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AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

OFFICE OF THE AUDITOR GENERAL

AREA AUDITOR GENERAL/EAST ASIA

AUDIT REPORT

UNITED STATES A.I.D. MISSION TO VIETNAM (USAID/VN)

CONTRACT NO. AID 730-3529

BETWEEN VINNELL CORPORATION AND

VIETNAM ENGINEERING AND CONSTRUCTION COMPANY (VECCO)

(PROJECT NO. 730-15-390-414, VIETNAM CONSTRUCTION INDUSTRY (VECCO))

Period covered: September 29, 197[illegible] [illegible]ough November 30, 1973
Audit Report No. 9-730-74-69
Date report issued: March 11, 1974

TABLE OF CONTENTS

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PART I - PURPOSE AND SCOPE

We have made an interim audit of fixed-rate contract No. AID 730-3529 between Vinnell Corporation of Alhambra, California and the Vietnam Engineering and Construction Company (VECCO) of Saigon, Vietnam. Our review was conducted at the contractor's office within the VECCO organization, and covered the period from contract inception on September 29, 1972 through November 30, 1973.

The scope of our examination was limited to a review of the contractor's compliance with the terms of the contract and did not include an evaluation of the VECCO organization as a separate operating entity. An audit of VECCO is currently in process and will be issued as a separate report.

The purposes of our review were to: (1) ascertain the propriety of fixed-rates billed to VECCO and paid by the USAID; (2) evaluate USAID's management inputs; and (3) evaluate contractor performance. Our audit was made in accordance with generally accepted auditing standards giving due consideration to applicable AID regulations.

Our examination included a review of contractor's reports, accounting and personnel records, USAID/VN planning and funding documents, reports and other documentation. We interviewed the senior U.S. contractor advisors and VECCO management officials, and their comments have been given consideration in our audit report.

PART II - BACKGROUND

A - VINNELL CORPORATION CONTRACT

Contract No. AID 730-3529 is funded under project No. 730-15-390-414, Vietnam Construction Industry, which was designed to facilitate the establishment of a Vietnamese heavy-construction industry within the private sector. In a narrower context, it was first necessary to establish a central organization from which technique, materials and other supporting factors and services could flow to the private sector. This was done in June 1970 when the Government of Vietnam (GVN) established the Vietnam Engineering and Construction Company (VECCO). As a new autonomous organization, VECCO requires assistance in all organizational elements. Under separate but related agreements, U.S. Government-excess equipment and facilities were transferred to VECCO, thus providing the initial operating base for revenue generation. The effective utilization of equipment and facilities, however, is dependent on the managerial capabilities of VECCO and the private sector for which it was created to support. To initiate the development of VECCO managerial expertise, USAID/VN agreed to provide the grant funds for training and advisory assistance. This assistance was initiated on September 29, 1972 by the execution of contract No. AID 730-3529 between Vinnell and VECCO. The objectives of the contract are to provide the requisite services designed to strengthen the corporation structure of VECCO and to enhance the managerial capabilities of its staff in order to better perform its supporting functions.

The contract was divided into two phases. Phase I provided for six U.S. advisors to counterpart top-level VECCO managers in major departments. On January 20, 1973, Phase II was formalized as Amendment No. 1 to the contract, and provided 22 additional U.S. advisors to counterpart VECCO supervisors at operating levels of management. The original contract was for a 20 month period in the amount of $295,630 and VN$15,000,000. Amendment No. 1 for Phase II increased the contract price to $1,551,546 and VN$118,429,630 and extended the completion date to 28 months, or through January 1975. As of November 30, 1973, totals of $1,483,000 and VN$71,000,000 have been committed and obligated by USAID/VN to cover contract costs.

B - CONTRACT MANAGEMENT

As the designated Contracting Officer, the VECCO General Manager is responsible for contract management. However, backstop services in USAID/VN are provided by the Assistant Director, Engineering Technical Assistance Division (AD/ETA) who organizationally reports to the USAID/VN Associate Director for Commercial and Capital

Assistance (AUCCA). As donor, USAID/VN retains certain administrative approval authority under the contract, in addition to acting as trustee and disbursing agent for VECCO.

