ***In planning its event schedule, USFCS Japan attempts to select events that have potential for MIPRO approval.***

Not correct. In reality, we conceive and organize events based on our view of Japanese market demand (Emergency Preparedness, Food Safety Technology, US Housing), future demand (ITS, xDSL), and in support of USG policy priorities (Electronic Commerce, Semiconductor). At the same time, we evaluate the interest of U.S. companies in reaching this market through a trade exhibition or other vehicle. Both of these factors are of far greater importance than MIPRO agreement, though by our method we have developed new events that MIPRO has been pleased to support.

We have held successful trade promotions without the financial support of MIPRO; we have never held a successful event without visitors (demand) or exhibitors.

7. Lack of management support for the Trade Center -- (p 13, para 3)

It is inaccurate to state that US&FCS management has not supported the USTC. Over the last two years, US&FCS Japan management has given the Trade Center Director an American Junior Officer, a PSC employee, and authority to start the Virtual Trade Center. In addition, management has repeatedly and consistently encouraged all US&FCS Japan employees to use the Trade Center whenever possible. While the long-term viability of the TC may be a real issue, lack of support from management is not. We agree that a study should be made on the long-term viability of the TC facility, as the new on-line Virtual Trade Center is developed.