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AUDIT OF
THE FINANCIAL STATEMENTS
OF THE HONDURAN INSTITUTE
OF COFFEE (IHCAFE) AS OF
DECEMBER 31, 1987

Audit Report No. 1-522-89-32-N
March 29, 1989

AGENCY FOR INTERNATIONAL DEVELOPMENT

S. MAILING ADDRESS:
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OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

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March 29, 1989

MEMORANDUM

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

FROM : RIG/A/T, *for* Coinage N. Gothard, Jr. *Twitt B. Orr*

SUBJECT: Audit Report No. 1-522-89-32-N, "Audit of the Financial Statements of the Honduran Institute of Coffee (IHCAFE) as of December 31, 1987"

This report presents the results of a non-Federal financial audit requested by your Mission of the financial statements of the Honduran Institute of Coffee (IHCAFE) as of December 31, 1987. The certified public accounting firm of Price Waterhouse prepared the report, which is dated March 13, 1989.

The purpose of this audit was to express an opinion on the balance sheet of IHCAFE for the year ended December 31, 1987 and opinions on the statements of income and retained earnings and changes in financial position for the three years ended December 31, 1985, 1986, and 1987. This was in addition to the audit of the Small Farmers Coffee Improvement Project managed by IHCAFE, which is the subject of another report.

In the opinion of Price Waterhouse, the financial statements referred to above do not present fairly the financial position of IHCAFE as of December 31, 1987 and the results of operations and changes in financial position for the years ended December 31, 1985, 1986, and 1987. This opinion was expressed because IHCAFE had not (1) recorded provisions for losses on loans, notes, and accounts receivable which were considered material in relation to the financial statements taken as a whole; (2) recognized losses of approximately \$12,800,000 as a result of a permanent decline in the value of its investments in PANCAFE, S.A., a multinational corporation created by coffee producing countries, which has been bankrupt since 1980; and (3) recognized losses of approximately \$3,444,000 resulting from a claim by a local bank on a coffee producer cooperative that has not paid its obligations since 1983 and IHCAFE is the cooperative's guarantor before said bank.

Since this report is primarily for disclosure purposes, no specific recommendations were made by the Price Waterhouse report dated March 13, 1989. As a result, we are not including any recommendations in the Office of the Inspector General's audit recommendation follow-up system.

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INSTITUTO HONDUREÑO DEL CAFE
FINANCIAL STATEMENTS
DECEMBER 31, 1987

INSTITUTO HONDUREÑO DEL CAFE (IHCAFE)

FINANCIAL STATEMENTS
DECEMBER 31, 1987

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Price Waterhouse

March 13, 1989

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

Dear Mr. Gothard:

This report presents the results of our audit of the financial statements of the Honduras Institute of Coffee (Instituto Hondureño del Café, IHCAFE) as of December 31, 1987.

BACKGROUND

In May 1981, the U.S. Agency for International Development in Honduras (USAID/Honduras) approved the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176. The project's goals were to strengthen the capability and expand the coverage of the extension service of IHCAFE, and to increase the availability of investment credit for coffee producers in order to mitigate the impact of spreading coffee rust in Honduras.

The borrower/grantee is the Government of Honduras (GOH), which, in turn, granted funds to IHCAFE. Credit funds are administered through tripartite agreements between GOH, IHCAFE, and the Central Bank of Honduras. The funds were made available through the Central Bank to the Banco Nacional de Desarrollo Agrícola (BANADESA), and three private banks: Banco Hondureño del Café (BANHCAFE), Banco de Occidente, S. A., and Banco Sogerin, S. A. These banks would then provide credit to farmers participating in the project. Project funds include the USAID/Honduras loan of US\$16,000,000, the USAID/Honduras grant of US\$4,250,000, and a counterpart contribution of US\$29,002,000. The project includes the following components:

- a) Extension Activity
- b) Credit Activity
- c) Coffee Processing Activity

The project completion date was scheduled for May 26, 1990, and the first disbursement was made by USAID/Honduras in May, 1982. As of December 31, 1987, the disbursements made by USAID/Honduras for the project amounted to approximately US\$16,136,606.

IHCAFE was created in December 1970, through Law Decree No.83 of the Honduran National Congress. IHCAFE's principal purposes are to study, promote, guide and supervise coffee growing and commercialization activities in Honduras. IHCAFE has five experimental centers in different parts of the country, and eight regional offices in Santa Bárbara, Santa Rosa de Copán, Yoro, El Paraíso, Comayagua, Marcala, Olancho and San Pedro Sula.

