OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID'S INTERNAL CONTROLS OVER PREPOSITIONED FOOD ASSISTANCE FOR THE HORN OF AFRICA

AUDIT REPORT NO. 4-962-13-004-P
JANUARY 7, 2013

PRETORIA, SOUTH AFRICA

Office of Inspector General

January 7, 2013

MEMORANDUM

TO: USAID/DCHA/FFP Director, Dina Esposito
USAID/M/OAA/T Director, Denise Scherl

FROM: Regional Inspector General/Pretoria, Robert W. Mason /s/

SUBJECT: Audit of USAID's Internal Controls Over Prepositioned Food Assistance for the Horn of Africa (Report No. 4-962-13-004-P)

This memorandum transmits our final report on the subject audit. We have considered carefully your comments on the draft report and have included them in their entirety (without attachments) in Appendix II.

The report includes four recommendations to strengthen USAID's internal controls over prepositioned food assistance for the Horn of Africa. We acknowledge that a management decision has been reached on Recommendation 4 and that final action has been taken. In accordance with Automated Directives System (ADS) 595.3.1.1.e, a management decision on Recommendation 1 cannot be acknowledged until an estimated target date for final action is specified. Furthermore, in accordance with ADS 595.3.1.2.c, management decisions cannot be acknowledged for Recommendations 2 and 3 until indications of agreement or disagreement, detailed corrective actions, and target completion dates for actions are provided. Please have the responsible official give us written notice within 30 days on actions planned or taken regarding Recommendations 1, 2, and 3. Recommendation 4 is closed upon report issuance.

I want to express my sincere appreciation for the cooperation and courtesy extended to my staff during the audit.

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Abbreviations

The following abbreviations appear in this report:

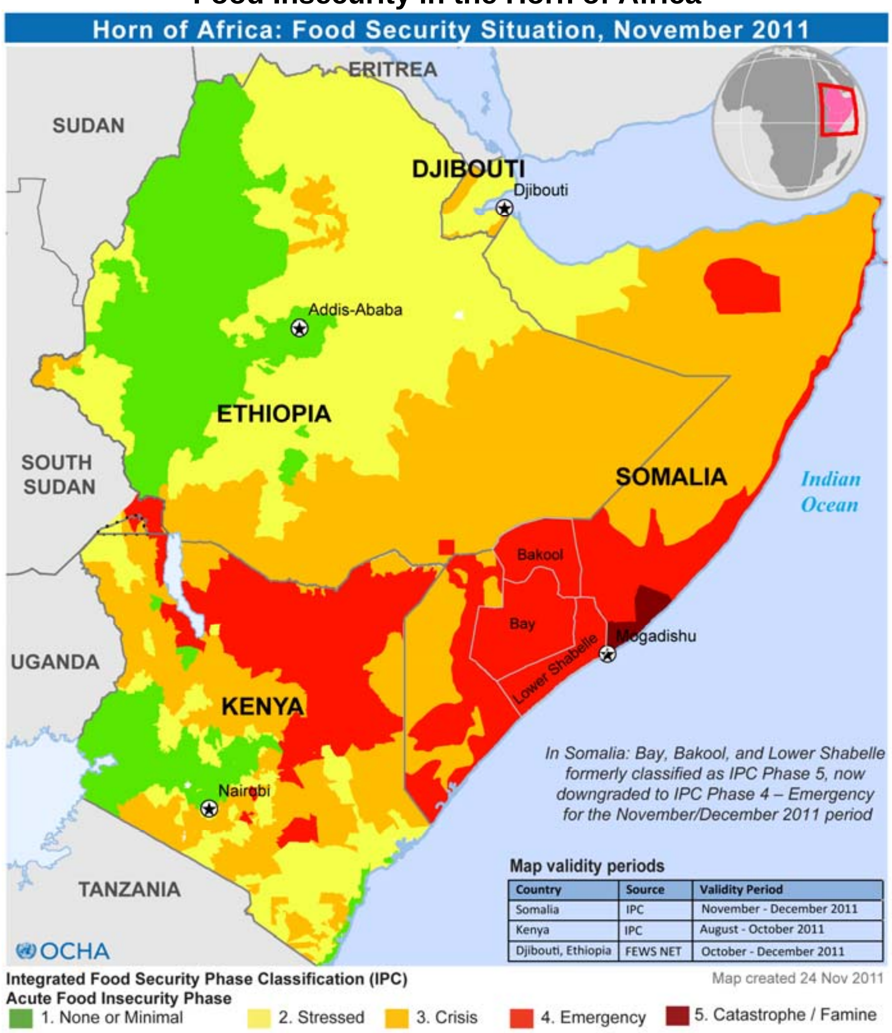
ADS	Automated Directives System
GAO	Government Accountability Office
FFP	Office of Food for Peace
FY	fiscal year
NMT	net metric ton
RIG	Regional Inspector General
WFP	United Nations World Food Programme

SUMMARY OF RESULTS

USAID's Office of Food for Peace (FFP) in the Bureau for Democracy, Conflict and Humanitarian Assistance administers food aid programs as described in the Food for Peace Act (Public Law 480). These programs provide U.S. agricultural commodities for emergency relief and development and are essential in the Horn of Africa (Djbouti, Somalia, Ethiopia, and Kenya) where famine and malnourishment are widespread and difficult to predict largely because of political instability and drought.

Political instability in Somalia is increased by al-Shabaab, a terrorist group active in southern and central Somalia since 2006. The ongoing insurgency has forced many Somalis to seek refuge in other parts of the country and in Kenya and Ethiopia. Compounding this problem, the Horn had its worst drought in years in 2011. The map below shows the resulting food shortages.

