REPORT

OF

OPERATIONS APPRAISAL

OF

AGENCY'S PROGRAM IN CAMBODIA

By the

Operations Appraisal Staff

of the

Office of the Auditor General

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I. Summary of Findings

The AG/OAS review of Mission management and operations in the Khmer Republic, December 5 to 20, found that AID's program was well managed, and that the overall objective of maintaining the standard of living in the war-torn Khmer Republic was being achieved. The AID program, with the exception of the working class price index, was having the indirect effect of keeping inflation within reasonable bounds.

From FY 1971 through FY 1973, the U.S. has given the Khmer Republic six grants totalling $139 million. There have been two PL 480 Title I Sales Agreements valued at $45.2 million. Grants 601, 602, 604, and 606 directly financed imports through a Commodity Import Program (CIP). Grant 603 was a cash transfer, and Grant 605 provided the U.S. contribution to the Exchange Support Fund (ESF).

The CIP, after initial difficulties, was working reasonably well. Much of the success could be attributed to four principal factors: (1) Khmer importers and the Société nationale d'Exportation et d'Importation (SONEXIM), quasi-government agency for imports, had become acquainted with American procedures; (2) the 30 percent premium for American imports; (3) AID/W agreement in Grant 602 to permit up to 50 percent purchases from Code 941 countries; and, perhaps most important, (4) a realistic exchange rate.

Twelve million dollars of Grant 602 was set aside for the purchase of public sector commodities. With no in-house technical resources, the Mission has found these public sector purchases extremely difficult to manage. In the case of the commodities for Electricite du Cambodge, there have been particular difficulties and long delay in

anticipated arrival raises a question as to whether this type of commodity is suitable for ~~CIP.~~ financing under the CIP for the Khmer Republic.

CIP programming is based on studies made of import composition and volume in 1968 and 1969. This method has been adequate for FY 1973. ~~and can serve for FY 1974.~~ But the need for more sophisticated analyses of current import trends and the impact of the CIP and ESF on the domestic price structure and production is apparent and cannot be postponed, ~~for any great length of time.~~

The ESF has been successful as a multilateral mechanism to provide the Government of the Khmer Republic (GKR) with foreign exchange for imports not ~~eligible~~ financed under the CIP and in sustaining a flexible exchange rate. Administrative measures to provide audit and inspection services taken by the Working Group in recent months should provide necessary safeguards.

There have been two PL 480 Title I Sales Agreements, totalling $45.2 million. The AID Mission is completely responsible for all dollar aspects of these agreements and the operation has been successful. The 1972 rice crisis was met at a very heavy expense of Mission personnel time. The problem of insuring that Phnom Penh has a continuous supply of rice absorbs a major fraction of the available time of Mission personnel.

Rapport between the Mission and the GKR is good, and the Mission has been active--and, in many cases, successful--in seeking GKR economic policy changes through the ESF mechanism or through its own actions. The Mission also serves as the Economic Section of the Embassy, and coordination is good. Section 656 of the Foreign Assistance Act limits American personnel in the Khmer Republic to 200 at

one time. The Mission is, therefore, managing a program approximating $100 million a year with 15 employees, including four secretaries. It is very thin in economic and technical expertise and vulnerable to absence for any cause--sickness, R&R, etc. Providing the missing expertise through temporary duty personnel has had mixed results.

II. Background and Scope

AG/Audit and AG/IIS have made audits and inspections of AID activities in the Khmer Republic. AG/Audit made its first audit of the reactivated AID GKR program, September-December 1971, and a second audit, July-August 1972. Both audits concentrated on arrival and end-use accounting. The IIS inspection, October 1972, concentrated on the licensing system. A General Accounting Office (GAO) four-man team reviewed the program in February-June 1972. This audit has not been published but "Interim Memorandums" delivered to the principal AID officer were made available to the AG/OAS team. Replies by the AID Representative to both the GAO memorandums and the AAG/VN audit were also made available.

Our operations appraisal took account of the aforementioned inspections and audits but, in the main, the thrust was an overview of progress and problems in planning and general operational effectiveness in relation to AID strategy and objectives. We reviewed the effectiveness of Mission management including financial management, the Commodity Import Program, the Exchange Support Fund, and PL 480 activities. In the case of financial management, we did not audit the accounts but, rather, ascertained that all required reports were current and Mission

Controller was aware of his responsibilities. An AAG/VN audit of arrival and end-use accounting is scheduled for early January 1973; our review, therefore, was restricted to methodology. Normally, AID PL 480 responsibility is restricted to Title II, but, in Phnom Penh, AID has managed the Title I program. The current rice crisis has absorbed a large fraction of the attention of AID personnel, and a detailed review of the rice files was necessary to obtain an appreciation of AID/Phnom Penh management responsibilities.

Before leaving AID/W, we interviewed Bureau officers, in particular those on the Cambodian Desk, officers in SER/COM and SER/~~Controller~~ FM dealing with the Cambodian CIP program, and read all pertinent documents. AAG/Saigon was visited and audit workpapers and other documents reviewed. The Resident Auditor, Bangkok, audited AID/Phnom Penh activities supported by USAID/Bangkok. His review was discussed in Bangkok and is incorporated in our report.

III. Program Perspective

U.S. assistance to Cambodia (now officially the Khmer Republic) was initiated in 1951 and was terminated in 1963. As the war in Indochina intensified and swept into Cambodia in 1970, the Cambodian economic situation worsened. Normal foreign exchange earnings disappeared, and budget deficits grew as defense expenditures increased, with resultant deficit financing. The absence of export earnings placed severe limitations on Cambodia's ability to finance imports, and the rapid increase in the money supply coupled with a shortage of goods spelled price inflation and declining standards of living. The Cambodian Government (CKR) was fighting a

battle on two major fronts: the first to maintain its national integrity, and the second to maintain civilian support and morale.

In November 1970 the President of the United States requested economic assistance for Cambodia, and an initial appropriation for $70 million for economic assistance was enacted ~~by the Congress~~ into law on January 8, 1971. In 1968 and 1969 Cambodia had an import bill of approximately $90 million which was offset by an equivalent amount of exports, foreign grants and imported capital. In testimony before the Congress, the Agency testified that the AID request for Cambodia was intended to keep the supply of imports to the Cambodia economy at a relatively even keel; the amount was based on a study of imports in the 1968 and 1969 period. It was noted specifically that the amount requested was not to combat inflation or to offset budget deficits.

