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REPORT ON AUDIT OF THE VIRGIN ISLANDS COMPANY, 1945

LETTER

FROM

ACTING COMPTROLLER GENERAL OF THE UNITED STATES

TRANSMITTING

REPORT ON AUDIT OF THE VIRGIN ISLAND COMPANY FOR THE FISCAL YEAR ENDED JUNE 30, 1945

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LETTER OF TRANSMITTAL

GENERAL ACCOUNTING OFFICE,
Washington 25, D. C., July 9, 1946.

The SPEAKER OF THE HOUSE OF REPRESENTATIVES.

DEAR MR. SPEAKER: There is presented herein report on audit of the Virgin Islands Company for the fiscal year ended June 30, 1945. this audit was made by the Corporation Audits Division of the General Accounting Office pursuant to and in accordance with the requirements of section 5 of Public Law 4 of the Seventy-ninth Congress, approved February 24, 1945.

Respectfully submitted.

FRANK L. YATES,
Acting Comptroller General of the United States.

CONTENTS

	Page
Summary	1
I. History and organization	3
Brief economic history	3
Incorporation of the Virgin Islands Company	4
Purposes of the Virgin Islands Company	4
Organization and management	5
Operating agreement with the United States Government	6
Capital sources	7
II. Activities	7
General comments	7
Sugar and rum operations	8
Reasons	8
Prior periods' operating results	9
Operating results for fiscal year 1945	9
Dispute over trade name and change in distributors	10
Other operations	11
Employees' and officers' dwellings	11
Poultry farm	11
Stone crusher	11
Abattoir	11
The yacht *Flight*	12
The market and cold-storage plant—St. Thomas	12
Other operations in prior years	13
Rural Electric Division	14
Taxes	14
General comments	15
Exceptions	16
III. Comments on financial position	16
General Operations Division	16
Comparative balance sheets at June 30, 1945 and 1944	16
Property operated under contract not reflected in accounts	17
Relief fund grants for working capital purposes and amounts applied to operating losses	17
Net income accumulated payable into the United States Treasury but temporarily reserved by corporation for operating purposes	17
Comments on major items of current assets	18
Receivables	18
Inventories	19
Contingent liabilities	20
Rural Electric Division	21
Comparative balance sheets at June 30, 1945 and 1944	21
Comments	21
IV. Scope of audit	22
Balance sheet items	23
Income statement	25
V. Other comments	25
Opinion of financial statements	25

Financial statements and schedules: Page
Exhibit 1. Balance sheet of General Operations Division, Rural Electric Division, and combined as of June 30, 1945 27
Exhibit 2. Income and earned surplus statements for the year ended June 30, 1945—General Operations Division 28
Exhibit 3. Income and earned surplus (deficit) statements for the year ended June 30, 1945—Rural Electric Division 29
Schedule 1. Statement of cost of goods produced and sold—sugar and rum—for the year ended June 30, 1945—General Operations Division 30
Schedule 2. Overhead expense for the year ended June 30, 1945—General Operations Division 30
Schedule 3. Selling and administrative and general expenses for the year ended June 30, 1945—General Operations Division 32
Schedule 4. Summary of "other" sales, costs, and profits for the year ended June 30, 1945—General Operations Division 32
Appendix. Memorandum of recommendations on financial and accounting matters 33

AUDIT REPORT TO THE CONGRESS OF THE UNITED STATES, ON THE VIRGIN ISLANDS COMPANY, FOR THE FISCAL YEAR ENDED JUNE 30, 1945

(By the Comptroller General of the United States)

GENERAL ACCOUNTING OFFICE,
CORPORATION AUDITS DIVISION,
Washington 25, April 26, 1946.

Hon. LINDSAY C. WARREN,
Comptroller General of the United States.

DEAR MR. WARREN: We have audited the financial statements and accounts of the Virgin Islands Company for the year ended June 30, 1945, pursuant to the requirements of section 5 of Public Law 4 of the Seventy-ninth Congress, approved February 24, 1945. Our report, which follows, contains the following significant points:

1. The Company was incorporated in 1934 by local ordinance of the Colonial Council for St. Thomas and St. John, V. I., for the purpose of aiding in effecting the economic rehabilitation of the Virgin Islands. Although the Company was incorporated through action of the Department of the Interior without specific authority of any Federal statute, its corporate existence has been recognized by the Congress in subsequent Federal legislation. The corporation functions as an instrument of the Department of the Interior in operating sugarcane plantations, sugar mills, a rum distillery, employees' housing, a rural electrification project, and various other related activities on the island of St. Croix.