Food Insecurity in the Horn of Africa



Source: United Nations Development Programme.

According to the United Nations World Food Programme (WFP), 4.5 million people in Ethiopia needed emergency food assistance after the 2011 drought. An October 2011 USAID report noted that 3.3 million people in Somalia needed life-saving assistance, with 750,000 of those at risk of imminent starvation. The drought also affected northern and eastern Kenya, which also was grappling with the growing number of Somali refugees. Furthermore, in Djibouti USAID donated food to benefit 70,000 rural residents during the 2012 dry season.

To respond swiftly to crises like these, USAID implemented the prepositioning warehouses program. According to a cost-benefit analysis FFP did in 2008,[1] the program's strategy is to store commodities (such as lentils, yellow split peas, and vegetable oil) in designated warehouses for future use to "eliminate the time it takes to procure and transport the commodities to U.S. port for shipment." In doing so, USAID can cut months off the response time. The Office of Acquisition and Assistance's Transportation Division oversees operations, including managing the contracts and tracking the shipments in and out as well as the stock available in each warehouse. FFP makes decisions about the type and quantity of food, or commodity, to store in each prepositioning warehouse.

The volume of prepositioned food in FFP's emergency response program has grown. According to the Government Accountability Office (GAO), only about 3 percent of FFP commodities were prepositioned in 2005 and 2006.[2] However, recent information from FFP showed that almost 29 percent of food assistance provided in the Horn of Africa was shipped from prepositioning warehouses in fiscal year (FY) 2011. As shown in Table 1, almost 89 percent went through warehouses in Djibouti, Djibouti; Durban, South Africa; and Mombasa, Kenya.[3]

Table 1. Summary of Prepositioned Food Assistance Delivered to Horn of Africa in FY 2011 (Amounts Unaudited)

Prepositioning Warehouse Locations	Metric Tons	Amount ($ million)	Percent of Total Value of Prepositioned Food Assistance
Djibouti	63,710	71.12	57.28
Durban	32,280	31.45	25.33
Jacinto	8,960	12.28	9.89
Mombasa	6,710	7.48	6.02
Lomé	1,260	1.84	1.48
Total[†]	**112,920**	**124.17**	**100.00**
Total dollar value of FFP commodities delivered to the Horn of Africa in FY 2011 ($ million)			**435**
Prepositioning assistance as a percentage of total FFP commodities delivered to the Horn of Africa in FY 2011			**28.5**

[†] None of the food in warehouses in Las Palmas and Colombo was shipped to the Horn of Africa in FY 2011, and the warehouse in Lomé, Togo, was no longer in operation at the time of audit fieldwork.

[1] Janet R. Vandervaart, *Public Law 480 Title II Prepositioning Cost/Benefit Analysis*, January 2008.
[2] GAO, *Foreign Assistance: Various Challenges Impede the Efficiency and Effectiveness of U.S. Food Aid* (GAO-07-560), April 2007.
[3] At the time of audit fieldwork, FFP also prepositioned food in Houston, Texas; Las Palmas, Canary Islands; and Colombo, Sri Lanka.

From the prepositioning warehouses, food is delivered to cooperating sponsors. Cooperating sponsors reviewed in this audit, WFP and Catholic Relief Services, work with USAID to transport the food to their own regional warehouses and distribute it to beneficiaries on USAID's behalf.

The Regional Inspector General/Pretoria (RIG/Pretoria) conducted this audit to determine to what extent USAID has implemented internal controls to help provide reasonable assurance of the timely delivery of its prepositioned food assistance to intended beneficiaries in the Horn of Africa.

After reviewing shipments to the Horn of Africa in 2011 and visiting warehouses in Djibouti, Durban, and Mombasa, the audit determined that USAID does have internal controls in place to provide reasonable assurance of timely delivery of food commodities to intended beneficiaries in the Horn of Africa. A review of program records showed that cooperating sponsors were receiving prepositioned emergency food generally as scheduled. Also, visits to the prepositioning warehouses showed that in most cases the food had been kept safe and delivered as intended.

However, the audit identified some areas for improvement in this program.

- USAID did not determine whether the benefits of prepositioning overseas outweigh costs (page 5). To reduce delivery times for food shipments, more have been prepositioned overseas. Despite this effort, some food prepositioned in the United States reached the Horn sooner than food prepositioned overseas. USAID lacked comprehensive analysis showing that prepositioning commodities overseas resulted in timelier delivery than domestically, although a 2008 cost-benefit analysis found prepositioning commodities overseas was about seven times more expensive than doing so in the United States.

- Warehouse inventory records were not monitored closely (page 6). A comparison of inventory record amounts could not be reconciled within an acceptable percentage threshold. Auditors found discrepancies in inventory records resulting from a number of factors, including incomplete records and survey reports conducted by an independent contractor hired to monitor warehouse activities.

- USAID did not hold warehouse contractors responsible for poor storage conditions (page 7). During site visits, auditors saw that some commodities were at risk because of poor storage conditions, including improper stacking and handling of damaged commodities.

To address these problems, this report recommends that FFP:

1. Conduct and document an independent evaluation to quantify the differences in cost and timeliness between overseas and domestic prepositioning, and adjust the use of overseas prepositioning appropriately (page 6).

In addition, the report recommends that the Office of Acquisition and Assistance's Transportation Division:

2. Implement a system of internal controls to reconcile its records regularly with reports from warehouses and outgoing shipment reports to identify and resolve any differences in a timely manner (page 7).

3. Implement a system of internal controls to monitor and track losses more closely at warehouses, including procedures for recovering losses from warehouse contractors (page 9).

