

***U.S. DEPARTMENT OF COMMERCE***  
***Office of Inspector General***

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***INTERNATIONAL TRADE  
ADMINISTRATION***

*US&FCS China Is Meeting the Demands of Its  
Clients, but Internal Operations Need Attention*

*Inspection Report No. IPE-10915 / September 1999*

*Office of Inspections and Program Evaluations*



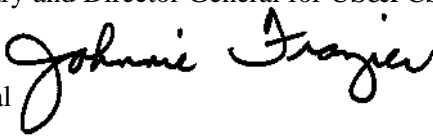


**UNITED STATES DEPARTMENT OF COMMERCE**  
**The Inspector General**  
Washington, D.C. 20230

September 24, 1999

**MEMORANDUM FOR:** David L. Aaron  
Under Secretary for International Trade

Awilda Marquez  
Assistant Secretary and Director General for US&FCS

**FROM:** Johnnie Frazier   
Inspector General

**SUBJECT:** Final Report: *US&FCS China Is Meeting the Demands of Its Clients, but Internal Operations Need Attention* (IPE 10915)

As a follow-up to our May 18, 1999 draft report, attached is the final report on our inspection of US&FCS China. The report includes comments from the July 14, 1999 written response of the Director General and Assistant Secretary for US&FCS.

US&FCS China is meeting the demands of many clients despite the heavy stream of U.S. visitors that traveled to China in the last two years. U.S. exporters are generally pleased with the products and services they receive, especially export counseling and advocacy support. However, some improvements are needed in the quality and marketing of select products. In addition, management, both in Washington and Beijing, needs to pay more attention to building a strong, integrated operation in China that can better serve U.S. exporters.

The financial operations of the five different posts--Beijing, Shanghai, Guangzhou, Chengdu, and Shenyang--are very problematic. In addition to problems in the State Department's financial operations that impact US&FCS, we cite concerns with the lack of monitoring of appropriated funds, deposit funds, ICASS expenses, and unliquidated obligations. Also, other serious administrative matters require management's attention. Of most importance, the commercial facility in Beijing is overcrowded and unsuitable to serve the U.S. business community. Management in Washington and Beijing also needs to pay more attention to personnel matters as well as training, property controls, and information technology needs. US&FCS China suffers from a shortage of experienced foreign commercial officers as well as skilled foreign nationals. Headquarters' delay in filling the Deputy Senior Commercial Officer position for nearly 15 months created many additional problems for post that could have been prevented.

Lastly, the Shanghai Commercial Center, while successful in a number of areas, is not operating as originally intended. The Center is an impressive facility with an active events and outreach program. However, the commercial staff is not working effectively with the collocated partners. In addition, the costs to provide the enhanced services that the commercial center offers will most likely not be fully recovered due to high start up and annual operating costs and low revenue collections. More oversight and support from Washington are needed for the commercial center program.

Please provide us with your action plan addressing the recommendations in our report within 60 calendar days. We thank the personnel in ITA and US&FCS China for their assistance and courtesies extended to us during our review. If you have any questions or comments about our report, please contact me on (202) 482-4661.

Attachment

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## EXECUTIVE SUMMARY

The People's Republic of China is the fourth largest trading partner of the United States today. During the last six years, U.S. exports to China have increased over 90 percent from \$7.5 billion in 1992 to \$14.3 billion in 1998. However, China's exports to the U.S. have grown faster. In 1998, the U.S. trade deficit with China reached \$57 billion. Although much progress is still needed in tariff negotiations, market access, standards, and intellectual property rights, China, with a population of 1.3 billion, is a market with enormous potential for U.S. companies.

Recognizing the importance of China to overall U.S. trade relations, the International Trade Administration and its U.S. and Foreign Commercial Service (US&FCS) have focused much attention on this emerging market. In addition to carrying out its core trade promotion responsibilities, US&FCS China has assisted many other U.S. government agencies, Members of Congress, state delegations, and senior Administration officials who have traveled to China to deal with a variety of trade policy and promotion issues. For example, US&FCS China hosted or assisted at least 27 different groups of high-profile visitors or delegations from October 1997 to August 1998, including President Clinton, the Secretaries of Commerce and State, several Congressional delegations, and other business and government executives. Despite the steady stream of visitors, US&FCS China has also counseled a multitude of U.S. businesses, providing them a realistic picture of the opportunities and pitfalls that companies face when doing business in this market. All five posts in China offer a wide range of services to American business clients, including the handling of trade disputes and organizing trade events to meet the needs of U.S. businesses.

In late August 1998, the Office of Inspector General (OIG) conducted a two-week inspection of US&FCS's operations in China, visiting all five posts: Beijing, Shanghai, Guangzhou, Chengdu, and Shenyang. The inspection team interviewed most of the staff at post, clients of US&FCS, partner and multiplier organizations, as well as individuals from other U.S. government agencies. The inspection focused on programmatic, management, financial, and administrative issues at each post. In addition, the inspection team reviewed the commercial center in Shanghai. While we noted significant US&FCS China successes, we also found problems that warrant management's attention.

### **US&FCS China Is Helping U.S. Businesses, But Should Improve the Quality and Marketing of Some Products**

The Senior Commercial Officer (SCO) and his staff received high marks from the U.S. Ambassador, exporters, and partner organizations for their ability to skillfully handle multiple trade issues. Our inspection found that U.S. business clients were mostly satisfied with the services provided by US&FCS China, especially the export counseling sessions and trade advocacy efforts. Clients were impressed with the officers' professionalism, knowledge of the market, and willingness to assist them. Clients praised the officers' candor in presenting both the opportunities and pitfalls of doing business in this complicated market, and their assistance in helping them resolve trade disputes.

We found that the production and timeliness of the market research products, specifically the International Market Insight and Industry Sector Analysis reports, produced by US&FCS China have increased over the past three years. However, the quality of content and consistency of reporting among the five posts in China should be improved.

US&FCS China's services designed to help U.S. exporters identify actual business leads and contacts received mixed critiques. Clients who purchased the Gold Key Service, a custom-tailored service that combines orientation briefings, market research, and appointments with potential partners, were generally pleased with the quality of the service. However, some clients pointed out the need for better targeting and pre-screening of companies. Clients who purchased the Agent/Distributor Service, a customized overseas search for qualified agents, distributors, and representatives for U.S. firms, rated this service the lowest due to cancellations by post, poor targeting of potential companies, and long delivery times. US&FCS Beijing is taking steps to solve some problems with the Agent/Distributor Service (see page 5).

### **Export Controls are Still an Issue**

In addition to handling trade promotion activities, US&FCS China is also fulfilling its export control responsibilities to the extent that the Chinese authorities permit pre-license checks and post-shipment verifications. While export controls are still an ongoing issue in China, we did note that some pre-license checks were completed, while others were canceled. Permission to conduct post-shipment verifications from the Chinese authorities was authorized after our inspection. However, we continue to monitor export control issues as part of our interagency OIG review of the export licensing process (see page 13).

### **Management Should Address the Needs of US&FCS China**

Management, both in Washington and Beijing, needs to pay more attention to building a strong, integrated operation in China that could better serve U.S. exporters. Considering the importance of China to overall U.S. trade relations, we found it incomprehensible that Washington would delay filling the position of the Deputy Senior Commercial Officer for over 15 months. This action put extra pressure and demands on the first-time SCO and left him juggling and delegating many responsibilities to first tour officers. Although the SCO is highly respected by many because of his strong knowledge of this market and impeccable Chinese language skills, he has been unable to pay enough attention to the needs of his staff and the five different posts.

In the last year and a half, the SCO, absent a deputy, has had little time to devote to managing internal operations and building a strong, integrated country program. Our inspection found US&FCS China to be five independent operations not working together to effectively promote U.S. exports. We also noted that many responsibilities in the financial and administrative areas were neglected. While we found that headquarters, especially the Deputy Regional Director for East Asia/Pacific, has provided valuable assistance to posts on financial and administrative matters, headquarters has not provided sufficient guidance to US&FCS China on developing a stronger trade promotion program. Headquarters has, for example, not developed a regional plan for the China Economic Area to deal with the Asian financial crisis and also to coordinate projects between US&FCS China and other posts that could maximize opportunities for U.S. businesses (see page 14).

### **US&FCS China Needs To Resolve Longstanding Problems in Its Financial Operations**

Our inspection found the financial operations of US&FCS China to be troublesome due to inexperienced staff, the lack of emphasis placed on monitoring and managing funds by management,

as well as problems in Embassy Beijing's Budget and Fiscal Office (B&F) and the cashier operations at the Consulates. Unfortunately, US&FCS China cannot rely on the financial reports produced by the B&F office as a means of monitoring its finances because the reports do not provide an accurate detail of the post's financial status. The time delays in processing US&FCS China's vouchers by the B&F Office and overstated obligation reports provide a false picture of US&FCS China's financial position.

US&FCS China needs to place greater emphasis on monitoring and managing its finances to comply with government regulations and to ensure that resources are used efficiently. Improvements are needed at all five posts in monitoring appropriated funds, overseeing deposit funds, reducing large unliquidated obligation balances, and correcting weak internal control systems. In addition, more attention needs to be paid to the State Department's International Cooperative Administrative Support Services system to ensure that US&FCS China is charged an equitable portion of the total costs paid by government agencies for administrative services.

US&FCS Beijing management needs to address problems in its financial operations. They have to create systems to not only better manage the Beijing office's budget but also to monitor and track the budgets of the other four posts. Beijing must also improve communications and coordination with the State Department's B&F Office and with the constituent posts to better manage their financial operations and ensure that funds are properly obligated (see page 18).

### **Administrative and Personnel Matters Require More Attention**

Washington and Beijing have to pay more attention to the administrative and personnel matters of US&FCS China to (1) ensure that staffing and operational needs are met, (2) improve the financial and administrative practices, and (3) implement controls to prevent fraud, waste, or abuse of government assets. Our inspection found that US&FCS China has serious personnel constraints at the officer and foreign national (FN) levels. US&FCS China is primarily staffed with a less-experienced officer corps due, in part, to difficulties headquarters has faced in attracting mid-level officers to bid on this hardship post. Although this less experienced corps are very committed to their jobs, more mentoring and training are needed. We also believe it is necessary for headquarters to create incentives to attract experienced officers to bid on China or to directly assign mid-level officers.

The requirement to hire FNs from the Diplomatic Service Bureau (DSB), a Chinese government agency, has created many obstacles for management. US&FCS China has not been able to build a strong, experienced core staff, in comparison to operations in other countries, because of constant turnover among FNs. The inability for FNs to advance in conjunction with offers from the private sector has created the turnover. We believe management can address this by working more closely with the State Personnel Officer to ensure FNs are classified at grade levels comparable with their job responsibilities and by paying more attention to the career development paths of the FNs. Performance appraisals and training courses in English language, computers, writing, business counseling, market research, and industry sectors are needed.

In addition, management should pay more attention to property controls. Our inspection found that US&FCS China has not established adequate systems to ensure that government assets are safeguarded against waste, fraud, and abuse. Washington has not required the post to track residential

property purchased by the agency even though the *Foreign Affairs Manual* requires US&FCS to track all residential property regardless of cost. US&FCS China has acquired \$77,044 in household furnishings over the past three years, yet no inventory records exist to account for these assets.

Our inspection also found the need for Washington to better coordinate information technology (IT) needs. Government resources have sometimes not been used effectively because of the lack of coordination and planning. We found computers purchased by post in 1997 were not compatible with the IT modernization in 1998 and had to be discarded. Headquarters needs to develop an IT plan which coordinates acquisitions of hardware and software worldwide to avoid such wasteful expenditures. Purchases by posts would need to be in accordance with the IT plan developed by Washington.

Lastly, Washington and Beijing need to explore options to relocate the Beijing commercial section, which is now located in the Embassy complex. Increases in personnel in Beijing have outstripped the available space and led to an inefficient, less-than-professional-looking, office environment. The facility poses hazards with the high density of staff and furniture in the allotted office space. We have expressed our concerns to management and they are in the process of trying to resolve this issue (see page 30).

### **Each of the Four Constituent Posts Has Had Successes and Problems**

*Shanghai Commercial Center has made progress, but improvements are needed in several areas*

US&FCS Shanghai, an operation in transition, is a distinguished post in that it is one of four commercial centers that was opened under ITA's Big Emerging Markets Initiative. Since the opening of the Shanghai Commercial Center in July 1996, the operation has been busy providing the additional services a commercial center offers while carrying out its core trade promotion responsibilities. With four U.S. state government and trade association partners in place and an active schedule of trade events, the Shanghai Commercial Center is more active than the other commercial centers we have visited in the last few years. However, we found that the commercial center has not been functioning as originally intended. In particular, US&FCS personnel and the collocated partners are not working together effectively to promote U.S. exports. Costs for the additional services provided by the commercial center will most likely not be recovered due to high start-up costs, high annual operating costs, and low revenues collected. Lack of support and oversight from US&FCS headquarters for the commercial center program has also impacted the center (see page 43).

Aside from concerns about the commercial center partnering efforts, we noted successes and problems in the post's operations. US&FCS Shanghai has increased its promotion efforts with the development of a successful post-initiated events program and its coordination with the local multiplier organizations. We also found the commercial library to be a valuable resource to the business community but were troubled by the thin staff coverage of key industrial sectors. Our inspection noted some best practices in the financial operation, but more oversight and accountability are needed. Funds as well as government assets must be monitored more closely. Unauthorized use of the



government vehicle and excessive overtime incurred by a driver related to the use of the vehicle were troubling. The SCO should ensure that overtime is monitored more closely, and he should work with the Shanghai Principal Commercial Officer to improve his management style due to morale problems at post. Both the SCO and PCO also need to reassess the resource allocation in Shanghai, and the PCO, in conjunction with the Consulate's Administrative Officer, should attempt to renegotiate the expensive lease of the commercial center facility (see page 54).

*US&FCS Guangzhou needs to diversify its promotion program  
and improve its financial and administrative practices*

US&FCS Guangzhou, a vital link to Hong Kong, needs to diversify its trade promotion program in order to better serve U.S. exporters. Although the post has been able to coordinate some trade events with Hong Kong, it relies heavily on the International Buyer Program as a means of increasing U.S. exports. More emphasis on producing other products and services such as ADSs, ISAs, and IMIs is needed. Our inspection also identified lax practices in the post's financial and administrative operations including weak internal controls over cash, collections, procurements and government assets (see page 63).

*US&FCS Chengdu's promotion program has high productivity*

US&FCS Chengdu, an operation covering a territory of 200 million people, is performing well considering the few resources it has. US&FCS Chengdu produced the highest number of trade promotion success stories per staff person compared with all the other US&FCS China posts. The post will need to broaden its promotion program such as hosting more post-initiated trade events to increase market penetration for U.S. firms. The PCO—a State Department economic officer on loan to US&FCS—has done a commendable job of coordinating the commercial section's work with the rest of the consulate and in gaining strong support from the Consul General and U.S. companies. US&FCS Chengdu, however, needs to pay more attention to its financial and administrative activities by tracking finances, reconciling its expenditure records with official accounting data, and recording all obligations (see page 67).

*US&FCS Shenyang's operations continue to lag without a PCO manager*

US&FCS Shenyang, an operation heavily involved in trade disputes, has yet to reach its potential due to the many challenges it has faced. The location of the post in northeast China's "rust belt" makes it an unlikely target market for U.S. firms because of the many inefficient, state-owned enterprises in Shenyang, coupled with high unemployment rates. Headquarters' inability to staff the PCO position with a career foreign commercial officer during the last seven years has affected the post. Without a PCO, US&FCS has had to hire a personal services contractor (PSC) to manage the operation. Unfortunately, the PSC has not been provided proper management training normally offered to officers that would assist him in managing the post. Although the PSC is fluent in Chinese and has business experience in China, he is not familiar with the agency's operations or government regulations. The internal operations of the post, both financial and administrative, have suffered primarily because the PSC does not believe he has proper authority to handle some of these responsibilities (see page 69).

US&FCS may want to explore the possibility of moving the post 200 miles to the coastal city of Dalian, which is believed to be a more prosperous market for U.S. firms. Although the PSC recognizes the attractiveness of locating the operation in Dalian, he believes it may prevent U.S. firms from seeking potential customers further inland to Shenyang. The SCO believes that a move to Dalian would make sense if the U.S. consulate was relocated there and if US&FCS could elevate the commercial officer position to an FS-02 level. However, he acknowledged such a move would ultimately require long negotiations with the Liaoning provincial government (see page 70).



In its written response to our draft report (see page 78), US&FCS agreed with most of our recommendations and has taken steps to implement a number of them. We are especially pleased to see that the posts and US&FCS headquarters have indicated their commitment to address so many of the program gaps and management and administrative problems highlighted in our report.

The IG Team credits the Deputy Director for East Asia/Pacific, the Senior Commercial Officer, and the Deputy Senior Commercial Officer with taking on the substantial task of responding to the numerous recommendations contained in the report. These individuals, with the help of the other commercial officers at all five posts in China, have done a good job in implementing many of the recommendations in the months since our visit. Some problems and areas still need to be addressed, including those we request in an action plan. We believe, however, that the resolution of these remaining concerns will result in a more successful China-wide trade promotion program that is well managed.

Our recommendations for addressing these concerns appear beginning on page 72.

## INTRODUCTION

Pursuant to the authority of the Inspector General Act of 1978, as amended, and the requirements of the Omnibus Trade and Competitiveness Act of 1988, the Office of Inspector General conducted an inspection of U.S. and Foreign Commercial Service (US&FCS) operations in China. During the review, we visited all five posts in mainland China: Beijing, Chengdu, Guangzhou, Shanghai, and Shenyang. This review took place in conjunction with an inspection of US&FCS Hong Kong, which will be covered in a separate report.

Inspections are special reviews that the OIG undertakes to provide agency managers with timely information about operational issues. One of the main goals of an inspection is to eliminate waste in federal government programs by encouraging effective and efficient operations. By asking questions, identifying problems, and suggesting solutions, the OIG hopes to help managers move quickly to address problems identified during the inspection. Inspections may also highlight effective programs or operations, particularly if they may be useful or adaptable for agency managers or program operations elsewhere. This inspection was conducted in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency. Our field work in China was conducted from August 14 to 28, 1998, followed by several weeks of consultations with the International Trade Administration and US&FCS headquarters offices in Washington. During the review and at its conclusion, we discussed our findings with the Senior Commercial Officer (SCO) in Beijing, the Director General of the US&FCS, the Deputy Assistant Secretary for International Operations, and the Regional Director for East Asia/Pacific.

## PURPOSE AND SCOPE

The purpose of this inspection was to assess the management, program, financial and administrative operations of US&FCS China, including the Shanghai Commercial Center. This included assessing the development of goals and objectives, determining whether goals are being achieved, evaluating the economy, efficiency, an effectiveness of the operation, and assessing the posts' compliance with applicable regulations and instructions. We also examined the coordination between the posts and other organizations in achieving the overall goals of the International Trade Administration (ITA) and the Department of Commerce.

In conducting this inspection, we reviewed strategies and plans developed by ITA to increase exports to this market. We also reviewed the posts' organizational structures and operating approaches used in administering activities; interviewed appropriate Commerce and State Department personnel, as well as other U.S. agency personnel involved in trade promotion or having overseas business opportunities; examined pertinent files and records relating to the posts' operations; and met or spoke with officials from U.S. and foreign firms, trade associations, and state and local governments. We interviewed 89 U.S. clients of US&FCS China by telephone concerning their evaluation of the posts' products and services and staff knowledge and skills. Finally, the inspection included a review of ITA headquarters and domestic office activities that support the posts' operations.

## BACKGROUND

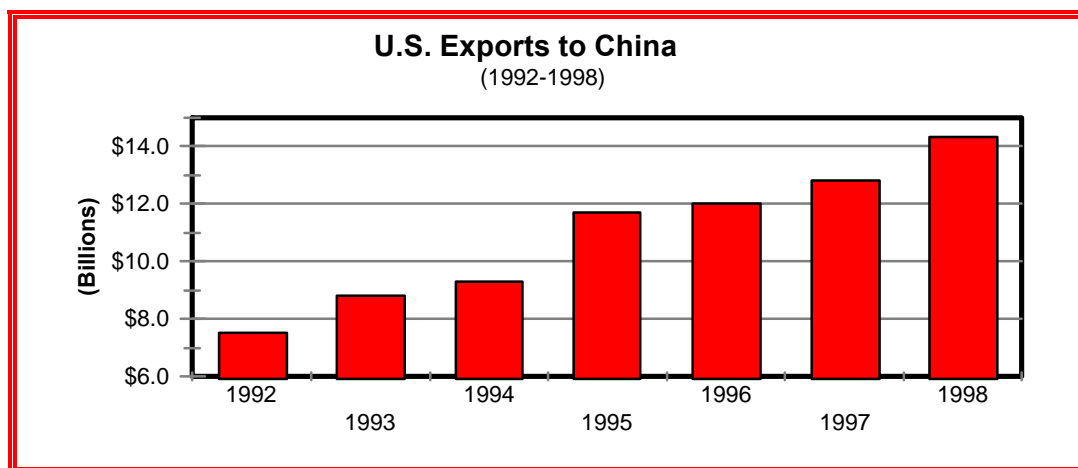
Over the last 10 years, China has experienced an average annual economic growth rate of 10 percent. With a population of 1.3 billion, China is a market with enormous potential for U.S. exporters. As China's middle class is emerging, consumers can now afford such goods as televisions, stereos, portable telephones, and even automobiles. As a result, foreign firms now have many opportunities, such as providing expertise and equipment to meet China's infrastructure needs, supplying industrial equipment and supplies to China's booming industries, and selling consumer goods and services to China's middle class.

As U.S. firms have increasingly recognized the potential of the Chinese market, U.S. foreign investment in China has grown every year since 1992, reaching a total of \$14.1 billion. This makes the U.S. the largest "overseas" investor in China, although Hong Kong and Taiwan are still by far the leading "foreign" investors in China. It is anticipated that increased U.S. foreign investment in China and market openings by the Chinese government will lead to expanded U.S. exports to China in the future. However, in the short term, the recent economic crisis in Asia compounded by existing trade barriers and new protectionist measures erected by the Chinese Government, make it challenging for U.S. exporters. It is not yet known whether the recent allegations about theft or sale of sensitive technology to China will change the prospects for continuing growth in general U.S.-China trade.

### *U.S.- China Trade*

China is the fourth largest trading partner of the United States today. In the last six years, U.S. exports to China have increased over 90 percent (see Figure 1). The strongest growth in exports to China has been in the services sector. However, China's overall exports to the U.S. have grown even faster. Our 1998 trade deficit with China reached \$57 billion. Despite the fact that most imports from China have been low-cost, low-quality goods, our current trade deficit cannot be taken lightly. Much progress is needed in tariff negotiations, market access, standards, and intellectual property rights.

**Figure 1**



Source: National Trade Data Bank

The United States recognizes that it cannot ignore the China market despite the obstacles U.S. companies face including the violation of intellectual property rights, the requirement to establish joint ventures with Chinese firms, and the lack of a sufficient system of commercial laws to protect the interests and investment of U.S. companies. Although U.S. firms looking to enter the market must balance its tremendous potential against the daunting barriers to success, time has proven that some U.S. firms have succeeded in China. U.S. firms attracted to the long-term potential of this country must pay attention to the basics of producing, distributing, and marketing a successful product. US&FCS, the Department's international trade promotion agency, is playing a major role in advising U.S. businesses seeking to enter the China market and is also hard at work handling trade disputes and assisting the United States Trade Representative and the Department of State in their efforts to bring down trade barriers.

### *US&FCS China*



US&FCS is strategically located throughout China to provide U.S. exporters with the appropriate products and services needed to enter the market. Posts are located in Beijing, Shanghai, Guangzhou, Chengdu, and Shenyang. US&FCS China is one of the agency's largest operations and covers one of the largest geographical territories.

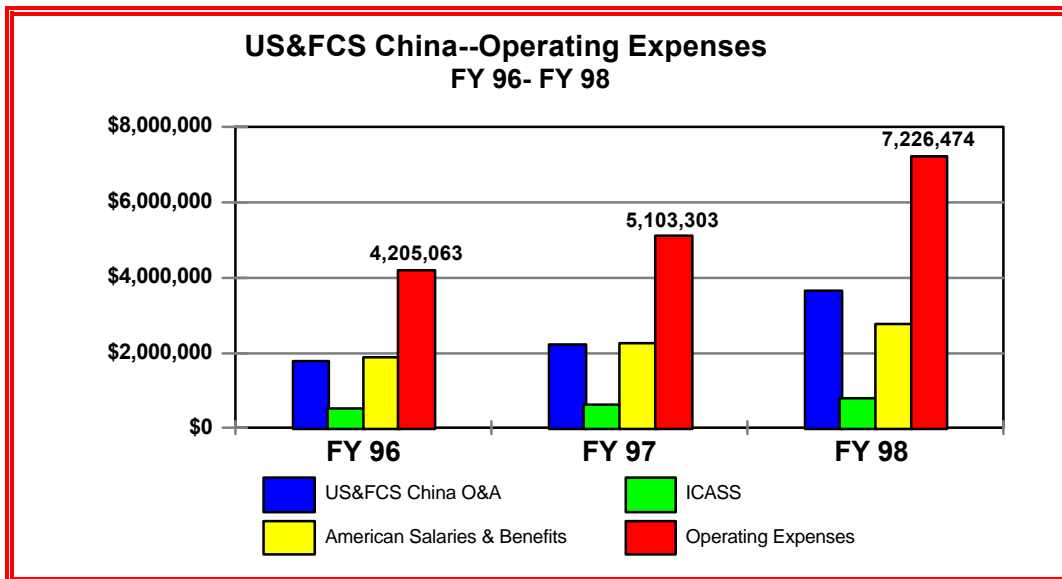
The primary objectives of US&FCS China are to (1) provide in-depth analyses of market prospects in a particular industry, (2) produce timely reports on new opportunities and background studies on factors shaping business in China, (3) offer counseling services to business visitors, (4) arrange appointments for business development delegations, (5) assist with trade complaints and provide advocacy support, and (6) support trade shows, "matchmaker" events, U.S. trade missions to China, and Chinese buyer missions to the United States.

The Department understands the importance of the country's trading relationship with China and the need to correctly advise U.S. companies seeking to enter the China market. In the last three years, headquarters has increased US&FCS China's operating and administrative budget (O&A) by approximately 58 percent. As expected, US&FCS China's operating expenses have increased 72 percent from \$4,205,063 in 1996 to \$7,226,474 in 1998 (see Figure 2).<sup>1</sup> Operating expenses include O&A expenses, the salaries and benefits of American officers, and expenses for administrative support services, referred to as the International Cooperative Administrative Support Services. In addition to increasing resources for its core trade promotion program, US&FCS opened a commercial center in Shanghai in July 1996, as authorized by Title IV of the Jobs Through Exports Act of 1992. (See Chapter II, US&FCS Shanghai, for our observations on the Shanghai Commercial Center and costs associated with opening the center.)

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<sup>1</sup> Operating expenses do not include a \$2,060,936 initial investment in the Shanghai Commercial Center, which were funds disbursed in fiscal year 1996 under the commercial center cost center, or its annual operating expenses. The initial investment primarily included up-front lease payments for two years, build-out expenses, and furniture and equipment.

Figure 2



Sources: FMC 60 reports, ITA Aims Reports, ICASS Invoices

US&FCS China’s personnel consists of a combination of career foreign commercial officers (FCOs), limited appointees (LA),<sup>2</sup> personal services contractors (PSCs), and foreign nationals (FNs). At the time of our inspection, US&FCS China’s operations were staffed with the following combinations (see Table 1):

Table 1

US&FCS China’s Staffing On Board as of August 1998					
LOCATION	FCOs	LAs	FNs	PSCs	TOTAL
Beijing	5	3	20	8	36
Shanghai	2	1	13	3	19
Guangzhou	2	0	6	6	14
Chengdu	0	1	3	1	5
Shenyang	0	0	3	1	4
<b>TOTAL</b>	<b>9</b>	<b>5</b>	<b>46</b>	<b>19</b>	<b>79</b>

Source: US&FCS

(See Chapter I for additional discussion on personnel staffing in China.)

<sup>2</sup> Limited appointments are individuals brought into the Commercial Service, without the standard competitive assessment of career officers, for a period of no more than five years.

## OBSERVATIONS AND CONCLUSIONS

### **I. Despite Hectic Schedule, US&FCS China Assists Many Clients, But Beijing Needs To Improve China-wide Program and Operations**

In the last two years, US&FCS Beijing, as well as the other posts in China, have been operating at a very hectic pace. In addition to carrying out its primary trade promotion responsibilities and assisting U.S. businesses, the posts have had a steady flow of visitors including the presidential visit in June 1998, numerous congressional delegations, high-level visits by top Commerce and other Executive Branch officials, state governors, and trade associations. For example, between October 1997 and August 1998, the post was involved in hosting or supporting over 27 delegations or visits by VIPs. Considering this heavy schedule, US&FCS China has performed well but improvements are needed to better serve U.S. exporters and to ensure resources are used efficiently.

Our inspection noted that clients were generally pleased with the services they received from US&FCS China, however, the quality and marketing of some products need improvement. We found that Washington and Beijing need to strengthen management and oversight of the operation in order to build a more effective trade promotion program and to address administrative issues. The financial operations of US&FCS China need immediate attention as we noted problems in many areas.

#### ***A. Posts deliver many services, but need to improve product quality and marketing***

##### U.S. businesses and multipliers are pleased with US&FCS

U.S. businesses and multipliers (such as the American Chamber of Commerce and other non-governmental organizations promoting trade) we spoke with in Beijing believe that US&FCS is doing a good job of supporting trade and business interests in China. We received positive feedback from representatives of the American Chamber of Commerce (AmCham), including several of its member companies (such as APCO Associates, Chubb Group of Insurance Companies, Earth Tech, Environmental Resources Management, and Ingersoll); Association for Manufacturing Technology; U.S.-China Business Council; and United States Information Technology Office. AmCham praised US&FCS Beijing for the publication of *Contact China*, and with initiating the "Express Lane Visa" program, which they believe to be working very well. The visa referral program was designed to facilitate and expedite business visa processing for AmCham member company employees. Based on interviews, it appears that the commercial section is maintaining strong, productive relations with its clients and multiplier organizations.

Overall, the businesses and multipliers we met with in China felt that US&FCS China does a great job and gave the commercial section high marks for being responsive, available, and knowledgeable. All agreed that the importance the Chinese place on government access and support means that US&FCS's role is more critical to U.S. business interests in China than it may be in other countries. US&FCS China adds stature to any request, organization, or event simply by participating or lending its name.