The first grant (601) under the FY 1971 appropriation was for $20 million; it was given on a reimbursable basis, i.e., AID would reimburse the GKR for specified ~~American~~ U.S. and Code 941 country imports ~~previously financed~~ for which foreign exchange had been previously provided by the Banque Nationale du Cambodge (BNC). The second grant (602) was a normal Commodity Import Program grant except that ~~the~~ U.S. Government agencies, such as General Services Administration (GSA), were to be the procurement agents. Various factors (see Section IV. B.) inhibited this arrangement, and the drawdown on the grant was extremely slow; as of ~~September 30, 1972,~~ December 1, 1972, $~~4.0~~ 4.3 million was still uncommitted. The GSA arrangement did not work well, and it was eliminated as the major procurement source except for capital goods for the public sector and

~~Business imports procured under GKR reserves~~

certain bulk commodities. The existence of a largely unspent "602" reduced the need for additional CIP grants in U.S. FY 1972. However, since ~~but~~ the slow drawdown under the U.S. grants forced the burden of imports onto the GKR foreign exchange reserves ~~of the GKR~~ which had fallen to dangerously low levels, ~~and~~ a Cash Grant (603) of $20 million was made in October 1971. In June 1972, by which time the bulk of Grant 602 had been committed, CIP Grant (604) ~~of~~ for $16.5 million was signed in order to assure an uninterrupted flow of commodities into the Khmer Republic.

In U.S. FY 1973 CIP Grant (606) for $20 million was signed on October 14, 1972; only $1.4 million of "604" was committed as of that time. In the late 1960's only three percent of Cambodia's imports came from the United States. Despite the fact that the CIP program in Cambodia permits the financing of imports from the lesser developed countries as well as the United States, the CIP program was inadequate to meet Cambodia's import needs. With the advice of the International Monetary Fund (IMF), Cambodia created the ESF in February 1972 (see Section V). Grant 605 provided $12.5 million as the U.S. contribution to the CY 1972 operations of the ESF.

Total U.S. grants to Cambodia in U.S. FY 1971, 1972, and 1973 were $139 million (see Table I for details). In addition, there were two PL 480 Title I Agreements totalling $45.2 million for a total of $184.2 million bilateral economic assistance. Cambodia also had a very small amount of PL 480 Title II funds in a UNICEF program.

The AID program in Cambodia significantly differs from other AID programs in that the Agency has adopted a policy ~~which states we will~~ of not becoming involved in capital projects nor ~~will~~ offering or undertaking Technical Assistance ~~be offered or undertaken~~ in Cambodia. Secondly, there is the so-called

"low profile" stance in Cambodia. Section 656 "Limitations on United States Personnel and Personnel Supported by the United States" of the Foreign Assistance Act states that the total number of employees of executive agencies of the ~~employed by the~~ United States government, civilian or military, that may be present at any one time shall not exceed 200 and that the total number of third country nationals employed by the United States shall not exceed 85. The 200 figure, therefore, must accommodate all Executive Branch personnel: diplomatic, AID, military, information and temporary duty personnel. This has placed severe constraints on staffing the AID presence in Cambodia. In addition, the principal AID officer also acts as the Economic Counselor of the Embassy. It should be noted that the Mission has not assumed a low profile in matters of Cambodian economic policy. Through our membership in the ESF Working Group and directly, the U.S. has urged major economy policy changes--many times successfully.

At time of writing (mid-December) the political situation is such that it is difficult to discern future trends, let alone discuss them. ~~A~~ Peace could change the whole climate and immediately outmode all existing plans. The program is in transition but the end objective is not clear. There are serious inflationary trends, which the American establishment is aware and concerned but, for the moment, FY 1974 plans are much like those ~~of~~ for FY 1973.

IV. Progress on CIP Activities

A. Planning and Programming the CIP

The intensification of the war in Cambodia in 1970 had a severe economic impact. Export earnings decreased 70 to 80 percent, domestic production lessened, normal trade between Phnom Penh and the provinces ceased, and the government budget grew through multiplied military spending. Deficit financing resulted in a sharply increased money supply at a time when domestic production was low and the country was starved of the foreign exchange necessary to finance imports. Inflation was a way of life in Phnom Penh.

The AID program introduced in 1971 was designed to assist the government-controlled economy to reach a modified state of normal consumption and to stabilize it at that level. Unlike the program in South Vietnam, it was not designed to control inflation though, hopefully, the resulting increase in the supply of consumption goods would counter the inflationary spiral substantially. Defined simply, the purpose was to maintain the standard of living. The weakness of this theory in other countries has been the difficulty in keeping government employees' salaries at a level where they could compete for goods in a market where all prices were rising. Government salaries have apparently kept pace with inflation (at least during the last six months) and to a large extent with those of consumers from the private sector for non-luxury goods and, therefore, this was not a prime problem at the time of our review.

A CIP in Cambodia faced ~~three~~ four major problems. Firstly, only a very small fraction of Cambodia imports had traditionally come from the United States, and American commercial representation was nonexistant; secondly, American prices for the type of goods Cambodians wanted to import were not competitive with Cambodia's usual sources; ~~and~~, thirdly, the long pipeline involved in bringing goods from the United States defeated the desire to have a relatively quick impact; and, finally, GKR unfamiliarity with the demands of U.S. Government paperwork.

Grant 601 was on a reimbursable basis, and this compounded the problem -- although outwardly accepting the reimbursement principle, the GKR initially was reluctant to commit its own foreign currency on what they considered just a promise to reimburse. Grant 602 was a normal CIP agreement but because of slow implementation failed to solve the problem which was intensified by shrinking Cambodian foreign exchange reserves. Grant 603 which was a cash transfer was designed to refurbish those reserves. Two important actions were taken to accelerate implementation of Grant 602. It was agreed that up to 50 percent of imports financed by "602" could be procured in Code 941 countries which were more competitive in price terms and had a shorter delivery time. A 25 percent discount in riel terms was given to importers buying in the United States in January 1972; by end of February this was raised to 30 percent. The remaining gap of the objective of maintaining the standard of living was to fill the need for those commodities ~~ineligible for financing~~ not financed under the CIP. This was done by the creation of the ESF (see Section V) to provide ~~the~~ foreign exchange for commodities ~~ineligible~~ not financed in the CIP and to widen sources of supply. By far the most important element was the freeing of the riel from the unrealistic fixed rate to one approximating the so-called curb or sidewalk rate and providing through the nouveau marché, a mechanism for keeping the rate current.