4. Remind warehouse contractors in writing of their responsibility for lost commodities in their possession and their obligations to store commodities in accordance with USAID's *Commodities Reference Guide* (page 9).

Detailed findings appear in the following section, and the scope and methodology appear in Appendix I. Management comments are in Appendix II, and our evaluation of them is on page 10.

AUDIT FINDINGS

USAID Did Not Determine Whether Benefits of Prepositioning Overseas Outweigh Costs

According to Office of Management and Budget Circular A-123,[4] "The proper stewardship of Federal resources is an essential responsibility of agency managers and staff. Federal employees must ensure that . . . Federal resources are used efficiently and effectively to achieve desired objectives."

The purpose of prepositioning food is to improve the response time for emergency aid. Traditionally, USAID procures food only after a need is identified, which results in food taking 4 to 6 months to arrive in country. In 2008 USAID commissioned a cost-benefit analysis of the U.S. Government's food prepositioning activities in response to a GAO audit. While this report did not compare the timeliness of domestic and overseas prepositioning, it recommended that USAID consider increasing the amount of domestic prepositioned stockpiles because the Agency needed to maintain a large, diverse inventory to be able to respond to every possible scenario. In subsequent communication, the report's author said she anticipated that a large domestic stockpile would supplement overseas stock.

According to the report, prepositioning food domestically added $23 per metric ton to the cost of traditional food assistance, while prepositioning food overseas added $164 per metric ton. "The overseas pre-positioning premium is higher due to the need for two ocean freight movements of the commodities positioned in the overseas stock," it explained, "first from U.S. port to the overseas stock location, and then from stock location to designated discharge port."

Despite the recommendation to increase domestic stockpiles, on September 30, 2010, USAID awarded contracts for five overseas prepositioning warehouses without increasing the number of domestic ones. Further, although USAID paid a premium to preposition food overseas, it was unable to demonstrate objectively that doing so overseas rather than domestically improved the timeliness of food assistance deliveries.

USAID officials said prepositioned commodities, whether overseas or domestic, could respond to emergency food needs 2 to 3 months faster than standard food aid deliveries. Additionally, one official said the decision to increase prepositioning overseas rather than domestically "was based on the idea that prepositioning food as close to the anticipated recipient countries as possible would have the biggest impact on expediting delivery of emergency food assistance."

However, the overseas shipping time is only a fraction of the total time that it takes to transport goods from the prepositioning warehouse to the recipient countries. For example, when WFP in Somalia asked for food aid in April 2011, a shipment from Houston arrived in the Horn of Africa 3 weeks before a shipment from Durban because of delays stemming from making arrangements to get a ship from Durban.

[4] "Management's Responsibility for Internal Control," December 2004.

USAID officials never conducted a comprehensive study of the timeliness of overseas shipments to determine when to preposition food overseas. They did not do this because they deemed their monitoring of individual shipments sufficient to evaluate timeliness. Furthermore, the program's objective is to provide food aid rapidly during emergencies, and that often comes at a premium.

Nevertheless, USAID should be able to show that the additional cost of prepositioning food aid overseas improves the timeliness of food assistance deliveries compared with prepositioning food aid domestically. For example, 12,620 metric tons of food were shipped through the Durban prepositioning warehouse to the WFP program in Somalia in 2011. This audit did not calculate the premium paid for overseas prepositioning, but based on the premium calculated in the 2008 cost-benefit analysis, these shipments could have cost USAID $1.8 million more than if they had been prepositioned in Houston, Texas. USAID incurred these costs without reasonable assurance that the Durban routing was faster.

The program's lack of comprehensive analysis showing that prepositioning commodities overseas leads to faster deliveries than doing so domestically contradicts the Agency's responsibility to use government resources efficiently and effectively. As such, the audit makes the following recommendation.

> ***Recommendation 1.*** *We recommend that USAID's Bureau for Democracy, Conflict, and Humanitarian Assistance, Office of Food for Peace, conduct and document an independent evaluation to quantify the differences in cost and timeliness between overseas and domestic prepositioning, and adjust the use of overseas prepositioning appropriately.*

Warehouse Inventory Records Were Not Monitored Closely

According to Automated Directives System (ADS) 202.3.6.1, "Assessing Performance of Contractors and Recipients," a contracting officer's representative "must ensure that the implementing partner is performing in accordance with the terms contained in the contract." Additionally, GAO's *Standards for Internal Control in the Federal Government* defines internal controls as integral components of an organization's management to confirm that operations are effective and efficient. Periodic reconciliations are one internal control that can be used to enhance the effectiveness and efficiency of operations.

USAID's system for tracking compliance with terms stipulated in warehousing contracts was weak. The contracts for operating the prepositioning warehouses state that a loss rate of 0.02 percent is considered poor performance. However, the audit found that the incoming and outgoing net metric tons (NMT) of food at the Djibouti warehouse could not be reconciled within 0.5 percent, as shown in Table 2 on the next page. This is 25 times more than the 0.02 percent threshold established in the contract. Nevertheless, auditors did not identify any instances of theft or fraud related to food commodities.

Table 2. Summary of Djibouti Warehouse Inventory Reconciliation for 2011 (Audited)

Commodity	Total Shipped (USAID Records, NMT)	Ending Inventory (USAID Records, NMT)	Ending Inventory (Warehouse Records, NMT)	Difference (NMT)	Difference (%)
Corn-Soy Blend	22,337.70	1,497.39	1,521.81	(24.42)	-0.1
Yellow Split Peas	9,877.76	632.69	583.60	49.09	0.5
Vegetable Oil	14,241.34	5,395.89	5,660.79	(264.90)	-1.9
Total	**46,456.80**	**7,525.97**	**7,766.20**	**(240.23)**	**-0.5**

The prepositioning warehouse program has a complex supply chain with multiple sets of data and inventory records. Although USAID hired and relies on an independent contractor to monitor warehouse operations and inventories, the program does not have an adequate system in place to reconcile these records and consistently identify and resolve discrepancies. Records are produced by USAID, warehouse contractors, inventory surveyors, and program recipients located in the Horn of Africa and around the world.