Client satisfaction high, except for ADS customers

To identify the level of business client satisfaction with US&FCS products and services, we obtained a list of U.S. companies that had used US&FCS China's services and contacted them. We contacted 89 clients by telephone to get their feedback. Clients registered their high level of satisfaction with US&FCS China, giving it an average overall rating of 8.0 on a scale of 1 (low) to 10 (high). Many mentioned US&FCS China's professionalism, helpfulness and availability to U.S. businesses. A few specifically noted the lack of a "bureaucratic response," observing the willingness of US&FCS China staff to attend to the client's problem and priorities. Small differences in satisfaction levels among the individual posts were not statistically significant. However, satisfaction did depend on which products or services the clients had received from US&FCS China. Customers who obtained advocacy support from the offices were the most positive, giving the service an overall quality rating of 9.3. On the contrary, Agent/Distributor Service (ADS) clients expressed their dissatisfaction with the office, with an average overall satisfaction rating of 4.9 (for further explanation see page 10).

The officers (and PSC commercial specialists) overwhelmingly received praise from the clients regarding their professionalism, knowledge of the Chinese market, and enthusiasm for helping American firms. One FCO was described as "one of the most impressive individuals I have met anywhere." Clients rated the knowledge and skills of the officers at 8.8 out of 10. The officers impressed all but a handful of clients with their local market knowledge, awareness of the American companies present in China, industry-specific knowledge, and the ability to identify and explain cultural differences. Officers were described as being willing to accommodate U.S. business people and persistent in helping them with their problems. The few negative comments we received primarily concerned staff members' lack of knowledge of the client's specific industry.

We also noted that the officers provide a very balanced picture of the risks and opportunities of doing business in China during counseling sessions. The officers were not only identifying and analyzing market opportunities for U.S. firms, but were also citing the obvious and more subtle risks of doing business in this emerging market. U.S. business cannot and should not expect instant success because China is still not a relatively open market for exporters. There are a number of hurdles and subtle barriers to success facing an exporter to this market.

Customers rated the FN commercial assistants slightly lower than the officers at 7.9 out of 10. FNs were complimented on their local industry and governmental contacts, helpfulness, and industry knowledge. Clients noted that the FNs were adept at arranging meetings, fulfilling requests, and generally handling logistics. The commercial assistants were lauded for their familiarity with the economy and the local business climate. Negative comments ranged from a lack of aggressiveness to a language problem (for example, situations in which the FN did not clearly communicate US&FCS's products and services).

Impressive expansion of product output offset by need for quality improvements

*Overall IMI production increases, though some US&FCS posts lag*

International Market Insight (IMI) production by US&FCS China has increased over the last two fiscal years and has been of good quality. IMIs are prepared by staff to provide a short highlight of market



conditions or opportunities in China, including those involving multilateral development banks. In fiscal year 1996, US&FCS China wrote 190 IMIs, which increased to 254 in fiscal year 1997 and to 268 in fiscal year 1998.<sup>3</sup> Although the 41 percent increase in IMIs fell short of the 58 percent increase in operating expenditures from fiscal year 1996 to 1998, it nevertheless demonstrates a substantial increase in output.

However, IMI production by the constituent posts of US&FCS China is uneven. Of a sample of 194 IMIs drawn from the National Trade Data Bank (NTDB) for the 10-month period December 1997 to September 1998, 70 percent were produced by US&FCS Beijing (136 IMIs). Although the greater output of US&FCS Beijing results in part from its greater size (36 staff members), its location in the capital city of China, and US&FCS Beijing's innovative product, the *China Daily Commercial Brief*, there should be more production by other posts. US&FCS Chengdu produced 35 IMIs during the period, a substantial number considering that it employs only five staff. Shenyang and Shanghai produced only 2 IMIs each, the fewest of the five posts. In particular, Shanghai, the second largest US&FCS post in China with 19 staff, should be producing more market information for dissemination. IMIs are the only US&FCS information product that provides timely information on changes in trade laws and regulations, business customs, recent market developments, upcoming major projects and purchases, and other time-sensitive developments.

We chose a sample of 25 fiscal year 1998 IMIs from the NTDB in order to assess their quality. The IMIs sampled generally covered topics that were appropriate for American exporters, were of timely interest, and had few problems with clarity. The topic of IMIs varied from the *China Daily Commercial Brief* to pronouncements by the government regarding new regulations in certain industries. However, a few of the IMI topics from US&FCS Chengdu seemed to be more appropriately issued as Trade Opportunity Program trade leads because they involved a request by a specific company for products to be imported. Two of the IMIs sampled from US&FCS Guangzhou described trip reports of International Buyer Program delegations, detailing the itinerary, and listing the Chinese companies that had participated. These IMIs contain little useful information for exporting companies. US&FCS Guangzhou should focus on market and industry profiles, trade contacts and upcoming trade shows, and major projects and purchases rather than trip reports.

The reports on time-sensitive information (with one exception) were provided with ample lead time for companies accessing the NTDB to use the information to their advantage. For example, trade shows were generally announced three to six months before they occurred. Also, information obtained from Chinese governmental announcements or trade magazines was generally available on NTDB within only a few weeks of its release or publication.

*US&FCS China should improve timeliness and quality of ISAs*

US&FCS China is making significant progress in producing Industry Sector Analyses (ISAs); however, the timeliness and quality could be improved. For fiscal year 1998, US&FCS China completed 30 ISAs (see Table 2). Although the majority of ISAs were submitted considerably late, 28 of the 31 scheduled (planned) ISAs had been written. In addition to the 31 ISAs that had been included in the fiscal year

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<sup>3</sup> Fiscal year 1998 figures are based on the best available information from US&FCS's Export Promotion Service.

1998 plan submitted to the Office of Export Promotion Services, US&FCS China produced two additional (voluntary) ISAs that had not been in the plan. Two ISA topics were released as IMIs instead, and one ISA had been postponed for production until fiscal year 1999. Clearly, US&FCS China has impressively increased the market information on Chinese industry sectors available to U.S. businesses. The total of 30 ISAs in fiscal year 1998 is 50 percent greater than the 20 ISAs written in fiscal year 1997 and is 2½ times greater than the 12 ISAs completed in fiscal year 1996. US&FCS China is closer to fulfilling its goals as well. This increase in production of ISAs outstrips the 58 percent rise in operating expenses for US&FCS China and the moderate increase in personnel from fiscal year 1996 to 1998.

Although the production of ISAs has been increasing over the past two years, the submission of ISAs continues to be substantially later than the agreed-upon delivery date. The average length of time for overdue submission of ISAs for all three fiscal years exceeded four months. Many of the ISAs received by US&FCS's Export Promotion Services unit in December 1998 were actually sent at the end of September, but the delay was exacerbated by e-mail problems, the Lotus Notes roll-out, and a lack of follow-up to ensure receipt. Therefore, the record of overdue fiscal year 1998 ISA submissions tends to be somewhat exaggerated, indicating that US&FCS China is in fact making improvements to ensure more timely submission of ISAs. However, more improvement is warranted because 24 of 30 ISAs were submitted late in 1998.

US&FCS China is finally achieving parity with other US&FCS posts in the East Asia/Pacific region in ISA production. When compared to US&FCS Japan, which, along with China, is one of the largest US&FCS posts, the 30 ISAs produced by China nearly equals the 33 ISAs produced by Japan. A number of smaller posts in the region, such as US&FCS Hong Kong and US&FCS Taiwan, write a proportionately large number of ISAs given their size (each had completed 15 for fiscal year 1998). Although US&FCS China does not produce ISAs at this level of productivity (*e.g.*, Hong Kong produces 0.63 ISAs per staff member compared to 0.38 per staff member produced by China), given the lack of FN commercial specialists (only 2 in Beijing compared to 5 in Seoul and 5 in Bangkok, for example), US&FCS China must rely on its officers and PSCs to produce most ISAs. Its commercial assistants usually do not have the expertise or the ability to write clearly and correctly enough in English to research and produce an ISA. US&FCS China's production of ISAs does, however, compare favorably with the output of other operations in US&FCS's East Asia/Pacific region: Thailand, Indonesia, and the Philippines.

As with IMI production, Beijing writes the majority of ISAs (19 out of 30 ISAs in fiscal year 1998). US&FCS Beijing produced one ISA for every two staff members, as did US&FCS Shenyang and US&FCS Guangzhou. US&FCS Shanghai produced only 2 ISAs with a staff of 19 (including Commercial Center staff) in 1998, and US&FCS Chengdu has not produced any ISAs in the last three fiscal years. We did, however, observe that US&FCS Chengdu was working on an ISA while we were visiting the post. We encourage US&FCS Chengdu and US&FCS Shanghai to increase their reporting of ISAs, which are virtually the only in-depth information that many American companies, particularly small- and medium-sized enterprises, have access to regarding specific industries in developing countries such as China. Some of the clients that we talked to listed ISAs as the most valuable product that US&FCS provides. Similarly, we heard suggestions from customers to increase ISA reporting, particularly from US&FCS China.

**Table 2**

US&FCS China: ISA Production and Timeliness, Fiscal Year 1996-98			
	FY 1996	FY 1997	FY 1998
Completed	12	20	30
Canceled or Postponed	8	5	1
Overdue	11	11	23
Average # of days overdue	123	130	122

*Source: FY 1996, FY 1997, FY 1998 ISA Tracking Matrix, US&FCS*

We sampled 10 fiscal year 1997 and fiscal year 1998 ISAs representing all of the US&FCS China offices except US&FCS Chengdu and found that they frequently lack standard information and sections required by the *US&FCS Operations Manual*. Only 2 of the 10 included all of the statistical data required. For consistency, US&FCS China should also attempt to include statistics in the form outlined in the manual and use the receptivity index listed in the *Operations Manual*, in addition to the often excellent text concerning receptivity. The end-user receptivity index to U.S. products/services is a five-point scale (5 = extremely receptive, 1 = not receptive) that reports on how open and willing the local country end-users are to buying U.S. products versus local products or third-country products. Sections on market demand and assessment were missing in 5 of the 10 ISAs, although nearly all included an end-user profile. The required information and sections were developed in order to achieve reports that cover the important broad market aspects that an exporter would expect to learn from a survey report. In order to provide a consistent product worldwide, US&FCS needs to ensure that its constituent posts are including all of the information in a standard format. Clients who use ISAs extensively then can compare both figures and market conditions among different countries (or different markets within countries) when making business decisions. A lack of consistency in the timeliness and quality of ISAs reduces their usefulness and US&FCS's reputation.

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In its response, US&FCS mentioned that US&FCS China plans to produce 31 ISAs and has produced 140 IMIs (as of June 15) in fiscal year 1999. Furthermore, the response stated that US&FCS believes that the quality of IMIs has improved along with their numbers. For FY 1999 all officers have been assigned reporting goals, and the SCO has emphasized the need to comply with the formatting requirements specified in the *US&FCS Operations Manual* and to improve punctuality in submitting ISAs. US&FCS felt that our "comparison of US&FCS China's productivity vs US&FCS Japan's in ISA production did not sufficiently take it into account that the FSN staff in Japan is one of the most experienced in the US&FCS, in contrast with US&FCS China's."

We are pleased that US&FCS China continues in FY 1999 to have a high level of ISA production. However at the current rate of IMI production, post will only have written 200 IMIs in FY 1999, erasing the gains since FY 1996. We welcome the changes that the SCO has made in management of market research subsequent to our field visit.

We did not intend for the comparison of US&FCS China with US&FCS Japan regarding ISA production to be critical. On the contrary, we stated our satisfaction with the nearly identical levels of ISA production for FY 1998 by the two operations. Also, we had noted this high production level with the backdrop of a lack of FSN commercial specialists in China compared to other countries in the East Asia/Pacific region.

*Gold Key quality is good, but better communication and targeting are needed*

Client satisfaction with the Gold Key Service (GKS) was roughly the same as the overall satisfaction with US&FCS China offices. The Gold Key is a custom-tailored service that combines orientation briefings, market research, appointments with potential partners, interpreter service for meetings, and assistance in developing follow-up strategies. The companies were particularly positive on the briefings and information that US&FCS China provided them and the service and dedication of the staff. One American exporter mentioned that US&FCS told “the truth” about experiences with Chinese partners in joint ventures and thereby potentially saved the company a substantial amount in what would have been an unrecoverable investment. The pre-briefs usually provided to the GKS customers, whether on the overall economic situation in China or the specific industry segment, were rated favorably. US&FCS China staff were described by some clients as outstanding, professional, helpful, and gracious.

The problems most often encountered by GKS clients were primarily due to the difficulty in communicating with US&FCS China, and the need for better targeting and prescreening of Gold Key companies. A couple of clients mentioned having trouble communicating with US&FCS China offices either by e-mail or facsimile. Although the poor Chinese telecommunications infrastructure is partly to blame for this lack of communication, we hope that with the rollout of Lotus Notes complete, e-mail communication between US&FCS China and American companies will be swift and reliable. Seven of the 25 GKS clients that we talked to mentioned a lack of targeting, prescreening, or understanding based on the needs of the client. Two GKS clients of US&FCS Guangzhou complained that their meetings had been scheduled with bureaucrats or ex-officials as opposed to companies or business people. Because a primary benefit of the GKS is the ability of US&FCS to arrange meetings with the most appropriate individuals, companies, or officials, a thorough understanding of the client’s needs is essential. Perhaps the best summation of the requirements of the GKS can be found in the suggestion by one customer that all GKS engagements include: (1) a pre-briefing, (2) knowledge of the client’s industry in China, (3) prior research on target companies and the client, (4) knowledge of the target company, and (5) a tight schedule.

*ADS is a poorly rated product, but may improve under new system*

The Agent/Distributor Service is US&FCS China’s most poorly rated product. Whereas the overall satisfaction with US&FCS China averaged nearly 8 on a scale of 1 to 10, the 13 clients who had contracted for ADSs from US&FCS China, rated the service less than 5. Dissatisfaction with ADSs resulted from cancellations by US&FCS China, poor targeting, and long delivery times. One client said that the US&FCS China office misplaced his literature. A number of customers mentioned that the US&FCS post fulfilling the ADS had either missed sizable companies in the targeted field (and obvious choices for an ADS), did not understand the client’s product area, or simply sent a list of Chinese producers.

US&FCS Beijing has recognized that improvement is needed in its ADSs and has instituted the ADS Toolbox, a system of tools and guidelines developed and implemented by post to bring about more consistency, accountability, and quality in its production of ADSs. Although the staff have been trained in its use, the ADS Toolbox is still being converted for use with the newly installed Lotus Notes system. US&FCS China expects to implement the Toolbox at all posts after the conversion. As the Toolbox has been so recently introduced, we were not able to judge its effect on ADS production. However, the flowchart of responsibilities, the tight deadlines, and the naming of an ADS coordinator should address at least the timing and cancellation issues noted by the clients. The Toolbox names an ADS coordinator who is responsible for receiving all ADS requests, distributing and assigning ADS requests to the proper industry officer, and corresponding with the requesting domestic US&FCS Export Assistance Center. The Toolbox also tracks the completion of the ADS and all deadlines, and records any success stories. In order to reduce the completion time of ADSs from the 60 to 90 days that had been promised by US&FCS China previously to the 30 to 60 days as advertised by US&FCS, the ADS coordinator is given 2 days to respond to the initial request by the export assistance center, and the FN assigned to the task is given between 30 and 45 days to complete the ADS after receipt of company materials. Through the use of standardized questionnaires, forms, and communication, the time needed for FNs to research the ADS should be reduced. We encourage US&FCS China to continue implementation and monitor the effectiveness and efficiency of the ADS Toolbox.



US&FCS stated in its response that the officer in charge of US&FCS China's ADS program has continued to improve the Toolbox by incorporating feedback from other personnel. The response indicated that with the number of ADS requests sent to post this year dropping by half, measurement of effectiveness of the new procedures is hampered. Nevertheless, the SCO places a high priority on improving ADS performance.

While we understand that US&FCS China does not control demand for ADSs, post should be able to monitor the quality of service through feedback from clients, success stories and completion times of ADSs regardless of the number of ADSs issued. We reiterate our recommendation that US&FCS China evaluate the efficiency and effectiveness of the new ADS Toolbox. Without monitoring the new ADS procedures, US&FCS China will not be able to determine whether they are an improvement and whether the Toolbox should be implemented China-wide.

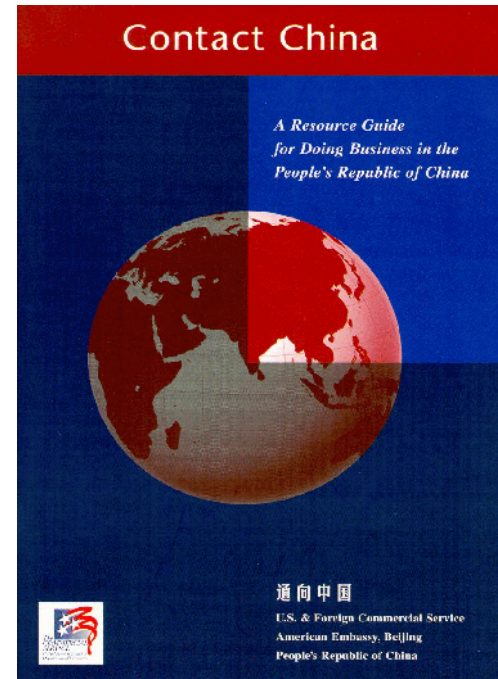
US&FCS China needs an integrated marketing strategy to advertise its products and services

US&FCS China has been creative in developing materials to advertise its products and services. In particular, US&FCS Beijing has produced a very informative resource guide, *Contact China*, for doing business in China. We were impressed with the quality and comprehensiveness of the guide and believe that U.S. businesses will benefit from it. However, the guide is being distributed only to clients in China. We believe the guide could be distributed to a wider audience to attract the clients that US&FCS traditionally serves. US&FCS China should distribute the guide to a wider audience which might include the industry and country "Teams" in the United States and a select number of USEACs that frequently deal with companies interested in China. US&FCS's "Teams" have been set up to promote better coordination between the domestic and overseas offices to match export opportunities

with export-ready U.S. firms by focusing team efforts on specific geographic regions, such as the Asia Pacific area, or specific industries, such as telecommunications. US&FCS China has only had sporadic contact with the teams. Further distribution of marketing materials to the Teams could help spark more cooperation.

In addition to the resource guide, US&FCS Shanghai has created very attractive brochures advertising the Shanghai Commercial Center and its products and services. Specifically, US&FCS Shanghai has produced three different brochures, *U.S. Commercial Center Shanghai*, *Trade Promotion Services at the U.S. Commercial Center Shanghai*, and *Marketing in the East China Region with the Commercial Service*.

US&FCS Beijing has also developed an Internet web page that provides visitors with basic information on US&FCS China's background. The web page lists contact information, market information, the products and services offered, and helpful insights on doing business in China. We are pleased that US&FCS China has taken the initiative to develop a home page but we believe it could be improved to provide readers with a more comprehensive overview of US&FCS China, and to help attract U.S. businesses to China.



To start with, the web page needs more information about the different operations in China and the products and services they offer. The five US&FCS posts are all unique operations serving different markets. A visitor to the home page needs to know about these different operations and the markets they serve. It might also be useful to list the names of the officers serving in China and their industry portfolios. Moreover, the web page would be more attractive if it included photographs to provide the reader with an image or a personalized message from the SCO. We note that the SCO does provide his top 10 tips for doing business in China, but a photograph of him and a personalized message would be a nice touch (see US&FCS Japan's home page for a comparison). Furthermore, we believe the web page should advertise the Shanghai Commercial Center and possibly include a photograph of the multi-purpose room or library facility. Finally, we believe that the web page could provide more information, such as the trade events being held in China.

As US&FCS China continues to expand, we believe it is necessary to develop an integrated marketing strategy covering all five locations. To date, marketing materials have been created piecemeal. The *Contact China* guide is most suitable for Beijing, and the Shanghai brochures are tailored for Shanghai. There are three other operations in China serving approximately three to five provinces which encompass over 250 million people. However, these three posts have received little publicity. US&FCS should develop and implement an effective integrated marketing plan that would communicate US&FCS China's mission as well as the products and services it offers at all five posts.

US&FCS China generally agreed with our recommendations regarding the advertising of its products, services, and markets, and is in the process of addressing various concerns. Post is preparing a new version of the “*Contact China*” brochure which will include sections on the various regions US&FCS serves. Upon completion of this brochure, we request a copy be attached with the action plan. Post also intends to distribute the new version of “*Contact China*” to the Asia/Pacific Team and select USEACs, pending availability of funds for printing and distribution. US&FCS China is updating its web page which we will continue to monitor. We reiterate our recommendation that the web page should include more information on the Shanghai Commercial Center. Lastly, the response states that the Director General has taken steps to improve the overall marketing of US&FCS. We request that US&FCS provide us with a summary of these steps in the action plan.

#### Export controls are still an issue in China

The controversy over U.S. strategic trade with China has escalated considerably since our August 1998 visit to China. While US&FCS’s primary role is to promote all types of U.S. exports, it does have an ancillary role in helping to control the illegal export of sensitive U.S. products and technologies. The Department’s Bureau of Export Administration relies on US&FCS posts to assist it in carrying out its export control responsibilities. Specifically, BXA requests that the posts perform pre-license checks (PLCs) and post-shipment verifications (PSVs) to verify the legitimacy of certain export transactions and end users of U.S. exports. A PLC, conducted prior to issuance of an export license, determines if an overseas person or entity is a suitable recipient of controlled U.S.-origin goods or technical data. A PSV, conducted after an export has occurred, confirms whether goods exported from the United States were received and are being used in accordance with the provisions of the export license.

While the United States wants to help its high-tech industries remain competitive in China, it cannot ignore China’s military modernization or its role in weapons proliferation. Thus, identifying the distinction between a civilian and military end use is critical when determining whether to issue an export license for these sensitive technologies. Due to these concerns, US&FCS and BXA reached an agreement in which BXA relinquished one of its full-time equivalent positions to US&FCS China in exchange for placing one of BXA’s employees in US&FCS Beijing.<sup>4</sup>

End-use checks have always been an issue in China. For instance, the Chinese began denying requests for PLCs from late 1996 to May 1998 (see Table 3). Of the 10 PLCs requested in 1996, five were completed and five were canceled. Of the five completed, four were considered favorable and one unfavorable. Of the four PLCs requested in 1998, one was completed and determined to be favorable while two were canceled. Of the two that were canceled, one was due to the Chinese refusal to allow the check and one was due to the fact that BXA determined that the item in question did not require an export license. The fourth request was still pending at the time of our on-site visit in August 1998.

While the Chinese allowed the United States to conduct some PLCs, PSVs had never been allowed until September 1998. According to BXA officials, one of the accomplishments of the U.S.-China Summit in June 1998 was that the Chinese agreed to a framework allowing PSVs of U.S. exports.

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<sup>4</sup> The employee, who speaks Mandarin Chinese, arrived in Beijing in August 1995 under a limited appointee status. His responsibilities include both export controls and export promotion (concentrating primarily on the computer industry).

However, under this framework, the Chinese government still reserves the right to arrange these visits on a case-by-case basis, while the U.S. maintains the ability to take appropriate action if this occurs—which can include denying future licenses to the Chinese end user.

**Table 3**

PLC History in China Fiscal Years 1996-98				
Fiscal Year	Requested	Completed	Canceled	Pending
1996	10	5	5	0
1997	10	0	10	0
1998	4	1	2	1

*Source: US&FCS Beijing*

At the time of our inspection, there were three pending PSVs (two of which had been pending for more than 30 days and a third that was new). We have since learned that in early September 1998, the Chinese allowed these checks to be conducted. The results of these checks, which were conducted jointly by Chinese and U.S. officials, were favorable. The OIG continues to monitor export control issues with China and addressed them in its recent interagency review of the export licensing process for dual-use commodities.<sup>5</sup>

**B. Management should address the needs of US&FCS China**

Both US&FCS headquarters and Beijing need to pay more attention to building a strong, integrated operation in China to better serve U.S. exporters. The failure of Washington to fill the D/SCO position for over 15 months heavily burdened the new SCO as well as the entire country operation. The lack of involvement from the Regional Director for East Asia/Pacific in developing a regional plan for China has left the operation not working effectively with other posts to maximize opportunities for U.S. exporters. Our inspection also found that the SCO, while highly respected, has yet to develop a strategic plan that integrates the activities of the five posts in China and defines the goals and objectives of the China mission.

Delay in filling Deputy SCO position burdens US&FCS China

China, a top priority market, ranks number two on the US&FCS overseas resource allocation model (ORAM) behind Japan. The ORAM is a management tool used to distribute resources worldwide, taking into consideration various factors. Considering the importance of this market, we found it

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<sup>5</sup> The Senate Committee on Governmental Affairs requested this review from the Inspectors General of the Departments of Commerce, Defense, Energy, State, and the Treasury, and the Central Intelligence Agency. The Commerce OIG report, *Improvements Are Needed to Meet the Export Licensing Requirements of the 21<sup>st</sup> Century*, IPE-11488, June 1999, was the subject of Senate testimony by the Acting Inspector General on June 23, 1999.



inexcusable that the position of D/SCO for US&FCS China would remain vacant for 15 months while ITA attempted to recruit a particular candidate.

In December 1996, the SCO of China unexpectedly resigned from the Foreign Commercial Service, leaving the post shorthanded. Soon thereafter, the D/SCO was promoted to the SCO position, creating an empty D/SCO position. At that time, headquarters began the recruitment process to fill this important position. The recruitment process took longer than expected which left the new SCO handling one of the largest posts in the world essentially alone.

The Department and ITA senior management officials recruited and paneled a candidate from ITA's Market Access and Compliance (MAC) for the D/SCO position on a limited appointment basis. Following months of medical, security, and other clearances, the candidate withdrew due to the loss of a close family member. Despite the many months which passed from the time the candidate was first selected until he withdrew, US&FCS had to essentially start the whole recruitment process over. Luckily, US&FCS was able to recruit the D/SCO from Taiwan, an experienced officer with excellent Chinese language skills, for this position. In April of 1998, the new D/SCO arrived in Beijing just in time to assist the SCO in preparing for the upcoming Presidential visit which also included preparations for the Secretary of Commerce.

The practical effect of the protracted recruitment process for the D/SCO was that the SCO was compelled to rely on himself and many first-tour officers to handle a multitude of responsibilities. Inevitably, some responsibilities were neglected or were delegated to individuals with limited training or experience. Most importantly, we found problems with the internal operations including the financial and administrative area as discussed below, which we attribute in part to insufficient management oversight. In the future, we believe it is imperative for headquarters to fill such an important position as the D/SCO promptly.

#### More involvement from Regional Director is needed

The Regional Director for East Asia/Pacific, in the Office of International Operations, oversees multiple US&FCS missions in the region. While we recognize that the Regional Director handles broad operational responsibilities, we found that she has not been closely involved in assisting US&FCS China with program planning.

Our inspection noted that there was no regional plan to coordinate activities between China and other closely linked markets, such as Hong Kong. Few regional opportunities outside of China have been targeted and little emphasis has been placed on developing Asia-Pacific regional strategies. As a result, posts are not working together as effectively as they could to maximize opportunities for U.S. exporters. Although we found that US&FCS Hong Kong submitted a regional plan for the China Economic Area to Washington, no action was ever taken by headquarters. We believe that a regional plan identifying joint projects between the posts would help increase opportunities for U.S. exporters.

In addition to the lack of regional planning taking place, we also found US&FCS China did not have a strategic plan in place to define its country-wide goals and objectives. Such a plan would help FCOs and FNs develop joint projects and coordinate activities within China amongst the five different posts. While we believe it is primarily the responsibility of the SCO to create a strategic plan, the Regional

Director should be involved in the process to provide input and guidance. In the future, we suggest that the Regional Director be more involved in the planning process for US&FCS China, as well as other posts in the region.

On a separate note, the Regional Director's office was generally helpful to the post on non-programmatic matters. We did receive very positive remarks from all personnel in China, as well as Hong Kong, especially on the Deputy Regional Director for the East Asia/Pacific region. Many were very appreciative of the support and guidance that he has provided to all posts on financial and administrative matters. They commented on his timely responses to their requests and willingness to always provide answers to their questions.

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In its written response to our draft report, US&FCS management conceded that posts in the China Economic Area (such as China and Hong Kong) might benefit from receiving broader direction from the Regional Director in dealing with the evolving regional crisis and future developments and that such direction would likely come in the context of a region-wide strategic plan. It also indicated that US&FCS China and Hong Kong have already begun collaborating on various projects, particularly relating to environmental control and energy development. As to Taiwan, US&FCS said that although some trade missions will visit both the island and the mainland, political tensions as well as significant market disparities make cooperation between the commercial sections in Taiwan and China more problematic.

#### First-time SCO meets multiple demands, but should pay attention to the country operation

The SCO has been doing a creditable job since assuming his position in January 1997. For an experienced SCO, let alone a first-timer, running US&FCS China is a very demanding assignment. Although the SCO faced the extra pressure of having to handle his duties without a deputy for 15 months, he has earned the respect of his staff and others.

The remarks we received about the SCO from the staff, U.S. Ambassador, business clients, and trade organizations were all positive. In our interviews with the commercial section staff, we found morale to be high despite the heavy workload. Staff also noted the SCO's impressive language skills, which give him a distinct advantage in advocating on behalf of U.S. firms before Chinese authorities. The Ambassador praised the SCO for his excellent judgment, responsiveness to the needs of U.S. businesspeople, and management of the commercial section. The multipliers we interviewed all found the SCO to be helpful to their organizations in keeping them informed on the status of trade issues. The interaction between the SCO and the multipliers consisted of information exchanges and referrals of clients/member companies and reciprocal attendance at board meetings and trade events.

Our inspection also found that the SCO has done an excellent job of handling a heavy visitor load and addressing policy issues in the last year and a half. He has worked on addressing the objectives of the Joint Commission on Commerce and Trade and handling the China-America Telecommunications Summit. The SCO has also been active on a number of other policy efforts, supported trade missions including ITA's Under Secretary's trade mission to China in early 1998, and worked well on overall

policy issues with the China desk in MAC. Furthermore, our inspection noted that the SCO has successfully handled the various high-priority issues that all posts in China, especially Beijing and Shanghai, have had to contend with. Although we noted many successes of the SCO, we did note areas for improvement.

As noted above, the SCO has not succeeded in building a strong, integrated China-wide mission. Our inspection found that US&FCS China was essentially five independent operations not working together as effectively as they could. The SCO has not paid enough attention to the needs of the other posts, as he has delegated much to the respective PCOs. We found that communication and coordination among the five posts have been limited. At certain times, the SCO has not been available for his PCOs due primarily to the demands placed on him in Beijing. However, since the arrival of the D/SCO in April 1998 and our August visit, communication has improved significantly between the constituent posts and Beijing. We believe it is important that the SCO seek additional opportunities to increase his communication with the PCOs to discuss program issues as well as internal operations. If funds are available, it would be beneficial to hold quarterly meetings, perhaps rotating sites among the posts, involving the SCO, D/SCO, and PCOs to discuss issues and plan future events and/or joint efforts.