The project is managed by IHCAFE through a special implementing unit under the direction of a project coordinator. Project accounting is processed in Tegucigalpa independently from IHCAFE's accounting records.

AUDIT OBJECTIVES AND SCOPE

In addition to the financial and compliance audit of the project which was performed in accordance with generally accepted auditing standards and the U. S. Comptroller General's "Standards for Audit of Governmental Institution, Program, Activities, and Functions" (1981 Revision), and for which a separate report was issued, we were engaged to conduct an audit of the financial statements of IHCAFE for the year ended December 31, 1987 and of the income statements for the years ended 1985 and 1986. Our audits on the financial statements were performed in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary under the circumstances in order to express an opinion on whether such financial statements fairly present the financial position of IHCAFE as of December 31, 1987 and the results of its operation and changes in financial position for the three years ended December 31, 1987 in accordance to generally accepted accounting principles.

AUDIT RESULTS

Financial statements as of December 31, 1987

In our opinion the financial statements of IHCAFE as of December 31, 1987 do not present fairly, in accordance with generally accepted accounting principles, the financial position of Instituto Hondureño del Café as of December 31, 1987 and the results of its operations and changes in its financial position for the year then ended. Our opinion is based on the following facts:

- a) IHCAFE has not recorded provisions for losses on loans, notes and accounts receivable which are material in relation to the financial statements taken as a whole.

- b) IHCAFE has not recognized losses of approximately L25,600,000 (US\$12,800,000 at the official exchange rate) as a result of a permanent decline in the value of its investments in PANCAFE, S. A., a multinational corporation created by coffee producing countries, which has been bankrupt since 1980.
- c) IHCAFE has not recognized losses of approximately L6,888,000 (US\$3,444,000) as a result of a claim from a local bank for a coffee producer cooperative that has not paid its obligations since 1983 and IHCAFE is the guarantor of this cooperative before said bank. At this time, such coffee producer cooperative does not have the financial capacity to pay its obligations to IHCAFE.

Results of operations for the years ended December 31, 1986 and 1985

Our audit of the results of operations of IHCAFE for the years ended December 31, 1986 and 1985 revealed that income and expenses were appropriately documented and recorded and reflect only transactions related to IHCAFE's operations, except that the provisions and losses mentioned above were not allocated to the expenses for each year presented.

In our opinion, due to the material effects of losses and provisions for losses not recorded, the income statements do not present, in accordance with generally accepted accounting principles, the results of operations of IHCAFE for the years ended December 31, 1986 and 1985.

MANAGEMENT COMMENTS

This report was discussed with IHCAFE representatives whose comments and observations were taken in consideration and incorporated herein, as considered appropriate.

Sincerely,

Price Waterhouse

Price Waterhouse

September 28, 1988

To the Board of Directors
of Instituto Hondureño del
Café (IHCAFE)

We have examined the accompanying balance sheet of Instituto Hondureño del Café (IHCAFE) as of December 31, 1987 and the statements of income and retained earnings and of changes in financial position for each of the three years in the period ended December 31, 1987. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 3 to the financial statements, approximately L35,805,873 of the outstanding loans, notes and accounts receivable are past due as of December 31, 1987. We consider that the majority of these accounts are of doubtful recovery in the normal course of operations. IHCAFE has not recorded provisions for doubtful accounts in the three year period ending December 31, 1987, or in previous years. The effect of not recording such allowances for doubtful accounts is material to the above mentioned financial statements taken as a whole.

As discussed in Note 4 to the financial statements, the investments in PANCAFE, S. A. suffered a permanent decline of value since this multinational company went into bankruptcy in 1980. As of December 31, 1987, IHCAFE has not recognized the losses on this investment which amount to approximately L25,600,000.

As discussed in Note 8 to the financial statements, IHCAFE has received a claim from a commercial bank for payment of a L6,888,000 loan to a coffee growers cooperative which was guaranteed by IHCAFE. This cooperative went into default with the bank in 1983. IHCAFE should establish a provision for a loss on this claim.

In our opinion, because of the effects of the matters discussed in the preceding three paragraphs, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of Instituto Hondureño del Café as of December 31, 1987, or the results of its operations and changes in its financial position for each of the three years in the period ended December 31, 1987.