Discrepancies can be caused by differences between the quantity of a commodity booked for shipment by USAID and the quantity the warehouse received. This can happen when the amount scheduled to be shipped is reduced because of limited space aboard the vessel on the day of shipment. Differences can also result from a series of small commodity losses that are not reported to or accounted for by USAID.

According to a USAID official who managed shipments, “A more robust system to track compliance with contract terms could add greater transparency and potentially more efficiency to the overall prepositioning system.” Reconciliations throughout the supply chain would improve the reliability of the system and allow USAID to evaluate the performance of the warehouse contractors accurately. In addition, information about losses could help the Agency manage the warehouses more efficiently and effectively.

The cost-benefit analysis noted $235,919 in losses at the overseas prepositioning warehouses in 2007. With this information, USAID was able to modify its policies, which decreased the amount of spoiled goods in the warehouses. However, USAID did not track losses in 2011 like it did in 2007, and this precluded any policy changes that could have improved efficiency and effectiveness. Therefore, we make the following recommendation.

> ***Recommendation 2.*** *We recommend that USAID’s Office of Acquisition and Assistance’s Transportation Division implement a system of internal controls to reconcile its records regularly with reports from warehouses and outgoing shipment reports to identify and resolve any differences in a timely manner.*

USAID Did Not Hold Warehouse Contractors Responsible for Poor Storage Conditions

The USAID *Commodities Reference Guide* provides guidance on storing and handling commodities distributed under FFP programs. It states that damaged food must be removed and then tested to determine whether it can be salvaged. If the food is unfit for human consumption, it must be destroyed.

However, auditors noticed that this guidance was not followed consistently. For example:

- In the Djibouti warehouse, damaged containers of vegetable oil could have been caused by being stacked improperly. Uneven stacks of oil looked like they were about to fall, creating a safety hazard. This practice also created difficulties for warehouse staff members and surveyors who were unable to count how many containers were in each stack.

- In Durban, damaged commodities that are not prepositioned normally arrived unexpectedly at the warehouse. Staff members could not determine where they came from or what they had to do with USAID. As a result, USAID could not authorize their disposal without properly identifying the commodities first.

- Also in Durban, commodities infested by ants and tobacco beetles were not fumigated, and they put undamaged commodities at risk. Although USAID had already requested that the damaged commodities be tested to determine whether they were still fit for human consumption, they were not well organized or marked for disposal or reuse.

Damaged commodities, left, in the Durban warehouse are not marked for disposal or reuse. Bug-infested commodities, right, are stored near undamaged ones. (Photos by RIG/Pretoria, May 2012)

Poor storage practices can damage commodities and increase costs. For example, even if damaged commodities are reused, the extra testing and handling could delay shipments and drive up costs for USAID. The system used by the Office of Acquisition and Assistance's Transportation Division does not include losses that occur in the warehouse. Although damage to commodities generally occurs during transport, loading, and unloading, warehouse contractors sometimes move commodities within the warehouse between shipments that can be damaged because of poor stacking. For example, we observed commodities that were stacked on broken pallets and others that had fallen or whose bags were ripped because of poor stacking. However, these losses could not be quantified because neither USAID nor the warehouse contractors tracked them. Although the warehouse contracts specify that these costs should be the responsibility of the warehouse contractor, USAID paid them during the audit period because the contractors did not report any losses.

Warehouse staff members did not follow USAID's guidance on commodities because their internal procedures were unclear or not adhered to, and USAID's attempts to monitor warehouse conditions were not effective. The Agency contracted with an independent surveyor to monitor the conditions at each warehouse, but this was not effective at addressing all commodity storage problems as shown by the photos on the previous page. In addition, USAID sent its own staff to monitor the conditions, but because there were no FFP staff in Djibouti and no USAID staff in Durban or Mombasa, these visits were costly and time-consuming, which limited their frequency and, therefore, their effectiveness.

USAID paid the costs that resulted from poor storage conditions because it did not have a system to identify loss of inventory or hold the warehouse contractors accountable for any losses identified. The Agency could not identify losses because it was unable to rely on inventory records for the Djibouti warehouse, as discussed above. In addition, USAID did not always confirm that the independent party counted all outgoing shipments, which would be necessary for verifying any inventory losses at the warehouse.

USAID has changed its policy already and now requires an independent party to verify all outgoing shipments; that entity should have the records needed to monitor losses within the warehouse. Therefore, we make the following recommendations to support USAID efforts to hold warehouse contractors responsible for losses caused by poor management.

> ***Recommendation 3.*** *We recommend that USAID's Office of Acquisition and Assistance's Transportation Division implement a system of internal controls to monitor and track losses more closely at warehouses, including procedures for recovering losses from warehouse contractors.*

> ***Recommendation 4.*** *We recommend USAID's Office of Acquisition and Assistance's Transportation Division remind warehouse contractors in writing of their responsibility for lost commodities in their possession and their obligations to store commodities in accordance with USAID's* Commodities Reference Guide*.*

EVALUATION OF MANAGEMENT COMMENTS

USAID's FFP and Office of Acquisition and Assistance/Transportation Division (hereafter referred to as "management") prepared a joint response to the draft audit report. In their response, management agreed with Recommendation 1 and noted Recommendations 2, 3, and 4. As discussed in detail below, we acknowledge that a management decision has been reached on Recommendation 4, but do not acknowledge that management decisions have been on Recommendations 1, 2, and 3. In addition, final action has been taken on Recommendation 4.

