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AUDIT OF THE FINANCIAL STATEMENTS
OF REZCO AGRICOLA, S. DE R. L.
IN HONDURAS

AUDIT REPORT No. 1-522-88-17-N
August 22, 1988

AGENCY FOR INTERNATIONAL DEVELOPMENT

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August 22, 1988

MEMORANDUM

TO : D/USAID/Honduras, John A. Sanbrailo

FROM : RIG/A/T, *Coinage N. Gothard*
Coinage N. Gothard, Jr.

SUBJECT: Audit Report No. 1-522-88-17-N, "Audit of the Financial Statements of Rezco Agricola, S. de R.L. in Honduras as of May 31, 1987"

This report presents the results of a non-Federal financial and compliance audit requested by your Mission of the financial statements of Rezco Agricola, S. de R. L. (REZCO) as of May 31, 1987. The financial statements include funding provided by USAID/Honduras Project No. 522-0207 as well as counterpart funds in local currency generated by Economic Support Funds (ESF). The audit firm of Price Waterhouse in Honduras prepared the report, which is dated July 29, 1988.

The purpose of this audit was to (1) express an opinion on the financial statements of Rezco as of May 31, 1987; (2) report on the systems of internal accounting control and procurement; and (3) report on compliance by Rezco with applicable laws, regulations, and loan contract terms.

Price Waterhouse disclaimed an opinion on the financial statements because they could not apply adequate auditing procedures to express an opinion. This scope limitation occurred because (1) Rezco was no longer in operation and certain required audit steps such as physical examinations, observations, inspections, and confirmations could not be performed and (2) Rezco's accounting records did not provide sufficient support to validate the sales, cash transactions, expenditures and costs reflected in the financial statements. Also, the auditors were unable to obtain a management representation letter in accordance with generally accepted auditing standards. Price Waterhouse's study and evaluation of internal accounting control and procurement practices was limited to a preliminary review because they determined that the small size of Rezco did not permit an adequate internal control system and they observed some control weaknesses during the preliminary review phase which they believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements, taken as a whole, may occur and not be detected within a timely period. The weaknesses observed

were (1) an inadequate accounting system, (2) a lack of independent testing and processing controls over accounting transactions, and (3) an inadequate procurement system. Price Waterhouse disclaimed an opinion on those items tested for compliance as well as on untested items due to the scope limitations mentioned previously related to the financial statements. However, they determined that there was non-compliance with certain loan contract terms and applicable laws and regulations requiring (1) costs and expenses to be supported with adequate original documentation and (2) all costs and expenses charged to be related to Rezco's legitimate business operations.

The Price Waterhouse report does not contain any recommendations related to the internal control weaknesses or non-compliance because Rezco's fixed assets and remaining inventories of materials and supplies were liquidated and the company discontinued operations on September 30, 1987. As a result, we are not including any recommendations in the Office of the Inspector General's audit recommendation follow-up system. This report is advisory only concerning the fairness of Rezco's financial statements as of May 31, 1987.

AUDIT OF THE FINANCIAL STATEMENTS
OF REZCO AGRICOLA, S. DE R. L.
AS OF MAY 31, 1987

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

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Price Waterhouse

July 29, 1988

Mr. Coinage N. Gothard
Regional Inspector
General for Audit
U.S. Agency for
International Development (AID)
Tegucigalpa, D. C.

Dear Mr. Gothard:

This report presents the results of our audit of the financial statements and additional information of Rezco Agricola, S. de R. L. as of May 31, 1988. These financial statements include funding from agreement No.522-0207 between the Government of Honduras (GOH) and the U.S. Agency for International Development in Honduras (USAID/H).

BACKGROUND

Rezco Agricola, S. de R. L. (Rezco) was incorporated in Honduras, Central America in June 1986 as a limited liability partnership. It was located in the city of Choluteca, and its principal activity was the production of melons in Honduras and their commercialization in the United States. Rezco started its operations in June 1986, with a specific project to produce and export 260,000 boxes of honeydew melons over a period of one year. The total estimated cost of this project was L2,040,000 (\$1,020,000).

The above mentioned project was financed with an advance contribution of L500,000 (\$250,000) to Rezco's paid-in capital made by its partners and with two loans to Rezco Agricola, S. de R. L. totaling L1,540,000 (\$770,000) made in August 1986 by the Central American Financing Corporation (Financiera Centroamericana, S. A., FICENSA), a local commercial bank. The funding was provided to FICENSA by the Central Bank of Honduras through a rediscount line of credit provided by the Export Development and Services Project, USAID/Honduras Project No.522-0207. The Central Bank agreed to guarantee up to 60% of the loan repayments, if necessary.

The project was initiated by USAID/Honduras and the Government of Honduras (GOH) on August 31, 1984, with the purpose of increasing non-traditional exports. USAID/Honduras provided \$23,500,000 in loan and grant funds and the GOH provided \$24,000,000 as

Mr. Coinage Gothard
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counterpart funds in local currency generated by Economic Support Funds (another program between the GOH and the United States Government).