Problems in implementation of the CIP remain (see next part of this Section) but, ~~in the~~ overall, the American plus other foreign aid is currently meeting the objective. There are few statistical data in Cambodia to measure this, but the best available is the "European" consumer price index compiled by the government and, to a lesser extent, the middle class index. In CY 1971, the former rose 131 percent, and the latter, 72 percent. Comparable increases from January to September 1972 were 17 percent and 25 percent. The sharp decrease in the acceleration rate reflected the fact that supply of imports by summer 1972 approached ~~to~~ that of the pre-1970 base period.

A relatively, in-depth, study of imports in 1968 and 1969 has served as the basis for the calculation of import needs, regardless of source of financing. The base figure did not allow for the import of rice, cotton, or tobacco, since virtually all these needs were supplied from the domestic economy. These commodities are currently being supplied through PL 480, although in 1972 some Thai rice was financed through ESF and more may be supplied either through CIP or ESF in 1973. As noted previously, the present formula for calculating American aid ~~has~~ worked reasonably well. Base figures have to be inflated by increases in world commodity prices and freight costs. This formula ~~will~~ is, however, has become dated ~~if political events cause a~~ with the changes in the composition of the program. Political events could cause further changes.

In the overall, this method of planning leaves sizeable gaps. The Mission is not staffed to analyze current import demand in terms of current prices. Prices in the economy move at differing paces. At the time of our review, the working class price index was showing the

sharpest increases. There is no staff to analyze this trend. It is not known whether the cost of the Thai rice is totally or partially additive. The ratio between ESF and CIP are arrived at through crude estimates of market demand. Raising the premiums given for importing from the United States from 25 to 30 percent obviously had an impact. Importers have now become acquainted with the American market, and American commercial interests are creating agencies in Phnom Penh. All of this might indicate that a 30 percent premium is excessive in terms of the need to make American imports competitive. Could a different composition of imports increase domestic production? These are some of the questions which should be considered if more sophisticated programming is to be done. Under the constraints of post ~~But, given current~~ Mission staffing, this has not been ~~is not~~ possible. Temporary duty personnel provided a partial, but not a satisfactory, solution. Originally, it was thought that the IMF would fill this gap but, in fact, it has not. current plans to bolster the economic and program staffs hopefully will help fill this gap, of which the Mission is aware. ~~The AG/OAS team, in view of current Mission staffing and the problems the Mission faces, has no recommendation.~~

B. Commodity Imports

There have been two basic methods of financing the CIP for the Khmer Republic, the procedures for which vary widely: Reimbursable Grant and regular CIP Grant.

1. Reimbursable

The original Grant Agreement 442-K-601 of March 2, 1971, for $10 million--increased to $20 million by amendment dated March 27, 1971--was kept as simple as possible because of the lack of recent GKR experience with CIP and weak administrative GKR organization. ~~Another~~

The objective was to create as early an impact as possible to keep essential imports flowing. Thus, the requirements of AID Regulation 1 were waived except for the mandatory requirements as described in M.O. 1457.1. II.A.1. An Eligible List of commodities, giving maximum dollar amounts by two digit codes, was attached to the Agreement. Reimbursement was to be effected upon GKR presentation of requests to be accompanied by receipted invoices, bills of lading, and GKR customs delivery receipts.

Even under the relatively simple procedures of this Agreement, the flow of commodities proceeded more slowly than anticipated. Frequent extensions of terminal shipping and disbursement dates were required. In fact, nineteen Implementation Letters have been issued, primarily to broaden the impact of the Agreement and to ease certain original restrictions.

Inexperienced personnel and other weaknesses within the SONEXIM system, combined with data lags within the AID system made it difficult to reconcile commodity flow information. Although TDY assistance from the AID/W Price Analysis Staff helped speed up import license approvals, major delays persisted between issuance of the licenses and reimbursement to the GKR for the foreign exchange. Slow and incomplete document submission by importers plagued the system. This situation was eased by Implementation Letter 13, September 4, 1971, which permitted reimbursement to the GKR on the basis of evidence of shipment rather than of evidence of arrivals. We estimate that three-quarters of the commodities had actually arrived within the first year of the Agreement, although reimbursement documentation did not reflect this.

As of December 15, 1972, the status of this Grant was as follows:

	($000)	
Total Grant		$20,000
Less Administrative Costs		213
Net Available for Licensing		19,787
Licenses Issued	$19,825 1/	
Less to be Withdrawn	181	
Net Licenses	19,644	
Reimbursement Requests (net)	19,299 1/	
To be Requested	345 2/	
Total to be Requested		19,644
Balance not Used		$ 143

2. Regular CIP Grants

Three regular CIP Grant Agreements have been signed: 442-K-602, May 31, 1971, $50 million from FY 1971 funds; 442-K-604, June 23, 1972, $16,502,000 from FY 1972 funds; and 442-K-606, October 14, 1972, $20 million from FY 1973 funds.

The original provisions under Grant 602 contained standard financing procedures and AID Regulation 1 was applicable. As of November 9, 1972, 19 Implementation Letters had been issued, ~~the total result of which was to change~~ changing considerably the original provisions of the Grant Agreement. ~~i.e.,~~ Major revisions pertained to shipping eligibility; source eligibility; methods of procurement (e.g., bulk items originally intended to be

1/ Includes 334 for rice transportation from Vietnam

2/ Includes 265 known to have arrived; thus arrival data is lacking on only 80.

All procurement under this Grant was intended to be limited to U.S. sources and it was contemplated that procurement would be effected by the GSA and the USDA, the latter under barter arrangements. GSA procurement for private commercial transactions proved to be unwieldly, slow, and generally unsatisfactory, although it had improved by April 17, 1972, when this method was dropped. Notwithstanding lessons learned under the relatively simple procedures of Grant 601, the original constraints under Grant 602 caused difficulties for SONEXIM and Khmer private importers. The usual relationship between supplier and importer was absent and could not be replaced by GSA. ~~Suppliers rather than importers had been concerned with specifications;~~ the Khmer importer was ~~were~~ concerned about name brands and customer preferences; his supplier had looked after the specification side. Detailed specifications, which had to be in English and in terms of U.S. goods, complicated commodity codes, requirements for proprietary procurement, AID regulations--all were new to the Khmer and all helped to create early confusion and delays in the procurement process. The complicated procedural chain between importer and supplier frustrated Khmer importers, who cancelled over half of their import applications intended to go through the GSA procurement route.