We disagree with management's assertion that the commodities shown in the photographs on page eight of the report were "never purchased or stored in the USAID preposition warehouses." The two photographs were taken by auditors in the Durban USAID prepositioning warehouse in May 2012. In fact, one of the photos is a magnified version of a photo suggested by management. Commodities were labeled clearly with USAID branding and marking.

Also, management states that the potential savings of $1.8 million mentioned on page six for shipping to Somalia from Houston rather than Durban does not include additional charges for freight and storage. However, these items were included as part of the 2008 cost-benefit analysis, which was used as the basis for these calculations.

Recommendation 1. Management agreed with the recommendation and stated that it will begin reviewing data to improve current data collection and analysis of prepositioning activities. The review of the data collection process should inform the scope of work and purpose of an external evaluation. However, in subsequent correspondence, management was unable to set a target date for conducting this evaluation because implementation could be impacted by uncertainties regarding future funding and that authority to conduct such an evaluation expired on September 30, 2012. Therefore, in accordance with ADS 595.3.1.1.e, Recommendation 1 remains without a management decision pending establishment of a target date for completion of planned actions.

Recommendation 2. Management noted the recommendation. However, for a management decision to be acknowledged, ADS 595.3.1.2.c (1) requires that the audit action officer indicate agreement or disagreement with the recommendation. This did not occur for Recommendation 2. Consequently, no management decision was made for this recommendation.

Despite the development of improved inventory systems in conjunction with the Djibouti warehouse vendor, which appears responsive to the recommendation, management's emphasis on the Agency's "current reconciliation process" in its request for closure indicates ambiguity regarding its agreement or disagreement with the recommendation. In fact, it was this process—in which the ending inventories at the Djibouti warehouse per USAID and contractor records were not reconciled within contract specifications—that resulted in the recommendation. Moreover, although USAID provided a 2011 inventory reconciliation for the Djibouti warehouse near the end of the audit, auditors did not see evidence of reconciliations being performed monthly. Thus, it is unclear whether management's comments about the current process reflect new procedures instituted in response to deficiencies identified in the audit or its belief that the procedures in place during audit fieldwork were adequate.

Recommendation 3. Management noted the recommendation. ADS 595.3.1.2.c (1) requires that the audit action officer indicate agreement or disagreement with the recommendation, which did not occur. Consequently, no management decision was made for Recommendation 3.

In our opinion, management's comments do not reflect the intent of this recommendation. The claims process described in Phases 1 and 2 does not demonstrate clearly how losses that occur within the warehouse are identified and recovered.

Recommendation 4. Although management did not state whether it agreed or disagreed with this recommendation, it described actions that were taken to implement it. Unlike Recommendations 2 and 3, these actions are sufficient to indicate agreement.

On November 7, 2012, the contracting officer reminded all warehouse contractors of their responsibility for lost commodities in their possession and their obligations to store commodities in accordance with USAID's *Commodities Reference Guide*. Therefore, based on management's comments and supporting documentation provided, we acknowledge that a management decision has been reached, and final action taken on Recommendation 4.

SCOPE AND METHODOLOGY

Scope

RIG/Pretoria conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with our audit objective. We believe that the evidence obtained provides that reasonable basis.

The objective of the audit was to determine to what extent USAID had implemented internal controls to help provide reasonable assurance of the timely delivery of its prepositioned food assistance to intended beneficiaries in the Horn of Africa. We conducted audit fieldwork from May 11 to August 6, 2012.

According to USAID, the Agency delivered food aid worth $435 million to the Horn of Africa in calendar year 2011. Of this amount, food worth about $124 million was prepositioned in warehouses worldwide. Warehouses in Djibouti, Mombasa, and Durban handled the majority of the food, with total shipments of $110 million. Of this amount, we judgmentally tested warehouse records to analyze and reconcile inventory amounts. We focused our audit on activities resulting from the recent expansion of the prepositioning warehouse program, which had grown from 3 percent of total FFP food aid delivered in FY 2006 to 28.5 percent in FY 2011. We limited our scope to the three warehouses mentioned above because they housed almost 89 percent of the food prepositioned in 2011 and were located closest to program beneficiaries.

In planning and performing the audit, we communicated with GAO staff members who had worked on similar audits to avoid duplicating efforts. We also obtained an understanding of and assessed the following internal controls: the program's management structure, internal controls, inventory reconciliation processes and reviews, contracting mechanisms, and monitoring and evaluation and site visit processes. This included a review of contracting officer's representative designations letters, survey reports from Intertek (the principal inventory surveyor), inventory records and supporting documents from warehouse contractors like bills of lading, and agreements issued from USAID/Washington. Audit procedures to review warehouse inventory records focused on activities in calendar year 2011.

We visited warehouses and ports in Djibouti, Mombasa, and Durban. At these sites, we also conducted meetings at the offices of the warehouse contractor, WFP, and Intertek. We met with key USAID and WFP staff members in Nairobi, Mombasa, Djibouti, and Addis Ababa, Ethiopia. We also conducted a significant portion of fieldwork with FFP staff and officials from the transportation division in Washington via teleconference and e-mail.

Methodology

To answer our audit objective, we focused fieldwork and site visits on evaluating USAID and cooperating sponsors' internal controls related to food commodity shipment through selected prepositioning warehouses.