As part of the project, Rezco Agricola, S. de R. L. signed a technical assistance contract with Shemesh Agro-Tech, S. A., a subsidiary of an Israeli company with previous experience in the production of melons in this zone. It also signed a distribution contract in November 1985 between its affiliated company Rezco Agro-Industrias, S. A. and Cal Fruit of Los Angeles, California. Rezco began operations in June 1986 with the following management personnel:

-	Mr. Mohammed R. Rezai	General Manager
-	Mr. Amir R. Rezai	Administrative Manager
-	Mr. Arnold Fard	Production Manager

The last shipment of melons to the United States was made in April 1987. As of May 31, 1987, Rezco Agricola, S. de R. L. had a recorded accumulated loss of approximately L913,000 (US\$456,500) net of its paid-in capital of L5,000 (\$2,500). According to Honduran Commercial Law, the loss of two-thirds of the paid-in capital is sufficient cause for any interested party to declare a company in bankruptcy. In July 1987 FICENSA declared its loans to Rezco due and called the principal and accrued interest which, to that date, amounted to approximately L1,692,000 (US\$846,000). As a result, all of Rezco's fixed assets and remaining inventories of materials and supplies were liquidated with an additional loss to Rezco of approximately L372,000 (US\$186,000). The company finally discontinued operations on September 30, 1987.

AUDIT OBJECTIVES AND SCOPE

We performed a financial and compliance audit of Rezco Agricola, S. de R. L. for the period from June 30, 1986, to May 31, 1987. The objectives of this audit were as follows:

1. Express an opinion on the financial statements of Rezco Agricola, S. de R. L. as of May 31, 1987.
2. Determine if Rezco's internal accounting control system was adequate for the purposes of the project.
3. Determine if Rezco's procurement practices were fair, open and competitive, including the procurement of the services of Shemesh Agro-Tech, S. A. and Cal-Fruit.

4. Determine if Rezco Agrícola, S. de R. L. complied with applicable laws, regulations and loan contract terms.

Our examination was performed in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities and Functions" (1981 Revision).

The scope of our work consisted of the following:

1. Selective examination and testing of supporting documentation made available by Rezco Agrícola, S. de R. L. for direct costs related to salaries, allowance for travel and transportation, fringe benefits, equipment and supplies and other direct costs.
2. Study and evaluation of the Rezco's internal accounting control and procurement practices during the period of 11 months ended on May 31, 1987, including the procurement of the services of Shemesh Agro-Tech, S. A. and Cal-Fruit.
3. Review of Rezco's compliance with loan contract terms and applicable laws and regulations.

RESULTS OF AUDIT

Financial Statements

At the time of our engagement Rezco had discontinued its operations and had no employees. This situation has remained unchanged to this date and we were not able to conduct the following obligatory audit steps:

1. Study and testing of the effectiveness of the internal accounting control and procurement procedures or whether these controls and procedures were performed by persons having no incompatible functions.
2. Conduct physical counts of inventories and inspections of fixed assets for valuation and comparison with recorded amounts.
3. Obtain confirmation of the bank account balances and responses to our inquiries for confirmation of accounts receivable and accounts payable.

4. Interviews with and written reports from management. We did not obtain the representation letter from management as required by auditing standards and we issued this report without the benefits of an exit conference to discuss the audit findings and to corroborate other oral representations.

Rezco's accounting records do not provide sufficient support to validate the cash and sales transactions or to permit the application of adequate auditing procedures. During our review, we observed that Rezco's financial statements as of May 31, 1987, were materially affected by departures from generally accepted accounting principles. These significant departures are described elsewhere in this report.

As explained in the preceding paragraphs, we were unable to apply adequate auditing procedures regarding the validity of certain evidence, existence of assets, and cash and sales transactions. Therefore, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements of Rezco Agricola, s. de R. L. as of May 31, 1987.

Internal Accounting Control and Procurement Practices

Our study and evaluation of the internal accounting control and procurement practices did not extend beyond a preliminary review of the system to obtain an understanding of the control environment and the flow of transactions through the accounting system. Because the organization of Rezco Agricola, S. de R. L. was too small to permit an adequate segregation of duties and due to the major weaknesses observed in our study and evaluation, we chose to perform substantive audit tests instead of relying upon the internal accounting control and procurement practices of Rezco Agricola, S. de R. L.

Our study and evaluation, made for the limited purposes described above, would not necessarily disclose all material weaknesses in the system of internal accounting control and procurement practices. However, our examination disclosed conditions that we believe result in the probability that errors and irregularities in amounts that would be material in relation to the financial statements of Rezco Agricola, S. de R. L. as of May 31, 1987, taken as a whole may occur and not be detected within a timely period. The principal weaknesses observed were related to the lack of an adequate accounting system; lack of independent testing and processing controls over accounting transactions; and lack of appropriate procurement procedures.