C - PRIOR AUDIT REPORTS

Audit Report No. 9-730-74-03, dated July 13, 1973 covered the VECCO project, No. 730-15-390-414. There are no open recommendations.

PART III - SUMMARY

Almost complete assimilation of advisors into the VECCO organization has generated certain undesirable characteristics under the contract. Advisors have assumed many operational tasks at the risk of retarding VECCO development. In some respects, such involvement is a subsidy to VECCO, which could evolve as a source of criticism under present AID policies (pages 8 and 15).

An evaluation of advisory benefits indicates that the level of assistance is too high. This conclusion, plus the fact that contract objectives have been met in certain areas led us to suggest that a number of advisory positions be eliminated (page 7). However, USAID/VN feels such action would be premature at this time.

PART IV

STATEMENT OF FINDINGS AND RECOMMENDATIONS

For the Office of the Director, USAID/VN

A - CONTRACT FUNDING

The following schedule summarizes the source and status of contract funds as of November 30, 1973:

PIO/T Number	U.S. Dollars Obligated	Expended	Unliquidated Balance
730-414-3-(21)20452	$ 300,000	$300,000	$ -0-
730-414-3-(31)30171	1,183,000	327,524	855,476
Totals	$1,483,000	$627,524	$855,476

PIO/T Number	VN Piasters Obligated	Expended	Unliquidated Balance
730-414-3-(21)20452	VN$15,000,000	VN$15,000,000	VN$ -0-
730-414-3-(31)30171	56,000,000	27,956,058	28,043,942
Totals	VN$71,000,000	VN$42,956,058	VN$28,043,942

B - CONTRACT EXPENDITURES

During the current audit period, contract expenditures totalled $627,524 and VN$42,956,058 (see Exhibit A). No exceptions were noted pertaining to piaster expenditures. Dollar costs are considered proper with minor exceptions. These exceptions, which primarily involved small overcharges for mobilization have been discussed with the Contracting Officer and the Contractor's Chief of Party. A joint review by the two parties is presently being conducted to determine the precise amount of the overcharge, which will then be corrected by adjustment on the next billing voucher.

C - CONTRACT MANAGEMENT

1 - Contract Award

Solicitation of bids was sent to seventeen architect and engineering (A&E) firms. Only eight applicants responded. The bid evaluation process used for the eight proposals was based on the application of a numerical system. Vinnell was given the highest overall rating with a 77.32. The runner-up was considerably lower with a 61.31. Compared to the bidder with the lowest cost proposal, Vinnell was second with a 11 percent price margin, but with a higher overall rating margin of 24 percent. Based on these facts, and other priority requisites, Vinnell was chosen to negotiate with VECCO for the contract. This selection process appeared both objective and orderly.

We have reviewed the cost proposals for both Phase I and Phase II. In retrospect, VECCO's and USAID/VN's review appeared thorough except for two basic shortcomings: (1) no request was made for a financial review of the two proposals totalling over $1.5 million; and (2) international transportation was included in the daily time rates. Ordinarily, international transportation expense is a reimbursable cost item. Consequently, the contractor has supplemented its profits where U.S. advisors were hired in-country.

2 - Contract Plan

The contract is to provide advisory assistance to VECCO Management for the various departmental units, which include; Personnel Administration, Financial Management, Contract Administration, Marketing, Equipment Management and Production Management. According to Appendix A of the contract, the contract advisors were to initially provide in-service training to supplement the managerial skills of their counterparts during the early stages of the contract, and then gradually retreat to a purely advisory role. Generally, we have found that advisors have been fully assimilated into the VECCO organization at the respective departmental levels, with close counterpart relationships established at important positions of management and supervision. Although there are distinct advantages to this planning strategy, we noted that the intimate exposure to the day-to-day departmental activities has caused advisors to become overly involved in direct operational matters. Advisors have become operationally involved in bill collection, inventories, equipment management and repair, accounting, writing procedures, customer contracts, availability of working capital and many other aspects of VECCO's day-to-day activities. In effect, by divorcing themselves more and more from the advisor/teacher role, contract personnel are contributing to opposite purposes of the contract. By this time, over 1 year since inception, it was presumably the intent for many advisors to have withdrawn to advisory capacities only, yet the opposite trend appears predominant. Further, with such involvement, we noted an adverse effect on the development of a self-sustaining VECCO organization. The performance of direct functions not only retards VECCO learning, but is in effect a subsidy to VECCO's operations. To a degree this distorts its cash-flow and income accounts by conveying a more favorable financial position that indicates VECCO has reached a higher level of self sufficiency and achievement. This becomes particularly evident in the case of four advisors who had worked as direct-hires for VECCO, but were later hired as contractor advisors with little change in job activity. Such seemingly direct subsidization is not the purpose of the contract. To achieve contract objectives in establishing an efficient, self-sustaining organization, advisors must be withdrawn from direct operations as quickly as practicable.