First, we obtained USAID's lists of the incoming and outgoing warehouse shipments for 2011. We compared this information with warehouse contractor records for the same shipments. We then reconciled outgoing warehouse shipment records with receiving records from WFP and Catholic Relief Services. Next, we compared these records with Intertek's surveying reports for the movement of shipments under review. We conducted this review to reconcile data from multiple relevant parties to assess USAID's internal controls. We were unable to perform this review for all shipments to and from selected prepositioning warehouses in 2011 because USAID provided an incomplete list of outgoing shipments. Although we later received a complete list, we could not trace these shipments to WFP or Catholic Relief Services records because we had concluded our travel already. However, we did receive survey reports for each of these shipments from USAID officials.

We also reviewed FFP program strategic and performance documents, including a 2008 cost-benefit analysis for prepositioning activities. We used these documents to gain an understanding of the program's inception and the strategic decisions made to form these activities.

To conduct these procedures, we traveled to warehouses in Djibouti, Mombasa, and Durban to compare inventory records with food commodities on hand and to observe the conditions of those commodities and warehouses, as well as security. We spoke with warehouse and surveyor staff members and observed commodities being shipped to recipients. We judgmentally sampled inventory records at warehouses for incoming and outgoing shipments in calendar year 2011. Due to the judgmental selection of the sample, the results of this review could not be projected to the entire population of warehouse records.

The materiality threshold established in USAID agreements with warehouse contractors states that a food commodity redelivery rate—the quantity of food shipped out of the warehouse to recipients as a percentage of the quantity of food shipped in—of less than 99.98 percent during warehouse storage is considered poor performance. We applied this same threshold to the audit.

MANAGEMENT COMMENTS

November 9, 2012

MEMORANDUM

TO: Robert W. Mason, Regional Inspector General/Pretoria

FROM: Dina Esposito, Director, Office of Food for Peace /s/
Denise Scherl, Director, Office of Acquisitions and Assistance/Transportation Division

SUBJECT: Management Responses to RIG/Pretoria Draft Report on Audit of USAID's Internal Controls over Prepositioned Food Assistance for the Horn of Africa (Report No. 4-962-13-XXX-P), dated October 10, 2012

On October 10, 2012, the USAID Office of Food for Peace (FFP) and USAID/Management Bureau/Office of Acquisitions and Assistance/Transportation Division (M/OAA/T) in Washington, DC received the draft report on the subject audit containing four recommendations to strengthen USAID's internal controls over prepositioned food assistance for the Horn of Africa. The purpose of this memorandum is to clarify information contained in the draft report and describe the actions already taken by USAID for each of the four recommendations. In addition, FFP and M/OAA/T request that management decisions be issued for all four recommendations and that all recommendations be closed based on explanations provided in this memorandum and actions taken to date.

Overall, USAID appreciates the efforts undertaken by the auditors to strengthen the systems and procedures in place for prepositioned food assistance used by FFP food programs throughout the world to save lives and decrease suffering. USAID includes comments on select text of the draft report content as well as responses to each of the four recommendations below for your consideration in revising the final report content.

On page three, the report states:

> *The Regional Inspector General/Pretoria (RIG/Pretoria) conducted this audit to determine to what extent USAID has implemented internal controls to help provide reasonable assurance of the timely delivery of its prepositioned food assistance to intended beneficiaries in the Horn of Africa. After reviewing shipments to the Horn of Africa in 2011 and visiting warehouses in Djibouti, Durban, and Mombasa, the audit determined that USAID does have internal controls in place to provide reasonable assurance of timely delivery of food commodities to intended beneficiaries in the Horn of Africa.*

- USAID underscores that the auditors' review and analysis determined that USAID does have internal controls in place and has delivered food aid to the Horn of Africa in a timely and effective manner.

On page five, the report states:

> *For example, when the WFP program in Somalia requested food aid in April 2011 the shipment from Houston arrived in the Horn of Africa 3 weeks prior to the shipment from Durban because of delays arranging for a vessel from Durban.*

- USAID flags that this example is an isolated incident and is not representative of movements out of the preposition warehouse(s) supporting the program. It applied to only one shipment out of a total of eighteen shipments out of Durban PREPO warehouse that occurred in FY 2011.

On page six, the report states:

> *For example, 12,620 metric tons of food were shipped through the Durban prepositioning warehouse to the WFP program in Somalia in 2011. This audit did not calculate the premium paid for overseas prepositioning, but based on the premium calculated in the 2008 cost-benefit analysis these shipments may have cost USAID $1.8 million more than if they had been prepositioned in Houston, Texas, without reasonable assurance that the Durban routing was faster*.

- USAID states that when prepositioning food aid commodities into any of the USAID warehouses, USAID does not do so with a definitive country or emergency destination. The commodities are prepositioned to respond more quickly to emergency needs in the respective regions. Therefore, when commodities were prepositioned in Durban, Somalia was not necessarily the intended destination.
- Additionally, this page six language remarks that prepositioning commodities in Houston (as opposed to Durban) for the Somalia response would have saved USAID more than $1.8 million. In finalizing this audit draft report, it is important to note that not only should freight charges, which are typically higher out of the US, be included but also the storage charges and all other associated costs to preposition food aid in the respective warehouses.

On page seven, the report states:

> *In the Durban warehouse, standard prepositioning commodities infested by ants and tobacco beetles were inappropriately stored. By not fumigating the infested commodities, the warehouse put undamaged commodities at risk of infestation. Although USAID had already requested that the damaged commodities be tested to determine whether they were still fit for human consumption, these stocks were not well organized or clearly marked for disposal or reconstitution.*

- USAID clarifies that the sweepings were segregated from the other cargo in the warehouse. The closest commodity to the sling bags containing the sweepings was vegetable oil in cans and cartons. The sweepings were consolidated and stored in bulk supersacks. Intertek (i.e., USAID's cargo surveyor) had already tested the commodity and found it to be unfit for human consumption. The sweepings were sold to a buyer who planned to use them for fertilizer. When the buyer arrived to retrieve the sweepings, the truck that he brought was too small to hold the full amount. Therefore, some of the sweepings were left behind and picked up at a later date.