Mr. Coinage Gothard
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Findings 1 to 4 included in our report on internal accounting control and procurement practices did not include recommendations because Rezco Agricola, S. de R. L. had closed operations in September 1987.

Compliance with Loans Contract Terms and Applicable Laws and Regulations

Because of the limitations imposed on the scope of our examination it was not possible to determine if transactions selected for testing were in compliance with loan terms and applicable laws and regulations. Accordingly, we do not express an opinion on compliance, of tested as well as untested items, with loan contract terms and applicable laws and regulations by Rezco Agricola, S. de R. L. during the period from July 1, 1986 to May 31, 1987.

However, the results of our study determined that, for certain items tested, Rezco Agricola, S. de R. L. did not comply with loan contract terms and applicable laws and regulations as listed below:

1. Documents supporting certain costs and expenses were not available for examination.
2. Certain costs and expenses were incorrectly paid and charged by Rezco to its operations.

MANAGEMENT COMMENTS

This report has been issued without the benefit of an exit conference to discuss the audit findings and to corroborate some financial data and other information obtained from external and other sources because Rezco Agricola, S. de R. L. did not have management and administrative personnel in Honduras. As mentioned elsewhere in this report, we were not provided with a written management representation letter as required by auditing standards.

Price Waterhouse

Price Waterhouse

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987
USAID/HONDURAS PROJECT NO.522-0207

REPORT ON FINANCIAL STATEMENTS

AUDITOR'S OPINION

We have examined the balance sheet of Rezco Agrícola, S. de R. L. as of May 31, 1987, and the related statements of losses and accumulated deficit and of changes in financial position for the period of eleven months ended on that date. Except as explained in the following paragraph, our examination was made in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We were engaged as auditors on March 2, 1988, when Rezco Agrícola, S. de R. L. (Rezco) was no longer in operation; its principal assets had been liquidated and there were no management, administrative, or accounting personnel in Honduras. Due to these situations we were unable to test the validity of certain control procedures, and we could not review certain evidential matter related to the production and export activities and the existence of Rezco's assets. We could not perform certain required audit steps such as physical examinations, observations, inspections and confirmations. We were unable to obtain a management representation letter to complement our auditing procedures. Additionally, we believe that Rezco's accounting records did not provide sufficient support to validate the sales, cash transactions, expenditures and costs reflected in the financial statements as of May 31, 1987, and thus permit the application of adequate audit procedures.

Rezco was organized mainly to carry out a project for the production of melons in Honduras and their export to the United States during the period from June 1986 to May 1987. The project failed and generated an initial loss of approximately L917,600, which caused FICENSA to declare due Rezco's loans and accrued interest. As a result Rezco went out of business. As explained in Note 7 to the financial statements, in July 1987 Rezco repaid part of the bank loans from the liquidation of its inventories

and fixed assets incurring a further loss of approximately L372,000, which is not reflected in the accompanying financial statements. In addition, accrued interest amounting to approximately L117,000 was not recorded in Rezco's financial statements as of May 31, 1987. As a result, the financial statements of Rezco Agricola, S. de R. L. as of May 31, 1987, do not include losses nor provisions for losses of approximately L489,000.

Because we were unable to apply adequate auditing procedures as explained in the second paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements of Rezco Agricola, S. de R. L. as of May 31, 1987.

May 27, 1988

Price Waterhouse

REZCO AGRICOLA, S. DE R. L.
(A Honduran Company)

BALANCE SHEET
MAY 31, 1987

<u>ASSETS</u>	Lempiras (<u>Note 2</u>)
Current assets:	
Cash and banks	L 22,776
Accounts receivable (Note 3)	126,376
Inventories at cost (Notes 4 and 7)	185,873
Prepaid expenses	6,404
Total current assets	<u>341,429</u>
Machinery and equipment at cost, less accumulated depreciation (Notes 5 and 7)	956,510
Other assets	200
	<u><u>L1,298,139</u></u>
 <u>LIABILITIES AND PARTNERS' EQUITY</u>	
Current liabilities:	
Bank loans (Notes 6 and 7)	L1,574,647
Accounts payable to partners	50,129
Accounts payable and accrued expenses	85,959
Total current liabilities	<u>1,710,735</u>
Advances from partners	500,000
Partners' equity:	
Paid - in Capital	5,000
Accumulated deficit	(917,596)
	<u>(912,596)</u>
	<u><u>L1,298,139</u></u>

REZCO AGRICOLA, S. DE R. L.
(A Honduran Company)