In exit conferences with the contractor, the VECCO General Manager and USAID/VN's Contracting Officer Representative, this matter was thoroughly discussed. In general, there was a consensus that the situation should be examined. USAID/VN's response to our draft audit report stated that the withdrawal of contractor advisors from direct operations is now underway and that direct involvement is continued only where needed. We are therefore making no recommendation.

3 - Contract Accomplishments

We examined contractor progress in terms of actual accomplishments and costs of advisory services. Our review focused on contractor activities by functional department. Departmental dispersion of contractor advisors currently assigned is as follows:

Department	Advisor Positions		
	Filled	Not Filled	Total
Administration:			
Organization	2		2
Financial Management	4		4
Marketing Management	1		1
Personnel Management	1		1
Contract Administration	1		1
Construction Manager		1	1
Revenue Production:			
Production Management	5		6
Equipment Management	11	1	12
Totals	26	2	28

Our review approach was to divide the activities into two categories, administration (indirect) and revenue production (direct). Administrative departments were reviewed on the basis of accomplishments without attempting to factor in an intangible financial benefit in relation to costs. Organization is comprised of the Chief of Party and an administrative assistant, thus their effectiveness is primarily measureable in terms of the other advisors.

a. Administrative Advisors

Our review of the remaining administrative departments led us to conclude that contract objectives have been met to the extent that five of the six presently filled advisory positions could now be eliminated, resulting in a projected savings of more than $135,000 under the contract. Contrarily, one position, Market Advisor, should be strongly encouraged to expand marketing expertise for maximum benefits.

(1) Financial Management Advisors

The contract provides four advisors to establish a uniform financial management system for budgeting, commercial (general) accounting, cost accounting, and auditing. This area is considered one of the most successful by VECCO management.

An audit manual including procedures and sample programs has been completed by the U.S. advisors and very little future assistance is contemplated for audit advisory services.

A cost accounting system was introduced and fully implemented. A further modification somewhat decentralizing the cost accounting system was introduced during January 1974. Therefore, only refinement will be required in the future.

Financial statements are now developed by VECCO staff and are considered to be issued on a timely basis. Further assistance in the general accounting area will be needed in subsidiary accounting techniques only. This, however, is not considered a major undertaking.

A 1973 budget was prepared and the 1974 budget will soon be completed. Further, a thorough budget analysis has been prepared for 1973. On-going refinement in technique is all that will be needed in this area.

In summation, a financial management and reporting system has been installed for the most part. However, VECCO management would like to retain the advisors in this area for assistance in subsidiary accounting systems, modification and refinement, and writing procedures for the systems which have already been installed. Much of this is admittedly needed for professional and efficient operation, however, the retention of all the financial advisors would constitute an unnecessary luxury that is not justified and could in fact retard the progress already made. The dangers would be twofold. Advisors could continue to involve themselves in day-to-day operational activities, and, with a high probability, continue to modify and refine the system to the point of over-sophistication.

Procedure writing by advisors for systems already installed is also not justified. This is a direct function and VECCO should be able to provide this service from its own staff. It would be professionally beneficial for VECCO staff as well as a cost saving to the contract. The cost saving would not only be the difference between U.S. and Vietnamese salary scales, but an elimination of unnecessary translating costs. The VECCO General Manager generally agreed with this, but stated that assistance in regard to "form" will be required. This however would involve minimal advisory effort.

Given the present situation, with assistance needed only in refinement and general accounting subsidiary records, one advisor is sufficient to provide any necessary assistance after January 1974. Therefore, three advisory positions could be eliminated from the contract. Savings to the U.S. Government would be in excess of $75,000.