Price water house

INSTITUTO HONDUREÑO DEL CAFE
(An Autonomous Agency of the Government of Honduras)

BALANCE SHEET
DECEMBER 31, 1987
(expressed in Lempiras - Note 2)

Assets

Current assets:

Cash	L 2,010,569
Time deposits at 12% annual interest	7,684,481
Loans, notes and accounts receivable (Note 3)	43,236,464
Inventories of chemical products	633,019

Total current assets 53,564,533

Long-term investment (Note 4) 26,219,002

Property, vehicles and equipment at
cost - less accumulated depreciation
(Note 5) 4,754,342

Other assets 134,726

L84,672,603

Liabilities and Equity

Current liabilities:

Short-term loans payable (Note 6)	L23,396,206
Commercial accounts payable	110,828
Other accounts payable and accrued expenses	2,255,501

Retentions for coffee programs
(Note 7) 7,337,097

Total current liabilities 33,099,632

Long-term loans payable (Note 6) 16,062,047

Deferred credits 311,799

16,373,846

Equity:

Initial paid-in capital 1,791,813

Granted capital 13,715,907

Retained earnings 19,691,405

Total equity 35,199,125

Commitments and contingencies (Note 8)

L84,672,603

INSTITUTO HONDUREÑO DEL CAFE
(An Autonomous Agency of the Government of Honduras)

STATEMENTS OF INCOME AND RETAINED EARNINGS
(expressed in Lempiras - Note 2)

	<u>Year ended December 31,</u>		
	<u>1987</u>	<u>1986</u>	<u>1985</u>
Income:			
Coffee export permits	L10,009,417	L 8,697,727	L 7,733,303
Gains in exchange of coffee qualities	4,618,546		
Retentions for coffee programs		7,218,712	8,090,917
Interest income	3,093,419	3,008,924	3,558,068
Other income	2,932,753	1,947,930	2,044,813
	<hr/>	<hr/>	<hr/>
Total income	20,654,135	20,873,293	21,427,101
	<hr/>	<hr/>	<hr/>
Expenses:			
Salaries and employee benefits	6,801,073	6,016,652	5,578,388
Per diems and travel expenses	632,034	552,932	526,773
Leasing of buildings, land and equipment	443,417	394,339	404,729
Maintenance and repairs	572,307	175,736	132,912
Supplies and accessories	613,834	692,396	497,788
Interest expense	2,967,881	3,536,172	4,979,608
Other expenses	3,425,886	3,882,346	3,958,329
	<hr/>	<hr/>	<hr/>
Total expenses	15,456,432	15,250,573	16,078,527
	<hr/>	<hr/>	<hr/>
Net income	5,197,703	5,622,720	5,348,574
Retained earnings at the beginning of the year	14,493,702	8,870,982	3,522,408
	<hr/>	<hr/>	<hr/>
Retained earnings at the end of the year	<u>L19,691,405</u>	<u>L14,493,702</u>	<u>L 8,870,982</u>

INSTITUTO HONDUREÑO DEL CAFE
(An Autonomous Agency of the Government of Honduras)

STATEMENTS OF CHANGES IN FINANCIAL POSITION
(expressed in Lempiras - Note 2)

	<u>Year ended December 31,</u>		
	<u>1987</u>	<u>1986</u>	<u>1985</u>
Financial resources were provided by:			
Net income	L 5,197,703	L 5,622,720	L 5,348,574
Plus item not requiring the use of working capital:			
Depreciation	299,370	310,842	379,978
	<hr/>	<hr/>	<hr/>
Working capital provided by operations for the year	5,497,073	5,933,562	5,728,552
Sale of fixed assets	282,842	88,518	11,759
Grants received	2,330,686	1,362,800	1,002,354
(Decrease) increase in deferred charges	(20,962)	73,841	(427,263)
Loans obtained			11,238,905
	<hr/>	<hr/>	<hr/>
	8,089,639	7,458,721	17,554,307
Financial resources were used for:			
Acquisition of fixed assets	466,023	1,329,683	140,410
Portion of long-term loans transferred to current liabilities	1,556,728		
Loan repayments		5,930,265	
Increase in investments	735		
Decrease in deferred credits	18,588	9,830	289,881
	<hr/>	<hr/>	<hr/>
	2,042,074	7,269,778	430,291
Increase in working capital	<u>L 6,047,565</u>	<u>L 188,943</u>	<u>L17,124,016</u>

STATEMENTS OF CHANGES IN FINANCIAL POSITION
(expressed in Lempiras - Note 2)