STATEMENTS OF LOSSES AND ACCUMULATED DEFICIT
FOR THE ELEVEN-MONTH PERIOD ENDING MAY 31, 1987

	Lempiras (<u>Note 2</u>)
Sales (Net of marketing and packing expenses)	<u>L1,105,919</u>
Costs and expenses:	
Production costs	1,590,553
General and administrative expenses	414,892
Interest expenses (Note 6)	<u>18,070</u>
	<u>2,023,515</u>
Net loss and accumulated deficit at the end of the period	<u><u>L (917,596)</u></u>

REZCO AGRICOLA, S. DE R. L.
(A Honduran Company)

STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR THE ELEVEN-MONTH PERIOD ENDING MAY 31, 1987

	Lempiras (<u>Note 2</u>)
Cash was provided by:	
Capital	L 5,000
Advances from partners	500,000
Bank loans	1,574,647
Accounts payable to partners	50,129
Accounts payable and accrued expenses	85,959
	<hr/>
Total cash provided	2,215,735
	<hr/>
Cash was used for:	
Net loss	917,596
Less items not affecting cash:	
Depreciation	(71,578)
	<hr/>
Cash used for operations	846,018
Other uses:	
Increase in accounts receivable	126,376
Increase in inventories	185,873
Increase in prepaid expenses	6,404
Acquisition of machinery and equipment	1,028,088
Increase in other assets	200
	<hr/>
Total cash used	2,192,959
	<hr/>
Cash balance at the end of the period	L 22,776
	<hr/> <hr/>

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987
USAID/HONDURAS PROJECT NO.522-0207

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The more important accounting policies adopted by Rezco Agrícola, S. de R. L. are described below:

Inventories

Inventories of material and supplies were valued at average cost.

Machinery and equipment

Fixed assets were recorded at cost and are depreciated on a straight-line basis over their estimated useful lives. Expenditures for repairs and maintenance were charged to income. Expenditures for additions and improvements were capitalized and depreciated over the estimated additional life of the related assets.

Severance compensation

Compensation, accrued according to length of service under the terms of the Honduran Labor Code, may be payable to the employees in the event of dismissal. No definite liability existed in this respect at May 31, 1987, however, a provision of L8,100 was registered for severance payments.

NOTE 2 - GENERAL INFORMATION:

History and operations

Rezco Agrícola, S. de R. L. (Rezco) was incorporated in June 1986, in accordance with the laws of Honduras, as a limited liability partnership. It is domiciled in Choluteca, Honduras and its principal activities are the production of melons in Honduras and their commercialization in the United States.

Currency and exchange

Rezco's accounting records were kept in Honduran lempiras, denoted by the symbol L in the accompanying financial statements. The current exchange rate of two lempiras for one United States dollar has remained constant for many years. In accordance with the Honduran foreign exchange controls, which became effective in September 1981, all foreign currency acquired must be exchanged through the Exchange Control Department of the Central Bank of Honduras and all remittances abroad must have the written approval of said department.

NOTE 3 - ACCOUNTS RECEIVABLE:

Accounts receivable at May 31, 1987 were as follows:

Trade	L 63,276
Officers and employees	87
Others	63,013
	<hr/>
	L126,376
	<hr/> <hr/>

NOTE 4 - INVENTORIES:

Inventories at May 31, 1987 were as follows:

Chemical products	L 20,996
Melon seeds	1,159
Packing materials	163,718
	<hr/>
	L185,873
	<hr/> <hr/>

As explained in Note 7 to the financial statements, the inventories were liquidated in July 1987 for approximately L10,000 to pay bank loans.

NOTE 5 - MACHINERY AND EQUIPMENT:

Fixed assets at May 31, 1987 were as follows:

Leased improvements	L 43,320
Machinery and equipment	886,571
Vehicles	84,418
Office equipment	4,965
Tools and other	8,814
	<hr/>
	1,028,088
Less - Accumulated depreciation	71,578
	<hr/>
	L 956,510
	<hr/> <hr/>

As explained in Note 7 to the financial statements the fixed assets were liquidated in July 1987 to repay bank loans and accrued interest.

NOTE 6 - BANK LOANS:

Loans were obtained from FICENSA at 14% and 19% annual interest and secured by first mortgage on all fixed assets of Rezco. Due to financial difficulties, Rezco was in default with the bank at the date of the financial statements.

Accrued interest as of May 31, 1987 amounting to approximately L117,000 was not recorded in Rezco's books.

NOTE 7 - SUBSEQUENT EVENTS:

The last shipment of melons to the United States was made in April 1987. As of May 31, 1987, Rezco Agricola, S. de R. L. had a recorded accumulated loss of approximately L913,000 net of its paid-in capital of L5,000. According to Honduran Commercial Law, the loss of two-thirds of the paid-in capital is sufficient cause for any interested party to declare a company in bankruptcy. In July 1987, FICENSA declared due its loans to Rezco and called the principal and accrued interest which, to that date, amounted to approximately L1,692,000. As a result, all Rezco's fixed assets and remaining inventories of materials and supplies were liquidated with an additional loss to Rezco of approximately L372,000. Rezco discontinued operations on September 30, 1987.