- As reported to the audit team during discussions (a July 2012 teleconference call), USAID determined that these sweepings came off of a vessel that had called Durban with commodity destined for the warehouse. Durban was the last port of call for this vessel. When cleaning out the ship, the carrier sent all sweepings to the warehouse. The contract between USAID and the vessel owner was for delivery of the commodities to the warehouse door; thus, the sweepings were delivered along with the cargo. We acknowledge that the carrier should not have done this and the warehouse should not have accepted it. The warehouse operator has since been advised never to receive and accept this type commodity again in the future. Please see Exhibit A.

On page eight, there are two photos included in the report.

- USAID requests that the two photos used in the report be removed and replaced with the photo previously provided by the auditors (included below). The two photos included currently in the report reflect commodities never purchased or stored in the USAID preposition warehouses.

Also on page eight, the report states:

Poor storage practices can result in damaged commodities and increased costs. For example, even if damaged commodities are reconstituted, the extra testing and handling may delay shipments and drive up costs for USAID. Although the warehouse contracts specify that these costs should be the responsibility of the warehouse contractor, they were paid by USAID during the audit period.

- USAID remarks that the opening sentence of the above is largely accurate. If commodities are stored improperly, then the result is increased costs and damaged commodities. If the damages are the result of poor storage, thereby the fault of the warehouse contractor, then the warehouse contractor would be responsible for the costs as stated in the contract.

- It is important to note that there are two phases to the discharge operation; they will be referred to as Phase I and Phase II below. Phase I commences as cargo discharges from the vessel and is drayed to the warehouse. Phase II occurs when the inland conveyance is unloaded at the warehouse door and the cargo is then stacked into the warehouse. Generally, damages and/or losses occur during either (1) during the ocean transit portion of the trip, or (2) when the cargo is being unloaded into the warehouse or loaded from the warehouse.

  PHASE I: The U.S. Department of Agriculture (USDA), on behalf of USAID, contracts for the services of a professional discharge surveyor. The discharge surveyor's responsibilities include, but are not limited to, observing unloading of cargo from the vessel, comparing the manifested, i.e., Bill of Lading quantity, with the quantity that is actually discharged, witnessing the unloading and stacking into the warehouse, noting any damages when they occur, and in the case of containerized shipments, verifying the container seal numbers against the Bill of Lading and seal integrity. USDA's discharge surveyor reports findings back to USDA for evaluation and if necessary USDA files a marine claim for loss and/or damage against the ocean carrier.

  PHASE II: If any cargo is damaged while being unloaded at the warehouse door and stacked into the warehouse, USAID's independent warehouse inspector notes cause and severity of damage and provides information to USAID for claims filing against the warehouse contractor. Depending on the severity of the damages, any commodity determined after appropriate testing to be in sound condition will be reconstituted immediately and prepared for future use.

Additionally on page eight, the report states:

> *USAID paid the costs that resulted from poor storage conditions because it did not have a system to identify inventory shrinkage or hold the warehouse contractors accountable for any losses identified. USAID was unable to identify losses because it was unable to rely on inventory records for the Djibouti warehouse, as discussed above. In addition, USAID did not ensure that an independent party counted all outgoing shipments, which would be necessary for verifying any inventory losses at the warehouse.*

- USAID highlights that the draft report draws conclusions based on isolated incidents, which it subsequently applies to all warehouses and to the program as a whole, in general. The draft report confounds losses upon delivery into the warehouse with losses as a result of poor storage and warehouse culpability.
- Per the draft report, *USAID paid the costs that resulted from poor storage conditions because it did not have a system to identify inventory shrinkage or hold the warehouse contractors accountable for any losses identified.* The report improperly connects the above three assertions. The report does not show any evidence that USAID incurred costs from poor storage practices. In fact, none of the warehouses had increased costs due to poor storage practices. Poor storage practices are not the result of the supposed lack of an inventory shrinkage system as suggested above. USAID has both an inventory system and a method by which the contractor is held responsible. As stated earlier, USAID and the Djibouti warehouse vendor are in the process of employing a new inventory control system to elevate the cargo monitoring within that warehouse. This report provides no specific evidence illustrating losses as a result of poor storage.

- Finally, Intertek is hired by either the PVO or USAID. In FY 2011, due to a miscommunication between one of the Cooperating Sponsors and USAID, Intertek did not attend all of the shipments. Prior to the audit, this had been resolved during a meeting on May 10, 2012, between M/OAA/T and the United Nations World Food Program Heads of Transportation and Operational Risk Management (Claims). During this meeting, agreement was reached on a strategy to ensure that an independent third party surveyor would always be in attendance to witness and verify all cargo re-deliveries from the warehouses. Intertek is now present for all shipments from the warehouses.

Recommendation 1: *We recommend that USAID's Bureau for Democracy, Conflict, and Humanitarian Assistance, Office of Food for Peace, conduct an independent evaluation to quantify the differences in cost and timeliness of overseas prepositioning as compared to domestic prepositioning and adjust the use of overseas prepositioning appropriately.*

Response 1: USAID agrees with this recommendation. USAID will begin the data review process to determine how to improve current data collection for future data analysis of prepositioning (M/OAA/T in conjunction with FFP) and look into carrying out an independent external evaluation. The plan to capture and rigorously review data on-hand will inform the scope of work and purpose of an external independent evaluation. Therefore, based on the proposed plan, we request that RIG/Pretoria close Recommendation 1 prior to the issuance of the final report.