Our inspection also noted that the SCO has not set goals and priorities for US&FCS China. As we discuss in the planning section above, the SCO, in coordination with the D/SCO and PCOs, needs to develop a countrywide strategy and outreach plan that identifies specific goals and milestones for each post and industry sector. This strategic plan should be the basis for defining the program's annual goals and measuring its performance. The posts' staff indicated that they are unaware of which projects their colleagues are working on or what the offices' objectives are. The plan should identify US&FCS China's goals and objectives and identify ways that it can maximize its potential to better serve its clients.

Last year, the SCO did organize an in-country meeting in Xian for the entire US&FCS China staff. The staff told us how beneficial this all-hands meeting was because it allowed them to meet others from the various posts and also to learn what the constituent posts were working on. We agree that such meetings are helpful and encourage the post, and headquarters, to support them, perhaps on a biannual basis. A biannual meeting will help US&FCS China develop plans that establish goals and priorities as well as performance measures for the country mission. These measures could then be translated to the responsibilities of individual officers and FNs and incorporated into their annual performance plans.

In our discussions with the PCO in Chengdu, he suggested ways that US&FCS could take better advantage of its resources to build a stronger country mission. Sharing the expertise of officers and FNs among the other constituent posts with limited resources could present opportunities to coordinate more joint activities or projects while providing assistance when needed. For example, if the need for an officer with a specific industry specialty from Beijing arises in Chengdu to help out on a trade event or one-on-one meetings with local Chengdu companies, the SCO may want to consider sending an officer for that occasion. The PCO also suggested that an officer could be "borrowed" for a short period to help with post-specific initiatives. This arrangement could also hold true for Beijing FNs with highly specialized industry expertise.

The SCO recognizes the need to build a stronger country mission and discussed the possibility of forming industry teams within China. We believe the formation of industry teams is a good idea, as it would allow both FCOs and FNs the opportunity to work together and coordinate more projects. We encourage the SCO to move forward on this plan and also to develop a strategic plan. We believe that US&FCS China should seek a means to more fully utilize the unique trade promotion and industry expertise of its officers and FNs through brief in-country exchange visits.

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In its written response to our draft report, US&FCS partially concurred with our recommendation that the SCO develop a strategic plan for US&FCS China identifying its goals to strengthen the China-wide mission. Specifically, it stated that the commercial section portion of the Mission Program Plan (MPP) is the strategic plan for US&FCS China but the SCO conceded that the MPP is not the ideal format for creating a strategic plan. According to its response, US&FCS China is currently working on a new strategic plan that will be made available to officers and staff in a more user-friendly format.

In fact, during the current fiscal year, the SCO has set program goals for the ADS and Gold Key Service. He also held a PCO meeting in Xiamen this past winter, and is planning an all-hands conference before the end of the fiscal year, similar to that held in Xian last year. Through these venues, he is bringing a clearer sense of purpose to his staff and operations. Last year, he redistributed the officers' portfolios, and this year he is constituting industry teams.

Nonetheless, US&FCS's response also states that the SCO operates within narrow limits in setting priorities for US&FCS China and that posts' actions are to a great degree driven by the priorities of the Secretary of Commerce and the Under Secretary for International Trade. We agree with US&FCS that any strategic plan for China must have the active participation and agreement of these offices.

### ***C. Beijing needs to resolve longstanding problems in financial operations***

The financial operations throughout China are troublesome due to (1) problems in the State Department's financial operations that impact US&FCS China's ability to monitor funds; (2) the lack of emphasis placed on managing and monitoring funds by the SCO and PCOs and inexperienced administrative staff; and, (3) the lack of adequate internal control systems in place at various posts. Our inspection noted instances where US&FCS China was not in compliance with the *US&FCS Operations Manual*, the *Foreign Affairs Manual (4 FAM Financial Management)* and *GAO Standards for Internal Controls*.

#### **Troubles in State Department financial operations hamper US&FCS China**

Although our inspection did not include an in-depth review of the State Department's financial operations in China, we are noting problems found in a 1998 State Department OIG inspection of Embassy Beijing and the four consulates because the problems have an adverse effect on US&FCS China.<sup>6</sup> However, our inspection did include interviews with State's Minister Counselor for

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<sup>6</sup> *Embassy Beijing and Constituent Posts, and U.S. Information Service China*, State Department Office of Inspector General, ISP/I-98-23, March 1998.

Administration, the Budget & Fiscal (B&F) Officer, and the accountant responsible for US&FCS China's accounting and record keeping at Embassy Beijing. We also interviewed the State Department cashiers at the four consulates responsible for overseeing the constituent posts' finances. Based on these interviews, we are including observations we made on the financial operations of the State Department that affect US&FCS China. Specifically, we cite problems with the B&F office in Beijing, the cashiering operations at the four consulates, and the procedures in place to process US&FCS China's transactions.

*Problems in the Embassy B&F office affect US&FCS China*

The State Department's B&F office in Beijing oversees the financial services of the embassy, four consulates in China, Embassy Ulan Bator, Mongolia, as well as about 10 other U.S. government agencies in China. The State OIG inspection cited a history of problems in the B&F office including a shortage of officers, high turnover among FNs, language deficiencies, lack of adequate training for local staff, and computer system crashes.<sup>7</sup> As a result of these problems, the B&F operation has suffered. For example, serious delays in processing other agencies' vouchers have occurred. In 1997, the B&F office had a backlog of 1,000 travel vouchers. Other problems include errors in the posting of agencies' accounting data among the different object codes. Problems such as these affect US&FCS China's ability to monitor its finances based on the reports produced by the State Department. Our inspection determined that the monthly financial report, "Financial Management Center (FMC) 60 Status of Funds," which US&FCS China relies on to monitor its finances, does not provide an accurate picture of US&FCS China's current financial position.

*Weaknesses in cashiering operations noted*

In addition to the problems cited with the B&F office, the cashiering operations at the four consulates have been problematic. The cashiers at the consulates oversee the finances of US&FCS Shanghai, US&FCS Guangzhou, US&FCS Shenyang, and US&FCS Chengdu. This includes receiving collections from US&FCS, disbursing cash to the constituent posts, paying some of the posts' invoices, and processing some of the posts' invoices to Beijing. According to the State OIG, none of the four consulates has a resident budget officer or a competent local staff to manage a complex budget. Consequently, the embassy has decided against giving the consulates control over managing their entire budgets. Instead, each post is told the amount of discretionary money it has to spend and is held accountable for managing it.<sup>8</sup> B&F Beijing is the controlling authority responsible for handling most transactions and establishing policies and procedures in the financial arena. Unfortunately, communication and coordination between the B&F office and the constituent posts are limited.

The cashiering operations have large amounts of cash on hand from the collection of visa processing fees. In some cases, the cashiers pay US&FCS China's invoices in cash, and in other instances, the cashiers send vouchers to Beijing for further processing by the regional financial management center in Bangkok. The State Department's regional FMC is responsible for issuing checks to Beijing and the

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<sup>7</sup> At one time, the embassy was considering relocating the financial operations, along with other administrative functions, to a post with an experienced local staff because of these problems. However, at the present time, the officers believe such a move would be impractical.

<sup>8</sup> State OIG inspection report, ISP/I-98-23.

constituent posts to pay their agencies' invoices. The cashiers pay invoices in cash because there is cash on hand, China is a cash economy where credit cards are not widely accepted by most vendors, and it takes a long time to process a voucher from the consulates through Beijing to Bangkok. Having large amounts of cash on hand increases the risks of fraud and makes it even more important to have tighter controls over cashiering.

In addition to problems the State OIG found, we also noted problems and loose controls at the consulates that affect US&FCS China. For instance, in Guangzhou we noted that on a few transactions, the cashier did not obtain authorization for availability of funds from the B&F office before US&FCS made purchases in excess of \$500. Instead, the cashier paid cash for the purchases made by US&FCS or disbursed cash to US&FCS to pay the vendors, which resulted in funds not being obligated prior to purchases made. When the accountant in the B&F office discovered this, she entered retroactive obligations into the system. Actions such as these have serious implications. The Anti-Deficiency Act prohibits an officer or employee of the United States from making an expenditure, or creating or involving the United States in any contract or obligation to make future expenditures, in the absence of sufficient funds in the account to cover the payment or the obligation at the time it is made or incurred.

#### *Significant delays in processing US&FCS transactions affect financial reports*

We also noted significant delays in the processing of US&FCS China's transactions from the consulates to the B&F office in Beijing which affect US&FCS China's financial position. For instance, at the time of our inspection in August the B&F office had just received May receipts from one consulate. Although the receipts had been paid for in cash sometime in May or shortly thereafter, they would have not shown up as liquidated transactions on the monthly status of funds report until Beijing had signed off on them and entered them into the system. Delays such as this impact the accuracy of the FMC 60 report that US&FCS relies on to monitor its finances.

Based on interviews conducted during our fieldwork, it appears that Embassy Beijing is attempting to improve the financial operations throughout China. The B&F office is now fully staffed with three officers, which should greatly improve the operation. The B&F officer intends to travel more frequently to the consulates to work with them. He also stressed to us that he intends to make changes in Beijing that should benefit US&FCS. For instance, during the next fiscal year, he hopes to reduce the number of recurring obligations. Recurring obligations are funds committed for recurring expenses such as utilities, rents (see section below for discussion on recurring obligations and their impact on US&FCS). We are hopeful that the Minister Counselor and Budget Officer will continue to make improvements in all the operations throughout China that will benefit US&FCS China. Notwithstanding State's actions, the problems cited above have clearly impacted US&FCS China from monitoring finances to processing vouchers. However, despite the problems in the State Department's financial operations, the SCO is still responsible for managing his \$3.7 million budget.

#### SCO should emphasize financial management responsibilities China-wide

In the last three years, headquarters has increased US&FCS China's operating and administrative (O&A) budget from \$2,313,956 in 1996 to \$3,654,125 in 1998, yet it has not held US&FCS China accountable for resolving many problems in the financial arena that were first cited in an internal 1995

Management and Program Review report. Our inspection found problems in the financial operations similar to those that existed four years ago.

In particular, we found that management has not placed enough attention on managing O&A funds because (1) financial management responsibilities have been delegated by the SCO and the PCOs to individuals with limited experience and training; (2) the vacant D/SCO position for over 15 months left the first-time SCO stretched too thin; and (3) financial management responsibilities are not viewed as career enhancing, therefore officers do not make them a high priority.

Our inspection also revealed additional oversight over deposit funds is needed and more involvement in ICASS is warranted. We noted large amounts of unliquidated obligations left on the books in 1996 and 1997. Moreover, we found a lack of coordination and communication taking place between US&FCS Beijing, the constituent posts, and the B&F office in Beijing in handling transactions. Lastly, we cited internal control weaknesses that warrant attention.

*Monitoring of O&A budget should be mandatory*

Before the start of each fiscal year, US&FCS Beijing submits the annual O&A budget request to headquarters based on the needs of US&FCS China. US&FCS Beijing receives input from each constituent post when preparing the budget request. US&FCS headquarters uses the previous year's expenditures as a basis for determining the next fiscal year's O&A budget. After a budget has been authorized, US&FCS Beijing allocates it among the five posts. US&FCS Beijing is responsible for overseeing the budget and requesting any quarterly adjustments from Washington.

Once the budget has been divided among the five posts, US&FCS Beijing works under the assumption that each will operate within the limits of its individual budget. Although the posts attempt to operate within their budgets, they receive no feedback from US&FCS Beijing on their monthly financial status or when disbursements have been cleared through the B&F office. Likewise, US&FCS Beijing does not request any monthly reporting figures from the posts to track the overall budget. Instead, US&FCS Beijing relies on the monthly obligation report produced by the B&F office as a means of monitoring its finances. However, as noted above, the monthly obligation report does not represent an accurate picture of US&FCS China's financial position because of processing delays and overstated recurring obligations applied by the accountant in the B&F section.

US&FCS Beijing, as well as the constituent posts, do not track their individual budgets or expenditures because they either do not have adequate systems in place to do so or they do not maintain all cuff records. Although some posts track some expenditures, posts do not track all expenditures against the seven line item authorizations (*e.g.*, education allowance, administrative travel, direct program support), nor do they obtain copies of receipts sent directly to consulate cashiers or the B&F office. As a result, year after year, no one knows how much of the O&A budget has been spent or how much remains. Such poor fiscal management has created instances where US&FCS China has had either excess funds remaining in the fourth quarter or not enough funds to cover remaining expenses.

In instances when US&FCS China had excess funds remaining late in the fourth quarter, we noted the potential for waste of government resources. In particular, we obtained documentation, dated September 12 and 26, 1997, informing officers that there were excess funds remaining in the budget.

Officers were encouraged to “think of things that you really need or want.” Officers were also advised “we have over \$3,000 left in representation funds. Is there any way you guys could spend any more representation money on Monday or Tuesday? Invite a bunch of Chinese or U.S. business people to lunch.” Moreover, officers were advised that “we have \$20,000 left in residential furniture and equipment. Does the PCO want anything else for his apartment?”

In instances when US&FCS China did not have enough funds to cover yearly expenses, we noted the potential for noncompliance with *US&FCS Operations Manual* and *4 FAM Financial Management*. For instance, in the third quarter of fiscal year 1997, the B&F office raised the anti-deficit flag on the Shanghai Commercial Center because funds were depleted. The B&F office did not have enough funds in the Shanghai Commercial Center budget to cover remaining expenses. In addition, during the third quarter of 1998, US&FCS China came very close to depleting the funds allocated for personnel expenses. A good portion of this was attributable to overtime expenses that all five posts were not closely monitoring. In order to ensure that funds were available to pay remaining 1998 personnel expenses, US&FCS Beijing requested additional funds and a reprogramming of funds in the fourth quarter of 1998.

However, US&FCS Beijing neglected to consult with the constituent posts or the B&F office before requesting that the funds be reprogrammed. In fact, the B&F office, which was still receiving invoices from the constituent posts, was quite concerned that there would be insufficient funds in certain categories that US&FCS Beijing had requested Washington to decrease in order to reprogram increases to other categories. When Washington did authorize additional funds in the fourth quarter and reprogrammed the fund allocations, it decreased the representation amount despite the fact that US&FCS China had already spent most of the original authorization. Mishaps such as these could have been easily avoided if US&FCS Beijing and the constituent posts had more closely monitored their funds.

The *Foreign Affairs Manual* (FAM) requires proper controls to be in place to manage funds. Under 4 FAM, officials receiving an allotment of funds must be responsible for the following:

- < Restricting obligations to the amounts available in such allotments.
- < Identifying an obligation with the applicable appropriation or fund and allotment at the time it is incurred.
- < Certifying that funds are available before the applicable obligation documents are released and recorded.
- < Certifying payments when goods are received or constructive receipts occur.
- < Reviewing unliquidated obligations and de-obligating when appropriate.

Washington should hold the SCO responsible for establishing and maintaining proper controls over appropriated funds. The SCO should implement a system to track the obligations and disbursements of O&A funds and require the PCOs to do the same. We do not believe he can rely solely on inaccurate obligation reports issued by the B&F office, which are created from the FMC 60 report as a means of monitoring the budget. He has to obtain the monthly FMC 62 report which provides a detailed listing of all obligations and disbursements for each post. This report should be used to verify each post’s disbursements against their own internal records. Proper control systems at each post would provide the SCO, D/SCO, and PCOs with the necessary tools to track appropriated funds.



Lastly, we believe the constituent posts should be required to submit to US&FCS Beijing monthly financial reports indicating how much they have spent based on internal record keeping, and US&FCS Beijing should provide monthly feedback to the constituent posts informing them on the status of their disbursements that have been liquidated. These actions will allow US&FCS Beijing, as well as the constituent posts, to closely track funds.

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In its response to recommendation seven, US&FCS headquarters acknowledges that overseas posts do not have adequate systems in place to track individual budgets. Headquarters is in the process of implementing a new worldwide cuff record tracking system that was recently developed by Price Waterhouse Coopers. Personnel in China will be trained on this system and management will ensure that the system will be updated monthly and a consolidated report will be produced.

We hope that this system will be sufficient to allow overseas posts to track individual budgets against the seven line authorizations they receive but we understand there may be some limitations to this system. The success of this system for purposes of resolving some of the problems in China will depend on US&FCS China's ability to obtain all cuff records and enter them into the system. Because some of US&FCS's vouchers go directly to the cashiers at the consulates or to the accountant at the Embassy and thus bypass US&FCS China's administrative assistants, it is necessary for each post to obtain copies of these vouchers so that they can be entered into the system. For example, if the tuition bills for the dependents of officers are sent directly to the consulates and embassy, the administrative assistants should obtain a copy of these and enter them in the system against education allowance. In the action plan, we request a copy of the consolidated report be included.

With respect to recommendation eight, that US&FCS Beijing obtain the monthly FMC 62 report from the B&F office and use it to track the disbursements of each post and verify internal records, US&FCS did not fully address our recommendation but rather provided an explanation of why it will continue to have trouble tracking its funds. US&FCS China states that the OIG found the FMC 60 report to be inaccurate and questions the accuracy and timeliness of using the FMC 62 report to track its funds since the FMC 60 is derived from the FMC 62 report. As we explained in the report, the FMC 60 cannot be used as a means of monitoring the US&FCS China budget from the standpoint of tracking obligations because the obligations entered into the system by the accountant are rather high and don't represent a true picture of the financial commitments entered into by US&FCS China. If US&FCS Beijing worked more closely with the B&F office to ensure that funds are not over obligated, as noted in recommendation 11, the FMC 60 "Status of Obligations" may represent a more accurate picture of US&FCS China's financial commitments.

As noted in the report, the FMC 62 is a detailed report listing all of US&FCS China's transactions. Although the FMC 62 may not be timely in China, the monthly report does show all disbursements of post. We believe that if US&FCS China established a reliable system to track the budget, maintained all cuff records and entered them into the system, and used the FMC 62 to verify its own record keeping of disbursements, management would have a better indication of its financial position. Although the post claims that the root of the problem is the poor service it receives from the accountant in the B&F office, we believe that the post can take steps to lessen the impact on any shortcomings of State's B&F office.

We are encouraged that post is now getting the FMC 62 report and using it as a reference document, and the constituent posts are submitting their monthly cuff records to Beijing. We reiterate our recommendation that Beijing needs to provide monthly feedback to the constituent posts informing them of the status of their disbursements. In the action plan, we request that US&FCS provide us with a copy both of the monthly reports submitted by the constituent posts to Beijing and of the report that US&FCS Beijing provides back to the constituent posts reporting the status of their disbursements.

*Oversight of deposit funds needs improvement*

US&FCS provides a range of information products and services for sale to the public, including (1) agent/distributor service, (2) international company profile, (3) customized market analysis, (4) gold key service, (5) business facilitation services, and (6) trade events and missions. Revenue collected from the sale of these products and services is treated as deposit funds, which is different from O&A funds that are appropriated by Congress. Deposit funds are used to cover expenses ITA incurs in providing such services and information products, and cannot be commingled with any other funding authorization. It is the objective of the United States Government to try to make such goods or resources provided by an agency to specific recipients be self sustaining.

With the exception of US&FCS Shanghai, US&FCS China did not have adequate systems to track the authorizations, obligations, and liquidations of deposit funds. As a result, we noted one instance in which a post exceeded its authorization for hospitality on one trade event and a couple of instances in which two posts instructed Washington to withdraw too much money at the end of an event. In addition, we noted problems that US&FCS China faces when handling deposit funds because Washington sometimes aggregates three different events under one code.

US&FCS China needs to implement systems to track deposit funds more effectively. In particular, US&FCS Beijing, US&FCS Guangzhou, US&FCS Chengdu, and US&FCS Shenyang should begin using the same system US&FCS Shanghai has implemented to track deposit funds. We believe the spreadsheets created by US&FCS Shanghai should be treated as a "best practice," for they provide very detailed information on each product and service that falls under the deposit fund category. Adopting this system will allow each post to track authorizations, obligations, liquidations, and collections for each product and service.

In addition to the lack of systems, we also found problems with the collection of deposit funds. In particular, we found that before 1997, not all of the operations in China even tracked the collection of deposit funds on an annual basis. Thus, no one knew exactly how much US&FCS China collected and deposited each fiscal year. Problems still exist today in that there is little supervision over the collection of deposit funds, deposits are not being made on a weekly basis, and such collections are not being reconciled.

Because there are so many steps involved before monies collected overseas are actually deposited in the appropriate ITA account at the Treasury Department, there is a great need to ensure that the monies US&FCS collects are actually deposited and recorded in the correct account. Previous audits of ITA have reported that key reconciliations of all cash collections including overseas collections are not being performed. Based on our interviews with ITA and US&FCS personnel, it appears that reconciliations of cash collections are still not taking place.

In our attempt to reconcile records obtained at the five US&FCS China posts with ITA official accounting data that is used to prepare the audited financial statement, we noted the differences shown in Table 4.

**Table 4**

<b>Reconciliation of Accounting Records Related to US&amp;FCS China (FY 97-FY98)</b>		
<b>Post Records</b>	<b>FY 1997 Collections</b>	<b>FY 1998 Collections</b>
<b>Beijing</b>	\$31,872	\$54,637
<b>Shanghai</b>	10,167	33,462
<b>Guangzhou</b>	3,868	2,251
<b>Chengdu</b>	716	3,540
<b>Shenyang</b>	61	2,637
<b>TOTAL</b>	<b>\$46,684</b>	<b>\$96,527</b>
<b>ITA Accounting Data of Overseas Collections for US&amp;FCS China</b>	<b>\$59,740</b>	<b>\$72,845</b>
<b>DIFFERENCE</b>	<b>\$13,056</b>	<b>(\$23,682)</b>

*Source: Records obtained from US&FCS China and ITA Accounting data*

In fiscal year 1997, ITA accounting records show that US&FCS China collected 28 percent more than post records show, and in fiscal year 1998, ITA accounting records show that US&FCS China collected nearly 25 percent less than it claims.

We highlight these differences, as we have in previous OIG reports, to point out the need for reconciliations of all cash collections. We believe it is imperative to resolve this issue so that ITA, in conjunction with US&FCS, can accurately report revenues. While we believe it is ITA's responsibility to conduct such reconciliations on all cash collections, we believe US&FCS must also be held accountable for tracking cash collections by each country and ensuring that collections are deposited in a timely manner. Although US&FCS's Office of Trade Event Management receives weekly collection reports from overseas posts, we do not believe this data is used either to track how much each country collects or to determine whether overseas posts are depositing cash collections on a weekly basis. While we have recommended that the Director General establish worldwide procedures for US&FCS to address these problems, in this report we are recommending that the Director General require US&FCS China to: (1) establish systems to track the authorizations, obligations, disbursements, and collections of deposit funds, (2) begin making weekly deposits of deposit funds, and (3) ensure that proper supervision over deposit funds is instituted.

Furthermore, it is important that the Director General ensures that US&FCS China complies with the guidelines pertaining to deposit funds in the *US&FCS Operations Manual* and that US&FCS China establishes adequate internal control systems over deposit funds. For instance, the Director General must ensure that US&FCS China does not obligate deposit funds unless the appropriate authorization

has been received from Washington and the obligation is directly related to the information product or trade event.

With respect to recommendation nine concerning deposit funds, US&FCS China addressed our recommendations, in part, yet further explanations are needed. US&FCS China stated that it has developed a spreadsheet to track deposit funds and mentioned that it demonstrated this spreadsheet to the OIG in January of this year. At the time of the brief demonstration, we commended the administrative assistant for taking steps to improve the oversight of deposit funds. However, we suggested that post provide additional information about the capabilities of this new system in the response to our draft report. In the action plan, we request that US&FCS China provide us an up-to-date copy of this spreadsheet for FY 1999 that tracks the authorizations, obligations, disbursements, and collections of deposit funds for each post and explains what processes it has adopted at each of its posts to monitor deposit funds more closely.

US&FCS China also stated that the Office of Trade Event Management (OTEM) indicated to us that post has been depositing and reporting collections each week for two years now. Based on our interviews with officials from OTEM, we were informed that US&FCS China has made improvements in reporting collections during the last two years, but we did not discuss the timeliness of deposits for user fee collections. We noted that weekly collections were not always taking place and request that post explain in the action plan how OTEM can guarantee that collections are physically deposited each week and what measures it has taken to ensure such deposits take place. We also request that US&FCS elaborate in the action plan on what measures post has taken to ensure supervision over these funds as post states that proper supervision was discussed at a PCO conference.

Lastly, US&FCS China states that it cannot reconcile funds once they have been deposited to the cashiers and that it is the responsibility of OTEM to reconcile funds. Although we did not recommend that US&FCS China reconcile such funds, we believe it is the responsibility of ITA to do so in order that accurate revenues can be reported. In the action plan, we request clarification and/or an explanation as to whether OTEM or ITA's Office of Accounting will be conducting reconciliations for all posts. We reiterate our concern with the need for reconciliations and the need to accurately report revenues.

*More involvement in ICASS is needed*

US&FCS China, like all other overseas posts, must pay a portion of the costs for administrative support services, now referred to as the International Cooperative Administrative Support Services (ICASS). At most posts, the services are provided by units of the State Department's Administrative Section, such as the Personnel Office, Budget and Fiscal Office, General Services Office, Information Management Office, Medical Unit, and Security Office. The goal of the new ICASS system is to obtain quality services at the lowest cost, encourage use of the best and most economical service provider, provide participating agencies with more of a voice in the administrative decision-making process, provide a transparent system of cost-sharing and reimbursement for services, and ensure user satisfaction.

ICASS was officially implemented in fiscal year 1998. During the implementation, each post was responsible for establishing its own charter and memorandum of understanding (MOU) with the service provider(s). The charter established an ICASS Council made up of representatives from participating U.S. government agencies at post to promote cooperation, provide accountability, and ensure the equitable distribution of administrative services and their costs. The MOU established the terms and conditions of the agreement between the service provider(s) and serviced agencies.

Our inspection found that implementation of ICASS at Embassy Beijing was far behind schedule in comparison to other posts. The ICASS Council has not been very active during the implementation stage because many of the agency representatives to the Council have been overburdened with their own agencies' demands. As a result, the ICASS MOU has not been completed, few council meetings have taken place, and few working groups have been formed. Based on interviews with many government agencies at post and our observations, it appears that quality services are not being obtained at the lowest cost, the most economical service providers are not being sought out, agencies are not participating in the administrative decision-making process, and user satisfaction is not guaranteed. We believe there is room for improvement in ICASS.

US&FCS China's expenses for administrative services have increased at an average rate of 23 percent a year since 1996 and expenses are likely to increase as US&FCS China expands. We believe, and advised post management, that US&FCS China needs to get more involved in ICASS to ensure that costs are equally distributed and quality services are received. In the past, US&FCS China was only involved in monitoring ICASS expenses to the extent of confirming staff head counts and opting out of certain services. However, we believe this will change in the near future.

Upon returning from our on-site inspection, we learned that the SCO was recently appointed the new ICASS Council Chair. We applaud him for his willingness to undertake this responsibility. In preparation for this new role, the D/SCO and Administrative Officer recently completed ICASS training, which will greatly assist the SCO in fulfilling his role as Council Chair. We also believe the training will help US&FCS China monitor its own ICASS expenses more effectively. Notwithstanding Beijing's involvement with ICASS, it is still important for the PCOs at the constituent posts to be involved in ICASS at the consulate level. Either the SCO or D/SCO should ensure that the PCOs are involved in ICASS at the consulate level, and that the PCOs have a clear understanding of ICASS and the expenses that are being charged to their posts.

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US&FCS China addressed our recommendation but did not elaborate on our suggestion in the report that the SCO or D/SCO should ensure that the PCOs are involved in ICASS at the Consulate level and that they have a clear understanding of ICASS and the expenses that are being charged. We reiterate our suggestion that the PCOs also be more involved in ICASS.

*Unliquidated obligations still remain on the books*

Pursuant to 4 FAM, US&FCS management is responsible for controlling the use of funds to ensure that: (1) they are used only for authorized purposes, (2) they are economically and efficiently used, (3) obligations and expenditures do not exceed the amounts authorized; and (4) the obligation or expenditure of amounts authorized is not reserved or otherwise deferred without congressional knowledge and approval.

The FAM also requires officials receiving allotments to review unliquidated obligations and de-obligate when appropriate. It is important that funds be de-obligated when appropriate for several reasons. If funds were deobligated in the year they were authorized, US&FCS could use them elsewhere. If funds are not deobligated in the year they were authorized, they are to be carried over to the next fiscal year. In addition, ITA Accounting must report funds carried over to the next fiscal year to Congress during the annual budget process. Our review of the 1996 and 1997 FMC 60 reports on US&FCS China revealed large amounts of unliquidated obligations, as shown in Table 5. The 1997 unliquidated obligations for US&FCS China are high because either an excessive amount of funds were obligated in the first place or many outstanding transactions remain on the account.

**Table 5**

Unliquidated Obligations of US&FCS China		
	FY 1996	FY 1997
US&FCS China	\$58,962	\$581,914
Shanghai Commercial Center	14,194	144,465
<b>TOTAL:</b>	\$73,156	\$726,379

*Source: Financial Management Center (FMC) 60 "Status of Funds" Reports*

Review of the FMC 60 reports also showed balances of unobligated funds totaling \$137,445 in 1996 and \$5,044 in 1997. In order to comply with the FAM, the SCO should work with the B&F office to determine whether any remaining balances listed above can be de-obligated.

US&FCS China has taken steps to address our recommendations regarding its involvement and coordination with the B&F office at Embassy Beijing on obligations but the situation merits close monitoring by headquarters. US&FCS Beijing has requested that any remaining fund balances for FYs 1995, 1996, and 1997 be deobligated and anticipates the funds will be deobligated once the accountant determines there are no outstanding transactions on the books. We request that US&FCS include an updated FMC 60 in the action plan for FY 1995-98, indicating the amount of funds deobligated and the amount remaining on the books.

We are encouraged that the SCO will work with the B&F office to ensure proper obligation of funds and hope that in the future the obligations are adjusted to present a more realistic picture of financial commitments made by US&FCS. Our intent is not to request obligations be made on a case-by-case basis, thus increasing ICASS costs, but is to ensure excess funds are not obligated as a stopgap measure to the longstanding financial troubles in China.

Communication and coordination with State B&F and constituent posts are needed

Our inspection noted that US&FCS Beijing does not work as closely with the B&F office as it should to ensure that funds are properly obligated and to determine when funds have been disbursed. As a

result, the accountant responsible for handling US&FCS's records in the B&F office receives little guidance and input from US&FCS Beijing. Without such guidance or input, the accountant is left to "guesstimate" figures when entering recurring obligations. This practice has created instances where the accountant has obligated excess amounts. Additionally, US&FCS Beijing, as well as the other posts, have not always informed the accountant when making quarterly adjustments in the O&A budget or when instructing Washington to withdraw excess funds in the end-of-show reports. Instances such as these have increased the likelihood that US&FCS China will not have enough funds to cover incoming vouchers. To ensure proper fiscal planning throughout the year and that funds have been properly obligated, US&FCS Beijing should work more closely with the B&F office. It should also review all obligations entered by the accountant on a weekly basis.