It became increasingly apparent that commodities restricted to U.S. procurement were not going to flow at the desired rate. On October 29, 1971, Implementation Letter No. 4 acknowledged this fact by implementing a limited source waiver authorizing $25 million (half of the Grant) to be used for the purchase of eligible items in Code 941 countries. This step was a major departure from the original plan and was taken at the time of the major GKR monetary reforms. A further step to improve implementation was taken January 20, 1972, by the initiation of a 25 percent discount from the

floating foreign exchange rate on U.S. source procurement. This discount rate was increased to 30 percent on February 28, 1972.

The status of this Grant as of December 1, 1972, was that $28,612,413 had been committed for U.S. source and $17,075,541 for non-U.S. Code 941 source procurement, for a total of $45,687,954.

Grants 604 and 606 subsumed many of the implementation changes of Grant 602. The source of procurement for eligible commodities, however, reverted to the U.S., with the exception of Code 941 freight costs of transshipments and selected items from Code 910 countries. These agreements also contained the Exclusive List concept (commodities which could be financed

only under CIP) and the discount on the floating foreign exchange rate. The use of GSA was to be limited to certain bulk commodities, such as barter arrangements for petroleum and for procurement of public sector commodities. Private sector procurement would be financed under ~~the~~ regular Letter of Commitment/Letter of Credit procedures. Under Grant 604 as of December 1, 1972, $13 million in financing requests had been issued and $8.5 million in import licenses had been approved by the National Bank. The U.S. source procurement limitation has had to be eased because of continued import needs for POL and, under Grant 606, for rice from Thailand. It is apparent that even though problems arise daily regarding the flow of CIP commodities, the worst ~~of the problems~~ ~~are~~ is past. ~~and~~ Growing familiarity with U.S. products and with AID procurement practices by the GKR and Khmer importers has helped speed up ~~the process.~~ The commodity flow.

16 ¶ Our review of current CIP procedures and activities has led us to believe that this program now is functioning reasonably well and may be expected to continue to do so, barring unforeseen changes. There are some further actions which can be taken with regard to arrival accounting and end-use checks which will help tighten up CIP implementation. These are discussed in Section VII.C.

C. Public Sector Commodities

At the request and with agreement of the GKR, $12 million of the $50 million of Grant 602 was set aside for Public Sector Commodities. The $12 million has been totally allocated or earmarked (see Table 2).

~~The Agreed Minute to~~ Grant 602 states in Section ~~4.4~~ 4.7 that except as agreed to by AID in writing "not more than $100,000 from the proceeds of this Grant shall be made available by the Grantee for single-end use." But this provision does not preclude "use for the purposes of rehabilitations or modernization of an existing facility which does not involve a substantial change in the size or character of the facility." This is further clarified in Implementation Letter No. 1 (June 11, 1971) which stated that transactions of over $100,000 involving public agencies or enterprises may require "justification of need including technical and economic feasibility" as well as written undertakings by GKR on local cost financing and other relevant matters.

The GAO Interim Memorandum of May 25, 1972, took exception to the public sector commodities shown in Table 2 on four principal grounds. The GAO claimed that (1) there was ~~(1)~~ inadequate planning and cost estimates;

(2) USAID/Cambodia was not adequately staffed to monitor such purchases; (3) there was a serious question concerning the GKR's ability to utilize and maintain the facilities, and ~~finally, that~~ (4) some of the items were primarily military in character.

Mission files on these public sector commodities are voluminous, indicating that they were monitored as far as possible within the capacity of the Mission. The file on the $2.9 million for Electricité du Cambodge, however, indicates clearly the need for a better feasibility study and that temporary duty visits cannot replace resident technical staff. The absence of such staff to a great extent accounts for the fact that the facility is unlikely to be on stream before end of 1973 at the earliest--a fact that raises a serious question as to whether it should have been financed under a CIP grant designed to have an immediate impact on the economy.

At this point, with exception of some road machinery, the GKR is utilizing all the end items that have been put in place. The question of whether they will be maintained is premature. We were told, however, that the current inventory of the Ministry of Public Works contains pre-World War II equipment still in operation. The question of military versus civil use is difficult. The civilian economy of Phnom Penh depends on ~~the~~ Battambang rice arriving on Route 5, ~~and~~ which also is a main military thoroughfare. Route 4 ~~is~~ the road to the sea, ~~is~~ and the escape ~~route~~ path and, therefore, psychologically important, as well as an increasingly important supply lane from the ~~the~~ port of Kompong Som. ~~Route 5 is also a main military thoroughfare.~~ But the files disclose the problems involved in the purchase of the items required for Route 5 that can be encountered when AID depends on preliminary studies of other agencies without an in-house assessment capability of its own.

for which the GAO criticized the use of A.I.D. funds

At this point in time, the Hazardous Cargo Pier is used clearly and primarily for military purposes. Historically, and in the longer run, its proximity to the rice warehouses will make it important to the civilian economy. The danger involved in an ammunition barge exploding in the center of the city at the civil port is obvious. Utilization of OICC/Bangkok in rehabilitating this pier and the modernization of the Civil Port has produced two economic entities. In addition, the Mission argues that A.I.D. financed only materials handling equipment, which could be used at the civil port as well, and hence were not military items as such.

On the other hand, the Ministry of Public Works has shown serious inability to receive and manage road construction commodities. A stronger initiative and more energetic action by the same Ministry might have obviated the need for CIP imports of lumber. At the present time, however, the situation within the Ministry vis-a-vis use and designation of commodities has been strengthened by the presence of a strong U.S. civilian advisor financed by MAP funds. The airport improvement commodities is another case of fund mixing; it includes MAP, AID, GKR Defense and Public Works funds and whether it is primarily civilian or military depends on the time of day and the point of view.

This report does not discuss the issue of project versus nonproject. We believe that is primarily a semantics issue. The Mission says it is delivering commodities and the record indicates that is the case. It is and has been an emergency situation, and the Mission has acted to meet that emergency.