(2) Marketing Advisor

The lack of market information was recognized as a deficient area early in contract planning. Underlying this deficiency was the lack of a VECCO capability in marketing concepts and techniques. To correct this, the contract provided for the employment of a marketing advisor. On March 16, 1973, the contractor hired a marketing advisor who has since attempted to establish a distinct marketing unit within VECCO. This effort has been mostly ineffective and the marketing apparatus remains fragmented among the various VECCO departments with no central coordinated direction. Consequently, the U.S. advisor has been primarily used in direct operations, as information gatherer, in bill collection, in customer contacts, in leasing equipment, and on feasibility studies. In short, no institutional development has evolved.

It is understandable why this has not occurred. A successful marketing operation basically requires the free in-flow of information that pertains to all facets which affect demand and supply. Due to the lack of historical data, the complete absence of some vital information, and an overprotective attitude by information sources, there is no free flow of data into the system. It is, therefore, difficult for VECCO to attach any importance to the adoption of marketing concepts where results cannot be proven. This attitude is reflected in the counterpart relationship. VECCO has assigned only one professional position at a moderate salary to the full-time marketing activity. It has further given little prestige to the position. Based on discussions with the contractor and VECCO, and under the circumstances, it is unlikely that a marketing unit as such will ever evolve over the contract period.

Marketing information is one of the important data required by private enterprise to assure an efficient and profitable operation. More specifically, this information is needed by management to make proper and timely decisions on the size and type of organization and the assets required to meet the market demand. This information should be the vital factor in the justification of the VECCO organization and tailoring its corporate make-up. Under the current arrangement, the retention of the marketing advisor is not warranted. We believe, however, that because of the important role played by marketing, USAID/VN should strongly suggest that the contractor place greater emphasis on this program.

(3) Personnel Management Advisor

Upon arrival of the U.S. advisor, VECCO had no well defined personnel policies, no uniform system of job classification or wage and salary administration, no standard employee evaluation procedure, and no safety program. Our review of status reports and discussions with advisors and VECCO managers indicate that all of these programs have now been fully introduced into the organization and are in varied stages of implementation, but nearly completed. In addition, we noted that a new wage program has been introduced which will provide VECCO with a better competitive base to acquire qualified personnel. It is apparent that the advisor has been successful in making a significant contribution by instituting a professional personnel management system.

During our review, the U.S. advisor was engaged in refinements in the employee-management relations program, employee compensation policies, and the safety program. However, much of this refinement is predicated on management practices distinct to Vietnam and not a direct result of U.S. expertise. In other words, American personnel management techniques have been installed in the system and from here on it will primarily be a matter of infusing Vietnamese business practices into the system. A major example is the introduction of a cost of-living-allowance (COLA) as a part of employee compensation. Essentially, COLA is unique to American business practices. We believe that the services of the U.S. advisor to this department are no longer essential for refinement in the development process, and the position can now be eliminated from the contract. The cost saving on the contract would exceed $25,000.

(4) Contract Administration Advisor

The contract objective is basically to develop standard procedures and formats for sales and services contracts and agreements for rental and/or lease of heavy equipment and material production facilities. Generally, such standards have been developed, and VECCO personnel are capable of continuing this activity on their own.

Despite this, the U.S. advisor is asked to continue furnishing VECCO with direct legal assistance which could be obtained by VECCO through its own staff or contracting for part time Vietnamese legal assistance from sources outside the VECCO organization at a much lesser cost. The continuation of this advisor in this capacity essentially subsidizes the VECCO operating capital account and contributes very little to the contract purpose. If subsidization is the intent, similar Vietnamese services could be obtained at a fraction of the cost. We therefore believe this U.S. advisory position could be eliminated. Contract savings would exceed $35,000.