CHANGES IN COMPONENTS OF WORKING CAPITAL

	<u>Year ended December 31,</u>		
	<u>1987</u>	<u>1986</u>	<u>1985</u>
Increase (decrease) in current assets:			
Cash	L 925,310	L (648,474)	L 701,835
Time deposits	(2,023,914)	1,097,555	(1,148,481)
Loans, notes and accounts receivable	3,022,948	(669,956)	7,608,788
Inventories of chemical products	(63,222)	(59,176)	(193,354)
	<u>1,861,122</u>	<u>(280,051)</u>	<u>6,968,788</u>
(Increase) decrease in current liabilities:			
Short-term loans payable	2,595,434	1,654,479	8,980,130
Commercial accounts payable	412,742	(245,462)	(248,197)
Other accounts payable and accrued expenses	(160,709)	865,957	1,253,326
Retentions for coffee programs	1,338,976	(1,805,980)	169,969
	<u>4,186,443</u>	<u>468,994</u>	<u>10,155,228</u>
Increase in working capital	<u>L 6,047,565</u>	<u>L 188,943</u>	<u>L17,124,016</u>

INSTITUTO HONDUREÑO DEL CAFE
(An Autonomous Agency of the Government of Honduras)

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1987

NOTE 1 - OPERATIONS AND ACCOUNTING POLICIES:

History and Operations

The Instituto Hondureño del Café (IHCAFE) was created in December, 1970, through Law Decree No.83 of the Honduran National Congress. IHCAFE's principal activities are to study, promote, guide and supervise coffee growing and commercialization in Honduras. IHCAFE has five experimental centers in different parts of the country, and eight regional offices.

The more important policies adopted by the Institute in accordance with generally accepted accounting principles in Honduras, are described below:

Inventories

Inventories of fertilizers and chemical products are stated at average cost.

Properties, vehicles and equipment

Fixed assets are stated at acquisition cost. Improvements and expenditures for repairs that extend useful lives of the assets are capitalized. Other expenditures for repairs and maintenance are charged to income. Depreciation is applied on a straight-line basis over the estimated useful lives of the assets.

Income from coffee export permits

IHCAFE is the regulating institution for coffee export activities, and obtains revenues from coffee export companies for permits extended. This income is recognized when the permits are extended.

Other income

Gains on exchange of coffee qualities, interest and other income are recognized when they accrue.

Severance compensation

Compensation, which accrues according to length of service under the terms of the Honduran Labor Code, may be payable to employees in the event of dismissal. No definite liability exists in this respect as of December 31, 1987, and it is the policy of the IHCAFE to consider such severance payments as expenses in the period in which they become payable.

NOTE 2 - RATE OF EXCHANGE:

The records of IHCAFE are maintained in Honduran lempiras. The present rate of exchange of two lempiras per one United States dollar has remained constant for many years. Payments in foreign currencies are subject to licenses extended by the Central Bank of Honduras under a system of priorities.

NOTE 3 - LOANS, NOTES AND ACCOUNTS RECEIVABLE:

The loans, notes and accounts receivable are:

Loans:

Individual coffee farmers	L11,035,405
Coffee farmer cooperatives	16,935,167
	<hr/>
	27,970,572
	<hr/>

Notes and accounts receivable:

Individual coffee farmers	5,186,428
Coffee farmer cooperatives	1,811,612
Accrued interest	5,418,078
Other	2,849,774
	<hr/>
	15,265,892
	<hr/>

Total	L43,236,464
	<hr/> <hr/>

The loans to individual coffee farmers were originally granted by Banco Nacional de Desarrollo Agrícola (BANADESA), with the guarantee of IHCAFE. However, due to a lack of repayments from debtors, such loans were transferred to IHCAFE in 1985. As of December 31, 1987, approximately 70% of the loan portfolio is past due. This portfolio is managed by BANADESA, acting as trustee.

The loans receivable from the cooperatives of the coffee farmers are substantially all past due. IHCAFE did not receive sufficient collateral from the cooperatives to cover possible

losses on the loans receivable and accrued interest as of December 31, 1987. In May, 1988, the Honduran Federation of Coffee Grower Cooperatives (Federación Hondureña de Cooperativas Cafetaleras, FEHCOCAL), one of the largest cooperatives was liquidated. IHCAFE did not recover its loans and accrued interest, which amounted to L9,322,573.

The notes and accounts receivable and their respective accumulated interest have been past due since 1983. These accounts were originated principally by the credit sales of fertilizer made by IHCAFE to coffee farmers and cooperatives in 1980.

NOTE 4 - LONG-TERM INVESTMENTS:

Long-term investments are:

PANCAFE, S. A.	L25,648,302
Banco Hondureño del Café, S. A.	550,000
Others	20,700
	<hr/>
	L26,219,002
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The investment in PANCAFE, S. A. was undertaken by IHCAFE in June, 1980, with the objective of sharing in the benefits of this corporation created by the coffee-growing countries, for the purpose of stabilizing coffee prices in the international market.