US&FCS Beijing also does not communicate and coordinate with the constituent posts as often as it should in order to track the China-wide budget. As mentioned earlier, US&FCS Beijing does not know how much the constituent posts spend, nor does it require the constituent posts to report to Beijing their monthly or quarterly figures. As a result, US&FCS Beijing operates under the assumption that the constituent posts spend within their limits. Unfortunately, this is not always the case, as we determined that one post had exceeded its budget for staff overtime. In order to prevent potential shortfalls at the end of each fiscal year, US&FCS Beijing should communicate more regularly with the constituent posts to have a clear understanding of the financial status of each constituent post.

#### Internal control weaknesses noted at all posts

US&FCS China has not established adequate internal control systems to meet the requirements of the Federal Managers' Financial Integrity Act of 1982 (FMFIA), *US&FCS Operations Manual*, and *GAO Standards for Internal Controls*. Internal control systems are organizational structures, operating procedures, and administrative practices adopted by all levels of management to provide reasonable assurance that programs and administrative activities are effectively carried out. FMFIA requires managers to establish good internal control systems to ensure that:

- < Obligations and costs are in compliance with applicable law;
- < Funds, property, and other assets are safeguarded against fraud, waste, and abuse; and
- < Revenues and expenditures applicable to agency operations are recorded and accounted for so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained.

The key standards for internal controls developed by the General Accounting Office include:

- < Documentation - transactions and events are to be documented, and the documentation is to be readily available for examination;
- < Records - transactions and events are to be promptly recorded and classified;
- < Authorization - transactions and events are to be authorized and executed only by persons acting within the scope of their authority;
- < Separation of duties - key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals;
- < Supervision - qualified and continuous supervision is to be provided; and

- < Accountability for resources - access to resources and records is to be limited to authorized individuals, and accountability for the custody and use of resources is to be assigned and maintained.

Our review of transactions and events handled by the five posts revealed that none of them met all of these standards for internal control systems. Our inspection at each post included a review of the internal controls governing the following: (1) user-fee collections for information products and trade events, (2) imprest fund, (3) representation funds, (4) time and attendance records, (5) travel orders and vouchers, and (6) inventory.

Although US&FCS Beijing has made progress in establishing internal controls since the 1995 Management and Performance Review, more systems are needed to meet GAO standards. In general, US&FCS Beijing lacked complete documentation and records on transactions and events. As mentioned above, US&FCS Beijing needs to establish systems to monitor appropriated funds. Such systems should include computerized spreadsheets with supporting documentation and records on expenditures that are readily available for examination. Of the records US&FCS Beijing does keep, we noted incomplete documentation on the official representational forms. Representational forms were not always completely filled out, nor were official guest lists kept. US&FCS Beijing needs to maintain complete and accurate records on all transactions and events. Furthermore, US&FCS Beijing should also establish better systems to track deposit funds that include records on revenues and expenditures.

US&FCS Beijing has generally done a good job of separating duties and ensuring that adequate, and continuous supervision is provided over transactions and events. Since the arrival of the administrative officer and the D/SCO, most transactions and events are approved by at least two individuals or a manager. However, we did note a potential weakness in the handling of the imprest fund and time and attendance records. At the time of our inspection, the sub-cashier responsible for handling the imprest fund also handled an industry portfolio. Because it is conceivable that she could submit her own petty cash receipts to be reimbursed from the imprest fund she controls, these duties should be separated.

***D. Administrative and personnel matters require more attention***

US&FCS headquarters and management in Beijing need to pay more attention to administrative matters throughout China to ensure the needs of the staff are met, improve the overall operation, and prevent fraud, waste, or abuse of government resources. In particular, Washington and Beijing should address (1) personnel issues at both the FCO and FN level, (2) the training needs of all personnel serving in China, (3) property management issues, and (4) information technology needs.

**Shortage of experienced commercial officers in China affects operation**

US&FCS headquarters has had difficulty trying to fill commercial officer positions in China with experienced officers. We consider foreign commercial officers who have completed at least one overseas tour with US&FCS to be “experienced.” Experienced officers appear to be reluctant to bid on China for several reasons, including the relatively poor living conditions in China (e.g., pollution, housing units for officers, with the exception of Shanghai), the difficulty in learning the Chinese



language, and the length of the language training required at the Foreign Service Institute. As a result, US&FCS China is primarily staffed with first-tour officers who have limited Chinese language skills or with non-tenured limited appointees and personal services contractors, all whose Chinese language skills range in scores from 2-2 to 4-5.<sup>9</sup> Limited appointees are hired by US&FCS without the standard competitive assessment of career officers, for terms no longer than five years. There are few, if any, incentives in place to attract experienced commercial officers to bid on China, a hardship post.

While we recognize US&FCS's dilemma in trying to get experienced officers to bid on China, we note that posting first-tour officers and hiring limited appointees and personal services contractors places additional burdens on the operation. For example, these staff require more attention from the SCO, D/SCO, and PCOs, as time is needed to train them and "bring them up to speed." Considering the hectic schedule US&FCS China has been under for the last 18 months, the SCO, D/SCO, and PCOs have not had the time to adequately train first-tour officers and limited appointees. In fact, one PCO does not believe it is his responsibility to train new officers or limited appointees.

While the first-tour officers, limited appointees, and personal services contractors in China have made great progress with on-the-job training and are very dedicated to their jobs, most have not had enough overseas experience with US&FCS to "hit the ground running." There is a learning curve involved in becoming an experienced officer. One must learn (1) the different products and services US&FCS offers, (2) the organization's processes and procedures, and (3) the relevant government regulations that one must abide by. In the end, the experience level of the officers serving in China ultimately affects the operation. Table 6 provides a breakdown by post, identifying the FCOs' level of experience in China at the time of our inspection.

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<sup>9</sup> Language proficiency scores are rated on an individual's ability to read and speak. A score of 5-5 is considered the highest.

**Table 6**

Tenured Experienced Officers Serving in China as of August 1998					
Post	No. of Officer Positions <sup>10</sup>	Tenured Experienced Officers	First Tour Officers	Limited Appointees <sup>11</sup>	Vacant Positions
Beijing	9 FCOs, 1 Admin	2	3	4	1
Shanghai	4 FCOs	1	1	1	1
Guangzhou	3 FCOs	1	1	0	1
Chengdu	1 FCO	0	0	1 <sup>12</sup>	0
Shenyang <sup>13</sup>	1 FCO	0	0	0	1
<b>TOTAL</b>	<b>18 FCOs, 1SEC</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>4</b>

The proportion of experienced officers to the total officer corps in China is 22 percent, roughly one-fifth. In order to attract more experienced officers to bid on China, US&FCS headquarters needs to create additional incentives. Such incentives might include an increased probability for career promotions, different language requirements or expanded opportunities to learn the Chinese language in-country or elsewhere, or more support from headquarters to obtain better housing arrangements in Beijing or employment opportunities for spouses. If additional incentives still do not attract experienced officers to bid on China, the Director General should directly assign experienced officers to China.

In its response, US&FCS did not agree with our recommendation that it needs to create additional incentives to attract more experienced officers to bid on China, a hardship post, or directly assign experienced officers to serve there. US&FCS believes it is more important to have officers who can speak the language rather than directly assign mid-level officers. In the past, when there has been a shortage of Chinese-speaking officers, US&FCS has complemented the officer corps with limited appointees who are fluent Chinese speakers. As a solution, US&FCS proposes staggering the tours of the current incumbents in order to ensure a more balanced mix of veterans versus newcomers.

While we agree that staggering the tours of officers will help the staffing problem, we disagree with other parts of US&FCS's response. To begin with, China is a very important mission for the

<sup>10</sup> Based on official records from the Office of Foreign Service Personnel.

<sup>11</sup> Although a limited appointee may have served more than one tour with US&FCS, he or she is not considered a permanent foreign commercial officer.

<sup>12</sup> The officer serving in Chengdu is experienced, however, he is on detail from the State Department and this is his first time working for US&FCS.

<sup>13</sup> The one FSO position is being filled by a personal services contractor.

Department of Commerce and we do not believe it is advantageous for US&FCS to staff the mission with a large proportion of first-tour officers and limited appointees. Core US&FCS programs need to be managed as well as top economic policy initiatives. Experienced mid-level officers play an important role in handling these responsibilities while at the same time bringing years of experience to a mission. Second, if US&FCS claims that language skills are more important than experienced officers in such a high-profile post, then we question why in the past it has assigned experienced officers without adequate language skills to other high-profile posts, including Hong Kong, Japan, and Vietnam. Lastly, we believe that US&FCS should be supporting its policy that officers are expected to bid on a hardship post and be available for worldwide assignments. Again, we understand US&FCS's dilemma in trying to attract mid-level officers to serve in China, yet we reiterate our recommendation that Washington needs to create additional incentives to attract officers to bid on China or directly assign them.

#### The hiring and classification of FNs creates obstacles for management

US&FCS China is also faced with additional personnel constraints when hiring Chinese foreign nationals (FNs) as commercial specialists or assistants. Such constraints include the requirement to hire FNs through the Diplomatic Service Bureau (DSB), the restrictions US&FCS China faces when employing FNs from DSB, and the grade classifications of the FNs as determined by State Personnel.

##### *US&FCS China is bound by DSB restrictions*

US&FCS China, like all other U.S. government agencies operating in China, must hire local employees through DSB, a Chinese government bureau responsible for providing candidates to U.S. government agencies. Because US&FCS China cannot hire FNs "off the street" as is done in other countries, it does not have total control over the type of candidates it can hire nor does it have much control over the pay structure and benefit package of the FNs. Moreover, US&FCS China has very little control, if any, over its relations with DSB because the State Department is the U.S. agency responsible for handling such relations. The State Department is responsible for the contract negotiations with DSB, specifying the terms and conditions of employment for FNs. The relationship between the State Department and DSB has not always been particularly cordial, especially when relations between the United States and China hit a low eight years ago.

This poor relationship created obstacles for government agencies operating in China, including US&FCS. DSB often provided unqualified candidates to U.S. government agencies; used U.S. agencies as an English language training ground for FNs; recalled strong candidates; and limited the amount of take-home pay and benefits of the DSB employees. As a result, the quality of the candidates agencies had to choose from was not as high as those employed with the U.S. government in other countries. In addition, there was no continuity among the local staff as turnover tended to be frequent. There is still a lack of continuity among the local staff and turnover remains high. The turnover is now more attributable to the lack of promotion potential (discussed below) and the lucrative job offers being made to the FNs by the private sector.

Recently, the relationship between the State Department and DSB has apparently been improving. The State Department's Minister Counselor for Administration told us that he is committed to having a "collective relationship" with DSB, and he believes that he has made some progress on various issues.

Improvements have been made in the quality of candidates U.S. government agencies receive from DSB, as it is now hiring recent college graduates with English language skills. In addition, the pay structure and benefits package provided for the FNs has improved somewhat, although DSB continues to take a large percentage of the FNs' salaries (approximately 60 percent). U.S. government agencies, including US&FCS, are now permitted to pay overtime directly to the FNs, and the salaries of the FNs have been rising. Moreover, an embassy-wide awards system has now been instituted to recognize excellent performance of FNs. However, we were informed that US&FCS China has taken less advantage of the awards system than other government agencies operating in China. US&FCS China should recognize excellent performance of FNs through the awards system.

*Accurate classification of FNs is critical to operation*

In previous years, DSB maintained much of the control over hiring and employing FNs, and as a result, position descriptions were never established for the FNs nor were performance appraisals given to them. When the new Minister Counselor arrived in Beijing, he recognized the importance of establishing FN positions in line with the worldwide system. At the time of our inspection, State was in the process of classifying all the FN positions for US&FCS. Position descriptions, as well as individual personnel files, have now been created for the FNs. However, there are very few FN positions classified as "commercial specialists," which limits the upward career mobility for FNs. State claims that the FNs performing commercial assistant responsibilities are not performing at the "commercial specialist" level in comparison to commercial specialists in other countries. However, the Minister Counselor informed us that State could classify positions at the commercial specialist classification once skills are developed.

While we recognize that the FSNs serving in other countries may be more skilled, we believe it is essential to have senior commercial specialists serving in China. Throughout our inspection, we observed the various job responsibilities being tasked to senior FNs and noted that a few are heavily burdened and might not be classified at the appropriate level. While it is not our position to determine the grade classifications of FNs, we do believe it is necessary to ensure that there is upward mobility for the FNs. The operation of US&FCS China has suffered in the past due to the high turnover rate among FNs caused by the lack of upward mobility, and this will continue unless changes are made.

We compared the grade classifications of the FNs working for US&FCS in China to the grade classifications of foreign service nationals (FSNs) working for US&FCS in other Asian countries, and noted the differences in Table 7.<sup>14</sup>

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<sup>14</sup> Employees hired through DSB are referred to as foreign nationals, unlike foreign service nationals in other countries, because they work under contract with DSB, and not directly for the U.S. Government, as do FSNs.

**Table 7**

Breakdown of Classified Positions for Foreign Service Nationals at US&FCS Posts in Asia <sup>15</sup>					
Post	Grade 10	Grade 11	Grade 12	TOTAL COMMERCIAL SPECIALISTS	TOTAL COMMERCIAL ASSISTANTS
China	2			2	34
Japan	8	13	1	22	9
Korea	2	3		5	6
Vietnam	2			2	10
Thailand	3	1	1	5	3

*Source: Staffing patterns obtained from Office of Foreign Service Personnel (October 1998)*

In order to build staff continuity and FN expertise in China, management in China should request, within authorized limits, the classification of positions at the Grade 10, 11, and 12 commercial specialist level. If they do not believe some of the more experienced FNs are performing at these levels, we recommend that they either (1) work with the current FNs in developing their skills or (2) attempt to recruit more experienced FNs from the DSB.

In addition, if management encounters unwarranted resistance from the State personnel office in classifying positions at the Grade 10, 11, and 12 levels, it should formally appeal the classifications through the appropriate channels. We would also like to be kept informed of this situation. Furthermore, either management in China or the appropriate officers should begin conducting annual performance reviews for all FNs to (1) document current-year performance, (2) provide feedback on performance, and (3) discuss the next year's responsibilities. We believe this will enhance career development at the FN level. In our interviews with the FNs, we noted an eagerness, especially among many of the younger employees, to develop their expertise, get more training, and expand their ability to assist U.S. companies.

US&FCS China generally agreed with our recommendation to upgrade FN positions at the Grade 10, 11, and 12 specialist levels, and has already upgraded one position in Beijing. Post stated that it will work with headquarters and the Embassy to upgrade other positions as appropriate. In the action plan, we request that post explain where and when it intends to upgrade positions to the specialist level at the constituent posts. Post also agreed to begin conducting performance appraisals with the Chinese FNs at least once a year or more often as needed.

<sup>15</sup>Analysis of positions includes vacant positions but does not include PSC positions.

*Additional resources may be needed to meet the demands of U.S. businesses*

Our observations of the five posts in China indicate that additional resources at the FN level may be needed in some posts to meet the demands of U.S. businesses. In Shanghai and Chengdu, we noted that either the FNs' coverage of industries was too thin or that they were not able to keep up with the demands of their clients due to the lack of sufficient resources (see Chapter II and IV for more discussion). In order to maximize opportunities for U.S. exporters, we believe that management should consider allocating additional resources to those cities where resources are stretched too thin. However, we do not believe that US&FCS China should fill any new future authorized FN positions with PSCs, as the operation is already heavily dependent on PSCs. Moreover, if additional resources are allocated to China, the FNs should be assigned to cover industry portfolios rather than to handle special projects of interest to managers.

Washington should move forward in overhauling its training program

In many of our overseas inspections, including the inspection of US&FCS China, we have observed that the training needs of overseas personnel, including FCOs, limited appointees, and FSNs/FNs, are often unmet. Among the reasons for this situation are the following:

- < a combination of the time constraints of overseas employees and the infrequent offering of courses has made it difficult for employees to attend training;
- < past budget constraints placed on headquarters have prevented it from developing a comprehensive training program that can be offered each year;
- < past budget constraints placed on posts have prevented managers from providing training in country;
- < some SCOs have not included training in their annual budget requests because they have different priorities or prefer that headquarters fund training;
- < some FCOs prefer not to spend time in training when on home leave or rest and relaxation; and
- < training has not been viewed by some as a high priority.

Overseas personnel, including those in China, have expressed the need for new courses that are not only more in line with their actual responsibilities. They also believe the quality of training could be improved and want more frequent course schedules. Of most importance is the need for financial and administrative training, especially for officers that are responsible for managing operations. Many officers have pointed out that the lack of training in these areas has prevented them from fully understanding the rules, regulations, procedures, and policies that they must abide by in managing funds, ICASS, procurement actions, personnel, facilities, and other overseas functions. Because Washington does not mandate that courses covering these subject matters be taken before one can handle these responsibilities, FCOs learn through trial and error or do not learn at all. US&FCS should require mandatory finance and administrative training for an officer before assigning him/her to a managerial position, be it a PCO, D/SCO, or SCO position.

In addition, officers at all levels, including those in China, have also expressed the desire for training on the following subjects: project management, team building, organizational skills, managing individuals from different cultures, understanding cultural sensitivities, business counseling, marketing, and public

speaking. FSNs, including FNs in China, have expressed the need for training in language, computers, writing, business counseling, market research, and industry background. Moreover, for those FSNs or FNs handling financial and administrative responsibilities, they have expressed the need to have training in these areas when they are first assigned these duties. Unfortunately, some FNs in China took finance and administrative training two years after having been assigned these responsibilities.

US&FCS headquarters recognizes the need for improved training and has recently taken some steps in this area. The new Director General is currently creating a "Commercial Service Institute" (CSI) for both domestic and overseas personnel. The CSI will be rolled out in phases but the initial plan is to offer five core courses via distance learning; *e.g.*, videos, CD-ROM, and correspondence courses. The courses are designed to provide employees with a better understanding of US&FCS's and other government agencies' roles in international trade. The subject matter of the courses will cover basic exporting concepts, team building, strategic planning, and finance and administration. We believe that the Director General should require personnel, both domestic and overseas, to complete training in courses that are in line with their responsibilities. For instance, we believe that management training, including finance and administrative training, should be mandatory for FCOs that are assigned to positions in which they are responsible for managing operations.

While we recognize that the Director General's new training initiative will take some time to be fully implemented, we do not believe US&FCS China can postpone the training needed by its FCOs, limited appointees, and FNs. If necessary, the SCO should request funds from Washington to provide the needed training. If funds are not available, the SCO should explore ways to offer in-house training.

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US&FCS did not fully address our recommendations with respect to training for foreign commercial officers. While US&FCS acknowledges that it has not provided the appropriate training needed for officers to carry out their responsibilities, it did not comment on our recommendation that mandatory finance and administrative training be required before assigning officers to managerial positions at the SCO, D/SCO, and PCO levels. US&FCS did, however, state that it will seek to schedule administrative and finance training for incoming PCO-level or higher officers before their tour in China. US&FCS believes that as more officers receive this training over time, the number of those who are deficient in these areas will diminish. In the action plan, we request that US&FCS provide us with any proposed training sessions that it will seek to provide incoming officers at the PCO level or higher. Again, we recommend that finance and administrative training be mandatory before officers are assigned to managerial positions. When issues or problems arise in these areas, officers are often quick to point out that Washington has never required them to have this training and, therefore, they should not be held accountable or were not necessarily at fault. Problems will continue to occur in these areas until Washington requires this training and enforces regulations that apply in the financial and administrative arena.

With respect to training for the FNs, US&FCS agreed with our recommendation and has taken steps to address our concerns. We are pleased that management has enrolled the local staff in a variety of training courses. We hope management can continue to offer training in the future at all five locations in China pending availability of funds.

More accountability over U.S. government property is needed

In past years, US&FCS has paid the State Department to handle its property management, including the maintenance of inventory records. The expenses paid were a portion of the total expenses paid for administrative services under the Foreign Affairs Administrative Support system (FAAS). Under FAAS, US&FCS had difficulty obtaining accurate, up-to-date, inventory records from the State Department on certain overseas posts. When State dissolved FAAS and implemented ICASS, US&FCS decided to begin opting out of inventory services at certain overseas posts in order to save costs and gain greater control over its inventory. As a result, many overseas posts are now responsible for maintaining their own inventory records and reporting inventory levels twice a year to headquarters. However, US&FCS China, as well as other overseas posts, has not established adequate systems to ensure that property and other assets are safeguarded against fraud, waste, and abuse.

US&FCS China is currently following the Department's inventory policy, which requires property with an acquisition cost of \$2,500 or more and sensitive items, such as TVs, VCRs, laptop computers, and cellular phones, to be accounted for. However, the Department policy does not address regulations governing foreign affairs agencies such as US&FCS. To date, US&FCS headquarters has not required the overseas posts to account for residential property nor has it required posts to track beepers, which we consider sensitive items. The regulations outlined in 6 FAM 220, "Personal Property Management," require residential property to be accounted for regardless of cost. We believe the Director General needs to ensure that inventories on residential property are taken at overseas posts and that beepers are accounted for.

With the exception of US&FCS Shanghai, each post in China is responsible for tracking what is defined as "accountable inventory" and sensitive items. While our inspection noted that most posts were tracking inventory, we found weaknesses that warrant attention. To begin with, no post in China tracks any residential furniture and equipment purchased by US&FCS. Although US&FCS China is in the embassy's residential furniture pool and most of the residential property is owned and tracked by the State Department, we noted that US&FCS China purchased \$19,738 in household furnishings in fiscal year 1996, \$52,312 worth in 1997, and \$4,994 in 1998. Thus, in the last three years, US&FCS China has acquired \$77,044 in household furnishings, yet there are no official inventory records accounting for these assets. The FAM requires all non-expendable residential furniture and equipment, regardless of cost, to be accounted for. In order to ensure that US&FCS China is in compliance with the FAM and that U.S. government assets are safeguarded against fraud, waste, and abuse, US&FCS headquarters needs to establish a policy requiring China and all other overseas posts to track all residential furniture and equipment purchased by US&FCS.

In addition, we noted the following property control weaknesses or issues at each post that should be addressed:

- < **US&FCS Beijing** - the inventory log needs to be updated more frequently, as we located items in the facility that were not on the log and noted a seven-month lag between entries (November 1997 to June 1998). In addition, US&FCS Beijing does not keep inventory on beepers purchased, which we consider to be sensitive items that should be added to the log.



- < **US&FCS Shanghai** - US&FCS Shanghai is the only post in China that is not responsible for tracking office inventory; it pays the State Department under ICASS to track office inventory. However, in reviewing a March 1998 printout of US&FCS Shanghai's inventory, we noted that only three items purchased in fiscal year 1997 were accounted for and nothing purchased in fiscal year 1998 was accounted for. Typically, State applies different monetary thresholds in tracking inventory and accounts for a majority of items. Based on this practice and the interviews we conducted, we have reason to believe that State is not updating the inventory log periodically, nor has US&FCS Shanghai requested State to do so.

Furthermore, we note that according to procurement logs maintained by US&FCS Shanghai, it has purchased sensitive items in fiscal years 1997 and 1998 that do not appear to be accounted for on the inventory log. In addition, it has purchased residential furniture that is not officially inventoried. US&FCS Shanghai should request State to update its inventory log to account for recent purchases. The PCO, SCO, and Property Manager in Washington should determine if it is cost effective to have State continue tracking inventory or if it is in the best interest of US&FCS to assume this responsibility. If it is not cost effective for State to continue, US&FCS Shanghai should opt out of this service under ICASS and begin tracking its own office furnishings, sensitive items, and residential property.

Finally, we noted that US&FCS Shanghai recently purchased a new photocopier to replace an older model. However, at the time of our inspection, US&FCS Shanghai had not disposed of the older model. US&FCS Shanghai should dispose of the older model in accordance with the regulations outlined in 6 FAM.

- < **US&FCS Chengdu** - the inventory log needs to be updated and all pertinent information must be entered in the data fields on the inventory log. Our inspection noted that the inventory of residential property purchased by US&FCS Chengdu was not accounted for. The post also should begin tracking residential property.
- < **US&FCS Guangzhou** - the inventory log needs to be updated as we noted many items that were not accounted for. We also found that US&FCS Guangzhou had a large number of surplus computers and electronic equipment in storage that should be disposed of. In all, we identified eight CPUs, two laptop computers, two printers, two tape back-up drives, one server, one modem, and one digital camera that are being kept in storage. The purchase price of the merchandise totals over \$25,000. Although computers depreciate rapidly, the value of the merchandise is likely to still be several thousand dollars. Timely disposal of surplus property allows the government to obtain the highest price for the merchandise if sold or to make the most valuable donation it can with the merchandise.

After our site visit, US&FCS Guangzhou identified surplus equipment for disposal. The post plans to donate some of the computers and sell the remainder by auction. We are encouraged by US&FCS Guangzhou's prompt response to our observation and expect that in the future the post will ensure that excess inventory is disposed of promptly.

- < **US&FCS Shenyang** - we found no significant issues at Shenyang since most items purchased are under \$2,500 and all sensitive inventory is being tracked.

US&FCS did not fully address our recommendations concerning inventory. As noted in the draft report, even though the FAM requires foreign affairs agencies to track residential furniture regardless of cost, US&FCS has not officially required posts to account for residential furniture that it purchases overseas. We reiterate our recommendation that Washington establish an official policy requiring all overseas posts to track residential furniture. One way to accomplish this is with an outgoing cable to all overseas posts requiring that residential property be officially tracked regardless of cost. In the action plan, please provide us with a copy of such a cable or policy directive indicating US&FCS' compliance with the FAM requirement on tracking residential furniture. The action plan should also include a listing of all residential furniture purchased by US&FCS China during the last three years as requested in the draft report. US&FCS China did address our recommendation concerning beepers and has added beepers to the main inventory list.

US&FCS did agree with our recommendation that the PCO, SCO, and Property Manager should determine if it is cost-effective for the State Department to track inventory. The post has opted out of this service and will begin tracking inventory. Concerning our recommendation that an older copier be disposed of, US&FCS stated that the new copier is not a replacement machine and disposal is not warranted at this time.

#### Options to relocate from Beijing facility need to be explored

US&FCS Beijing is located on the embassy compound in a two-story building which is in proximity to the ambassador. The facility has a small commercial library and conference room, as well as offices for the FCOs and FNs. We found the overall facility to be quite crowded and unappealing to serve U.S. businesses. Most officers share small offices with FNs, which makes it difficult to conduct private phone conversations as well as counsel clients. The conference room is frequently in use, leaving little room to hold simultaneous meetings or counsel multiple clients. Often, the FCOs are left to counsel clients at two small tables in the entrance room with the receptionist. In addition, the library is small, which prevents US&FCS Beijing from keeping a large number of publications conveniently stacked on the shelves. Instead, US&FCS Beijing must use the back stairwell to store resources and place filing cabinets, which poses a potential fire hazard.



*Back stairwell, FCS Beijing*

With US&FCS Beijing's current resources, we think the SCO, in consultation with Washington, should consider the option to relocate all or a portion of the operation to a new facility with more space. We understand the value of being in proximity to the ambassador and having a physical presence in the embassy, but we do not believe US&FCS Beijing can serve U.S. businesses effectively, especially now that additional resources have been added to the operation since our on-site inspection. Furthermore, we do not believe it would be the most efficient use of government funds for US&FCS Beijing to continue making minor

renovations to the current space to accommodate new FCOs. The building cannot hold any more staff without posing risks. We also do not believe that US&FCS Beijing can wait the eight years projected for the new embassy to be constructed. We believe that US&FCS Beijing should conduct a cost-benefit analysis to determine if it is feasible and beneficial to move out of the current facility to nearby commercial space. If the move is warranted, US&FCS should seek the funding from ITA and the Congress to carry out the move as soon as possible. The U.S. Customs Service has already moved out of the embassy compound.

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US&FCS has taken steps to address our recommendations concerning the facility in Beijing, but no final decisions have been made to date. The SCO has developed a contingency plan based on a cost-benefit analysis. However, considering the lack of funding in FY 1999, a near-term move does not appear likely. We urge that US&FCS continue its efforts to obtain the necessary funding from the State Department or other sources. We request that the action plan include a copy of this contingency plan developed by the SCO.

#### Information technology requirements need a coordinated approach

Headquarters needs to ensure that there is a coordinated policy on information technology (IT) requirements to prevent potential waste of government resources. We noted that in fiscal year 1997, US&FCS China was authorized funds in late September to purchase a total of 10 computers: 3 each in Chengdu, Shenyang, and Guangzhou, and 1 in Beijing. According to the 1997 FMC 60 report, US&FCS China disbursed approximately \$78,150 for ADP equipment, including central processing units and related systems equipment, and minicomputer equipment.

In fiscal year 1998, US&FCS headquarters continued with its IT modernization initiative, which included the roll-out of Lotus Notes software worldwide. As part of this initiative, new computers were purchased to ensure compatibility. US&FCS China spent over \$300,000 on new computers in 1998. While management claims that these posts needed the new computers purchased in 1997, we question why headquarters did not require them to purchase computers that would have been compatible with the 1998 rollout. If an IT policy had been established requiring that all US&FCS computer purchases made by the regions be compatible with the standard equipment provided in the Lotus Notes rollout, the potential waste of government resources could have been prevented. Because such a policy was not created, some of the computers bought in 1997 are now of no use to the posts. In the future, US&FCS headquarters should develop a coordinated IT policy that covers the purchases of computers.

On a separate issue, our inspection revealed that many of the posts within China have Internet access on only one stand-alone computer. We heard complaints from many in China about the lack of Internet access on desktop computers. Most FCOs and commercial assistants believe Internet access would be useful in conducting market research. Upon returning from China, we followed up on this issue and were informed that many of the desktop computers overseas cannot have Internet access due to security regulations and that access can only be obtained through stand-alone computers. However, according to US&FCS headquarters, the new Lotus Notes system will have market research databases produced by ITA that personnel overseas can access. If management in China finds that the new

databases still do not provide sufficient information for personnel to conduct market research, then we believe that more Internet access could be obtained on the stand-alone computers that US&FCS China purchased in 1997.

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In response, US&FCS wrote, “the OIG report errs in stating that the US&FCS IT modernization initiative required overseas posts to purchase new computers to ensure compatibility.” We have modified the wording to clear up any misunderstanding. However, our main point about the purchase of the computers was that there was an inherent waste in procuring computers in late 1997 (the ten mentioned in the report) that cannot be used effectively as desktops with the Lotus Notes-based system. US&FCS wrote that they knew of no other way of minimizing the obsolescence of the computers. However, we believe the hardware requirements for those machines to be usable (at full capacity) with the Lotus Notes system should have been known in late 1997, and the purchasing of those computers in 1997 should have met all hardware specifications and capabilities required for the new system. Obsolescence should not occur only one year after procurement of the computers.

US&FCS also wrote that it intends to allow Internet access for each employee as soon as it solves technical and security issues and the budget is available. Until then, US&FCS agreed with our recommendation to use the computers bought in 1997 as stand-alone Internet access computers.