In our draft audit report we recommended that USAID/VN evaluate further benefits to be derived from continuing certain advisors provided by the contractor and consider eliminating five advisory positions. In their response to the draft report, USAID/VN stated "... the audit report does not give sufficient weight to the fact that construction activity was very low in 1973 but is expected to increase rapidly in mid-1974. VECCO and Vinnell have been using this quiet period to train and build the VECCO staff and to get its operations under control, but the test of VECCO's competence will come this summer. To prematurely withdraw a number of advisors in the interest of saving a small amount of money would jeopardize our major investments in VECCO just before its big test." For these reasons USAID/VN prefers to defer a decision on reducing advisors until after the VECCO expansion is completed. We suggest, therefore, that as soon as the VECCO expansion is considered completed, USAID/VN should evaluate the need of continuing certain advisory services under the Vinnell contract.

b. Revenue Production

As presently structured VECCO has established two revenue components. The first accounts for about 45 percent of revenues and includes U.S. donated facilities such as quarries, an asphalt plant, and concrete plants, which produce a marketable product or are leased to private industry. The other revenue producing area is the lease of U.S. donated equipment to private contractors.

Contract advisors have been assigned positions within these two revenue centers. With some overlapping of duties, six advisors have been assigned to Production Management and 11 to Equipment Management. The following summarizes the results of our review.

(1) Production Management

VECCO management rates the advisors in this area with the highest level of effectiveness in terms of tangible return. During the first 9 months of 1973, which corresponds to the contract period when advisory inputs were made, related gross revenue has increased dramatically as shown below.

Period Ending	Gross Production Revenues (VN$ millions)
1971	17.9
1972	30.1
1973 (through 9/30/73)	460.7

This would tend to substantiate the belief that contractor advisors had a direct influence on increasing total revenues. Other favorable events which occurred during the first three quarters of 1973 have also contributed to expanded production returns. These include (1) improved market conditions; (2) lease of a plant which contributed to increasing gross revenues by VN$52.5 million and; (3) acquisition of the Nui Sap Quarry, accounting for VN$72 million in gross revenues. Despite this, and if the above increases are eliminated, the production center still shows increases in gross revenues for the nine-month period of more than 1,000 percent over calendar year 1972. Production Management is given credit for this significant increase in productivity.

Increase in productivity, however, is only one of several means of measuring effectiveness. A more important and crucial test is what has been accomplished in terms of establishing a self-sustaining organization, with a sufficient re-generative capability to replace revenue producing assets. As of September 30, 1973, a favorable position in this regard has not been attained. For the production activity VECCO financial statements show a net cash gain for the first 9 months of 1973. Two critical elements, however, must be included to bring this figure into line with realities if the benefits of advisory services are to be properly weighed. These are the application of a depreciation factor to provide for replacement (despite the fact that most of the assets were donated) and the actual cost of advisory services. The following quantitatively demonstrates the advisory relationship to costs and benefits.

	Production Revenue Center (Nine Months Ended 9/30/73)	
	VN Piasters	US$ Equivalent at (1:550)
Net Cash Gain	VN$159,202,000	$289,458
Less: Depreciation (Based on Fair Market Value)	224,000,000	(407,273)
Net Profit (Loss)	(VN$ 64,798,000)	($117,815)
Dollar Cost of Production Advisory Services (Averaged)		(150,000)
Net Negative Benefit		($267,815)

This shows that cash gain would have to double before the cost/benefit ratio for advisory services and recovery of depreciable assets would even approach a positive figure. The prospect of this occurring over the life of the contract is highly unlikely given the current rate of growth of the construction industry and present economy of Vietnam. Under normal circumstances, the cost of advisory services could be allocated over a number of future years, resulting in a higher benefit ratio. In the case of VECCO, whose status as a GVN organization is only temporary, advisory costs must be related to the period in which services are rendered. This will continue to result in a negative benefit factor unless production advisory services are reduced accordingly.

(2) Equipment Management

The contract provides for 12 U.S. advisors in the following positions:

Position Title	No. of Advisors
Equipment Pool Management	4
Equipment Lease Management	2
Field Inspectors Maintenance	2
Maintenance Shop Management	2
Supply Management	2
Total	12

To date, all but one position, an Equipment Lease Manager, has been filled.