In December, 1982, PANCAFE, S. A. suffered operational losses of US\$383.4 million, and was liquidated by decision of its stockholders.

As of December 31, 1987, IHCAFE has not recognized the loss on this investment.

NOTE 5 - PROPERTY, VEHICLES AND EQUIPMENT:

Property, vehicles and equipment are described on the following page:

Buildings	L1,749,849
Vehicles	5,684,418
Office equipment	1,006,734
Other fixed assets	1,102,229
	<hr/>
	9,543,230
Less - Accumulated depreciation	6,843,875
	<hr/>
	2,699,355
Land	1,810,630
Construction in process	244,357
	<hr/>
	L4,754,342
	<hr/> <hr/>

NOTE 6 - LOANS PAYABLE:

Loans payable are:

	<u>Interest rate</u>	<u>Short-term</u>	<u>Long-term</u>
<u>In-country loans</u>			
Banco Central de Honduras -			
No.1	7%	L 714,286	L 1,428,571
No.2	7%	700,000	
Asociación Hondureña de Productores de Café	9%	66,000	736,000
Banco Financiera Hondureña, S.A.	4%		1,869,248
Banco Nacional de Desarrollo Agrícola -			
No.3700-007	11%	38,005	
No.3700-008	13%	113,354	
No.3700-010	14%	175,000	
No.3700-012	7%		7,945,435
No.3700-013	2%		3,359,470
		<hr/>	<hr/>
Carry Forward		L1,806,645	L15,338,724
		<hr/>	<hr/>

	<u>Interest rate</u>	<u>Short-term</u>	<u>Long-term</u>
Brought Forward		L 1,806,645	L15,338,724
<u>Foreign Loans</u>			
Chemical Bank	Libor plus 1%	4,589,561	
Lloyds Bank			
International -			
No.01	Libor plus 1-3/8%	7,000,000	
No.02	Libor plus 1-3/4%	10,000,000	
United Kingdom			723,323
		<u>21,589,561</u>	<u>723,323</u>
Total		<u>L23,396,206</u>	<u>L16,062,047</u>

Balances due on long-term debt for the next five years, were as follows:

1989	L 1,010,925
1990	1,010,924
1991	920,008
1992	920,008
1993	920,008
1994 and beyond	11,280,174
	<u>L16,062,047</u>

Foreign loans are payable in U.S. dollars (Note 2), except the United Kingdom loan which is payable in Pounds Sterling.

Past due loans as of December 31, 1987, amounted to L988,354 (in-country) and L4,697,308 (foreign).

NOTE 7 - RETENTIONS FOR COFFEE PROGRAMS:

The retentions for coffee programs are:

Exportable surplus fund	L1,804,232
Price stabilizing fund	1,711,926
Compensation fund	1,803,361
Other minor funds	2,017,578
	<u>L7,337,097</u>

These funds were established through deductions from coffee export proceeds with the main purpose, among others, of strengthening the price-level maintenance measures at the international level. These funds are primarily owed to the Honduran Coffee Producers Association, which can eventually request reimbursement.

NOTE 8 - COMMITMENTS AND CONTINGENCIES:

Commitments -

IHCAFE acts as the management unit for the Government of Honduras with respect to the Small Coffee Farmers Improvement project, financed by the U.S. Agency for International Development (A.I.D.) through Agreement No.522-0176. To comply with this mission, IHCAFE created an independent unit whose accounting records are maintained separately from IHCAFE's accounting records.

The Small Farmers Improvement Project is financed with a loan and grant from A.I.D. in the amounts US\$16,000,000 and US\$4,250,000, respectively, and counterpart funds from the Government of Honduras of US\$29,000,000. IHCAFE's contributions to the project amounted to L2,545,446 in 1985; L3,150,947 in 1986, and L6,989,456 in 1987.

IHCAFE's counterpart contributions to the project activities required by the agreements are included in other expenses in the accompanying statements of income.

Contingencies -

IHCAFE is the guarantor of Cooperativa Cafetalera Agrícola Industrial del Sur Limitada for a loan of L6,888,000 with Banco Sogerin, S. A. This Cooperative, according to a financial analyses made by IHCAFE in February, 1988, does not have the financial capacity to pay this obligation which has been past due since 1983. Banco Sogerin, S. A. demanded the payment of this commitment from IHCAFE in 1988.

APPENDIX II

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