## II. Shanghai Commercial Center Has Made Progress in the Last Year, But Several Areas Need Improvement

In the last two years, the US&FCS office in Shanghai has been in transition with the opening of the commercial center and the movement of the office from the U.S. consulate. The operation has more than doubled in size, in terms of both personnel and physical space. While our inspection noted progress in certain areas, we found problems that need to be addressed. In particular, we found that the Shanghai Commercial Center has not been functioning as originally intended. The partners occupying office space in the commercial center and the US&FCS Shanghai staff were not working together effectively to promote U.S. exports. We believe US&FCS will not be able to recover the costs associated with the additional services offered by the center due to start-up costs, high annual operating expenses, and low revenues collected. The lack of oversight for the commercial center program by Washington has also had a detrimental effect on the program.

Despite the above problems, our inspection did find that the PCO and his staff had expanded the trade promotion program and improved some internal operations. In particular, the PCO and his staff created a post-initiated events program, developed new products and services in the commercial library, instituted systems to track clients and performance, and established systems to document certain transactions (e.g., procurement log, representation log, spreadsheets tracking deposit funds). However, as a result of the heavy demands placed on the staff during the last year in trying to improve the operation and the PCO's leadership style, we found the working environment to be contentious and staff morale low. We also noted that better controls and oversight are needed for internal operations including monitoring expenses and ensuring government assets are protected against fraud, waste, and unauthorized use.

### A. Shanghai Commercial Center is impressive but not functioning as originally planned

Pursuant to Title IV of the Jobs Through Exports Act of 1992, US&FCS opened four U.S. Commercial Centers—Sao Paulo, Brazil (April 1994), Jakarta, Indonesia (November 1994), Shanghai, China (July 1996), and Johannesburg, South Africa (March 1998) as part of the Big Emerging Markets Initiative.<sup>16</sup> According to Section 401 of the act, the purpose of the centers is to provide additional resources for the promotion of exports of United States goods and services to the host country by familiarizing U.S. exporters with the industries, markets, and customs of the host countries. To carry out its objectives, each center is to provide the following services on a user-fee basis:

- < business facilities including exhibition space, conference rooms, and office space;
- < business services including language translation services, clerical services, and a commercial library; and
- < commercial law information services including a clearinghouse for information regarding the relevant commercial laws, practices, and regulations of the host country.

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<sup>16</sup> Public law 102-549.

US&FCS is to leverage its presence in these markets by collocating with U.S. industry representatives and Market Development Coordinator Program representatives in the centers.<sup>17</sup> The legislation requires that the centers be located in the primary commercial city of the host country and house all departmental personnel who are assigned to that city. While commercial centers are not very different from other US&FCS operations that have also moved out of embassies or consulates, they do offer extensive business facilities and more opportunities to collocate with federal, state, and private sector partners.

The Shanghai Commercial Center, located in the heart of Shanghai's business district, is perhaps unique among the four established centers because it is the first export promotion facility of its kind in the People's Republic of China and is one of the most active centers of all. During the initial planning stages of locating a commercial center in China, US&FCS encountered many obstacles from the Chinese Government. When Chinese officials finally authorized the opening of the center, many stipulations were imposed on US&FCS. For instance, the Chinese Government required US&FCS to register the center as a non-diplomatic entity separate and distinct from the commercial section. US&FCS was not able to operate the center as it had originally envisioned as a "home away from home for U.S. exporters," but was able to jointly collocate with state and partner organizations. However, the partners were not given their own legal status and therefore cannot register their representative office, precluding them from opening bank accounts in their name. In essence, the partners are considered to be a "subsidiary" of the center.

#### Lack of headquarters oversight of commercial center creates problems

According to the Trade Promotion Coordinating Committee's (TPCC)<sup>18</sup> 1996 *National Export Strategy* report to the Congress, "U.S. Commercial Centers are a key component of our strategy for expanding U.S. exports to the Big Emerging Markets."<sup>19</sup> However, our inspection found no one—in either US&FCS China or headquarters—marketing the services offered by the center to U.S. businesses or organizations. In fact, headquarters officials acknowledged that implementation of a centralized marketing plan for all four commercial centers was dropped after the top officials who designed the program resigned. At that time, the responsibility for the centers was given to the regional offices in the Office of International Operations that oversee the country where the centers are located.

Cognizant US&FCS staff have told us that the commercial center concept, an initiative of the former US&FCS Director General and her Deputy, was implemented too quickly and without fully considering the benefits of collocated partners. Now that the primary backers of the commercial center program have left US&FCS, there is little top-level support from Washington for the centers. As a

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<sup>17</sup> This ITA program provides competitive matching grants to states, trade associations, chambers of commerce, world trade centers, and other non-profit industry organizations. The purpose of the grants is to help underwrite the startup cost of new export market ventures.

<sup>18</sup> TPCC, first created in 1990, is designed to ensure that the federal government is doing all that it can to help U.S. companies, especially small- and medium-sized firms, take advantage of the opportunities in the global marketplace.

<sup>19</sup> Fourth Annual Report to the United States Congress, *The National Export Strategy*. Business America, September 1996, page 41.

result, the centers are not being marketed to U.S. businesses or potential partners as effectively as they once were when the initiative was being implemented. While the PCO would like to find additional partners, he has had little time to perform this task. Instead, he has spent much of his time trying to build a more cooperative relationship with the current partners, developing a strong trade promotion program, and carrying out his normal responsibilities as a PCO.

We believe it is quite difficult for the PCO to recruit U.S. partners from China considering the time constraints and the added responsibilities he has as PCO of the center. The mere fact that headquarters and the U.S. Export Assistance Centers deal with many partners everyday leads us to believe that the recruitment for partners should take place in the United States. Therefore, we are recommending that headquarters assign overall responsibility for commercial center program support and marketing to one specific individual in Washington, D.C.

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In its response to our draft report, US&FCS management acknowledged the desirability of our recommendation to assign the program responsibility for commercial center support and marketing to a single employee in US&FCS headquarters but that the lack of headquarters staffing resources is the chief obstacle to this assignment. In addition, while US&FCS states that the occupancy of four cooperators is “more than adequate” for the Shanghai Commercial Center, we remind US&FCS that it runs the risk of violating 31 U.S.C. § 1301 in renting more space than needed, not to mention their obligation, under the law, to recover costs associated with this service.

#### US&FCS Shanghai staff need to work more closely with partners

Since 1993, the TPCC, through its national export strategy goals, has stated that U.S. overseas missions must cooperate more with the private sector and state/local governments by developing opportunities to involve U.S. private sector partners, industry associations, AmChams, state and local government agencies, and in-country business groups. Furthermore, according to a 1996 memorandum from the US&FCS Director General, the main purpose for establishing the commercial centers was to,

“...enable U.S. companies and trade promotion organizations—targeting those who have the best chances for succeeding and, ideally, those for whom an overseas presence would otherwise not be an option—to have an affordable base in a priority market for one day to as long as a year....The long-term presence of partners gives us the opportunity to share some costs, expand the resources available to clients at one site, and multiply the number of clients served. From an organizational perspective, partnering is exactly what we should be doing more of overseas, though we may not call every operation a Commercial Center.”<sup>20</sup>

The idea of partnering and expanding resources available to U.S. exporters in a market are especially important in China. When the Shanghai center opened in July 1996, it was the only vehicle for U.S. states to open representative offices in China.<sup>21</sup> In an era of shrinking federal resources, the Shanghai

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<sup>20</sup> US&FCS Director General memorandum, October 10, 1996.

<sup>21</sup> To date, there still exist prohibitions against states registering independently in China.

center gave US&FCS an opportunity to work in partnership with public-private trade promotion organizations and to extend the range of resources and assistance available to support U.S. companies in China. However, instead of being the “model of private-public sector partnership,” the Center was at most a landlord for its collocated partners.

At the time of our on-site inspection, we found little evidence that the four partners (the States of Maryland, Michigan, and Washington, and the Association of Manufacturing Technology) located at the Shanghai Commercial Center had been adequately integrated into the Shanghai commercial operations. Based on our discussions with both the partners and US&FCS staff, we concluded that the interaction between the two is fairly minimal and uneven. However, both US&FCS and its partners saw the potential for greater joint efforts and cooperation.

While some partners told us that they have been somewhat dissatisfied with the past relationship with the commercial section, the current PCO has attempted to move the relationship from a landlord/tenant relationship toward one of cooperating partners. The partners indicated that they are grateful for the PCO’s efforts to reduce rental prices, provide them after-hours access to their offices, and integrate them more into US&FCS programs and activities in Shanghai. In fact, one state partner told us that the PCO worked closely with him to help coordinate a successful advocacy effort to obtain a contract to design China’s largest science museum. The science museum contract could open the door to long-term technical cooperation not only between the U.S. bidder and the Chinese entities, but other U.S. firms as well. But the PCO still needs to do more to get his staff to work more closely with the partners.

We also found that the partners are not part of the overall performance reporting of US&FCS Shanghai and, therefore, their activities and successes are not being captured in the post’s performance reporting. In order for US&FCS to assess the benefits of partnerships, the successes of partners should be captured and reported. We believe US&FCS should establish performance measures to show the effectiveness of leveraging outside resources. The Shanghai Commercial Center needs to develop and implement a system to capture the export actions generated by its partners.

The collocation of partners is one of the most important and distinguishing features of the commercial center concept. While the collocation of US&FCS and its partners cannot guarantee better export assistance to U.S. companies, we believe it can foster closer ties and strengthen information exchanges that can lead to better coordination of export assistance. Besides the obvious benefit of providing additional resources to help promote U.S. exports, the partners also have in-depth knowledge of their client base (whether it be a particular state or industry). We believe US&FCS Shanghai needs to pay more attention to enhancing its cooperation with state and local government and private sector resource partners. In addition, US&FCS Shanghai may want to encourage the participation of other federal agencies in the commercial center (*e.g.*, the Foreign Agricultural Service, Export-Import Bank, and USIS) in an effort to further coordinate U.S. commercial efforts overseas.

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In its written response to our draft report, US&FCS agreed to have the PCO in Shanghai and his staff pay more attention to improving cooperation with state and local government and private sector resource partners in the commercial center. In pursuit of this goal, US&FCS reports that during fiscal year 1999, (1) the PCO has written into each employee’s workplan for FY 1999 the requirement to



work directly with commercial center cooperators on specific export promotion programs, (2) cooperators have begun attending regular US&FCS staff meetings, (3) cooperators have been included on two US&FCS-organized trade missions and US&FCS-organized industry councils, and (4) cooperators have worked jointly on market research goals, trade promotion goals, and advocacy assignments in Shanghai.

Furthermore, in an effort to complement the services that US&FCS and its cooperators are offering at the Center, US&FCS stated it is discussing the idea of taking in a representative of the Export-Import Bank, who would function as a separate cooperator. We believe that the Export-Import Bank would also be a valuable partner to have at the Commercial Center.

#### User fees for commercial center services most likely will not recover costs

Under the original concept of the commercial centers, it was believed that US&FCS could recover the costs for the centers because of the anticipated low costs associated with opening up such centers and the projected revenue from user fees and partner contributions. However, this does not appear to be the case with the Shanghai Commercial Center. To date, the center has not been self-sustaining because of (1) high start-up costs incurred by US&FCS; (2) high annual operating expenses, especially in the first two years of operation; and (3) revenue from user fees and partner contributions has not met expectations. As a result, it is very likely that US&FCS will not recover the costs associated with the new services (*e.g.*, office space, conference/seminar room, commercial library) offered by the commercial center by the time the five-year lease expires May 31, 2001.

US&FCS is attempting to recover the costs associated with the new services provided by the Shanghai Commercial Center because the authorizing legislation required that specific services (*i.e.*, business facilities, business support services, and commercial law services) be provided on a user-fee basis. Criteria for user fees are best defined by OMB Circular No. A-25, which establishes the federal policy regarding fees assessed for government services and for the sale or use of government goods or resources. While user fees are generally supposed to be sufficient to recover the full cost to the federal government of providing a good or service, exceptions to this policy are sometimes granted. Without such an exception or waiver, US&FCS must recover the full costs associated with the services provided by the commercial center.



*Office Space Available for Partners*

#### *US&FCS incurred high start-up costs to open the Center*

When the commercial center initiative was implemented in Shanghai, US&FCS had to find a new facility that would collocate the US&FCS Shanghai operation at the consulate with the new commercial center. Once the Chinese government finally approved the plans for the commercial center, US&FCS chose to locate the new facility in the Shanghai Centre. The original site selected fell through because of the time delay in getting the plans for the center approved by the Chinese authorities and issues with the prospective landlord. At that time, the Shanghai Centre seemed like the

ideal location because the Foreign Agricultural Service was also located in the facility, as well as U.S. businesses and trade associations.

In opening the new facility, the Chinese authorities required US&FCS to physically separate the US&FCS Shanghai operation from the commercial center. The Regional Security Officer at the U.S. Shanghai Consulate also imposed security regulations. US&FCS paid approximately \$624,000 in start-up costs, which covered expenses for the build-out of the facility, design/architectural and engineering services, legal counsel, a quality assurance contract, and a portion of administrative services paid to the State Department.

In addition to the build-out costs, US&FCS also incurred additional expenses during the start-up phase because it was under pressure to open the facility by a certain deadline. After a public announcement was made by the Secretary of Commerce that the Department would open a new commercial center in Shanghai, the agency had to move fast. In order to meet this deadline, US&FCS sent two individuals from Washington, D.C., to Shanghai on a temporary duty assignment to assist in overseeing the construction phase. The costs of these temporary assignments, as well as travel expenses incurred by other officials from headquarters, contributed to the high start-up costs. On more than four occasions, officials from Washington traveled to Shanghai to inspect potential sites for the new facility.

*Annual operating costs are high, especially during the first two years*

In the first two years of operation, the annual operating expenses of the commercial center were high due to the annual lease payments as well as other expenses such as the salaries paid for personnel originally hired to work in the commercial center. At the time US&FCS negotiated a five-year lease for the facility, Shanghai real estate prices were at an all-time high. US&FCS agreed to pay \$75.50 per square meter for the first two years and \$70.00 for the remaining three years. US&FCS also agreed to pay an annual management fee based on three percent of base rent. The current annual lease payment is approximately \$786,000, including the management fee.

Since the lease was negotiated, the Shanghai real estate market has plummeted. At the time of our inspection, the going market rate for commercial office space was \$21 per square meter. While US&FCS is bound by the contract until the lease expires, it may be possible to renegotiate the current lease with the landlord. During our inspection, we were informed that State's General Services Officer had just renegotiated the residential leases for the American officers residing in the Shanghai Centre. If possible, we would encourage US&FCS to work closely with the General Services Officer to try to renegotiate the lease without extreme penalties.

In addition to the lease payments, other annual operating expenses in the first two years were high because US&FCS incurred more costs to get the center up and running or expenses were charged to the commercial center cost center. Such expenses included the cost of marketing materials for the facility and the salaries of the director and support staff hired to work in the commercial center. By the end of the first two years of operation, US&FCS had spent approximately \$2.5 million to establish the commercial center program in Shanghai based on expenses charged to the commercial center cost center, but not including expenses incurred by headquarters personnel. In the third year of operation, the annual operating expenses decreased as a result of changes in personnel and changes in accounting practices (see page 60 for observations on accounting practices). Despite these changes, the high

annual lease payment makes it unlikely that US&FCS will be able to recover the costs associated with the commercial center services.

*Revenue from user fees and partner contributions has not met expectations*

Although the Shanghai Commercial Center is probably the busiest of all the US&FCS commercial centers, it has not generated as much revenue as headquarters initially predicted. The office space available to partner organizations for a participation fee has not been fully occupied since the opening of the center. On average, only four of the six office suites have been occupied at any one time. When the offices are not occupied, US&FCS bears the costs, which makes it harder for the agency to recover its costs associated with the office space. Furthermore, revenues have not met expectations because the agency did not collect user fees for the use of the multipurpose room during the first two years of operation.

*Attempts to recover costs for different services vary*

US&FCS is attempting to recover its costs for the additional services that the center offers in various ways. For the seminar and conference room, US&FCS is attempting to recover its costs through a post-initiated event (PIE) program recently created by the PCO. US&FCS collects a user fee for events or seminars, based on a market-rate menu of prices it has developed. For the commercial law services provided, US&FCS charges a user fee to the public for the sale of publications. Although US&FCS is required to charge a user fee for the use of the commercial library in accordance with the legislation, it does not charge the public for using the library. However, US&FCS does collect user fees for some library services, such as the use of the copier machine or the purchase of information products.

US&FCS is attempting to recover the costs of the office space through annual participation fees charged to partners. Partners who sign a memorandum of understanding with the Department to occupy the office space in the commercial center do so pursuant to the Department's Joint Project Authority, 15 U.S.C. Section 1525. The Joint Project Authority authorizes the Secretary to enter into joint projects of mutual interest with nonprofit organizations, research organizations, or public organizations or agencies. The cost of such projects should be apportioned equitably, as determined by the Secretary, who may, however, waive payment of any portion of such costs by others, when authorized to do so under regulations approved by the Office of Management and Budget.

In determining an equitable portion of the costs to be paid by the partners, US&FCS is following the user-fee policy as it should. In the first two years of operation, partners were charged the following fees based on the square meters of office space occupied (offices 1-3: \$37,837, office 4: \$46,144, and offices 5-6: \$46,056). In the third year of operation, the new PCO sought a waiver from the requirement for full-cost recovery and requested that the annual participation fees paid by partners be reduced to account for the decline in real estate prices. US&FCS revised a cost model that was used to determine annual participation fees based on start-up costs, annual recurring costs, direct costs, and annual depreciation for furniture and equipment; however, the model did not take into account any indirect costs.

After careful analysis, the Acting Director General of US&FCS, in consultation with ITA's Chief Financial Officer, declined to grant post the full waiver it had requested, but did agree to reduce the

participation fees by excluding the expense of the temporary duty assignments during the construction phase and the salaries of employees no longer working in the commercial center. The fees were further reduced by charging the partners separately for certain other direct costs, such as after-hours security and utilities (air conditioning). Based on these revisions, partners are now charged the following participation fees; offices 1-3 (\$31,960), office 4 (\$38,977), and offices 5-6 (\$38,903). We found that, using these lower rates, US&FCS will not be able to recover the start-up and operating costs associated with the commercial office space even if the center was fully occupied for the term of the lease.

While US&FCS continues to strive toward full cost recovery on the additional services provided by the Shanghai Commercial Center based on start-up and direct costs, it may be facing an uphill battle due to extenuating circumstances. The high start-up costs and annual operating expenses, combined with lower revenues, make it unlikely that US&FCS will ever be able to recover its costs associated with the additional services. However, because US&FCS invested so heavily in opening this center, we believe the agency needs to continue to recover as much of its costs as possible for the remaining term of the lease. If, however, it becomes apparent that the additional services provided by the center are priced out of the market, we believe the PCO will need to request another waiver from headquarters to adjust the user fees for the services or the annual participation fees for the office space. We point out that the user-fee policy allows for exceptions to full cost recovery under certain conditions such as “when the recovery of full cost would seriously impair the objectives of the program.”

***B. Shanghai offers many services but industry coverage is stretched too thin***

Designated as one of four commercial centers worldwide, US&FCS Shanghai offers a variety of services. In addition to the normal services offered by any US&FCS operation, such as export counseling, advocacy support, producing market research reports, and selling existing products, US&FCS Shanghai also provides services to companies to host seminars or other functions in its multipurpose room and a commercial library to conduct market research. While we were impressed with the added services this operation has to offer, we found that key industry coverage by the staff was stretched too thin. We also found that the PCO was generally working well with most sections of the U.S. consulate, but he could do more cooperative projects with the Agricultural Trade Officer (ATO) and rebuild relations with the consular section.

**Development of post-initiated events program is successful**

The PCO and his staff have developed an impressive post-initiated events (PIE) program to help facilitate opportunities for its clients. The PIE program entails organizing events such as conferences, seminars, receptions, and meetings for U.S. companies, collocated partners, trade associations, and chambers of commerce. Events are held in the state-of-the-art multipurpose room. The multipurpose room includes a conference and seminar room as well as audiovisual equipment to be used for such events.



*Multipurpose room*

Clients are charged a user fee for the multipurpose room, which includes the cost for the room, set-up costs, staff costs, and equipment depreciation. The established fees were based on market prices after taking full costs into consideration. In accordance with OMB Circular No. A-25, user charges are to be based on market prices when the government, not acting in its capacity as sovereign, is leasing or selling goods or resources, or is providing a service. Under these business-type conditions, user charges need not be limited to the recovery of full cost and may yield net revenues.

In the first year of operation, the PIE program generated good results. US&FCS Shanghai organized more than 33 events for a variety of clients in addition to carrying out its other responsibilities. Events ranged from technical seminars hosted by U.S. companies to monthly AmCham meetings. We believe the PIE program supports US&FCS's mission to increase U.S. exports. We encourage US&FCS Shanghai to continue its expansion in the coming years.

#### Commercial library provides valuable resources to the public

The commercial library is used by US&FCS staff as well as the general public. It contains a variety of resources including current commercial periodicals, general and specific market data, and commercial directories. The library is visited daily by U.S. companies, Chinese companies, trade associations, and state organizations. Although US&FCS has generally ceased building commercial libraries in its worldwide operations, especially in countries that have similar facilities available, a facility such as the library in China is quite beneficial, considering the few resources available to the public.

Recognizing the importance of utilizing the commercial library to promote U.S. exports, the PCO and his staff have been busy developing new information products, services, and databases. In the last year, they produced a directory of *U.S. wholly-owned subsidiaries, Sino-U.S. joint ventures, and U.S. representative offices in Shanghai and East China*. The staff also produced a guide jointly with the China Council for the Promotion of International Trade, entitled *Doing Business in Shanghai*.

Additionally, the library staff has developed a client database to track business facilitation services conducted with clients (*i.e.*, counseling, advocacy) and a database to document success stories. At the time of our inspection, the PCO had plans to continue expanding products and services produced by the commercial library staff, including developing commercial newsletters and more electronic products.

We commend the PCO and his staff for their efforts in developing new products and services for the commercial library. Overall, we were impressed with the library and the amount of resources made available, as were some of the multipliers and partners we interviewed. However, we are concerned that the library may be consuming too much of the PCO's attention and it may be overstaffed. The PCO is very enthusiastic about developing revenue-generating products and services in the commercial library, yet we believe part of this enthusiasm is directed toward increasing revenues to offset commercial center costs. The PCO is attempting to show that while the center's annual operating costs are decreasing, revenues are increasing through new products and services, such as those in the commercial library and the PIE program discussed above. While we do not want to discourage the PCO from developing new products and services, we believe there needs to be a better balance achieved between the resources and management oversight devoted to the commercial library and to the core activities of US&FCS Shanghai—counseling U.S. companies, ensuring that key industries are appropriately covered, advocating on behalf of U.S. companies, and producing core products (Gold Keys, ADSs).

We also believe that the commercial library may be overstaffed while the commercial assistants covering industries may be understaffed. The commercial library had three staff members at the time of our inspection, and has since added a fourth. We caution both the PCO and the SCO that the primary focus of US&FCS Shanghai should be directed toward its core responsibilities—export counseling, advocacy support, preparing market research reports, and selling existing products (ADS, GKS, CMA). We recommend that the PCO and SCO work together to ensure that activities undertaken by US&FCS Shanghai are balanced, and that resources in Shanghai are adequately allocated.

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US&FCS agreed with our recommendation and has taken steps to address it. The SCO, D/SCO, and PCO have been working together to ensure that there is sufficient industry coverage in Shanghai while at the same time reducing the amount of time spent on activities in the library.

#### Additional resources may be needed to cover key industries

Shanghai, the city at the forefront of all commercial activity in China, has experienced phenomenal growth in the last few years. Much development is taking place in and around the city including the port, as well as in the outlying provinces. Although the recent financial crisis has somewhat slowed down development, there are many opportunities for U.S. exports, foreign investment, and joint ventures in this region. US&FCS Shanghai is responsible for covering this territory and ensuring that the needs of U.S. businesses are met. Although the US&FCS Shanghai operation has more than doubled in size since the opening of the commercial center, we found that coverage of key industries was stretched too thin. Many of the FNs were assigned to work in the commercial library or solely on

deposit fund activities—primarily events in the multipurpose room. While we believe the added services of the commercial center are a valuable tool to increase U.S. exports and facilitate relationships between U.S. and Chinese companies, key services such as export counseling and advocacy support should not suffer. At the time of our inspection, only four commercial specialists or assistants were assigned to handle industry portfolios, and one of these specialists was responsible for covering 15 top industries.

While we recognize the high turnover rate in China among local staff and the difficulty management faces in trying to find qualified staff to perform commercial assistant work, we believe that the SCO and PCO need to ensure that core services—export counseling, advocacy support—are adequately covered before special projects are undertaken.

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In its written response to our draft report, US&FCS management agreed to review its resource allocations in Shanghai and ensure that industrial sectors and core services—export counseling, advocacy support—are adequately covered before special projects are undertaken. Specifically, the response states that the SCO, D/SCO and PCO have been working this year to improve the balance of industry coverage versus new programs (*e.g.*, library activities). To begin with, resources have been redirected from the library program to cover basic commercial programs. Some industry responsibilities were also shifted to the Deputy Commercial Center Director position and the Marketing Center PSC position, which helped reduce the industry workload on the three subordinate-officer positions. In addition, as part of the SCO's plan to give each officer and commercial assistant in Shanghai, Guangzhou and Beijing specialization in one particular industry sector and market, he hopes to eliminate duplication of effort and to give each individual the country-wide lead on at least one issue.

Relationships with consulate are good, yet some adjustments are needed

Based on our discussions with other sections of the consulate, including the Foreign Agricultural Service, State Economic, Political, and Consular Sections, and USIS, the relationships between US&FCS Shanghai and the rest of the consulate appear to be working reasonably well except for a recent strain in the PCO's relationship with the Consular Section. Overall, there seem to be few battles over jurisdiction between the commercial section and other consulate sections. In fact, most gave the PCO high marks for his energy, enthusiasm, and knowledge of export promotion and trade policy. However, we believe there is room for the PCO to improve coordination with both the ATO and Consular Officer. The PCO should take advantage of the proximity of the ATO to coordinate joint projects such as participating in FAS's in-store promotions with supermarket chains as well as in the franchising area. On a separate note, the PCO needs to work more closely with the Consular Officer with respect to the visa application process so that he does not overstep boundaries.

**C. US&FCS Shanghai working environment is too stressful**

While our inspection found that the PCO has improved parts of the Shanghai operation, we also determined that his leadership and management style need to be more positive and inclusive. The PCO

seems to be extremely knowledgeable about trade promotion and policy issues. We found him to be innovative and effective in outreach to the business community. However, the PCO's management style has led to morale problems with both his American and foreign national staff.

Our discussions with the staff at post indicated that morale was clearly a problem. While the PCO claims he is open to new ideas and opinions from the staff, many staff members disagree. In addition, it seems as if the PCO's aggressive management style has prevented close teamwork between him and his staff. Furthermore, staff indicated to us that the PCO is too critical and confrontational—to the point of openly chastising staff members in the presence of others. Such a heavy-handed approach to management makes productive relationships difficult to establish and maintain and contributes to low morale.

Although recognizing the PCO's attempt to focus on performance results, we believe he needs to build teamwork amongst his staff and establish realistic goals for them. The PCO needs to learn how to effectively use the staff he has, and provide more one-on-one feedback to them on a regular basis. Creating realistic performance plans on which to evaluate them, should also help to reduce some of the tension and stress.

While the SCO and the Regional Director for EAP are aware of this problem, they have not taken any steps to correct it. Although morale has not yet significantly affected the US&FCS Shanghai program, we believe that worsening morale could reduce the staff's motivation and hamper the ability of US&FCS Shanghai to meet its objectives. The SCO should work with the PCO to modify his management style in a way that will improve morale.

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In its written response to our draft report, US&FCS management concurred with our recommendation to have the SCO work with the PCO of Shanghai to modify the latter's management style, increase teamwork, and help improve staff morale. The response acknowledged that while the PCO is a hard-charging, results-oriented, highly-innovative and disciplined individual, he may have placed the accomplishment of his objectives ahead of his staff's needs and concerns under certain circumstances. The response stated that the SCO took steps to work with the PCO in Shanghai, as well as encourage him, in seeking to bridge the differences which had appeared between management and staff.

***D. More supervision needed over financial operations and administrative matters***

Improvements have been made in the financial operation,  
but more accountability is needed

Our inspection found that the PCO has made progress in improving the post's financial operations, but more supervision and oversight are needed to monitor revenues and expenditures and to ensure that government assets are protected against fraud, waste, and abuse. Since his arrival in August 1997, the PCO has improved the financial operation by creating spreadsheets to record and monitor transactions and a filing system to maintain records. He also separated key budget/financial duties among the staff. Most notable is the progress made with respect to the recording and processing of deposit funds. The PCO has developed spreadsheets for each type of information product, event, and business facilitation



service that falls under the deposit fund category. For example, for all the Gold Keys produced and sold in fiscal year 1998, US&FCS Shanghai has detailed spreadsheets to track all authorizations received throughout the fiscal year, obligations committed, disbursements made, and income collected. The spreadsheets also include a budget plan and the name of the clients who received Gold Keys. These spreadsheets serve to document and record transactions and events, satisfying the standards for internal control systems. We believe that the system created by US&FCS Shanghai to monitor deposit funds is a “best practice” that should be implemented at the other four constituent posts in China. US&FCS Shanghai should work with US&FCS Beijing to help implement the spreadsheet system at the other posts.

In addition to creating a system to record and process deposit funds, the PCO has also directed his staff to create spreadsheets to track other transactions. In particular, US&FCS Shanghai has logs to track procurements made with O&A and deposit funds, representation funds spent, and funds collected from business facilitation services conducted in the commercial library. However, we did note that the procurement log does not provide a description of all the items purchased. We believe that a description of all items purchased should be maintained so that US&FCS Shanghai can easily demonstrate that all procurements were within authorized limits and government resources were used effectively. We point this out for two reasons: (1) US&FCS has invested heavily in the Shanghai operation over the last three years and headquarters should be aware of what funds are being spent for, and (2) resources are being accumulated in the commercial library and multipurpose room and we believe US&FCS Shanghai should be able to demonstrate that any such purchases that were made with deposit funds were directly tied to an information product or an event and business facilitation service.

Improvements have also been made in the financial operation by the separation of key budget and financial responsibilities among two FNs handling O&A and deposit funds. One FN is now responsible for handling the O&A funds, which entails preparing the annual budget for the two programs (in consultation with the PCO), tracking procurements, overseeing the imprest fund, and monitoring expenditures. The other FN is responsible for handling deposit funds, which entails preparing event budgets, requesting authorizations, processing obligations, and preparing the required reports to be submitted to Washington. We believe that the separation of duties is critical in China for three reasons: (1) it meets the standards of internal controls, (2) it ensures that no one individual is solely responsible for a transaction, and (3) it prevents total disruption to an operation when staff turnover occurs—of particular concern when considering the high rate of turnover in US&FCS China.