As noted, the items shown in Table 2 represent firm orders or earmarked items for which firm commitments have been made. Future plans called for further strengthening the Ministry of Public Works' ability

to maintain Route 5; specific specifications have been produced by the aforementioned MAP civilian advisor. (See Table 3) There are also plans to finance certain repair parts and the necessary maintenance tools primarily for quasi-public enterprises. (See Table 4) The AID Representative stated it is his policy not to enter into further items such as the electric generating equipment. This new policy does not raise the same questions as did previous items, and thus no recommendation is made in this report.

V. Exchange Support Fund

The ESF was established February 29, 1972. The U.S. officially agreed to contribute $12.5 million in an exchange of notes on May 13, 1972. A U.S. note of July 13, 1972, stated that the U.S. believed that "the ESF was designed to eliminate the need for administrative controls in the form of licensing, quantitative restrictions, or positive lists as a means of maintaining an artificial or unrealistic exchange rate structure." In addition, the ESF was designed to solve the problem of allowing the GKR to continue imports from its normal, but non-U.S. sources and of commodities not ~~eligible~~ financed under the CIP program, on a modified basis.

The financial structure of the ESF as of October 31, 1972, was as follows:

Contributions	In Thousands
United States	$12,500
Khmer Republic	10,000
Japan	5,000
Australia	1,000
Great Britain	522
Thailand	125
New Zealand	120
	$29,267
Disbursements and claims to Banque Nationale du Cambodge (BNC)	29,191
Balance	76
Resources Anticipated Oct/Dec	
Balance	76
Khmer Republic	5,000
Thailand	125
Malaysia	100
	$5,301

The ESF is working reasonably well. A Working Group, composed of a representative of the BNC on behalf of the GKR and each of the contributing countries (the IMF resident representative is an observer), holds frequent meetings, minutes are kept, and policy decisions recorded. There have been problems:

1. The Agreement called for the GKR to make an economic assessment in the third calendar quarter of 1972. This has not been done, and the GKR has attempted to shift responsibility to the IMF, but the American and other members are pressing the GKR to take more responsibility for such assessments.

2. No mechanism has existed for validating that the imports covered are true imports. (Data similar to that required by AID/CIP arrival and end-use accounting procedures.) The Working Group has agreed to employ the Société General de Surveillance (SGS) to do this work on a sample or survey basis. Price Waterhouse/Bangkok has been employed to make the audit required by the Agreement. At the time of our review the planned audit scope of work, i.e., traditional or management/operational, was not yet available.

3. The rice crisis, Thai rice, and PL 480 Title I freight, placed unexpected, but not heavy, pressures on ESF resources. The large rice import program planned for CY 1973 will ~~put~~ bring new pressures; at the time of our review, various measures to resolve the problem were being considered.

The plus side of ESF has outweighed the defects. The nouveau marché mechanism--for which the ESF provides foreign exchange--of requiring bidding for currency has resulted in a realistic exchange rate for the riel. At the time of our review, the rate was somewhat

by artificial appreciation of the riel skewed, as the GKR was insisting on a 400 percent deposit against non-CIP import licenses, thereby dampening the demand for foreign exchange. Our review of the monthly ESF reports did not disclose any violation of the Agreement that ESF funds were used for payment of debt, capital transfers, or other invisibles. All expenditures were for commodities. Actual verification, however, will not be available until the SGS review ~~is~~ and Price Waterhouse audit are completed. The current ESF Agreement terminates December 31, 1972; negotiations for a new agreement and continuance for CY 1973 were taking place at the time of our review.

VI. Agricultural Commodities Provided under Public Law 480

A. PL 480 Title I

There have been two PL 480 Title I Agreements. The first, signed on March 2, 1971, called for:

	Quantity	Value (000)
Cotton	14,000 bales	$2,016
Cotton Yarn	4.4 million lbs.	3,175
Tobacco	1,000 M/T	1,984
Vegetable Oil	1,000 M/T	350
Wheat Flour	19,000 M/T	1,697
		$9,222

Local Currency:	U.S. Uses	20%	
	104(c)	80%	
Convertible Local Currency:		104(b)(1)	$184,440
		104(b)(2)	184,440

The second Agreement, signed January 3, 1972, as amended June 23, 1972, called for:

	Quantity	Value (000)
Cotton	27,600 bales	$ 4,600
Cotton Yarn	7.5 million lbs.	6,442
Tobacco	1,750 M/T	4,525
Vegetable Oil	3,000 M/T	1,067
Wheat/Wheat Flour	50,000 M/T	3,218
		$19,852
Amended on October 2 and 20, 1972, to add:		
Rice	30,000 M/T	6,758
Amended on November 24, 1972, to add:		
Rice	40,000 M/T	9,348
		$35,958

AID normally has limited responsibility for PL 480 Title I but, in Phnom Penh, the AID Mission doubles as the Economic Section of the Embassy and handles all PL 480 Title I operations. The Mission Controller has estimated that one-tenth American manyear and four-tenths of a local employee manyear are spent in PL 480 Title I compliance matters. A review of the files, however, indicates that even when rice is excluded, considerably more than one-tenth year is spent by the AID Representative, his Deputy, and other officers on matters dealing with the negotiation and implementation of the Title I agreements.

The rice rioting by the military in September 1972 triggered concentrated action by the AID Mission. A review of the Mission files clearly indicates that the AID Representative and his Deputy had time for little else in September and October 1972. The crisis was met and

at the time of our review, stocks on hand and anticipated arrivals should prevent any new crisis. Two AID officers are spending full time on rice and it absorbs a considerable fraction of the AID Representative and his Deputy's time. At this point, it is not clear how much of the 150,000 tons needed for CY 1973 will be Thai rice financed through CIP funds, PL 480 Title I with the GKR's share of the freight financed through the ESF, or as a Japanese gift. Current planning is comprehensive and thorough, and the problem is well monitored.

B. PL 480 Title II

There is a small UNICEF Title II MCH program in Cambodia. Preliminary approval has been given for 72,000 pounds of NFDM and 96,000 pounds of blended/fortified food for approximately 5,000 participants. The Mission has referred all programming operations to UNICEF Regional Headquarters in Bangkok. The records also indicate the local UNDP has submitted quarterly reports; we suggested to the Mission that it routinely obtain copies of these reports. To date, the Mission has made no arrival or end-use checks. The program is very small and probably does not warrant much expenditures of time by a grossly understaffed Mission.