The proforma condensed balance sheet of Rezco Agricola, S. de R. L. as of May 31, 1987 after compensating for certain proforma adjustments arising from the closing of operations, is as follows:

ASSETS

Current assets	L174,186
Machinery and equipment - Net	2,817
Other assets	200
	<hr/>
	L177,203
	<hr/> <hr/>

LIABILITIES AND PARTNERS' EQUITY

Current liabilities	L1,078,413
Advances from partners	500,000
Partners' equity	
Paid-in capital	5,000
Accumulated losses	(1,406,210)
	<u>L 177,203</u>

The proforma condensed results of the operations of Rezco Agricola, S. de R. L. for the eleven months ended May 31, 1987, after compensating for the losses of closing operations is as follows:

Net sales	L1,105,919
Total costs and expenses	2,512,129
	<u>(L1,406,210)</u>

The foregoing financial position and results of operation reflect the following proforma adjustments related to the liquidation of assets mentioned above.

Interest expenses	L 117,000	
Loss in disposal of inventories and fixed assets	371,614	
Bank loans	671,008	
Accounts payable and accrued expenses		L 38,686
Fixed assets - net		953,693
Inventories		167,243
	<u>L1,159,622</u>	<u>L1,159,622</u>

Price Waterhouse

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROL
AND PROCUREMENT PRACTICES

AUDITOR'S OPINION

We have examined the financial statements of Rezco Agricola, S. de R. L. for the period ending May 31, 1987, and have issued our report thereon dated May 10, 1988, in which we disclaim an opinion due to significant limitations in the scope of our work. Except as stated in our report dated May 10, 1988, our examination was made in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision). Solely to assist us in planning and performing our examination, we made a study and evaluation of the internal accounting control and procurement practices of Rezco Agricola, S. de R. L. That study and evaluation was limited to a preliminary review of the system to obtain an understanding of the control environment and the flow of transactions through the accounting system. Because the organization of Rezco Agricola, S. de R. L. is too small to permit an adequate segregation of duties and due to certain control weaknesses observed (see findings Nos. 1 through 4), our study and evaluation of the internal accounting control and procurement practices did not extend beyond this preliminary review phase. Accordingly, we do not express an opinion on the system of internal accounting control and procurement practices taken as a whole. Also, our examination, made in accordance with the standards mentioned above, would not necessarily disclose all material weaknesses in its system of internal accounting control. However, our examination disclosed conditions that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements taken as a whole may occur and not be detected within a timely period.

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in our examination of the financial statements of Rezco Agricola, S. de R. L. as of May 31, 1987, and this report does not affect our report dated May 10, 1988 on those financial statements.

This report is intended solely for the use of the Agency for International Development. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

May 27, 1988

Price Waterhouse

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROL
AND PROCUREMENT PRACTICES

AUDIT FINDINGS

1. LACK OF AN APPROPRIATE FINANCIAL INFORMATION SYSTEM

Condition:

The financial information system of Rezco Agricola, S. de R. L. during the period of the project was lacking important financial data necessary to appropriately plan, manage and evaluate the project activities.

Criteria:

Management is responsible for establishing and maintaining a financial information system that, to the extent practical, ensures the orderly and efficient operation of the business and reduces related risks.

Cause:

Rezco did not develop appropriate financial and accounting capabilities to ensure that its operations were under management control.

Effect:

We could not find evidence of the issuance of the following key financial reports:

- monthly financial statements;
- actual revenues, production and marketing costs and general expenses compared with budgeted figures;
- monthly production and export reports; and
- monthly shipment liquidation reports.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROL
AND PROCUREMENT PRACTICES

AUDIT FINDINGS

2. LACK OF INDEPENDENT TESTING CONTROL

Condition:

Rezco's accounting records did not show evidence of testing by the Accounting Department of transactions made during the normal course of business.

Criteria:

The testing of accounts should be applied to the results of transactions. These testing controls are usually performed by individuals other than the processors and are designed to detect errors or irregularities that may occur before or during processing.

Cause:

Management was not aware of the necessity to verify the Company's transactions and to evaluate the results.

Effects:

The above condition caused the following:

- a) Bank accounts were not reconciled monthly and we could not review those reconciliations and/or apply other auditing procedures to determine the reasonableness of cash balances and transactions as of May 31, 1987.
- b) Rezco's Accounting Department did not prepare an aging analysis of accounts receivable. We found that the major accounts receivable were unsupported or were the result of incorrect accounting transactions.
- c) There were no reports or analysis of sales, shipping, returns and discounts. The related recorded transactions could not be reviewed in terms of quantities, prices and discounts.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROL
AND PROCUREMENT PRACTICES

AUDIT FINDINGS

- d) Rezco's Accounting Department did not take physical inventories of materials and supplies to verify their existence and safeguarding procedures. There was no support of the balances of inventories as of May 31, 1987.
- e) There were no reports or details of production costs and departmental expenses. The overhead costs were not distributed in accordance with a specific procedure, and it was not possible to evaluate the results and/or compare them with budgeted amounts.