*Finances have to be monitored more closely*

Despite the progress made in improving the financial operations, we found that the PCO did not closely monitor finances as effectively as he could because he delegated much of these responsibilities to a first-tour officer with limited experience and training in the budget/finance area. The officer, in turn, relied heavily on an FN to monitor funds as he was also responsible for handling an industry portfolio. Although the FN attempted to monitor funds by creating spreadsheets, she neither obtained all the cuff records needed to track the budget nor received any feedback from Beijing as to when funds allocated to US&FCS Shanghai had been obligated and disbursed. As a result, the post tried to operate within the limit of its budget without knowing its financial position; inevitably, mishaps occurred.

In the summer of 1997, before the arrival of the current PCO, the anti-deficit flag was raised on the commercial center cost center because almost all funds had been exhausted. While it appears that the problem was partly due to the cashier's misunderstanding of what to charge to the commercial center cost center versus the core US&FCS China cost center, and partly to unexpected costs for the commercial center, it is still a reflection of post's failure to closely monitor funds.

In the summer of 1998, the core US&FCS Shanghai program exceeded its budget for overtime because overtime costs were not being monitored. Although the anti-deficit flag was not raised this time because the B&F accountant notified US&FCS Beijing that funds for personnel expenses were about to be depleted for all of US&FCS China, this contributed to the shortage. Had the post monitored its funds closely, it would have known that it was running short of funds and could have notified US&FCS Beijing or requested that funds be re-programmed.

In reviewing Shanghai's records, we noted that although some of the overtime costs accrued were for preparations for the Secretarial and Presidential visits that took place in fiscal year 1998, a significant amount of overtime was being incurred by the two drivers. Of the 1,062 hours of all staff overtime claimed from October 1997 to July 1998, 889 hours of overtime was claimed by the drivers—approximately 83 percent of all overtime. Only 173 hours of overtime was claimed by the commercial assistants. In reviewing the records, we noted that excessive overtime was being charged by a driver to drive the PCO home from the Shanghai Centre to his residence. (See the following section for additional information on this issue.) While we recognize the need for overtime in China, especially considering the volume of high-level visits, we do not believe overtime should be claimed for the personal benefit of the PCO. During our visit, we heard complaints that legitimate overtime was being denied to commercial assistants who performed their duties after hours. The SCO needs to ensure that FNs are being compensated for legitimate overtime and that overtime expenses are being monitored. He should also hold the PCO accountable for managing the budget. US&FCS Shanghai should obtain all cuff records and track expenditures against authorizations.

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US&FCS has taken steps to address our recommendations yet further action is needed. US&FCS Shanghai will begin including descriptions of the items purchased on the purchase log as recommended. We request a copy of the updated purchase log be included in the action plan. The response also states that the PCO has taken back responsibility over financial and administrative duties and the two financial and administrative assistants will have completed training by the end of the summer.

We are pleased that management has taken measures to improve weaknesses noted in the report but the response does not address whether post will maintain cuff records and track expenditures against authorizations. We reiterate our recommendation that the PCO needs to be held accountable and that all cuff records be maintained. Unless post obtains cuff records sent directly to the Shanghai Consulate, it will never be able to track its expenditures against its authorizations.

#### More internal controls needed

US&FCS Shanghai has created some noteworthy internal control systems. In addition to separating duties among individuals handling deposit and O&A funds, it has also created a standardized form to

be used when submitting petty cash receipts, which enables the post to document and record transactions more consistently. Since there is a high margin of error associated with coding fiscal data on transactions in all of China, we believe such a standardized form could eliminate errors if proper fiscal data was recorded. Although we did find some transactions that were not properly recorded (as discussed below), we believe use of a standardized form is more beneficial than submitting loose receipts, which do not always provide as much detailed information. All other US&FCS China posts should develop standardized forms similar to the ones used by US&FCS Shanghai. Nevertheless, our inspection found weaknesses in other internal control systems that warrant immediate attention.

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US&FCS agreed with our recommendation to develop standardized forms in China for petty-cash transactions. Please include a copy of the form post has developed in the action plan.

*Supervision over government assets is needed*

US&FCS Shanghai did not have adequate systems in place to ensure that government assets were safeguarded against waste, loss, unauthorized use, and misappropriation. Most noteworthy, we found that unauthorized use of US&FCS Shanghai's official government vehicle was taking place. Our inspection revealed that unauthorized use of the official government vehicle was taking place from August 1997 to present. This was the result of office-to-home transportation being provided to the Principal Commercial Officer. In accordance with U.S.C. 31 § 1344, the statute prohibits the use of an official government vehicle for transportation of an officer or employee between his or her residence and place of employment. In accordance with this law, the *Foreign Affairs Manual* has issued regulations on the use of government owned vehicles. Specifically, 6 FAM 228.2-3 states that:

“... transportation for other than business purposes is normally an employee responsibility. Privately-owned vehicles are shipped to posts at U.S. Government expense in consideration of such responsibility. However, the Chief of Mission may approve other authorized use of official vehicles when public transportation is unsafe or not available or when such use is advantageous to the U.S. Government. The exercise of this authority requires a written finding of the circumstances which justify the use of official vehicles and adequate liability insurance coverage.”

“When public transportation is locally unavailable (not merely inconvenient), use of official vehicles may be authorized. Post policy should encourage the use of employees' privately-owned vehicle to the extent possible. However, consideration may be taken of the transportation needs of dependent family members.”

During our fieldwork, we obtained overtime records, drivers' logs, and additional evidence which led us to question whether unauthorized use of the official vehicle was taking place. As of late January 1999, the Chief of Mission had not authorized use of an official vehicle for office-to-home transportation. Hence, for the first 17 months of his duty, the PCO violated the laws and regulations pertaining to the use of an official government vehicle for transportation between an officer's domicile and place of employment. For this period, the U.S. government incurred expenses for the driver's salary, overtime, and meal allowance; gasoline; and wear and tear on the official government vehicle so that the PCO could be driven to his residence in the evening. Overtime records alone show that the

PCO's driver earned over \$5,700 during this time period. While some of this overtime was for official business, we believe that a significant portion was incurred for office-to-home transportation.

We discussed this issue at great length with the PCO, D/SCO, Deputy Regional Director for EAP, and various individuals from the Shanghai Consulate and Embassy Beijing. According to the Shanghai Consulate, the PCO attempted to have a formal policy instituted when he first arrived at post that would authorize the use of the official vehicle for office-to-home transportation. The PCO believes that because he lives some distance from the Shanghai Centre, works long hours, and direct shuttle service is not available to him, he should be provided office-to-home transportation. Other individuals living in the same complex as the PCO take advantage of the shuttle bus service provided to and from the Consulate. The shuttle bus operates twice a day—once in the morning and once in the evening around 5:00 p.m. In addition, taxicabs are readily available and inexpensive. Since the Shanghai Centre is part of a large hotel complex, taxis are available at all hours to accommodate the PCO or other US&FCS employees who may need to work past the shuttle hours. The PCO also has a private vehicle at post.

We understand the PCO's efforts put forth to formalize this matter. However, in this situation, we do not believe the distance from work, hours worked, or location of the US&FCS operation are grounds for authorizing use of the official vehicle for office-to-home transportation. Use of the official vehicle for office-to-home transportation requires a written finding from the Chief of Mission on the circumstances which justify the use of an official vehicle and adequate liability insurance coverage. We do not believe these standards have been met in Shanghai nor do we believe that U.S. government resources have been used efficiently and effectively. Thus, we believe the Director General should require the PCO to repay the U.S. government for all overtime, gasoline, and wear and tear on the official government vehicle for all days that office-to-home or home-to-office transportation was provided to him.

Contrary to our belief that public transportation is locally available and safe, the U.S. Shanghai Consulate issued an administrative notice on January 26, 1999, authorizing the use of an official government vehicle for office-to-home transportation between the Shanghai Centre and Hong Qiao Villa (residence of the PCO). We believe the notice was issued as a result of our inspection since we had raised concerns to both the PCO and consulate over his use of an official vehicle without an official policy signed by the Chief of Mission. The consulate based its finding on "grievous life-threatening traffic challenges present in Shanghai" and a State Department OIG concern over a potentially defective housing policy. Moreover, the consulate informed us that the policy was in accordance with the Beijing motor vehicle policy. Under this new policy, the Shanghai Consulate intends to charge employees a flat rate of \$2.70 each way for office-to-home transportation using an official government vehicle. However, the \$2.70 fee assessed by the Shanghai Consulate does not even begin to cover the expenses listed above.

As a result of this new policy, we contacted the State OIG and were informed that there was no defective housing policy. In addition, we obtained the Beijing motor vehicle policy, which states:

"... certain agencies may have a separate authority to authorize home-to-office transportation for their employees when the head of the agency determines that such transportation is necessary for the safe and efficient conduct of duties. This

determination must be made in writing by the head of the agency and a copy shall be provided to the post transportation officer.

Because of the limited availability of public transportation in Beijing, the embassy provides a morning and evening shuttle bus service between the embassy and the residential compounds. Employees are charged a transportation fee for this service based on operating costs and the average number of riders.”

Because of our discussions with State OIG, Embassy Beijing is currently in the process of updating the Beijing motor vehicle policy and revising the Shanghai motor vehicle policy, as it appears the January notice was not in accordance with the country-wide policy. At this time, neither the Director General of US&FCS nor the Secretary of Commerce have authorized use of an official vehicle for home-to-office transportation in China. While the Beijing policy authorizes use of a shuttle bus service, it does not authorize use of an official government vehicle for employees which no direct shuttle bus service is available. Based on our knowledge that local transportation (i.e., taxis) is available and safe, we believe that the new administrative notice issued by the U.S. Shanghai Consulate is inappropriate and costly. We disagree with this administrative notice because we do not believe it is in accordance with the laws or regulations and was designed to accommodate the inconvenience encountered by some employees working in the Shanghai Centre.

Finally, we believe that this policy sets a costly precedent that could have serious implications for the other constituent posts in China as well as worldwide. We strongly encourage the US&FCS Director General and Deputy Assistant Secretary for the Office of International Operations to ensure that US&FCS Shanghai, as well as all overseas posts, abide by the laws and regulations governing the use of an official government vehicle for office-to-home transportation. In light of the recent reduction in US&FCS’s appropriations, we question whether US&FCS funds should be spent on drivers’ salaries, overtime, gasoline, and wear and tear on a government vehicle for office-to-home transportation.

In addition to unauthorized use of the official vehicle, we also noted that other government assets, such as cellular phones and residential furniture, were not safeguarded in Shanghai. Logs or files have not been established to track use of cellular phones or furniture, therefore we could not account for all government property. As mentioned earlier, US&FCS Shanghai has purchased residential furniture in the last couple of years, but no inventory has been taken. The SCO needs to ensure that all government assets are safeguarded against waste, loss, unauthorized use, and misappropriation, and US&FCS Shanghai needs to establish logs to track all government assets.

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US&FCS disagreed with recommendation 27 that the PCO be required to repay the U.S. Government for all overtime, gasoline, and wear and tear on the official vehicle for all days that office-to-home or home-to-office transportation was provided to him. However, US&FCS management did state that it will require the PCO to pay restitution for individual trips, in keeping with the limits established in the FAM and to compensate the U.S. Government for use of the official government vehicle. In the action plan, we request a copy of the OF-158 receipt documenting payment to the appropriate account. US&FCS management also indicated that it will send out an official cable worldwide outlining guidance on the use of official motor vehicles and appropriate claims of overtime. It will preclude the use of overtime for employees to provide transportation other than for official business. In instances where the Chief of Mission has authorized home-to-office transportation for

foreign commercial officers, overtime will not be granted to drivers even though officers pay a monthly fee.

With respect to recommendation 29, our intent was to highlight the need for the SCO to ensure that all government assets including motor vehicles are safeguarded against waste, loss, unauthorized use, and misappropriation. US&FCS did not address this recommendation but stated that the State Department was responsible for US&FCS inventory up until FY 1999 and that a new junior commercial officer will be responsible for tracking inventory including cellular phones and residential furniture. We reiterate our recommendation and believe that it is the responsibility of the SCO to ensure government assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

*Revenues and expenditures should be properly recorded and accounted for*

US&FCS Shanghai has not established adequate internal control systems to ensure that revenues and expenditures are properly recorded and accounted for. Our inspection found errors in the recording of accounting codes on various transactions. The miscoding of documents has had a detrimental effect on the overall US&FCS China budget because expenditures could be inappropriately liquidated against incorrect object codes. Unless the consulate cashiers or the B&F office discover the miscoded documents, the financial reports will not accurately detail the liquidations against the correct object codes. We suggest that the administrative assistants at each post work with the cashiers to agree on the appropriate fiscal codes to be applied. Although standard codes have already been established by the State Department, there still appears to be a misunderstanding or confusion on the part of US&FCS personnel as to what fiscal coding should be applied to certain transactions.

In addition to the miscoding of expenditures, we also found that user-fee collections were neither deposited in a timely manner nor properly accounted for. On several occasions, user fees were not deposited weekly, as required by the *US&FCS Operations Manual*. We also noted that user-fee collections from the commercial library were not properly accounted for. During our inspection, we counted over \$500 in user-fee collections from the commercial library in an unlocked drawer. The PCO should ensure that all collections are turned over to the sub-cashier daily, kept in a locked box, and deposited on a weekly basis.

Lastly, we also noted that monthly surprise cash counts of the imprest fund were not taking place as required by the FAM. Monthly surprise cash counts are to take place and documentation is to be submitted to the consulate cashier. The PCO should ensure that monthly surprise cash counts of the imprest fund are performed.

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US&FCS agreed with our recommendations concerning user-fee collections and has taken steps to address them.

Accounting of expenditures for separate cost centers does not reflect actual expenses

Unlike most other US&FCS posts, US&FCS Shanghai is responsible for tracking annual operating expenses for two different programs. The purpose of separating the operating expenses of the

commercial center program from the core US&FCS program is to track annual operating expenses of the commercial center for cost recovery purposes.

In the first two years that the commercial center was open for business, the previous PCO charged a good portion of expenses to the center's accounting cost center, including the lease payment for the entire facility; residential lease payments for personnel; furniture and equipment; and the salaries of some FNs and the commercial center director. In 1998, the current PCO began charging expenses that were previously charged to the commercial center cost center to the core US&FCS program cost center, thereby decreasing the annual operating expenses of the commercial center program and increasing the expenses of the core US&FCS program. For example, the salary of the commercial center director was shifted to the cost center of the core US&FCS program because the PCO changed her responsibilities so that she now works solely on core US&FCS program activities. The PCO also started applying an 80/20 ratio (core US&FCS program/commercial center program) to all invoices that commingled core US&FCS program expenses with commercial center expenses. He believed an 80/20 ratio was a more accurate representation of expenses based on the proportion of square meters allocated to what was defined as the commercial center—the six office suites for rent.

Based on our analysis, we believe that some of the costs incurred during the first two years of operation should have been charged to the core US&FCS program cost center. We also believe that the current 80/20 ratio is a more accurate reflection of actual expenses. However, from documents reviewed during our on-site inspection, we believe that some expenses charged to the two cost centers do not accurately reflect either the core program or the commercial center program. For example, miscellaneous supplies purchased for the commercial center program are being charged to the core program including toner cartridges and sockets for the offices, etc. On the other hand, the salaries of two FNs who were originally hired to work for the commercial center program, yet are solely working on core program activities, are still being charged to the commercial center cost center. In reality, the salaries of the two FNs should be charged to the core US&FCS cost center.

While we recognize the difficulties in trying to track annual operating expenses for two programs and the increased risk for errors, we still believe it is necessary for US&FCS to separate the annual operating expenses for the two programs. We also believe it is important that expenses incurred actually reflect the expenses charged to the two programs. Therefore, we conclude that the salaries of the two FNs working on core US&FCS program activities should be charged to the core US&FCS cost center, and that expenses incurred for commercial center program activities should be charged to the commercial center cost center.

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The PCO and SCO concurred with our recommendation regarding the accounting of the expenses between the two different cost centers and will make the necessary adjustments.

#### Administrative matters require attention

Many of the administrative issues mentioned in Chapter I including training, inventory, and allocation of personnel resources also need to be addressed in Shanghai. High on the list of problems needing action is the lease for the Shanghai facility. The lease on the facility should be renegotiated as discussed on page 49.



We are pleased that US&FCS agreed with our recommendation and has taken steps to renegotiate the lease on the current facility in Shanghai. In the action plan, please enclose a copy of the new lease.



### III. US&FCS Guangzhou Needs to Broaden Its Promotion Efforts and Improve Internal Operations

US&FCS Guangzhou, the third largest post in China, needs to diversify its trade promotion program in order to take advantage of opportunities with nearby US&FCS Hong Kong and to better serve U.S. exporters in the Southeast region of China. Although the post has been able to coordinate some trade events with Hong Kong, it relies heavily on the International Buyer Program as a primary tool to promote U.S. exports. The post should place more emphasis on producing or selling other products and services such as the agent/distributor service, gold keys, industry sector analyses, and international market insights. Our inspection also identified lax practices in the post's financial and administrative operations including weak internal controls over cash, collections, procurements and government assets.

#### A. *Guangzhou's program needs diversification and strengthening*

##### Commercial News USA should be distributed to a wider audience

US&FCS Guangzhou currently receives and distributes fewer than 200 copies per month of *Commercial News USA (CNUSA)*, a US&FCS export promotion magazine. *CNUSA* is mailed only to about 15 Chinese companies, and typically only quarterly. Although US&FCS Guangzhou does set out copies for pick-up by Chinese companies that visit the office, the mail-out dissemination of *CNUSA* should be more aggressive. The primary benefits of *CNUSA*, exposing potential customers and distributors to advertisements for American products, can best be realized with the widest distribution possible. The *U.S. and Foreign Commercial Service Operations Manual* (313.5, page 2) requires posts to "develop and maintain a high-quality, up-to-date, carefully screened and regularly cleaned mailing list (or other efficient distribution system) for maximum effective distribution of *CNUSA*."

The current barriers to wider distribution in Guangzhou stem from local conditions, computer difficulties, and a lack of aggressiveness in distribution on the part of US&FCS Guangzhou. We encourage US&FCS Guangzhou to continue to work with Export Promotion Services to determine whether it would be feasible to print a Chinese language version of *CNUSA*. Currently, the librarian hand-addresses the mailing to *CNUSA* customers due to problems in creating Chinese characters in the post's word-processing programs. US&FCS Guangzhou needs to (1) find a solution that allows the usage of mailing labels with Chinese characters, and (2) strive to more actively screen and add new businesses, government officials, and individuals to the mailing list.

##### International Buyer Program is heavily used but may detract from other responsibilities

US&FCS Guangzhou has conducted several IBP trips during the past year. IBPs are intended to support U.S. trade shows by recruiting foreign buyers and distributors to attend the shows and helping exhibiting firms make contact with their international visitors. We are concerned that the number of IBPs conducted by Guangzhou may be crowding out other programs that the commercial section should be promoting.

A related concern to the number of IBP trips that are taking place each year is the potential for visa fraud. The Consulate General is characterized as a “visa mill” because of the high concentration of U.S. visas issued in Guangdong Province. Visa fraud has not been uncommon in China in that some Chinese nationals who travel to the United States never return home. Although we did not have hard evidence that any of the IBPs were conducted for other than legitimate purposes, we did suggest to the junior officer at Guangzhou that he be alert to potential abuse of this program. The officer responded that he, too, on occasion has had concerns about the use of IBPs and has reminded the staff through internal communications of the legitimate purpose of IBPs. The PCO should be alert to the potential for excessive use of IBPs and strive to diversify the promotion program of the commercial section.

#### More interaction with FAS could benefit the commercial program

US&FCS Guangzhou shares adjoining office suites with the Foreign Agricultural Service, an agency of the U.S. Department of Agriculture (USDA) that represents the interests of U.S. farmers and the food and agricultural sector abroad. It collects, analyzes, and disseminates information about global food supply and demand, trade trends, and emerging market opportunities. In our meeting with FAS, the Agricultural Trade Officer stated that she had occasion to coordinate trade events with the commercial section but admitted that they were not frequent. She acknowledged that a more concerted effort on FAS’s and US&FCS’s part might identify additional opportunities to jointly work on trade promotion projects.

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In its written response to our draft report, US&FCS agreed with our recommendations. Beyond diversifying its products and services, US&FCS Guangzhou also finds that their advocacy efforts have also led to U.S. firms’ winning of large infrastructure design contracts for the city. The PCO and CO also reaffirmed their commitment to continue the regular review of IBPs to ensure that they meet the program’s criteria and also agreed that the relative scale of IBPs should not be at the expense of other products and services they have available.

#### ***B. Roles of officers need to be clarified***

The PCO for US&FCS Guangzhou is a veteran commercial officer (first tour April 1983); his prior assignment was as PCO for US&FCS Shanghai. The PCO received high marks from his staff regarding his management of the Guangzhou office, and staff morale is good. However, we found that the roles of the PCO and the foreign commercial officer could be better defined. The PCO not only manages the office but also has an industry portfolio that covers all infrastructure projects except telecommunications, while the FCO handles consumer goods sector and telecommunications. At times, only one officer from the commercial section will be invited to attend an event or function and the PCO generally goes, regardless of which industry sector is featured. Unfortunately, this practice tends to limit the junior officer’s exposure to events that might more logically fall under his program responsibilities.

#### ***C. Guangzhou has a good system to track funds, but more internal controls are needed***

The former office manager for US&FCS Guangzhou developed a good system to track cuff records, which allowed post to monitor its O&A budget. Expenditures of O&A funds are tracked in a

spreadsheet by date and voucher number and cross-referenced by object class. Although US&FCS Guangzhou uses this system, it does not provide any financial tracking information to US&FCS Beijing. As noted previously in this report, US&FCS Beijing lacks the ability to track expenditures by individual post based on its current system or information provided by B&F Beijing. After our visit to China, US&FCS Guangzhou planned to begin sending US&FCS Beijing monthly budget tracking summaries to assist them in monitoring the US&FCS China budget.

#### China's cash-intensive environment exacerbates weak internal controls

As noted previously, cash transactions are the norm in China. The local business conditions and the status of Consulate Guangzhou as a hub for visas make cash transactions even more important in the southern provinces. A procurement assistant in the consulate explained that credit cards are rarely accepted by vendors in Guangzhou and that only about 20 percent of the vendors will accept payment by check. Other vendors do not accept checks either because they do not have a checking account or because of the six week or longer processing time required by B&F Beijing.

Consulate Guangzhou has a lot of cash on hand from visa application fees, and therefore makes many payments to vendors and contractors in cash. Our inspection found that US&FCS Guangzhou drivers handle large volumes of cash because the post is located about 45 minutes from the consulate by car and no one accompanies the drivers on their mail and cashier runs. All user fee collections and money spent on purchases are handled by the drivers and almost exclusively in cash. The cash-intensive nature of financial operations in Guangzhou contributes to weaknesses in internal controls of procurement and collections.

Our inspection found that user-fee collections were (1) commingled in the same safe with the imprest fund money; (2) not deposited weekly; and (3) not tracked on an annual basis. The *US&FCS Operations Manual* requires posts to physically separate user-fee collections from the imprest fund, make weekly deposits of collections, and review and reconcile records periodically with those maintained by supervisory offices. In order to prevent a mixing of the imprest fund and collections monies, we suggest that the user-fee collections be stored in a separate cash box and in a safe. We also suggest that weekly deposits be made, and that US&FCS Guangzhou keep track of collections on an annual basis, in addition to cabling its collection reports to the requisite ITA office. Without proper tracking of collections, US&FCS Guangzhou is unable to provide both US&FCS Beijing and ITA's accounting office with a basis for reconciliation and cross-checking of the collections data.

In addition, we noted weak internal controls over transactions surrounding procurements that warrant attention. In particular, funds are being disbursed by the State cashier without prior funds availability approval being obtained from the B&F office at Embassy Beijing. Without prior funds availability approval, non-recurring expenses are not being obligated before the funds are liquidated. The lack of prior funds availability approval could result in US&FCS China violating the Anti-Deficiency Act. As noted in Chapter I, we found two examples where funds were disbursed in cash by the State cashier based on the signature of the Administrative Officer, the Consul General, and the PCO. The State administrative section failed to send the purchase order to the B&F office in Beijing for funds availability approval. Although the funds were authorized in both cases, the responsibility to obligate the funding rests with the B&F office, which was neither asked to give funds availability approval, nor told that the funds needed to be obligated. Although the breakdown in the process appears to have been at Consulate Guangzhou, the possible adverse effects of the failure to get prior funds availability

approval for US&FCS China are great; US&FCS Guangzhou must ensure that prior funds availability approval is made.

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In response to our draft report US&FCS reports that US&FCS Guangzhou took actions last fall to rectify internal financial controls noted in our inspection. Post now has improved its funds tracking system and provides O&A budget information to Beijing monthly. US&FCS Guangzhou is in the process of procuring a new safe with separate sections for user-fee collections and imprest funds, and is now making regular weekly deposits of collections. Post has taken steps to eliminate the noted procurement irregularities, meeting with the State Administrative Officer at the consulate and now sending copies of all cable authorizations to B&F to effect timely funds verification between B&F Beijing and the State Administrative section in consulate Guangzhou.

Post agreed that too much excess equipment was being stored at site, and has in consultation with US&FCS headquarters and US&FCS Beijing disposed of most of the property. The remaining property will be used for back-up support.

Regarding the large number of cash transactions, US&FCS reports that US&FCS Guangzhou has “implemented a program where either the Office Manager or Administrative Assistant (both of PSC rank) will accompany the drivers when cash disbursements are expected which exceed normal amounts.”

#### **IV. US&FCS Chengdu Performing Well Despite Limited Resources**

US&FCS Chengdu, responsible for promoting U.S. trade interests in a territory of over 200 million people, is the only official foreign government trade promotion office in this provincial capital city. Sichuan Province and the other interior provinces that fall within US&FCS Chengdu's territory are just beginning to open themselves up for investment and importing. As a result, the demand for services and assistance from US&FCS Chengdu has been steadily rising. Our inspection found the operation was generally performing well and producing many success stories despite its limited resources. The PCO, detailed from the State Department, has been actively managing the operation and building the trade promotion program. However, we believe the post can expand its trade program by initiating more trade events and can make improvements in the financial operations. US&FCS headquarters has approved plans to expand Chengdu's staff in fiscal year 1999. This should help post better meet the needs of U.S. exporters and also strengthen internal operations.

##### ***A. Chengdu has high volume of success stories, but refinements needed***

US&FCS Chengdu had the highest number of success stories per capita of the China posts in fiscal year 1998. In the first three quarters of fiscal year 1998, US&FCS Chengdu already had logged 39 out of the 150 US&FCS China success stories. The office was on track to average nearly 10 success stories per staffer in fiscal year 1998. US&FCS Chengdu had set a target of 22 success stories for fiscal year 1998, it surpassed this goal by mid-year and was on track to more than double the figure. By mid-year, the value of the supported sales by US&FCS Chengdu's success stories exceeded \$30 million. Success stories are one of a number of performance measures that US&FCS uses to determine the effectiveness of its offices. As the post had only two success stories for all of fiscal year 1997, the arrival of the PCO and the addition of a PSC position have clearly contributed to a significant increase in the productivity of US&FCS Chengdu.

Despite the post's significant accomplishments in the past year considering its limited resources and the hectic schedule it has been under, we believe US&FCS Chengdu could expand its program by initiating more trade events. While the volume of client business that Chengdu is handling is impressive, post-initiated trade events would enable Chengdu to better influence market penetration for key U.S. industries.

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In its written response to our draft report, US&FCS noted that Chengdu has gradually added more trade events to its calendar. US&FCS states, however, that recruiting more trade events for Chengdu in particular, and Sichuan Province in general, remains a problem because many potential U.S. participants are relatively uninformed about this region.

##### ***B. Principal Commercial Officer has significant strengths***

The PCO was loaned to US&FCS from the State Department for a two-year assignment in Chengdu. The experience has been viewed a success by all concerned. The PCO has learned more about the operations of US&FCS, which will serve him well in any of his future posts with the State Department.

US&FCS has reaped the benefits of an innovative, energetic PCO who has established a successful record in helping U.S. businesses in Sichuan Province. Based on our interviews, we found staff morale to be very positive. The PCO was highly respected by the other officers at the Consulate. He has succeeded in gaining the cooperation of the other sections, whether the economic section or USIS, to coordinate efforts. He has also been successful in obtaining approval for a new FN position in Chengdu to be shared between US&FCS and FAS. Finally, the PCO has also been effective in gaining the support and enthusiasm of the Consul General regarding the commercial section's promotion program. The Counsel General, who had an exceptionally good understanding of the role of US&FCS, praised the PCO's success at forging ties with senior-level Chinese officials and his management of the commercial section, noting that US&FCS "had more work than they can do."

**C. *More attention needed on financial and personnel matters***

Although US&FCS Chengdu is burdened with a high demand for its services relative to its staff size, more attention needs to be paid to financial and personnel matters. US&FCS Chengdu must track its finances on an ongoing basis, submit receipts for reimbursement weekly, and maintain both residential and office inventories.

In our discussions with the Consul General, US&FCS Chengdu staff, and other consulate officials, they remarked that the demand on US&FCS Chengdu resources is continually growing as many Chinese companies are looking for U.S. manufacturers to obtain goods from or partners to form joint ventures. The Consul General concurred that many opportunities for facilitation of U.S. exports and investment are missed simply because US&FCS Chengdu lacks the resources to respond. He noted that the way of doing business in the interior of China differed from Beijing and the large coastal cities (Shanghai and Guangzhou). In Sichuan Province, it was not unusual for the governor to attend ribbon-cutting ceremonies for U.S. companies. The Consul General maintains that US&FCS needs to establish satellite offices in China (Wuhan in particular) and that the search for US&FCS officers with Chinese language fluency should not be a barrier. Instead, he would recommend that US&FCS select a good officer and then hire a competent FN to handle any translation duties. His strong preference would be to place more officers in key commercial locations within China rather than having several officers at only a few locations. While it may not yet be possible for US&FCS to adopt such an ambitious staffing plan for the Chengdu area, we believe that US&FCS's plans to increase its staff in Chengdu in fiscal year 1999 by two should increase its ability to service clients and maintain proper internal operations.

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Responding to our draft report, US&FCS reported a number of actions that US&FCS Chengdu has taken to improve financial and administrative operations as a result of our field visit. Post has hired a System Administrator/Clerk with administrative duties, set up a cuff record system which is updated regularly, is submitting receipts to the State cashier for reimbursement immediately, is keeping an up-to-date office inventory, and is completing an inventory of the PCO's residence.