VII. Financial Management

A. AID/W Operation

The first point for financial review of direct U.S. and Code 941 commodity procurement by AID/W is the supplier's Form 11 (SER/FM/Procurement Services Division). Within 48 hours this form is examined by FM/PSD for commodity and source eligibility and price in terms of U.S. prices. Price and quality comparisons for Code 941 or

Code 910 procurement cannot be checked carefully at this stage except for bulk and well-known commodities, ~~about which more information generally is available.~~ New or previously unknown suppliers' Forms 11 are looked at more closely, but on individual pieces of equipment or on items not produced in the U.S., the analyst has to rely primarily on his experience and judgment as to whether further information should be elicited before removal.

Payment upon shipment is made through one of two New York banks--First National City and Irving Trust--upon voucher examination by a small AID staff in New York. A closer postpayment check for price is made when copies of the vouchers and supporting documents are forwarded from New York to FM/PSD. At this stage Form 11 and the bank reimbursement documentation are compared. We believe that Khmer Republic procurement actions are scrutinized with reasonable care ~~fairly carefully~~ because of the newness of the program, congressional and other expressed interest, and the percentage of offshore procurement (under Grants 601 and 602). Obviously commodities procured offshore give more concern because of the difficulty of judging their quality on the basis of receiving documentation.

Requests for commodity procurement through GSA are made by PA/PR. GSA thus is responsible for the total procurement and supplier payment action, and subsequently bills AID. There have been some problems with the slowness of GSA's requests for reimbursement and ~~with~~ providing full supporting documentation. This has meant that there have been delays up to several months in recording data through the W-214 (Run 13) and the in-transit reports to the Mission. These delays have complicated arrival accounting and delayed billings to the GKR for counterpart, which are made on the basis of payments recorded on the W-214.

B. Bangkok Support

The Thailand AID Mission (USOM/T) originally was intended to provide complete fiscal services to the AID program in the Khmer Republic. As the program evolved and a controller function was established in Phnom Penh, the services provided by USOM/T Office of Finance settled down to the maintenance of the official accounting records for these allotments: administrative funds, technical support funds, and trust funds. (A small narcotics fund allotment may be added.) USOM/T processes an average of 55 obligating documents and 40 vouchers each month for the Khmer Republic AID program, and prepares three financial status of funds reports. The team found that the USOM/T controller activities on behalf of the Khmer Republic were adequate and functioned smoothly, **without unreasonable delays.**

Personnel ceiling restrictions and the difficulty ~~in~~ of obtaining qualified local accounting personnel for Phnom Penh have persuaded the team that this function should be continued by USOM/T for the time being. The mission in conjunction with USOM/T will assess the need for the local employee positions before the end of the current fiscal year and reduce the number if possible.

~~(This section incomplete. It will be rewritten or completed when Mr. Sohlin's reply received.)~~

C. Phnom Penh Activities

1. Arrival Accounting

Under Reimbursable Grant 601, the Economic Section of the American Embassy (also the AID Mission) was the primary point for commodity arrival data. This matter was examined fully by GAO (see Section IX.C.) ~~as reported in Chapter IX~~ Section C.) and as most of commodities under this Grant have arrived or are accounted for, the following discussion pertains to regular CIP Grants.

Because of unavoidable time lags in transmittal from AID/W of shipment intransit data, imperfections in the SONEXIM arrival accounting system, lack of current information on transshipments, and the time-consuming, tedious process of reconciling commodity arrival data from its several sources, the arrival accounting function has been ~~is~~ one of the problem areas in financial management.

The latest Intransit Listing, received in Phnom Penh in ~~the middle of~~ mid-December, reported shipping data as of October 31, 1972. The shipments reported were lifted at times ranging from December 1971 to early in October 1972. This report is based upon AID. actual reimbursements to U.S. banks and to other U.S. Government agencies. Because GSA has been slow in ~~asking for~~ requesting reimbursement or in submitting full documentation to AID/W, information on much of the GSA-procured commodities ~~procured through GSA and~~ actually shipped does not appear on the Intransit Listing or Report No. W-214, which shows the same information by AID Authorization Number. These two AID/W reports are one source of arrival data.

SONEXIM compiles arrival data for its monthly computer run directly from shipment documents. This report is cumulative and has no provision for suppressing the print-out of completed transactions. Manual reconciliation currently is performed between the SONEXIM report and the AID/W Intransit Listing. Both reports are prepared by vessel or other mode of shipment. There are obvious gaps because the Intransit Listing does not report all actual shipments.

The AID Mission receives separately copies of bills of lading, suppliers' invoices, etc. Information from these and other sources are recorded manually on Commodity Accounting Cards, also filed by vessel. These cards are consulted in the reconciliation process because the inflow of data into the SONEXIM computer at the time of receipt of basic arrival documents still has not been perfected, although revised procedures have been instituted for this purpose in SONEXIM. A high turnover rate ~~of turnover~~ of SONEXIM personnel has been ~~is~~ one of the problems. ~~causes.~~ The U.S. Arrival Accounting Officer still must act as a catalyst in helping SONEXIM to identify gaps and weaknesses in its system, especially between its ~~the~~ Central Secretariat, which passes the data to the computer section, and its ~~the~~ divisions dealing with the various commodities.

The most notable weakness in the arrival accounting system is lack of data on transshipments. Most of the incoming shipments currently are destined for Phnom Penh port, for which vessels must be made up into convoys because of security hazards along the Mekong River. Shippers and vessels willing to make this run from the

transshipment points, or from Code 941 source countries, often do not follow the requested procedures of providing the GKR and AID Mission with advance shipment data. Thus, commodities may wander around Southeast Asia on tramp steamers for weeks or months and then turn up in Phnom Penh unannounced. At that point, only the ship's manifest may tell whether and what AID-financed commodities are on board. We have made two suggestions which may relieve this situation in part: (1) the use of the Societe Generale de Surveillance (SGS)--under contract for inspection and tally work--as an information source through its offices in various Far East ports; and (2) occasional visits by AID personnel to Hong Kong and Singapore to observe transshipment operations and familiarize themselves with such activities and pertinent problems. We suggested also that greater use be made of SGS for the inspection and tallying of incoming commodities. This would strengthen both the arrival accounting and end-use activities.