During our review we observed many costs and expenses not supported with appropriate documentation and some appeared costs unrelated to Rezco's operations.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROL
AND PROCUREMENT PRACTICES

AUDIT FINDINGS

3. LACK OF PROCESSING CONTROLS

Condition:

Rezco did not implement basic processing controls to prevent or detect errors or irregularities which may have occurred during and/or before processing.

Criteria:

Processing control needs to be implemented in order to ensure proper recording of all transactions conducted during the normal course of business.

Cause.

Management and the Accounting Department of Rezco did not take all the necessary steps to properly record business transaction.

Effects:

The lack of internal accounting controls over processing procedures caused the following effects:

- a) Rezco did not have subsidiary records for cash and bank accounts, inventories, fixed assets, and other related accounts.
- b) Rezco did not issue receipts upon collection of sales proceeds and/or accounts receivable.
- c) Many checks were issued without proper supporting documentation and certain payments appeared not to be related to Rezco's operations.
- d) There were no copies of bills, bills of lading and custom certificates in Rezco's files to support the recorded sales transactions.
- e) The materials and supplies used in melon production were not documented with properly authorized requisitions.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROL
AND PROCUREMENT PRACTICES

AUDIT FINDINGS

4. LACK OF APPROPRIATE PROCUREMENT CONTROLS:

Condition:

Rezco did not use a formal procurement system. All the procurement was made by Cal Fruit and/or Rezco's partners without a specific system.

Criteria:

An appropriate procurement system includes fair, open and competitive bids to obtain the best prices and conditions and allows the detection of errors or irregularities, if any.

Cause:

The management of Rezco Agrícola, S. de R. L. did not consider it necessary to use a formal procurement system.

Effect:

Purchases made during the period were not supported by authorized purchase orders, competitive bids and receiving reports which are to verify if transactions were genuine, authorized and recorded appropriately.

Price Waterhouse

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON COMPLIANCE WITH LOAN CONTRACT TERMS
AND APPLICABLE LAWS AND REGULATIONS

AUDITOR'S OPINION

We have examined the balance sheet of Rezco Agrícola, S. de R. L. as of May 31, 1987, and the related statements of losses and accumulated deficit and changes in the financial position for the eleven months then ended, and have issued our report thereon dated May 10, 1988, in which we disclaimed an opinion due to significant limitations in the scope of our work. Except as stated in our report dated May 10, 1988, our examination was made in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities and Functions" (1981 Revision).

The management of Rezco Agrícola, S. de R. L. is responsible for compliance with terms of the above mentioned loan contract and applicable laws and regulation. In connection with our examination referred to above, we selected and tested transactions and records to determine Rezco's compliance with contract terms and applicable laws and regulations. However, due to the inadequacy of the accounting records, the lack of internal accounting controls and because we could not obtain the management representation letter to confirm compliance and noncompliance matters, we do not express an opinion on compliance of tested as well as untested items with loan contract terms and applicable laws and regulations by Rezco Agrícola, S. de R. L. during the period from June 1, 1986 to May 31, 1987. However, the results of our study determined that, for certain items tested, Rezco Agrícola, S. de R. L. did not comply with contract terms and applicable laws and regulations as described in findings Nos. 1 and 2.

This report is intended solely for the use of the U.S. Agency for International Development. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

May 27, 1988

Price Waterhouse

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON COMPLIANCE WITH LOAN CONTRACT
TERMS AND APPLICABLE LAWS AND REGULATIONS

AUDIT FINDINGS

1. DOCUMENTS SUPPORTING CERTAIN COSTS AND EXPENSES WERE NOT AVAILABLE FOR EXAMINATION

Condition:

Rezco did not maintain sufficient documents to support all costs and expenses recorded in its books, such as personnel files, payroll receipts, bills from vendors and other appropriate documentation. We observed that 159 checks representing approximately 30% of the issued checks had no supporting documentation.

Some examples follow:

<u>Check No.</u>	<u>Date</u>	<u>Concept</u>	<u>Amount</u>
348740	08/18/86	Professional Fees	L 1,000.00
348753	08/25/86	Warehouse Rent	400.00
348764	08/27/86	Purchase Advance	10,000.00
348807	09/18/86	Import duties	7,574.00
348829	09/25/86	Import duties	9,525.00
011	10/14/86	Fuel	1,118.00
026	10/15/86	Rent-A-Car	2,310.00
036	10/26/86	Freights	1,300.00
220	01/16/87	Chemical Products	14,776.00
405	04/22/87	Funds transfer	25,000.00

Criteria:

Income tax law establishes that all recorded transactions should be adequately supported.