## V. Lack of Career Officer in Shenyang Impacts Overall Operation

The US&FCS Shenyang operation continues to suffer because of US&FCS's inability to fill the PCO position and the current market conditions in this region. As a result, the trade promotion program has not yet developed to its fullest potential. We found that staff spend a good amount of time resolving trade disputes on behalf of U.S. companies. Our inspection also noted weaknesses in the internal operations of the post. We believe Washington needs to assess the overall operation and consider options such as relocating to Dalian, or directly assigning an officer in order to increase the effectiveness of the operation.

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In its written response to our draft report, US&FCS stated that, despite the current depressed economic conditions in Shenyang and Liaoning Province, the region does have the potential for development in which U.S. companies should participate. US&FCS reports that they have succeeded in assigning an officer to Shenyang, whose arrival at post is expected in the fall of 1999.

### A. *Shenyang's program has been constrained by volume of trade disputes*

Shenyang, located in Liaoning Province in Northeast China, is considered the nation's "rust belt," by virtue of its many state-owned enterprises, high unemployment (40 percent), and aging manufacturing base. US&FCS Shenyang has not historically attracted a large number of U.S. exporters, in comparison to other smaller operations—US&FCS Guangzhou and US&FCS Chengdu—because of the nature of this market. While the staff in Shenyang does carry out trade promotion activities, such as producing market research reports and counseling exporters that are interested in this territory, they spend a significant portion of their time trying to resolve trade disputes on behalf of U.S. businesses. The poor local economic conditions and uneven enforcement of laws have led to a large number of trade disputes between U.S. companies and their Chinese counterparts. The PSC manager believes that the post should assist U.S. companies trying to resolve trade disputes, and the SCO supports post's efforts. Furthermore, he believes that post's involvement on trade disputes will build stronger relationships with U.S. companies located in Shenyang so that they can work with these companies on trade promotion projects as opportunities arise.

### B. *Failure to recruit officer as PCO hampers success of post*

The location of Shenyang and its harsh living conditions have prevented US&FCS from attracting an officer to this post for the past seven years. US&FCS did, however, recruit a PSC in March 1997 to manage the operation. The PSC supervises three FNs hired by the Shenyang commercial section. According to US&FCS sources, following our on-site visit, this PSC planned to terminate his contract in the spring of 1999.

The inability of US&FCS to recruit an officer for this post has, in our view, hampered the effectiveness of the Shenyang commercial section. Although the incumbent PSC is fluent in Chinese and has prior work experience with U.S. companies operating in China, his stature within and access to the consulate

is limited. For example, the State Department General Services Officer in Shenyang stated that the PSC is a good worker but operates at a disadvantage for he does not have a security clearance and lacks complete access within the consulate. Furthermore, the PSC has not been afforded the basic US&FCS training in management and supervision, nor does he have the core knowledge of US&FCS products and services that a commercial officer would potentially bring to this post.

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As noted above, US&FCS has succeeded in recruiting an officer to be the PCO for Shenyang. Until the new officer arrives, the SCO in Beijing is rotating officers from Beijing and the other China posts to supervise and direct the FN staff members. US&FCS did acknowledge that, should a PSC again be placed in charge of the Shenyang commercial section, the individual would be familiar with US&FCS programs.

**C. US&FCS should explore option of moving operation to Dalian**

During our discussion with individuals at the Shenyang Consulate, it was brought to our attention that US&FCS may want to explore the option of relocating the commercial section to Dalian, a coastal port city about 200 miles from Shenyang. Some claim that more U.S. companies are located in Dalian and more commercial activity is taking place in that region. Moreover, the Japanese government has located its trade office in Dalian, though we understand that Japanese business activity there has recently been seriously impacted due to an economic downturn in Japan. Consulate officials also stated that headquarters may be able to attract an FCO to bid on Dalian if the position was based there. Lastly, the USIS officer at Embassy Beijing mentioned that if US&FCS moved to Dalian, he would push to assign one of his officers there.

When we raised this idea with the PSC in Shenyang, he acknowledged that Dalian is an attractive city, but was concerned that if US&FCS was located there, the officer assigned there might be unlikely to visit Shenyang frequently. He added that it was important for US&FCS to remain in Shenyang as a means to draw U.S. companies further into the province. While the SCO had no definitive position on whether the operation should be moved or not, he did say it would require lengthy discussions with the Liaoning provincial government if US&FCS made a decision to do so.

Considering the bleak commercial opportunities in the Shenyang market; the relatively small trade promotion program run by the US&FCS Shenyang operation; and headquarters' inability to assign an FCO to the operation for some time, we believe that headquarters needs to conduct an overall assessment of the US&FCS Shenyang operation to determine its future role in the China-wide mission. The option of moving the office to Dalian or elsewhere in the region, or closing it down should be evaluated. If headquarters believes that the current location of the Shenyang operation is the most reasonable location, then management needs to concentrate on placing an officer there even if it means directly assigning one. If US&FCS Shenyang can only be managed by PSCs, headquarters needs to ensure that any PSC employed receives the proper training needed to be knowledgeable on US&FCS' products and services, and have general management skills. US&FCS should also focus on building



the trade promotion program of US&FCS Shenyang to better serve the U.S. exporters located there or those who are interested in doing business in the region.

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In its written response to our draft report, US&FCS states it has also considered opening a commercial office in Dalian and has proposed it as a substitute for Shenyang. Although US&FCS's proposal has been favorably received by the Department, much depends on the availability of funding, the economic activity in the province, and its effect on the relative prominence of Shenyang and Dalian.

Concerning the need to focus on building a stronger, more proactive trade promotion program, US&FCS agrees that Shenyang's program needs work. US&FCS states that prior to the arrival of the new PCO, the other officers rotating through Shenyang (see discussion above) will use the opportunity to train local staff, broaden the outreach to the U.S. exporters in the region, and increase the commercial reporting. The new PCO will also have building a stronger promotion program as a high priority.

**D. Financial operations are of concern**

Although the PSC has ably carried out responsibilities that a contract person would normally perform, he has not aggressively taken the reins in the area of financial management. Because the PSC is under contract, and not a full-time employee, he has avoided handling any funds (such as petty cash or the imprest fund) due to restrictions placed on PSCs. The PSC has determined, somewhat erroneously, that the policy precluding PSCs from handling funds also extends to reporting on the use of funds. As a result, US&FCS Shenyang does not have reliable financial and reporting systems in place, nor does the post keep cuff records. The post does not have an estimate of planned versus actual budget expenditures. Instead, US&FCS Shenyang relies on US&FCS Beijing and the State Department for an estimate of its operating budget balances. While at post, we advised Beijing that Shenyang must establish an appropriate financial tracking system. The SCO and his Administrative Officer need to work with the post so that it can begin reporting monthly figures to Beijing, as recommended in Chapter I.

## RECOMMENDATIONS

We recommend that the Under Secretary for International Trade, and the Director General and Assistant Secretary for US&FCS, ensure that the following actions are taken:

### US&FCS Beijing (Recommendations concerning China-wide and Beijing operations)

1. Improve the quality and production of market research reports, specifically IMIs and ISAs, and develop an appropriate reporting plan for each post taking in consideration available resources and market conditions (see page 5).
2. Ensure that US&FCS China improves the quality and handling of the agent/distributor service and evaluates the efficiency and effectiveness of the new ADS Toolbox (see page 10).
3. Develop new marketing materials for US&FCS China and ensure that all five posts receive publicity on their different markets, products, and services (see page 11).
4. Distribute the *Contact China* guide to a wider audience, including the Asia/Pacific team in the United States and select USEACs (see page 12).
5. Require the Regional Director, in conjunction with US&FCS China and Hong Kong, to develop a regional plan for the China Economic Area that identifies joint projects posts can work on (see page 15).
6. Require the SCO to develop a strategic plan for US&FCS China identifying its goals to strengthen the China-wide mission (see page 16).
7. Require the SCO to establish reliable systems to monitor both the US&FCS China-wide and Beijing budgets in order to ensure that funds are used economically and efficiently, and obligations of such funds are in compliance with applicable law. Hold the SCO and PCOs accountable for establishing and maintaining proper controls over O&A funds (see page 20).
8. Require US&FCS Beijing to obtain the monthly FMC 62 report from the B&F office and use it to track the disbursements of each post and to verify their internal records. Direct the SCO to require the constituent posts to submit to US&FCS Beijing their monthly financial status reports and require US&FCS Beijing to provide monthly feedback to the constituent posts informing them of the status of their disbursements (see page 20).
9. Require US&FCS China to (1) establish systems to track deposit funds, (2) make weekly deposits of such funds, (3) ensure that proper supervision is instituted over these funds, and (4) reconcile such funds (see page 24).
10. Require US&FCS China to become more involved in ICASS to help ensure that charges are appropriate, costs are equally distributed, and quality services are received (see page 26).

11. Require the SCO to work with the Embassy Budget & Fiscal office to determine whether any remaining balances can be deobligated. Furthermore, require the SCO to work more closely with the B&F office in order to ensure proper fiscal planning throughout the year and to ensure that funds have been properly obligated. Lastly, require US&FCS Beijing to review all obligations entered by the B&F accountant on a weekly basis (see page 28).
12. Require the SCO to develop standardized forms, similar to those used by US&FCS Shanghai, for Beijing, Chengdu, Guangzhou, and Shenyang to document and record petty cash transactions (see page 56).
13. Create additional incentives in order to attract more experienced officers to bid on China or directly assign experienced officers to China (see page 30).
14. Develop a plan to obtain more foreign national positions classified at the GS-10, 11 and 12 specialist levels. If the SCO does not believe some of the more experienced FNs are performing at those levels, he should either (1) work with the FNs in developing their skills or (2) recruit more experienced FNs from the DSB (see page 33).
15. Require the SCO, and other rating officers, to conduct annual performance appraisals on all FNs to (1) document current year performance, (2) provide feedback on performance, and (3) discuss next year's responsibilities (see page 33).
16. Develop and implement a training program that will provide US&FCS China personnel with the training needed to carry out their job responsibilities. Require mandatory finance and administrative training for foreign commercial officers before assigning them to managerial positions especially at the SCO, D/SCO, and PCO levels. Ensure that FNs responsible for finance and administration are provided appropriate training to handle these duties (see page 36).
17. Request that the SCO ensure that his staff has been provided appropriate training. If funds are not available, have the SCO explore ways to offer in-house training (see page 36).
18. Establish a policy requiring all US&FCS overseas posts to track all residential furniture and equipment purchased by US&FCS, in accordance with the *Foreign Affairs Manual*. Require the SCO to submit a listing of all residential property purchased by US&FCS. Require posts to inventory and track beepers (see page 38).
19. Request US&FCS Beijing to conduct a cost-benefit analysis to determine if it is feasible and beneficial to move out of the current facility to nearby commercial space. If the move is feasible, seek the funding necessary to carry out the move as soon as possible (see page 40).
20. Develop a coordinated US&FCS policy on information technology which covers computer purchases by posts (see page 41).

21. Request the SCO to obtain more Internet access on the stand-alone computers that US&FCS purchased in 1997 if he finds that the new Lotus databases still do not provide sufficient information for personnel to conduct market research (see page 41).

### **US&FCS Shanghai**

22. Assign program responsibility for commercial center support and marketing to one individual in US&FCS headquarters (see page 43).
23. Require the PCO of Shanghai and his staff to pay more attention to improving cooperation with state and local government and private sector resource partners in the commercial center (see page 45).
24. Require the SCO to review resource allocations in Shanghai and ensure that industrial sectors and core services—export counseling, advocacy support—are adequately covered before special projects are undertaken (see page 52).
25. Require the SCO to work with the PCO of Shanghai to modify the latter's management style, increase teamwork, and help improve staff morale (see page 53).
26. Require the SCO to hold the PCO of Shanghai accountable for managing the budget. US&FCS Shanghai should maintain cuff records and track all expenditures against authorizations (see page 54).
27. Require the PCO to repay the U.S. government for all overtime, gasoline, and wear and tear on the official government vehicle for all days that office-to-home or home-to-office transportation was provided to him beginning August 1997 to present (see page 56).
28. Clarify and distribute the China motor vehicle policy approved by the Chief of Mission, and ensure that all officers abide by the regulations pertaining to use of motor vehicles (see page 56).
29. Direct the SCO to ensure that all government assets are safeguarded against waste, loss, unauthorized use, and misappropriation at US&FCS Shanghai. Request US&FCS Shanghai to establish logs to track government assets including cellular phones (see page 56).
30. Require the PCO in Shanghai, the SCO in Beijing, and the US&FCS Property Manager in Washington to determine if it is cost effective and in US&FCS's best interest, to have State continue tracking inventory. If so, the PCO should request the State Department to update its inventory log to account for recent purchases. If not, US&FCS Shanghai should opt out of this service under ICASS and begin to track its own inventory including residential furniture. Require US&FCS Shanghai to dispose of the older model photocopy machine in accordance with the regulations outlined in 6 FAM Property Management (see page 39).

31. Require the PCO of Shanghai to ensure that all collections are turned over to the subcashier daily, kept in a locked box, and deposited on a weekly basis, and that monthly surprise cash counts of the imprest fund are performed (see page 60).
32. Require the PCO of Shanghai to properly account for expenses and charge (a) the salaries of the two FNs working on core US&FCS program activities to the core US&FCS cost center, and (b) expenses for supplies and any other expenses incurred by the commercial center to the commercial center's cost center (see page 60).
33. Request that the PCO of Shanghai, in coordination with the State Department General Services Officer, attempt to renegotiate the lease on the commercial center facility, if it can be done without extreme penalties (see page 61).

### **US&FCS Guangzhou**

34. Ensure that the PCO strengthens the trade promotion program by (a) increasing distribution of *CNUSA*, (b) diversifying products and services, and (c) developing more frequent interaction with FAS officials and their programs (see page 63).
35. Require US&FCS Guangzhou to improve internal controls and administrative functions by (a) keeping collections in a separate cashbox, (b) making weekly deposits, (c) ensuring that all purchase orders in excess of the standard limit obtain prior funds availability approval from B&F Beijing before funds are disbursed, and (d) disposing of excess equipment (see page 64).

### **US&FCS Chengdu**

36. Expand US&FCS Chengdu's trade promotion program by initiating more trade events (see page 67).
37. Require post to track its finances, submit receipts weekly for reimbursement, and maintain both residential and office inventories (see page 68).

### **US&FCS Shenyang**

38. Conduct an assessment of the US&FCS Shenyang operation to determine its feasibility and future role in the China-wide mission. Review the feasibility of relocating to the port of Dalian. If US&FCS believes that the current location of the Shenyang operation is the most reasonable location, then US&FCS should concentrate on placing an officer there, either by bid or a direct assignment (see page 69).
39. If US&FCS does not succeed in placing an officer in Shenyang, ensure that any PSCs employed receive the training needed to be knowledgeable of US&FCS's products and services, and have general management skills (see page 70).

40. Focus on building the trade promotion program of US&FCS Shenyang to better serve the U.S. exporters located there and those who are interested in doing business in the region (see page 70).
  
41. Require the SCO and Administrative Officer to assist post in establishing an appropriate financial tracking system so that it can begin reporting monthly financial figures to Beijing (see page 71).

## APPENDIX A — Acronyms

ADS	Agent/Distributor Service
AmCham	American Chamber of Commerce
ATO	Agricultural Trade Officer
B&F	Budget and Fiscal
BXA	Bureau of Export Administration
CNUSA	<i>Commercial News USA</i>
D/SCO	deputy senior commercial officer
DSB	Diplomatic Service Bureau
FAM	Foreign Affairs Manual
FAS	Foreign Agricultural Service
FAAS	Foreign Affairs Administrative Services
FCO	foreign commercial officer
FMFIA	Federal Managers Financial Integrity Act
FN	foreign national
FSN	foreign service national
GKS	Gold Key Service
IBP	International Buyer Program
ICASS	International Cooperative Administrative Support Service
IMI	International Market Insight
ISA	Industry Sector Analysis
IT	information technology
ITA	International Trade Administration
LA	limited appointee
MAC	Market Access and Compliance
MOU	memorandum of understanding
NTDB	National Trade Data Bank
O&A	Operating and Administrative
OIG	Office of Inspector General
OIO	Office of International Operations
PCO	principal commercial officer
PIE	post-initiated event program
PLC	pre-license check
PSV	post-shipment verification
PSC	personal services contractor
SCO	senior commercial officer
US&FCS	U.S. and Foreign Commercial Service

## APPENDIX B — Agency Response to Draft Report

July 14, 1999

TO: Jill Gross  
Acting Assistant Inspector General  
For Inspections and Program Evaluations

FROM: Awilda R. Marquez

SUBJECT: US&FCS Response to Draft Inspection Report No. IPE-10915, May 1999  
("US&FCS China Is Meeting the Demands of Its Clients, but Internal Operations  
Need Attention")

This memorandum responds to your Draft Inspection Report, which summarizes OIG findings from an August 14 to 28, 1998 inspection of the Commercial Sections in China (Beijing, Chengdu, Guangzhou, Shanghai, Shenyang).

### **I. GENERAL COMMENTS:**

The thoroughness of the IG Team's preparations for its inspection of our commercial operations in China bespoke the Team's conscientiousness in approaching this onerous task, and led us to await a substantive, insightful and highly-specific report. The end product has met our expectations. It demonstrates the range, understanding, and attention to detail which characterize a successful review.

Your office will recognize our appreciation of the Team's observations in the diligence with which we have implemented several of its recommendations, notably in the area of financial administration, where you pointed to various shortcomings. SCO and post deserve credit for initiating the changes you strongly suggested, and for bringing a greater measure of order and accountability to our operations.

On the other hand, your report, which takes due consideration of the sweep of our presence and



programs in China (now our largest Commercial Section in the world, in recognition of this country's immense import potential), probably underestimates the administrative difficulties arising from the rapid growth of our staff in country, the complexity of working in a restrictive diplomatic and trade environment, and the enormous demands originating from all levels of the Washington establishment and management as China has become a primary focus of political and economic attention in the capital and elsewhere.

Before responding to the specific recommendations offered by the Team, we would like to make the following comments, which address some of the Team's more general observations:

- o We appreciate the essential importance of providing managerial guidance to our Commercial Section in China and acknowledge some lapses in our direction of post's activities. One must keep in mind, however, that the Commercial Section effectively serves more than one master, and that its efforts on behalf of the U.S. business community are both multi-faceted and subject to continuous reevaluation and changes of emphasis. While it is proper for the IG Team to ask for stronger management from the Office of International Operations, the imposition of another layer of requirements on a post agenda which perforce is largely reactive may not translate to a more successful operation. Indeed, the Commercial Section's flexibility, its adaptability to shifts in demands and circumstances, have proved essential to its effectiveness and to many of the achievements it has recorded in the past few years particularly.
- o The current SCO, who was placed in charge of our Commercial Section on short notice and without the experience of our more senior officers, has succeeded beyond all reasonable expectations in rising to the challenge--a challenge magnified, as the report rightly notes, by the absence of a full-time Deputy until April 1998. In retrospect, one would have to judge that it was not humanly possible for the SCO to address all the issues he had to face, including the administrative concerns in which post has been found deficient by the Team. Since the assignment and arrival of a Deputy SCO over a year ago, post has made great progress in improving its administrative practices, continuing a trend the Team did observe. We believe the Commercial Section is putting its affairs in order, and are encouraged by recent developments in this area.
- o The Commercial Section, faulted for the lack of experience and insufficient language skills of its officers, is quickly gaining in maturity on both counts. This is due in part to the assignment of a growing number of officers to China, whereby we are developing a cadre of increasingly experienced "China hands," and in part to the conversion of officers on limited appointment, fine Chinese-language speakers all, to the career Foreign Service, into which they have been selected through the assessment process. We see the

emergence of a staff unit which is more and more knowledgeable, sophisticated, cohesive, and impressive in its collective capabilities and achievements. In time, we should be able to draw on a pool of exceptionally qualified in-service candidates to fill our staffing needs in China. This takes time, but we are well on our way to passing the critical point.

- o The space occupied by the Commercial Section in Beijing has undeniably become inadequate. Although we intend to remedy this situation, as we must, we have been hampered by budget constraints which show no sign of loosening. Our plans to move our staff in Beijing to a private site outside the Embassy compound require the successful conclusion of ongoing discussions with the State Department, which is looking to take over our current site. In time, we would like all our commercial offices in China to present as prepossessing an appearance as our offices in Guangzhou and Shanghai. Budget permitting, this is a goal we hope to achieve in the coming years.
- o Finally, ITA requests modification of the wording on page 14 of the draft report, under “Delay in filling Deputy SCO position burdens US&FCS China,” as follows:
  - 1) *Remove Paragraph 3*
  - 2) *Replace the first two sentences in Paragraph 4 with: “ Department and ITA senior management recruited and paneled a candidate from MAC to fill the D/SCO position. Following months of medical, security and other clearances, the candidate withdrew due to the loss of a close family member.”*

Please see the following pages for more detailed discussions of the recommendations made by the Team.

## II SPECIFIC COMMENTS

### US&FCS Beijing (Recommendations concerning China-wide and Beijing operations)

Recommendation 1: Improve the quality and production of market research reports, specifically IMIs and ISAs, and develop an appropriate reporting plan for each post taking into consideration available resources and market conditions.

Reply: US&FCS China continues to improve both the quantity and quality of its ISAs and IMIs. In FY 98 US&FCS China produced 30 ISAs and 268 IMIs; in FY 99 post plans to produce 31 ISAs and has produced 140 IMIs (as of June 15). Quality is harder to quantify, but we believe that the quality of IMIs has improved along with their numbers. Each officer has been assigned reporting goals for FY 99, and the SCO has emphasized the need to comply with the formatting requirements specified in the US&FCS Operations Manual. The SCO has also impressed on his staff the importance of improving punctuality in submitting ISAs. The IG Team's unfavorable comparison of US&FCS China's productivity vs US&FCS Japan's in this area does not sufficiently take it into account that the FSN staff in Japan is one of the most experienced in the US&FCS, in contrast with US&FCS China's.

Recommendation 2: Ensure that US&FCS China improves the quality and handling of the agent distributor service and evaluates the efficiency and effectiveness of the new ADS Toolbox.

Reply: As the report recognizes, post has taken radical measures to improve its response to requests for ADS searches, with the assignment of an ADS coordinator whose function includes ensuring close program oversight in country, timeliness and quality in follow-up. The officer managing US&FCS China's ADS program has continued to improve the Toolbox by incorporating feedback from other officers and commercial assistants. The number of ADS requests sent to post has, however, dropped by nearly half this year, making it difficult for post to measure the effectiveness of the new procedures. Improving post's performance in this base program is among the SCO's top management objectives for this year and beyond.

Recommendation 3: Develop new marketing materials for US&FCS China and ensure that all five posts receive publicity on their different markets, products, and services.

Reply: US&FCS China is preparing a new version of the well-received "Contact China" which will include individual sections on each region served by a Consulate. Post is also in the process of updating the US&FCS China webpage to include more information on the Consulates and the markets they serve. At the same time, we continue to believe that US&FCS China is a single operation and should present a unified face to our clients. This is why comprehensive

information on US&FCS China's services will be available from the revamped webpage. We also believe that the marketing of US&FCS products and services needs to be improved on a worldwide basis, and note that the new Director General has taken steps to improve the overall marketing of the US&FCS.

Recommendation 4: Distribute the *Contact China* guide to a wider audience, including the Asia Pacific team in the United States and select USEACs.

Reply: Post plans to distribute the new version of *Contact China* to stateside clients through the Asia Pacific Team and select USEACs, subject to the availability of funding for printing a sufficient number of *Contact China* brochures for this purpose.

Recommendation 5: Require the Regional Director, in conjunction with US&FCS China and Hong Kong, to develop a regional plan for the China Economic Area that identifies joint projects posts can work on.

Reply: China is the focus of a great deal of political and economic attention. Arguably, it has attracted more such attention in the past few years than any other country with which the United States maintains full-fledged diplomatic and trade relations. This means that the Administration has a high-profile China policy, as does the Congress, and that the Department of Commerce implements these policies while proposing initiatives compatible with the formal guidance received from the executive and legislative branches. Our commercial section in China takes its policy direction primarily from the recommendations relating to preparations for and conclusions of the U.S.-China Joint Commission on Commerce and Trade (JCCT), chaired by the Secretary of Commerce for the U.S. side, which meets annually. Various initiatives, such as those on small and medium-sized U.S. companies' entry and participation in the Chinese economy, on housing, on standards, etc, are directly linked to the work of the JCCT.

When the economic crisis originating in Asia broke out in 1997, the Department decided to provide the U.S. business community up-to-date information on economic and trade developments and advice on trade opportunities available in the midst of the spreading crisis. To ensure the effectiveness of this outreach, the Department organized several seminars, throughout the United States, on the East Asian crisis, with an emphasis on business opportunities for U.S. companies, and initiated the Asia Commercial Overview (ACO), published weekly by the US&FCS Office of International Operations' East Asia/Pacific section. The ACO continues to appear weekly and is broadly distributed within the Department and via the Internet.

In sum, our posts in East Asia, and notably China and its economic area, do not lack for guidance, nor did the Department or the US&FCS look on passively as the crisis emerged and developed in the region.

Just as it has been recognized that the sharp differences among the markets of East Asia preclude a truly regional approach to trade in this geographic area, it has been difficult to prescribe remedies for the crisis which could target subregions within Asia. Moreover, it was acknowledged early on that China was at less of a risk than its neighbors, and the main crisis-related concern soon came to focus on the possibility of a currency devaluation, which now appears increasingly unlikely.

CS Hong Kong and CS China, however, are already collaborating on various projects, particularly relating to environmental control and energy development. Our officers and staff in Hong Kong and China stay in close contact through travel and frequent communications. As to Taiwan, although some trade missions will visit both the island and the mainland, political tensions as well as significant market disparities make cooperation between the commercial sections in Taiwan and China more problematic.

To conclude--the new Regional Director may indeed consider developing a formal plan for the China Economic Area. Posts in this area might well benefit from receiving broader direction from OIO/EAP in dealing with the evolving regional crisis and future developments, difficult though these are to predict at present. Such direction will likely come in the context of a regionwide strategic plan, loose enough to take account of disparities among markets. One must keep in mind, however, that the guidelines and initiatives mentioned above incorporate interconnecting plans for China, and that the volume of calls directed to CS China has imposed a reactive rather than proactive stance on this post. Accommodating these demands within a more effective framework will be part of the responsibilities the new Regional Director will consider taking on, with his staff.

Recommendation 6: Require the SCO to develop a strategic plan for US&FCS China identifying its goals to strengthen the China-wide mission.

Reply: The commercial section of the Mission Program Plan (MPP) is the strategic plan for US&FCS China. The SCO agrees that the MPP is not the ideal format for creating a strategic plan, but it is the Washington-approved format for that plan. The SCO's and officers' individual work plans provide specific guidelines for the SCO and officers. As part of the MPP process, US&FCS China is working on a new strategic plan and will make that plan available to officers and staff in a more user-friendly format.

In a larger sense, and as noted in our response to recommendation # 5 above, the SCO operates within narrow limits in setting priorities for US&FCS China. Our actions are to a great degree driven by the priorities of the Secretary of Commerce and the Under Secretary for International Trade. To be truly effective, a strategic plan for China must have the active participation and agreement of those offices.

In this fiscal year particularly, the SCO has set program goals for the ADS and Gold Key Service. Through leadership and example, he has established the performance level expected of his staff. He also held a PCO meeting in Xiamen this past winter, and is planning an all-hands conference before the end of the fiscal year, similar to that held in Xian last year. Through these venues, he is bringing a clearer sense of purpose to his staff and operations. Last year, he redistributed the officers' portfolios, and this year he is constituting industry teams. Access to Lotus Notes, permitting more rapid and frequent intra-China communications, is contributing to better coordination, among all China posts, of basic US&FCS programs like the Gold Key Service. It has also speeded up posts' response to information requests and opened possibilities for a more coherent operation. The strategic plan the Team would like to see developed should be a collaborative effort with the incoming Regional Director, again in keeping with our response to recommendation # 5 above. It would remain contingent upon the expectations and directives of the Department's senior management and, to a significant extent, on the orientation of U.S. policy toward China.

Recommendation 7: Require the SCO to establish reliable systems to monitor both the US&FCS China-wide and Beijing budgets in order to ensure that funds are used economically and efficiently, and obligations of such funds are in compliance with applicable law. Hold the SCO and PCOs accountable for establishing and maintaining proper controls over O&A funds.

Reply: US&FCS headquarters has come to realize that posts worldwide "do not have adequate systems in place" to track individual budgets. Meanwhile, US&FCS China has developed and implemented a China-wide cuff record system. In March, post was informed that ITA has contracted with PricewaterhouseCoopers to develop a system to track US&FCS individual accounts. Since then, US&FCS China has shared its version of the cuff-record spreadsheet with PricewaterhouseCoopers, which has deemed it "very similar" to its own system.

In August 1999, the US&FCS plans to implement the ITA worldwide cuff record tracking system. The SCO, administrative officer and five FSNs will participate in US&FCS-organized regional training sessions preparatory to implementation of the system. The SCO and PCOs will ensure that the system is updated monthly at all five posts, and a consolidated report will be developed in Beijing.

Recommendation 8: Require US&FCS Beijing to obtain the monthly FMC 62 report from the B&F office and use it to track the disbursements of each post and to verify their internal records. Direct the SCO to require the constituent posts to submit to US&FCS Beijing monthly financial status reports and require US&FCS Beijing to provide monthly feedback to the constituent posts informing them of the status of their disbursements.

Reply: The draft OIG report states that the monthly obligations reports and FMC 60 issued by the B&F office are “inaccurate,” and recommends that the SCO “obtain the monthly FMC 62 report.” But both the monthly obligations report and the FMC 60 reports are summaries of the FMC 62, which is the root of the inaccuracies contained in those reports. Like the FMC 60 and monthly obligation reports, the FMC 62 report comes out two to three months late.

US&FCS China has been using the FMC 62 as a reference document to track O&A cuff records each month, but the root of our problem remains poor service from our accountant, i.e., the State Department. Constituent posts are submitting their monthly cuff records to Beijing, which gives post a rough idea of the status of their disbursements, but post does not know what has actually been obligated and disbursed until it receives the FMC 62 reports, which, as noted above, are two to three months out of date. Until State fixes its system or USDOC moves away from reliance on the State Department, post will continue to have trouble keeping track of its funds.

Recommendation 9: Require US&FCS China to (1) establish systems to track deposit funds, (2) make weekly deposits of such funds, (3) ensure that proper supervision is instituted over these funds, and (4) reconcile such funds.

Reply: (1) US&FCS China has developed a spreadsheet to track deposit funds. In January, US&FCS Beijing’s Administrative Assistant demonstrated to the Team how to use this deposit-fund tracking spreadsheet. (2) EPS’s Office of Trade Event Management (OTEM) has indicated to the OIG that US&FCS China has been depositing and reporting collections each week for two years now. (3) Proper supervision of deposit funds was discussed at the PCO conference in January and post will continue to ensure such supervision over these funds. (4) US&FCS China cannot reconcile the funds once the money is deposited into the B&F cashier’s office. It is, rather, for OTEM to reconcile these funds. Post will furnish cuff records, as needed, to facilitate such reconciliation by OTEM.