The best source of arrival data will of necessity be the SONEXIM monthly report. Current Mission efforts must be continued to improve the timeliness and accuracy of that report. In time such improvements should eliminate the current necessity for the AID Mission to keep the manual card file~~--a very tedious exercise.~~ AID/W should also continue to exhort GSA to improve its system for requesting reimbursement so that the W-214 and Intransit Listing reports may be more current. With the current reconciliation work being done by the AID Mission, ~~ECON,~~ we believe that arrival accounting data is reasonably accurate, albeit a difficult and time-consuming exercise.

2. End-Use Checks

The most obvious fact of the end-use check activity is that there has not been enough personnel from the ~~small ECON~~ Miss.on staff to perform this service for an import program of this size and scope and variety of commodities, including PL 480. One additional end-use position has been approved and the officer selected. ~~But he is not yet on board.~~

This activity has come under the critical scrutiny of the GAO and AG auditors, not because of the substance of end-use checks which have been performed, but because they have been limited in number and commodity coverage. With limited personnel available, the Mission properly concentrated on large transactions and on obvious problems, such as a shipment of defective hoes from Taiwan. Five reports were completed in FY 1972 and seven ~~thus far~~ by mid-December in FY 1973. Reports covering batteries, sugar, and tires are expected to be completed by the end of December 1972. Other reports are planned covering cotton yarn (PL 480), soft drink ingredients, and fertilizer. The team believes that there is a need to delve into some of the small import transactions to determine whether or not appropriate end-users are receiving and using the commodities financed by AID. Partly to examine this aspect of the Mission's operation, a further AID audit team is expected to arrive early in 1973.

3. Counterpart Management

All counterpart fund accounts are kept by the Controller's Office in Phnom Penh, in contrast to the three allotment accounts kept by USOM/T.

Counterparts is generated from four sources: CIP, Cash Grant, the U.S. ESF Contribution, and PL 480 Title I.[1]

Generations (deposits due) occur at different points, depending upon the ~~particular~~ specific agreement. CIP counterpart under Grants 602, 604, and 606 for the private sector or revenue-producing public sector is billed when payments appear on the AID/W W-214 report. Under Cash Grant 603, counterpart ~~is~~ was due at the rate of free foreign exchange prevailing as of the date of deposit to the GKR dollar account in a U.S. bank. Under the bilateral ESF Agreement, U.S.-generated counterpart is transferred to Counterpart Special Account 4804 in the National Bank of Cambodia, in the name of the Minister of Finance. Under the first PL 480 Agreement (March 2, 1971), counterpart was generated at rate of exchange as of the date of CCC disbursement. The GKR paid the 20 percent U.S. uses and the 80 percent country uses at the same time. Under the second Agreement (January 13, 1972), the exchange rate is governed by the date the GKR pays the ~~U.S. Mission~~ U.S. in riels against the dollar billing. Under this Agreement, the ~~U.S.~~ Mission bills for the 80 percent immediately upon receipt of CCC disbursement information, but for the 20 percent U.S. uses portion only when such funds are required. Thus, there may be several rates of exchange resulting from any CCC shipment and disbursement action.

[1] Title I proceeds are of course programmed in the bilateral agreements. For convenience, the report refers to such proceeds as "counterpart."

Counterpart generated through AID-funded Grants (601 through 606) can be used for mutually agreed purposes between the GKR and the U.S. Government. The two PL 480 Agreements stipulate that the 80 percent country uses portion will be used for 104(c), common defense, which in effect has meant support of the GKR military budget. The Mission has no program plans for the use of the CIP-generated counterpart, although projections are made for the generation of funds under the CIP and PL 480. In actual practice, most of the CIP-generated currency also has been allocated to the GKR defense budget. However, an agreement concerning airfield improvement (using both CIP and PL 480 counterpart) has been signed and an activity concerning rice production is in the planning stages.

The Mission Controller's office prepares weekly local currency status reports by source of generation and on the trust fund. These reports, for Mission internal use, include information on generations, commitments, releases, and available balances. Regular quarterly reports (U-106, U-109, and U-205) are forwarded to AID/W, as is a monthly memorandum reporting the status of U.S.-owned foreign currency accounts. All of these reports are current.

Billings to the GKR appear to be current from all generation sources. GKR payments under the CIP generally are paid within two weeks of the billing date. Under the second PL 480 Agreement, there was some confusion as to the method of billing (100 percent, or only 80 percent country uses) and it took several months communication between the Mission and Washington (AID and the U.S. Treasury Department) to clarify this point. On the ~~local~~ host country side, a problem developed as

to the billing point within the GKR. To date, this has not been clarified, although a recent request for payment was sent to the Minister of Planning and National Development. Inherent in this problem is the possibility that some entity of the GKR will have to find funds in its budget to make up the difference between the funds collected from the sale of PL 480 commodities on the local market--for which the official price was set before the sale--and the riel equivalent of the dollar billing, which occurs some time after the commodities have been sold. ~~In other words, a depreciating riel would mean an effective subsidy due to time lapse.~~

~~The attached table~~ Table 5 shows the status of local currency generations, allocations, and releases as of December 1, 1972.

VIII. Administrative Matters

A. Mission Management

The Cambodian Mission operates with a minimally sized staff. The Ambassador is responsible for maintaining the limitations on personnel prescribed by Section 656 of the Foreign Assistance Act (FAA), and his decision controls the number of AID personnel that may be present in Phnom Penh at any one time. At the time of our review, there was a total of 15, including four secretaries and one FSR-5 (GSO) assigned to the Embassy on a reimbursable basis. Four additional positions have been created and are currently under recruitment; in one case, an officer has been recruited and will be arriving in January. Duties are fairly well delineated but, as usual in Missions of this small size, most decision-making is up to the AID Representative or his Deputy, who is also the Controller. Very few Cambodians who had worked with American agencies are available, and there are few

English-speaking younger Cambodians. The result is that the Mission has been unable to fill some of its local personnel positions. With the exception of the comments made in Section IV, Progress on CIP Activities, the addition of the four new positions should adequately staff the Mission for its current type of operations. If the Mission has to undertake a full scale refugee program, the question of staffing would have to be reexamined.

The Mission utilizes a great deal of temporary detail personnel. Many of these wrote reports and it was possible to make a partial assessment of those. The personnel detailed from Saigon on the rice crisis obviously made valuable contributions and filled gaps in Mission expertise; the reports in the CIP capital equipment and material were of more uneven quality. The Mission, itself, notes that TDY personnel making repeated trips are more likely to make a contribution than those making only one trip to Phnom Penh.