Our prior audit of VECCO pointed out that as of May 31, 1973, the rate of utilization of U.S. excess property donated to VECCO for rentals to private construction firms was only 4 percent. This low rate of utilization was a serious concern to USAID/VN management, and in part, explains the imbalanced input of advisors to this activity. Not unexpectedly, such imbalance has resulted in a significant negative cost/benefit ratio, even given the questionable assumption that increased revenue is wholly attributable to contract advisory efforts. Without factoring in a provision for depreciation, we note that the net gain from equipment rentals was about $155,000 for the nine-month period ending September 30, 1973. This compares unfavorably to the cost of contract advisory services which averages about $250,000 for a comparable period. If a provision for replacement (depreciation) were added, the negative cost/benefit would be considerably greater. It is true that advisory services are allocable to VECCO's internal equipment fleet and some production facilities as well. However, even if this quantitative refinement were made, cost benefits would not improve significantly.

Although the situation at the time may have been dictated by circumstances, the continued emphasis on use of advisory services in this activity is not justified. Since May 1973 equipment utilization has risen from 4 percent to about 35 percent. This has been influenced by increases in utilization as well as the return of equipment items to the U.S. Government which have little or no rental demand. Further, we were informed that equipment categories which are under demand are now leased at optimum levels of utilization, and may even become in short-supply in the near future. Assuming constants in prices, etc. this situation would imply that increases in rental revenues will not be noteworthy. The cost/benefit relationship is therefore not expected to change. VECCO is presently experiencing a serious cash-flow problem largely brought about by a lack of analysis and control of accounts receivable and attendant bill collection procedures. Cash shortages obviously have an adverse effect on operations. Equipment utilization is primarily affected by the lack of spare parts to service the rental equipment pool, and advisory services are accordingly diverted to less effective activities. No amount of advisory services in Equipment Management can correct this situation.

Although we are not making any recommendation due to our prior audit and the USAID/VN's comments noted on page 11, we suggest that USAID/VN also examine its posture on the contract in the light of the policy statement transmitted by the Deputy Assistant Administrator on November 16, 1973. Briefly, this statement emphasizes an important AID objective, that is, the generation of employment in labor intensive areas. To the extent that the contract displaces Vietnamese employment there is conflict with the policy, and corresponding reductions in advisors made by USAID/VN would demonstrate USAID/VN's determination to uniformly apply AID principles and objectives.

4 - Contract Monitoring

USAID/VN monitoring of contract activities is presently assigned to an engineer. From discussions with ADCCA/ETA, VECCO Managers and contractor personnel it is evident that VECCO activities under Production and Equipment Management have been closely observed and monitored from a technical viewpoint. On the other hand, we found that monitoring progress of VECCO as a developing autonomous organization has been less than desirable. For example, USAID/VN has made hardly any contact with advisors in administrative capacities and have not evaluated cost benefit factors. Therefore, the precise effect of the contract on VECCO's organization and administration is not known. Emphasis in these areas by current VECCO monitors can not be expected with the limited available USAID/VN resources presently assigned. For this reason, we suggested that present backstop services be strengthened with assistance from the ADCCA/Capital Development and Industry Division. USAID/VN has agreed to this.

D - CONTRACT PROVISIONS

The contract provides for reimbursement of contractor personnel and related costs through the application of fixed man-day billing rates. These rates include no provision for sick leave, vacation and holidays, thus permitting the application of the rates to such periods of absences, up to certain limitations. The contract states, however, that VECCO will pay the contractor only for days actually worked. Obviously this was not the intent, and this provision should be revised.

This point was discussed with the Contracting Officer (VECCO) who agreed to incorporate corrective measures in an amendment which is now being processed.

Contract No. AID 730-3529
Schedule of Contract Expenditures
For the Period from Inception through November 30, 1973

Description	Price	Contract Amounts: Expenditures	Contract Amounts: Unexpended
U.S. Dollars			
U.S. Personnel Costs	$1,531,546	$620,609	$910,937
Materials and Training Aids	20,000	6,915	13,085
Totals	$1,551,546	$627,524	$924,022
VN Piasters			
Vietnamese Personnel	VN$ 36,314,605	VN$16,531,764	VN$19,782,841
Office Supplies	15,130,500	4,739,547	10,390,953
Housing Allowances (U.S.)	50,490,565	18,929,520	31,561,045
Per Diem (In-Country)	12,308,210	1,962,555	10,345,655
Air Fare (In-Country)	4,185,150	792,672	3,392,478
Totals	VN$118,429,030	VN$42,956,058	VN$75,472,972

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