Cause:

Rezco's accounting procedures were not adequate to provide proper compliance with income tax laws and regulations.

Effect:

All unsupported costs and expenses could be unacceptable under the Honduran Income Tax Law and USAID/Honduras regulations.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON COMPLIANCE WITH LOAN CONTRACT
TERMS AND APPLICABLE LAWS AND REGULATIONS

AUDIT FINDINGS

2. CERTAIN COSTS AND EXPENSES WERE INADEQUATELY PAID BY REZCO
AND CHARGED TO ITS OPERATIONS

Condition:

The following deficiencies were observed on certain tested items:

- Telephone services, social security payments, and other expenses, amounting to L45,073, were paid by Rezco Agrícola, S. de R. L., and the supporting documentation was in the name of its affiliated company Rezco Agroindustrias, S. de R. L., certain Rezco officers and other individuals.
- Expenses amounting to L2,657 did not appear to be related to business operations (liquor, jewelry and travel expenses for the manager's wife).
- A purchase of fertilizer, amounting to L3,093, from Química Integrada was documented with photocopies.

Criteria:

All expenditures related to Rezco's operations should be properly supported with original documentation in the name of Rezco Agrícola, S. de R. L. Any other disbursement not related to Rezco's operations should be charged to the person who incurred the expense and/or received the benefit.

Cause:

Accounting procedures were inadequate for providing proper compliance with income tax regulations.

Effect:

These expenses may not be accepted for income tax purposes by the GOH's authorities and eventually could cause some penalties for Rezco Agrícola, S. de R. L. Additionally, USAID/Honduras, through FICENSA and the Central Bank of Honduras, can reject those expenses not related with the project.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON COMPLIANCE WITH LOAN CONTRACT
TERMS AND APPLICABLE LAWS AND REGULATIONS

AUDIT FINDINGS

3. INFRINGEMENT OF THE HONDURAN INCOME TAX AND OTHER LAWS

Condition:

Rezco did not comply with the Honduran Income Tax Laws that require tax withholding from foreign residents and Hondurans permanently living in the country. Additionally, Rezco did not file employees' tax, sales tax, and municipal tax returns.

Criteria:

Rezco as a Honduran company should comply with all tax regulations in Honduras.

Cause:

Rezco was not aware of the tax law requirements.

Effect:

Rezco could be held liable for certain taxes and penalties.

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON INTERNAL ACCOUNTING CONTROLS
AND PROCUREMENT PRACTICES

AUDIT FINDINGS

4. NONCOMPLIANCE WITH LOAN CONTRACT TERMS

Condition:

In July 1986, Rezco received two loans amounting to L1,535,000 from FICENSA. The loans were payable in yearly installments of L512,000 from May 31, 1987 to May 31, 1989 at annual interest rates of 14% and 19%. As of May 31, 1987, the accrued interest due amounted to approximately L117,000. Rezco was in default of the total amount due.

Cause:

The financial difficulties of Rezco Agricola, S. de R. L.

Effect:

In July 1988, FICENSA declared due the total debt and arranged partial repayment by liquidating Rezco's fixed assets and inventories. As a result, Rezco incurred additional losses of approximately L370,000.

Price Waterhouse

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987

USAID/HONDURAS PROJECT No. 522-0207

REPORT ON ADDITIONAL INFORMATION
TO THE FINANCIAL STATEMENTS

AUDITOR'S OPINION

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules of operations compared with the budget submitted to FICENSA (Exhibit A), summary of melon sales and export prices (Exhibit B) and summary of certain financial data (Exhibit C) as of May 31, 1987, are presented for purposes of additional analysis and are not a required part of the basic financial statements of Rezco Agricola, S. de R. L. as of May 31, 1987.

As explained in the first part of this report, we were unable to apply adequate auditing procedures, and the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on this additional information.

May 27, 1988

Price Waterhouse

EXHIBIT AAUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987USAID/HONDURAS PROJECT No. 522-0207ADDITIONAL INFORMATIONRESULTS OF OPERATIONS COMPARED WITH
BUDGET SUBMITTED TO FICENSA
(expressed in lempiras)

	<u>BUDGET</u>	<u>ACTUAL ADJUSTED AMOUNTS</u>	<u>DIFFERENCE</u>
Gross Sales	L4,680,000	L2,947,167	L(1,732,833)
Less Marketing Costs:			
Commissions on sales	434,200	288,564	145,636
Ocean freight	1,176,400	926,784	249,616
Inland freight		332,366	(332,366)
Handlines expenses (U.S.A.)	338,000	293,534	44,466
Total Marketing Costs	1,948,600	1,841,248	107,352
Net Sales	2,731,400	1,105,919	(1,625,481)
Costs and Expenses:			
Production costs	1,617,950	1,518,975	98,475
Depreciations	221,668	115,786*	105,882
General and adminis- trative expenses	281,000	414,892	(133,892)
Interest expenses	194,500	135,070**	59,430
Total Costs and Expenses	2,314,618	2,184,723	129,895
Income (Loss) before income taxes	L 416,782	L(1,078,804)	L(1,495,586)

* Depreciation includes an adjustment of L44,208 to compensate the differences in the depreciation rates used by Rezco for financial and budget purposes. The adjustment does not apply for financial purposes because Rezco used legal rates.