Recommendation 10: Require US&FCS China to become more involved in ICASS to help ensure that charges are appropriate, costs are equally distributed, and quality services are received.

Reply: Until last year, the absence of a Deputy SCO and lack of adequate administrative support within the Commercial Section undermined US&FCS China’s ability to work closely with the

ICASS Council and to look critically at the arrangements proposed by the Council. Now that the SCO is the head of the ICASS Council and the D/SCO is Vice-Chairman of the ICASS Working Group, post finds itself in a controlling position it will use to ensure an equitable distribution of administrative services and charges.

Recommendation 11: Require the SCO to work with the Embassy Budget & Fiscal Office to determine whether any remaining balances can be deobligated. Furthermore, require the SCO to work more closely with the B&F Office in order to ensure proper fiscal planning throughout the year and to ensure that funds have been properly obligated. Lastly, require US&FCS Beijing to review all obligations entered by the B&F accountant on a weekly basis.

Reply: US&FCS Beijing has requested that B&F deobligate remaining fund balances for FYs 95, 96 and 97. The funds will be deobligated once the B&F accountants determine that there are no orders outstanding from those three years. Our new cuff record system should help convince B&F that it can deobligate remaining FY-99 funds in a timely manner, but there is no incentive for B&F to deobligate funds, and every incentive to keep obligations on the books for as long as possible.

The SCO is working with B&F to ensure proper obligation of US&FCS China funds, but this remains a challenge. For example, the B&F accountant obligates recurring items-- *e.g.*, telephone bills, postage, transportation, payrolls, representation fund and rent--based on history, on a quarterly basis. When asked to obligate all of the costs on a monthly basis such as for lease payments and for representation on a case-by-case basis, the B&F officer has answered that, while this is possible, it would be expensive. The B&F officer estimates that this would triple post's ICASS cost for Accounts and Records, from \$31,800 to \$100,000. If the approach outlined in the Team's report is necessary to reflect a more accurate obligation status, US&FCS China will request B&F to change the frequency of obligations. Post now conducts a weekly review of all obligations entered by the B&F accountant.

Recommendation 12: Require the SCO to develop standardized forms, similar to those used by US&FCS Shanghai, for Beijing, Chengdu, Guangzhou, and Shenyang to document and record petty-cash transactions

Reply: Adopting the model developed by US&FCS Shanghai, US&FCS China has standardized petty-cash reimbursement forms for all five of its posts.

Recommendation 13: Create additional incentives in order to attract more experienced officers to bid on China or directly assign experienced officers to China.



Reply: The lack of experience among the officer complement in China has been inadvertently perpetuated by the assignment cycle, which has caused the almost complete turnover of incumbents every three years, by the time they have developed those veteran skills they lacked at the beginning of their tour. Our more senior officers serving in China and its economic area for the most part have spent much of their Foreign Service career in the region and are well acclimated to the culture. They also are our best Chinese (Mandarin) speakers. Because of the importance language skills play in China, we have complemented our officer corps with limited appointees who are fluent Chinese speakers and also armed with the requisite business background. New or career-candidate officers, on the other hand, are often short both on experience and language skills, even after a year's intensive Chinese study. On the whole, and given the make-up of our officer corps overall, this amalgam has nevertheless worked reasonably well.

Many of our experienced officers who have not served in China or the region are discouraged from bidding on such an assignment by their lack of language skills. We believe they see this as a greater drawback than the other hardships associated with a tour in China. Inasmuch as our system rewards Chinese-language skills with incentive language pay to offset the hardships of a Chinese posting, these non-Chinese-speaking experienced officers find insufficient incentives to consider serving in China. One would also fairly question their effectiveness, absent such skills, in this environment. Thus, direct-assigning experienced officers who are not Chinese speakers could create a morale problem among the individuals so assigned without significantly improving, if at all, the Commercial Section's productivity.

A solution to the problem identified in the Team's report would consist of staggering the tours of the current incumbents in order to ensure a more balanced mix of veterans vs newcomers. This depends in large part on the willingness of some at least of the incumbents to extend their tour, as appears to be the case with the present cohort of officers in China. We are also converting limited appointees to career officers, thereby adding to the contingent of staff combining experience and language skills, which provides the foundation for a more effective service.

Recommendation 14: Develop a plan to obtain more foreign national positions classified at the GS-10, 11 and 12 specialist levels. If the SCO does not believe some of the more experienced FNs are performing at those levels, he should either (1) work with the FNs in developing their skills, or (2) recruit more experienced FNs from the DSB.

Reply: The Embassy has recently signed a new contract with the Diplomatic Services Bureau (DSB) which will provide more flexibility in hiring FNs, and the Embassy Personnel Section is open to the idea of upgrading US&FCS positions. One position in Beijing has already been upgraded, and post will work with headquarters and the Embassy on upgrading other positions as appropriate.

Recommendation 15: Require the SCO, and other rating officers, to conduct annual performance ratings on all FNs to (1) document current year performance, (2) provide feedback on performance, and (3) discuss next year's responsibilities.

Reply: Annual work plans are in place for all FNs. Supervising officers will hold formal performance-related discussions with the Chinese-national employees at least once over the course of the year, and more often as needed.

Recommendation 16: Develop and implement a training program that will provide US&FCS China personnel with the training needed to carry out their job responsibilities. Require mandatory finance and administrative training for foreign commercial service officers before assigning them to managerial positions especially at the SCO, D/SCO, and PCO levels. Ensure that FNs responsible for finance and administration are provided appropriate training to handle these duties.

Reply: We acknowledge that the training the US&FCS provides our officers is short of comprehensive, given the breadth and variety of their responsibilities at post. At present, the size of our overseas staff, as well as budgetary and logistical factors, limit our ability to provide the "catch-up" training recommended by the IG team, especially for a commercial operation as big as that we have in China. We will seek to schedule administrative and finance training for incoming PCO-level or higher officers who have not had such preparation before their tour in China. As more and more officers receive this training over time, the number of those who are deficient in these areas will diminish. Ultimately, the creation of the Commercial Service Institute should remedy these shortcomings by establishing a systematic, year-round training program. Meanwhile, seven members of the US&FCS China staff will be attending an administrative and financial training course in Kuala Lumpur in July.

Recommendation 17: Request that the SCO ensure that his staff has been provided appropriate training. If funds are not available, have the SCO explore ways to offer in-house training.

Reply: Since the summer of 1998, US&FCS Beijing has provided training for FNs at Motorola University (Beijing) in English writing, public speaking, data management, PowerPoint and effective communication skills. The ADS coordinator is providing mandatory training on this product for all officers and FNs. As noted in our reply to recommendation # 16 above, seven staff (two officers, two PSCs and three FNs) have been designated for fiscal training to be provided this summer in Kuala Lumpur and four FNs for Commercial Specialist training to be held in Washington this summer. In the short and medium term, we will continue to depend on locally-provided training as the most effective way to make up for the knowledge gaps the Team has identified among our current staff.

Recommendation 18: Establish a policy requiring all US&FCS overseas posts to track all residential furniture and equipment purchased by US&FCS, in accordance with the Foreign Affairs Manual. Require the SCO to submit a listing of all residential property purchased by US&FCS. Require post to inventory and track beepers.

Reply: For FY 99, US&FCS has tracked all residential furniture and equipment purchased by US&FCS. US&FCS China's property inventories were prepared following Department of Commerce guidelines for Accountable and Sensitive property. It should be noted that ITA Administration is currently working with the Department to raise the accountability threshold to \$5,000. The inventory list was submitted to Ann Grant, OIO Property Management Specialist, in March 1999. OIO, however, has added beepers, and other new technologies, to its required inventory list. Since post had been keeping a separate beeper list, it has now merged the list for beepers with the main inventory list, in accordance with the OIG's recommendation.

Recommendation 19: Request US&FCS Beijing to conduct a cost-benefit analysis to determine if it is feasible and beneficial to move out of the current facility to nearby commercial space. If the move is feasible, seek the funding necessary to carry out the move as soon as possible.

Reply: It is clear to all visitors that the space available to our Commercial Section in Beijing and the overall condition of the facility have become inadequate. This is especially so as the size of our representation in Beijing keeps increasing, commensurately with the importance of this market and Administration commitments. The SCO has developed a contingency plan, based on a cost-benefit analysis, identifying several private-sector sites to which the Commercial Section could move as our budget permits. Lack of funding in FY 99 has made such a move problematic, and the SCO has held negotiations with the Administrative Section to determine if the State Department, which has expressed a strong interest in taking over the building currently occupied by the US&FCS on the Embassy compound, would, in whole or in part, pay the cost of the Commercial Section's move. These negotiations are ongoing. The advantages of moving to a private building, aside from an increase in work space, would be better access by the business community and a great improvement in the recognition and image of the US&FCS in a country where success depends in large part on presentation.

Recommendation 20: Develop a coordinated US&FCS policy on information technology which covers computer purchases by posts.

Reply: The report states that a coordinated approach (to IT requirements) is needed, citing a purchase of IT equipment in FY 97, followed by the IT rollout the following year. With over 150 locations in almost 90 countries, the Commercial Service has some 2,000 desktop computers in service worldwide. A program to upgrade the technology, equipment, applications and network bandwidth was begun in 1997 and is due to be completed by August, 1999. The OIG report errs

in stating that the US&FCS IT modernization initiative required overseas posts to purchase new computers to ensure compatibility. The US&FCS IT modernization initiative centralized procurement and configuration of computer equipment at US&FCS headquarters in Washington, DC, in order to minimize project costs. However, in the case of US&FCS China, the US&FCS IT modernization team was faced with difficult logistical, shipping, and customs issues. The US&FCS IT Modernization Team coordinated closely with US&FCS China to take advantage of procuring equivalent computer equipment in China at substantial savings in cost.

The OIG report refers to the prevention of potential waste of resources--the Commercial Service of course shares this objective. We know of no way of minimizing obsolescence in the IT arena, however, save for replacing 20 to 25 percent of the desktops every year on a scheduled rotation. The IT modernization initiative took into account advancing technology and used this as a base for establishing a replacement cycle that would fit into shrinking budgets.

Regarding Internet access--it is the stated intention of the Commercial Service to provide Internet access to the desktop of each employee as soon as practicable, which means based on budget availability and overcoming technical and security issues. In the meantime, we recommend that posts use those very same Pentium computers that we shipped out early in the rollout for stand-alone connection, just as the report mentions.

Recommendation 21: Request the SCO to obtain more Internet access on the stand-alone computers that US&FCS purchased in 1997 if he finds that the new Lotus databases still do not provide sufficient information for personnel to conduct market research.

Reply: All officers and Foreign-National employees at US&FCS Beijing, Guangzhou, Shanghai, and Shenyang now have Internet access from their desktop computer. At US&FCS Chengdu, Internet access is from a stand-alone computer.

### **US&FCS Shanghai**

Recommendation 22: Assign program responsibility for commercial center support and marketing to one individual in US&FCS Headquarters.

Reply: The responsibility for supporting and marketing all the commercial centers was originally assigned to an employee who had worked with the headquarters initiator of this program, the former Principal DAS for the US&FCS. This employee, together with her portfolio, was later transferred to the East Asia/Pacific region within the US&FCS Office of International Operations. Upon her departure from this office in 1998, the function of supporting the centers was divided among each of the regions where the four centers are located, but responsibility for marketing the centers was not specifically redistributed.

We acknowledge the desirability of assigning the time-consuming function of marketing the commercial centers to a single employee. Lack of headquarters staffing resources is the chief obstacle to this assignment. Also, the difficulties the employee previously charged with this function experienced in recruiting cooperators have amply demonstrated that this is a hard sale. In the case of the Shanghai commercial center, occupancy by four cooperators, while short of full, is considered more than adequate. At the same time, we are always seeking and pursuing expressions of interest, and aim to renew the pool of cooperators over time, after the Chinese authorities allow the State representatives located at the center to open their own offices, separately from a federally-operated entity.

Recommendation 23: Require the PCO in Shanghai and his staff to pay more attention to improving cooperation with state and local government and private sector resource partners in the commercial center.

Reply: Improving relations with the commercial-center cooperators has been a top priority of the SCO and PCO. In pursuit of this goal, the PCO has written into each FY-99 workplan the requirement to work directly with commercial-center cooperators on specific export promotion programs. In FY 99, cooperators began attending regular US&FCS staff meetings, they have joined two US&FCS-organized trade missions and US&FCS-organized industry councils, and have worked jointly on market research goals, on trade promotion goals and on advocacy assignments. The PCO has also been reminded to seek the cooperators' input for inclusion in the Commercial Section's quarterly reports. The trend is clearly positive, although there is room for closer cooperation still. To complement the services the US&FCS and its cooperators are offering at the Center, we are discussing taking in a representative of the Export-Import Bank, who would function as a separate cooperator.

Recommendation 24: Require the SCO to review resource allocations in Shanghai and ensure that industrial sectors and core services--export counseling, advocacy support--are adequately covered before special projects are undertaken.

Reply: The SCO, D/SCO and PCO have been working this year to improve the balance of industry coverage versus new programs in Shanghai. Resources have been redirected from the library program to cover basic commercial programs. Four officers and four FN commercial assistants are currently assigned to Shanghai. For FY 99, each of the three subordinate-officer positions was assigned one commercial assistant, and the fourth commercial assistant was assigned to the library with the specific responsibility of creating the office's first local-contact database. In response to the recommendations in this report, the SCO and PCO have agreed to de-emphasize the work attaching to the library and to return the fourth commercial assistant position to full-time industry assignments. In FY 98 and FY 99, some industry responsibilities also were shifted to the Deputy Commercial Center Director position and the Marketing Center

PSC position, which helped reduce the industry workload on the three subordinate-officer positions.

The SCO is also trying to give each officer and commercial assistant in Shanghai, Guangzhou and Beijing specialization in one particular industry sector and market. The objective is to eliminate duplication of effort and to give each individual the country-wide lead on at least one issue.

While we agree that industry coverage in Shanghai is thin, post staffing has increased dramatically over the past three years. At the beginning of FY 96, Shanghai only had two officers, three commercial assistants and no PSCs. At the beginning of FY 99, those numbers had more than doubled--to four officers, four commercial assistants, and three PSCs.

Recommendation 25: Require the SCO to work with the PCO of Shanghai to modify the latter's management style, increase team work, and help improve staff morale.

Reply: The SCO has taken pains to work with the PCO in Shanghai in seeking to bridge the differences which have appeared between management and staff. The PCO is a hard-charging, results-oriented, highly-innovative and disciplined individual, who may well have placed the accomplishment of his objectives ahead of his staff's needs and concerns under certain circumstances. The tension created by conflicting expectations is undoubtedly detrimental to realizing the achievements sought by the PCO and the Commercial Section. The PCO has been encouraged to adapt his management style to increase teamwork and improve morale. At the same time, many of the PCO's management initiatives--to increase the number of success stories, optimize utilization of the facilities, information products, etc.--have borne fruit, which has contributed to improving morale.

The PCO is now scheduled to leave Shanghai in September for an onward assignment, after a very solid if somewhat controversial two-year tour.

Recommendation 26: Require the SCO to hold the PCO of Shanghai accountable for managing the budget. US&FCS Shanghai should maintain cuff records and track all expenditures against authorizations.

Reply: As noted throughout this section of the report, Shanghai has made much progress in its financial administration, and in some areas is held up as an example to the other China posts. To address shortcomings, the purchase order log will begin to include descriptions of the purchased items, as the report recommends. In answer to the charge of lax supervision of the financial administrative assistant, the PCO took back responsibility for this function upon the departure of a first-tour officer. One of the two financial administrative assistants has received training

overseas since the inspection, and the other is scheduled to receive similar training in the summer of 1999. These actions should continue to improve post's budget-management capabilities over the longer term.

Recommendation 27: Require the PCO to repay the U.S. government for all overtime, gasoline, and wear and tear on the official government vehicle for all days that office-to-home or home-to-office transportation was provided to him beginning August 1997 to the present

Reply: The practice of providing office-to-home transportation for the PCO and other members of the CS staff ceased as a result of the OIG investigation. Contrary to the implication in the report, however, this practice predated the arrival of the PCO at post. It addressed an anomaly whereby every American officer assigned to the U.S. Consulate was provided transportation, except US&FCS officers who lived in the Hong Qiao suburbs and worked at the Shanghai Centre--a 20- to 30-minute commute. As of this writing (July 1999), and in spite of the legal prohibitions, government-owned or government-arranged transportation is still provided to all American officers except for US&FCS staff.

The PCO pointed out the anomaly to post's Administrative Section immediately upon his arrival at post and at subsequent intervals thereafter. The informal, and later formal, guidance received from the Administrative Section was exculpatory. Although the Administrative Section's guidance was subsequently shown to be deficient, the main issue is that the PCO at no time intentionally defrauded, misled, or misused government assets; rather, he tried to regularize an irregular situation, openly and in good faith.

We do not concur with the recommendation by the OIG to repay all overtime, gas and wear and tear, but will require the PCO to pay restitution for individual trips, in keeping with the limits established in the FAM.

Recommendation 28: Clarify and distribute the China motor-vehicle policy approved by the Chief of Mission, and ensure that all officers abide by the regulations pertaining to use of motor vehicles.

Reply: A copy of the March 8, 1999 guidance on the use of official motor vehicles has been provided to all officers in US&FCS China. US&FCS China fully abides by the regulations pertaining to the use of official motor vehicles.

Recommendation 29: Direct the SCO to ensure that all government assets are safeguarded against waste, loss, unauthorized use, and misappropriation at US&FCS Shanghai. Request US&FCS Shanghai to establish logs to track government assets including cellular phones.

Reply: During the period covered by the inspection, the State Department was responsible for the US&FCS inventory. In FY 99 the Administrative Assistant in Beijing traveled to Shanghai to remove US&FCS from the State Department inventory system and to resume direct control over inventoried items on behalf of US&FCS. The Junior Commercial Officer newly arrived in Shanghai has been assigned this responsibility, which will incorporate cellular phones, residential furniture, and all other relevant government assets.

Regarding the use of cellular phones, the countrywide policy has been to assign a cellular phone to each officer. An exception to this rule was the purchase of one additional cellular phone for the deputy director of the USCC, and that of two additional cellular phones assigned to the two drivers. All phone bills (for cellular and regular phones) are initialed by the individual users to confirm that all calls are for official purposes.

Recommendation 30: Require the PCO in Shanghai, the SCO in Beijing, and the US&FCS Property Manager in Washington to determine if it is cost effective and in US&FCS's best interest to have State continue tracking inventory. If so, the PCO should request the State Department to update its inventory log to account for recent purchases. If not, US&FCS Shanghai should opt out of this service under ICASS and begin to track its own inventory including residential furniture. Require US&FCS Shanghai to dispose of the older-model photocopier machine in accordance with the regulations outlined in 6 FAM Property Management.

Reply: As stated in the answer to recommendation # 29 above, US&FCS Shanghai has opted out of the State Department's inventory system. The second, newer photocopier was purchased to accommodate peak work periods at post. It is not a replacement machine, and disposal of the older copier is therefore not warranted at this time.

Recommendation 31: Require the PCO of Shanghai to ensure that all collections are turned over to the subcashier daily, kept in a locked box, and deposited on a weekly basis, and that monthly surprise cash counts of the imprest fund are performed.

Reply: Since the inspection pointed out these deficiencies, the librarian is now following the above procedures for collections. An officer has been designated to conduct the monthly surprise cash counts.

Recommendation 32: Require the PCO of Shanghai to properly account for expenses and charge (a) the salaries of the two FNs working on core US&FCS program activities to the core US&FCS cost center, and (b) expenses for supplies and any other expenses incurred by the commercial center to the commercial center's cost center.



Reply: The SCO and PCO concur with this recommendation. We will charge to the US&FCS cost center the salaries of the two individuals working on core US&FCS program activities, whose salaries have been charged to the USCC cost center. Their duties, however, remain split between the US&FCS and the USCC in a ratio of approximately 80/20 to 70/30. US&FCS Shanghai will also begin to budget to the USCC cost center those supplies ordered for the USCC's use.

Recommendation 33: Request that the PCO of Shanghai, in coordination with the State Department General Services Officer, attempt to renegotiate the lease on the commercial center facility, if it can be done without extreme penalties.

Reply: The PCO undertook negotiations with the USCC landlord before the June 1999 due date for payment of the lease. The new lease, at terms considerably more favorable to the US&FCS, will take effect during the summer.

### **US&FCS Guangzhou**

Recommendation 34: Ensure that the PCO strengthens the trade promotion program by (a) increasing distribution of *CNUSA*, (b) diversifying products and services, and (c) developing more frequent interaction with FAS officials and their programs

Reply: US&FCS Guangzhou is taking steps to bring US&FCS programs to a broader audience and to further rationalize its ongoing programs in response to the needs of exporters to Southeast China.

#### *CNUSA distribution*

US&FCS Guangzhou agrees that we could better distribute *CNUSA* to a broader South China audience. US&FCS Guangzhou intends to use its new CMS database to increase the list of contacts interested in *CNUSA* (although CMS inability to process Chinese characters severely limits its usefulness for list-keeping purposes in China). There are also numerous potential *CNUSA* users in Shenzhen, the wealthy area just across the border from Hong Kong--many of the companies operating in Shenzhen have hard-to-get import licenses to bring goods across the border from Hong Kong. Post will strengthen its outreach in this area to develop a more comprehensive list of *CNUSA* recipients. Post is also actively looking for mailing-label software permitting use of Chinese characters, so that, as our addressee list lengthens, staff will no longer have to hand-address each *CNUSA* sent.

### *Diversifying Products and Services*

US&FCS Guangzhou's client base has some unique characteristics. Southeast China and Guangdong province are manufacturing bases for many U.S. multinationals, as the region was the first area of China to open to Western businesses. There are a substantial number of U.S. investors there, whose interests US&FCS Guangzhou must serve in addition to traditional exporters. Meanwhile, many exporters believe that this market can be served through Hong Kong offices or distributors. The recent trend has been toward establishing separate distributors and representative offices in Guangdong province, but this pattern is more common among U.S. companies with experience in the China market, not newcomers.

Therefore, US&FCS Guangzhou has to meet the needs of companies with a longer presence in China. US&FCS Guangzhou agrees that more intensive promotion of programs such as the Gold Key Service and IMIs would be beneficial to our customer base. On the other hand, aggressive advocacy in the past year has led to U.S. companies' winning two of the most visible design projects in Guangzhou: the new airport terminal design contract, and a design contract to build the new Olympic-style stadium for the upcoming China National Games in 2001. US&FCS Guangzhou plans to increase its use of IMIs, advocacy and outreach to U.S. companies in pursuit of these kinds of projects.

The Team's report correctly states that US&FCS Guangzhou regularly uses the IBP program to promote U.S. exports to China. The report also cites potential irregularities with the Chinese staff's promotion of the IBP program because so many Chinese seek visas to the United States. While we agree that this post utilizes IBPs more frequently than other US&FCS posts in China, we feel that the program is one of the best ways to introduce South China buyers to U.S. products and services. Since U.S. companies new to the China market often do not consider South China in their initial strategy, US&FCS Guangzhou believes that bringing carefully-selected delegations to key trade shows in the United States is the best way to make connections with newer U.S. exporters. However, we agree that IBPs should not "crowd out" other programs beneficial to exporters. In addition, the PCO and CO will continue to regularly review delegation lists to ensure that the program is not used for fraudulent visa purposes. To date, we have found no evidence of misuse.

### *Interaction with FAS*

In the year since the OIG audit of US&FCS Guangzhou, efforts have been made to improve interaction with the FAS office. Late last year, the two sections jointly participated in a U.S. products (both food and non-food) promotion at a local theme park. As another example of our improved interaction, we helped implement the new U.S. ban on Chinese wood-pallet exports. With 40 percent of China's exports to the United States originating in Guangdong, various

sections of the Consulate (FAS, US&FCS and State Department staff) worked together under a tight deadline to meet with Chinese officials charged with implementing the ban on Guangdong's exporters. We expect similar cooperation with FAS in the future.

Recommendation 35: Require US&FCS Guangzhou to improve internal controls and administrative functions by (a) keeping collections in a separate cashbox, (b) making weekly deposits, (c) ensuring that all purchase orders in excess of standard limit obtain prior funds availability approval from B&F Beijing before funds are disbursed, and (d) disposing of excess equipment.

Reply: US&FCS Guangzhou took immediate steps last fall to rectify internal financial controls. The new Office Manager has further developed posts' system to track funds, and provides information to US&FCS Beijing more regularly in order to track Guangzhou's expenditures better. Post tracks expenditures on a daily basis, and provides an O&A spreadsheet to Beijing monthly.

As part of an overall program to improve US&FCS Guangzhou's security procedures, post has recently obtained quotes to procure a new safe with separate sections so that user-fee collections and imprest funds are no longer commingled. As part of this improvement, post has purchased a new cash box as suggested in the report. In response to additional OIG audit recommendations, US&FCS Guangzhou immediately began making regular weekly deposits to B&F.

The OIG auditors also noted irregularities surrounding procurements through our B&F section. There were examples of cash disbursements before receipt of funds-availability approval from B&F Beijing. Since the Team's audit, US&FCS Guangzhou has met with the Administrative Officer and B&F staff to rectify this situation. According to post's newly-arrived Administrative Officer, these irregularities occurred under the previous officer's management. The Administrative Officer feels this situation was due to a misunderstanding in Guangzhou's B&F section, and has assured post that there will be no more irregularities of this kind. As an additional measure, US&FCS Guangzhou now immediately sends copies of all cable authorizations to B&F in order to facilitate timely funds verification between B&F Beijing and Guangzhou.

US&FCS Guangzhou agrees that at the time of the OIG audit too much excess equipment was being stored and not disposed of properly. Since that time, post has obtained guidance from US&FCS headquarters and US&FCS Beijing on appropriate methods of property disposal, and has disposed of most of the excess property with no salvageable value. The remaining property is being repaired for back-up use when current equipment needs maintenance.

In addition, the report comments on the large number of cash transactions conducted by post, and notes that much of the cash being disbursed was transported to and from the Consulate via US&FCS drivers. As the report recognizes, it may not be feasible to alter this situation because of local-vendor demands for cash payments and the long distance between the Consulate and US&FCS locations. However, US&FCS Guangzhou has implemented a program where either the Office Manager or Administrative Assistant (both of PSC rank) will accompany the drivers when cash disbursements are expected which exceed normal amounts. A side benefit is that US&FCS Guangzhou's administrative staff will have better communications with the B&F staff, further remedying any of the discrepancies described above.

### **US&FCS Chengdu**

Recommendation 36: Expand US&FCS Chengdu's trade promotion program by initiating more trade events.

Reply: US&FCS Chengdu has been gradually adding trade events and will add even more in the future. For example, post will host a Multi-State Catalog Show this September, conducted a very successful joint effort with FAS/ATO at Chengdu's Wine and Candy Fair this spring, has begun organizing what we hope will be an ongoing series of product-introduction seminars with U.S. firms and trade associations, and has increased the number of accompanied and unaccompanied IBPs that it will recruit. Adequate recruitment of trade events remains a problem, largely because potential U.S. participants remain uninformed about Chengdu's and Sichuan Province's actual development and promise.

Recommendation 37: Require post to track its finances, submit receipts weekly for reimbursement, and maintain both residential and office inventories.

Reply: Post hired a System Administrator/Clerk in January 1999, whose commercial-promotion activities are limited to the computer sector. The new clerk has set up cuff records and is keeping those up-to-date. US&FCS Chengdu submits receipts to the State cashier immediately for reimbursement, although State sometimes waits up to a month to forward the receipts through its system. Office inventory is up-to-date and post is completing the inventory for the dedicated PCO apartment.

## **US&FCS Shenyang**

Recommendation 38: Conduct an assessment of the US&FCS Shenyang operation to determine its feasibility and future role in the China-wide mission. Review the feasibility of relocating to the port of Dalian. If US&FCS believes that the current location of the Shenyang operation is the most reasonable location, then US&FCS should concentrate on placing an officer there, either by bid or a direct assignment.

Reply: Liaoning Province and its capital, Shenyang, have been mired in economic depression for several years. This is not likely to be a permanent condition, however, and, like all heavily-populated areas in China, it harbors the potential for a rapid and massive development in which U.S. companies should take part. It is for this reason primarily that the US&FCS has maintained a presence in Shenyang. It has been very difficult to attract bidders for this post, which is admittedly considered less important at this time than the four other US&FCS sites in China. Yet we have paneled an officer for Shenyang, who will begin this assignment in the fall of 1999, upon receipt of her security clearance. Together with other country-wide assignments, this action will bring our program in China to full strength.

We have also considered opening a commercial office in Dalian, as a substitute for Shenyang. Dalian is a more attractive city, and arguably a more desirable site by virtue of its tourist and other facilities. We understand that a few countries are also reviewing the possibility of establishing diplomatic or other representation in Dalian. The US&FCS has actually proposed opening an office in Dalian to the Departmental hierarchy, and received a favorable response. A move to Dalian would depend on the availability of funding (we occupy rent-free space in the Consulate in Shenyang), as well as on economic activity in the province and its effect on the relative prominence of Shenyang and Dalian. We will continue to monitor this situation. For now, we feel that an important objective has been met in placing an officer in Shenyang.

Recommendation 39: If US&FCS does not succeed in placing an officer in Shenyang, ensure that any PSCs employed receive the training needed to be knowledgeable of US&FCS' products and services, and have general management skills.

Reply: The assignment of a limited-appointee commercial officer to Shenyang makes this recommendation moot. On the other hand, we acknowledge that, should a PSC hire again be placed in charge of the Commercial Section in Shenyang, this individual must be familiar with the US&FCS programs. For now, and until the arrival of the officer assigned to Shenyang, the SCO is rotating officers from Beijing and our other posts in China to Shenyang to provide interim supervision and direction to the national staff.

Recommendation 40: Focus on building the trade promotion program of US&FCS Shenyang to better serve the U.S. exporters located there and those who are interested in doing business in the region.

Reply: We agree that the trade promotion program in US&FCS Shenyang needs work. In advance of the newly-assigned PCO's arrival in Shenyang, US&FCS is sending officers from Beijing on extended TDYs (one to two weeks) in Shenyang. We plan to use these TDYs to train the local staff, broaden our outreach to U.S. exporters in the region and increase reporting on commercial opportunities in Northeast China. However, a truly effective trade-promotion program in Shenyang awaits the arrival of the incoming FCSO.

Recommendation 41: Require the SCO and Administrative Officer to assist post in establishing an appropriate financial tracking system so that it can begin reporting monthly financial figures to Beijing.

Reply: The tracking system recommended by the Team has been put in place. Shenyang is now reporting monthly financial figures to Beijing.