The Mission has no management staff although there is one AID officer on the Administrative staff of the Embassy. Management support is provided under an SAS agreement--the Mission ~~provides~~ pays 14 percent of the total. Costs are distributed roughly on the basis of numbers of personnel in Phnom Penh and adjusted for other factors. Current office quarters do not make for the greatest efficiency but they are dictated by security considerations. The quality and maintenance of personal quarters are satisfactory.

B. AID/W Support

From a logistics point of view, the ~~long~~ distance between Washington and Phnom Penh and sometimes uncertain means of transportation constitute ~~a~~ problems, although not ~~a~~ major problems. The primary concern is in the personnel management area. Phnom Penh is an isolated post with severe security restrictions to which wives, but not children, are allowed to accompany the employee. Moreover, without some ability to cope with the French language, an employee's effectiveness is reduced greatly. Safehaven arrangements have not proved to be entirely satisfactory--for example, two of three families safehavened in Bangkok were not allowed to bring in an automobile duty free--even though visitation rights have been established. Single personnel do not have the same R&R privileges as do those serving in Vietnam. Thus recruitment has been difficult and positions have remained vacant for months, throwing an even greater burden on the incumbent members of the small staff. As current tours are completed, the recruitment cycle will begin again.

IX. Impact of Detached Reviews

A. AG Audit/Inspection Activities

1. Audit

Auditors from AAG/Saigon have made two reviews of the Commodity Import Program for the Khmer Republic. The first report covered the period from the resumption of the program in March 1971 through December 1971, and the second brought the review period through August 1972.

The first report contained no recommendations, but a March 13, 1972, follow-on memorandum from the Acting AG to CO/SA made several recommendations pertaining to the use of GSA for procurement purposes, personnel requirements for the Mission, and procedures to expedite the flow of commodities. These recommendations subsequently were addressed and progress reported in assigning appropriate personnel to Phnom Penh, sending a team to inquire into the CIP procedures, and in GKR actions to increase the commodity flows.

The second report contained four recommendations concerning unutilized commodities (batteries, adding machines, bridging materials, and tires), one recommendation to increase end-use checking, and one recommendation pertaining to the improvement of SONEXIM's arrival accounting procedures. Arrival accounting, end-use checking, and reports in progress on tires and batteries are addressed in Section IV. The Mission answered satisfactorily the findings and recommendations on bridging materials and adding machines, although some follow-up activity is required.

The team found that a more in-depth arrival accounting and end-use audit was desirable and plans have been made for an audit review early in 1973.

2. IIS

In October 1972 two representatives of the Bangkok IIS office visited Phnom Penh to make an informal review of the Commodity Import Program. Whether payoffs to SONEXIM were involved in the approval of import licenses and release of commodities was of

particular concern, especially in light of the Moorhead Subcommittee hearings. The IIS team found that a consensus of key U.S. officials' opinions indicated that SONEXIM has been reasonably successful in handling the CIP. IIS interviews with 20 importers, while disclosing varying information with regard to their relations with SONEXIM, revealed no proof of substantial payoffs. The net result of the IIS review was that, although there were probably small voluntary tip or "tea money" payments to lesser officials, large payoffs were unlikely and SONEXIM officials enjoyed a reputation for reasonable honesty. Despite occasional newspaper articles alleging graft, the team found no evidence which would contravene the IIS review.

B. IGA Reviews

IGA has posed numerous questions and made numerous comments and recommendations to AID on the CIP from the time reimbursements began to be made under Grant 601 and commodities were ordered under Grant 602. Questions on commodity and source eligibility, which constituted the majority, were answered by AID/W shortly after they were posed and we believe that the answers were carefully considered and responsive.

The IGA report of August 2, 1971, commented at length on the port improvement activity and this subject was taken up again in April 1972. The cover memorandum forwarding the 1971 report acknowledged that substantive conclusions and recommendations in the report "have now been essentially adopted." The later inquiry, on the use of excess property, electric forklifts, and the use of the hazardous cargo port also was answered fully.

C. GAO

The November 26, 1971, GAO report on Assistance to the Khmer Republic, the review for which was conducted in March 1971--i.e., before the CIP began--stated that there were no procedures for monitoring and auditing assistance programs, but that such a system was being designed.

The other GAO comment relating to economic assistance was that the U.S. had taken no steps to recoup $2,198,541 in claims outstanding from prior programs. The AID position--that at this point GKR payment of such a claim would be merely taking money from one U.S. pocket and placing it into another--was spelled out in the Administrator's November 1, 1972 letter to Chairman Moorhead.

During February-June 1972 GAO performed a field review of the U.S. programs in the Khmer Republic and during that period issued nine Interim Memoranda, three of which related to the economic assistance program. GAO's overall comment, which appeared in Memorandum No. 8 of May 26, 1972, was:"our analysis of the overall economic assistance program indicated that, in spite of the numerous problems which developed, the program has thus far been successful to a degree in accomplishing the stated objectives." Moreover, the memorandum stated, "...it is fairly evident that without U.S. assistance, the GKR would have been bankrupt long ago."

Memorandum No. 4 examined U.S. Mission controls over Grant 601 and stated that such controls were weak with respect to arrival accounting, end-use, and reimbursement procedures. These items are addressed in Section IV.

Memorandum No. 7 commented on assistance to the public sector. (See Section IV.C. for GAO major criticisms). This memorandum questioned also the use of AID funds to rent a U.S. Navy radio transmitter, and questioned the proposed procurement of generating equipment to meet a short-term need on the grounds that such equipment may be excess over the long-term when hydroelectric power again is available. In addition, the memorandum included a discussion of financial (CIP) versus developmental assistance on the ground that the former may be expensive in long-range terms. Comments on the use of CIP to fund public sector activities are included in Section IV.C.

Memorandum No. 8 dealt with the Cash Grant (442-K-603) and the U.S. contribution to the ESF (442-K-605). GAO contended that the Cash Grant would not have been necessary had the earlier grants not been too restrictive and thus too slow and cumbersome in implementation. The Mission responded to this by stating that the Cash Grant was required and was in fact planned before some of the problems which arose under Grant 602 became apparent. The ESF Grant is discussed in Section V.

The OAS team has concluded that GAO's comments and criticisms--some of which were judgmental--were examined carefully by the AID Mission and either answered satisfactorily or steps were taken to improve implementation procedures. Such improvements of course are not one-time actions; continued vigilance will be required by the Mission.