** Includes an adjustment of L117,000 for the unaccorded interest at May 31, 1987. See Note 6 to the financial statements.

AUDIT OF THE FINANCIAL STATEMENTS OF
 REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987
 USAID/HONDURAS REPORT PROJECT No. 522-02-07

MELON EXPORT SALES
 (Expressed in Lempiras)

MONTHS	Export Sale *		Sales Price **			Price Reference New York ***		
	QUANTITIES (BOXES)	SALES AMOUNT	MAXIMUM	MINIMUM	AVERAGE	MAXIMUM	MINIMUM	AVERAGE
CAL FRUIT								
DEC. 1986	26,620	L 485,694	L22.00	L9.64	L18.25	Not available	Not available	
JAN. 1987	57,581	603,204	15.64	6.74	10.48	L24.00	L20.00	L22.00
FEB. 1987	7,293	121,668	6.74	4.78	16.68	18.00	10.00	14.00
MAR. 1987	26,925	620,820	24.96	19.36	23.06	32.00	28.00	30.00
APR. 1987	66,016	826,634	25.96	1.02	12.52	16.00	14.00	15.00
	<u>184,435</u>	<u>L2,658,020</u>			<u>L14.41</u>			<u>20.25</u>
CAAMMANO BROTHERS:								
MAR. 1987	5,883	196,638	35.96	31.12	33.42	32.00	28.00	30.00
APR. 1987	9,556	102,812	10.76		10.76	16.00	14.00	15.00
	<u>15,439</u>	<u>299,450</u>			<u>19.39</u>			<u>22.50</u>
TOTAL	<u>199,874</u>	<u>2,957,470</u>			<u>14.79</u>			<u>L21.00</u>
	=====				=====			=====
UNDETERMINED IN REZCO'S RECORDS		(10,303)			(0.05)			
GROSS SALES (EXHIBIT A)		<u>L2,947,167</u>			<u>L14.74</u>			
		=====			=====			

* Information prepared by Ficensa from sales liquidations submitted by Cal-Fruit and Caamano Brothers.

** In some cases, the price obtained was seriously affected by the poor quality, and/or damages in handling of the melons exported.

*** Information obtained from Federacion de Productores y Exportadores Agropecuarios y Agroindustriales de Honduras (FEPROEXAH), a Honduras exporter association.

EXHIBIT C

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCC AGRICOLA, S. DE R. L. AS OF MAY 31, 1987
USAID/HONDURAS PROJECT No. 522-0207

ADDITIONAL INFORMATION
SUMMARY OF CERTAIN FINANCIAL DATA
(Expressed in lempiras)

	<u>Budgeted</u> <u>Amounts</u>	Actual <u>Adjusted</u> <u>Amounts</u>	<u>Difference</u> <u>Amount</u>	<u>%</u>
Number of boxes of melons	260,000	199,884	(60,116)	(23)
Gross sales	L4,680,000	L2,947,167	L(1,732,883)	(37)
Gross sales price per box	18.00	14.74	(3.26)	(18)
Handling expenses in U.S.A.	338,000	293,534	(44,466)	(13)
Handling expenses per box	1.30	1.47	(0.17)	(13)
Ocean freight	1,176,400	926,784	(249,616)	(21)
Ocean freight per box	4.52	4.64	0.12	(3)
Inland freight	-.-	332,366	332,366	100
Inland freight per box	-.-	1.66	(1.66)	(100)
Total production and packing costs	1,839,118	1,634,761	(204,357)	(11)
Production and packing costs per box	7.07	8.18	(0.18)	(2)
Comission on sales	434,200	288,564	(145,636)	(33)
Comission on sales per box	1.67	1.44	0.23	14

AUDIT OF THE FINANCIAL STATEMENTS OF
REZCO AGRICOLA, S. DE R. L. AS OF MAY 31, 1987
USAID/HONDURAS PROJECT No. 522-0207

LIST OF REPORT FINDINGS

The following findings were disclosed in the accompanying report:

Internal Accounting Control:

1. Lack of an appropriate financial information system.
2. Lack of independent testing control.
3. Lack of processing controls.
4. Lack of appropriate procurement controls.

Compliance with Loan Contract Terms and Applicable
Laws and Regulations:

1. Documents supporting certain costs and expenses were not available for examination.
2. Certain costs and expenses were inadequately paid by Rezco and charged to its operations.
3. Infringement of the Honduran income tax and other law.
4. Non compliance with loan contract terms.

APPENDIX 1

REPORT DISTRIBUTION

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