Recommendation 2. *We recommend that USAID's Office of Acquisition and Assistance's Transportation Division develop and implement a system of internal controls to regularly reconcile their records with receiving reports from warehouses and outgoing shipment reports in order to identify and resolve any differences in a timely manner.*

Response 2: Recommendation 2 is noted; currently, reconciliation is done on a shipment-by-shipment basis as well as on a monthly basis. We reconcile the inventory reports against the reports from Intertek, our independent warehouse inspector. M/OAA/T is currently working with the Djibouti preposition warehouse vendor, Bahrain Maritime and Mercantile International (BMMI), on the development of an enhanced inventory control system. The system is designed to replace the manual entry system currently used to record the flow of commodities through the warehouse with a largely automated method eliminating many of the potential physical input errors associated with reconciling large volumes of data. The system is being designed with the capability to immediately identify imbalances between the imported and exported volumes and will include sections for delays in delivery, shortages, damages, and reconstitution areas. The system is currently being beta tested and is scheduled to come online by December 2012. Given the current reconciliation process and the new system designed to replace the manual entry system, FFP and M/OAA/T request that RIG/Pretoria close Recommendation 2 prior to the issuance of the final report. See Exhibit B – BMMI/USAID 3 PL.

Recommendation 3. *We recommend that USAID's Office of Acquisition and Assistance's Transportation Division develop and implement a system of internal controls to more closely monitor and track losses at warehouses, including procedures for recovering losses from warehouse contractors caused by substandard commodity management.*

Response 3: Recommendation 3 is noted. As explained above, M/OAA/T has a system of internal controls to closely monitor and track losses at warehouses, including procedures for recovering losses from warehouse contractors caused by substandard commodity management. There are two phases to the discharge operation; they will be referred to as Phase I and Phase II, below. Phase I commences as cargo discharges from the vessel and is drayed to the warehouse. Phase II occurs when the inland conveyance is unloaded at the warehouse door and the cargo is then stacked into the warehouse. Generally, damages and/or losses occur during either (1) during the ocean transit portion of the trip, or (2) when the cargo is being unloaded into the warehouse or loaded from the warehouse.

> **PHASE I:** The U.S. Department of Agriculture (USDA), on behalf of USAID, contracts for the services of a professional discharge surveyor. The discharge surveyor's responsibilities include, but are not limited to, observing unloading of cargo from the vessel, comparing the manifested, i.e., Bill of Lading quantity, with the quantity that is actually discharged, witnessing the unloading and stacking into the warehouse, noting any damages when they occur, and in the case of containerized shipments, verifying the container seal numbers against the Bill of Lading and seal integrity. USDA's discharge surveyor reports findings back to USDA for evaluation and, if necessary, USDA files a marine claim for loss and/or damage against the ocean carrier.
>
> **PHASE II:** If any cargo is damaged while being unloaded at the warehouse door and stacked into the warehouse, USAID's independent warehouse inspector notes cause and severity of damage and provides information to USAID for claims filing against the warehouse contractor. Depending on the severity of the damages, any commodity determined after appropriate testing to be in sound condition will be reconstituted immediately and prepared for future use.

In Djibouti (as noted in other parts of our response), M/OAA/T is working with our warehouse vendor to rollout a more comprehensive inventory control system, which should be beta tested before the end of the year. Included within it is a segment which allows for greater visibility in identifying losses. As well, MOAA/T is working with an in-house vendor here in Washington, DC to develop a single commodity tracking system that could be adapted to monitor movements of commodities in and out of the prepo warehouses. This would eliminate the multiple tracking mechanisms currently employed to monitor the commodities through the warehouses making the data more consistent.

Based on the current standard operating procedures and the claims process delineated in PHASEs I and II above, FFP and M/OAA/T request that RIG/Pretoria close Recommendation 3 prior to the issuance of the RIG report.

Recommendation 4. *We recommend USAID's Office of Acquisition and Assistance's Transportation Division remind warehouse contractors, in writing, of their responsibility for lost commodities in their possession and their obligations to store commodities in accordance with USAID's Commodity Reference Guide.*

Response 4: Recommendation 4 is noted. On November 7, 2012, the Contracting Officer issued a letter (see Exhibit C) for all warehouse contractors that stipulates their responsibility for lost commodities in their possession and their obligations to store commodities in accordance with USAID's Commodity Reference Guide.
As explained above under PHASE II, if any cargo is damaged while being unloaded at the warehouse door and stacked into the warehouse, USAID's independent warehouse inspector notes cause and severity of damage and provides information to USAID for claims filing against

the warehouse contractor. Depending on the severity of the damages, any commodity determined after appropriate testing to be in sound condition will be reconstituted immediately and prepared for future use.

Based on the letter and the claims process delineated in Phase II, FFP and M/OAA/T request that RIG/Pretoria close Recommendation 4 prior to the issuance of the RIG report.

Conclusion

This Memorandum serves as FFP's and M/OAA/T's response to the recommendations outlined in RIG/Pretoria's Memorandum dated October 10, 2012. As noted in the beginning of this response, USAID includes comments on select text of the draft report content as well as responses to each of the four recommendations discussed in the draft audit report for your consideration in revising the final report content. FFP and M/OAA/T staff will continue working closely and collaboratively to improve and strengthen the systems and procedures in place for prepositioned food assistance used by FFP's emergency programs throughout the world to save lives and decrease suffering.

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Avenue, NW
Washington, DC 20523
Tel: 202-712-1150
Fax: 202-216-3047
https://oig.usaid.gov