2. The properties operated by the Company, with the exception of the rural electrification project, are owned by the United States Government. They are operated by the Company under what is in effect a lease agreement extended to November 26, 1949. The costs of these properties (in excess of $3,000,000) are not carried in the Company's accounts, nor is depreciation provided thereon, except to the extent of minor additions made directly by the Company. There are no other charges against income in lieu of rent or depreciation of the properties. (However, it is provided in the operating agreement that the Company shall pay into the United States Treasury the net income, if any, from the operation of the properties.) Consequently, the net income of the Company is overstated and the losses prior to July 1, 1943, are understated from the viewpoint of the United States Government as a whole.

3. The Company received allocations from relief funds aggregating $899,327 against which have been charged net losses ($320,319) from operation of the properties to June 30, 1943, excluding the rural electrification project. The balance of these funds ($579,008) was used for working capital at June 30, 1945.

4. For the 2 years ended June 30, 1945, the Company's financial statements indicated net income of $443,729 from operations of the properties, excluding the rural electrification project. (This amount is not accurate, as explained in the report.) Although this net income is payable to the United States Treasury, in accordance with the operating agreement with the United States Government, it has been reserved by the management to provide additional necessary working capital. This income may be considered in the nature of a windfall because of the temporary unusual demand for rum in the United States. Because of a change in distributors, resulting in part from a dispute over ownership of the trade name "Government House Rum," the Company did not cash in fully on the lush rum market prevailing during a large part of the year ended June 30, 1945.

5. The corporation is badly in need of permanent arrangements for financing working capital and possible future operating losses.

6. The Company also operates a rural electrification project financed through a loan of $209,302 from the Rural Electrification Administration. This project is set up separately from the other operations but it is not on a sound operating basis.

7. The unsound financial and accounting organization and operation of the Company, commented upon in paragraphs 2 to 6, inclusive, may be corrected by reincorporation under Federal law, as required by the Government Corporation Control Act, if the Company is to continue in existence after June 30, 1948. In connection with possible reincorporation, we recommend as follows:

(*a*) The United States Treasury should own the capital stock, although the executive direction may continue to be in the Department of the Interior. The Treasury should be authorized by Congress to subscribe for adequate capital to cover permanent requirements for both fixed and working capital.

(*b*) The corporation should be authorized to borrow funds for temporary working capital purposes.

(*c*) The organic statute should provide, as in the case of Commodity Credit Corporation, that the Treasury, subject to appropriation of funds therefor, shall be required to reimburse the Corporation annually for any operating losses. Similarly, the Corporation should be required by law to deposit annually into the Treasury any net income from operations.

(*d*) Consideration should be given to the Corporation's owning all of the properties operated by it, including the rural-electrification project, although it might not have power to sell the properties except by superior approval. Depreciation on the properties should be required to be provided in determining net operating income or loss. (The REA loan should be paid from initial capital subscribed by the Treasury.) In no other way will the Corporation's financial statements reflect the investment in the projects operated by it and the true income or loss thereof.

(*e*) The Corporation is required to make payments in lieu of property taxes and income taxes to the local municipal treasuries. Consideration should be given to eliminating such payments as are in lieu of income taxes because the Corporation is a nonprofit corporation. (See report, p. 14.)

8. Because of the inaccuracies in the Company's financial statements, which cannot be immediately corrected, it is impossible for us

to certify that the Company's financial statements present fairly its financial position at June 30, 1945, and the results of its operations for the fiscal year ended that date. These inaccuracies relate to inventories, depreciation on the rural-electrification project, and the uncertain status of income taxes.

9. The Company's accounts have been poorly maintained, not only in respect to the inaccuracies mentioned in paragraph 8 but also in simple matters of bookkeeping, and the accounts have not been used by the management for operating-control purposes, as they should be. A memorandum of recommendations on financial and accounting matters is presented in the appendix.

I. History and Organization

BRIEF ECONOMIC HISTORY

The Virgin Islands were acquired by the United States from Denmark, August 4, 1916. It has been stated that the strategic relationship of these islands to the Panama Canal and the possible sale by Denmark to Germany during the First World War, and not economic reasons, led to our acquisition for a consideration of $25,000,000. The government of the islands was under the jurisdiction of the Navy Department until February 27, 1931, when it was transferred by Executive order to the Department of the Interior.

The activities of the Virgin Islands Company are located largely on the island of St. Croix, the largest of the group; this island has an area of 82 square miles and a population of approximately 13,000, about 95 percent of whom are wholly or partly negroid. Minor operations are conducted on the island of St. Thomas.

St. Croix's chief economic dependence for centuries has been upon sugarcane. However, the tremendous increase in the world's cane and beet acreage, and the consequent low price of sugar, have made St. Croix's sugar production unprofitable. A number of other factors, more local in nature but serious in effect, have contributed materially to this situation. Among the most important of these are the inadequate rainfall, which averages only 48 inches per year; the rapid runoff and evaporation; periodic droughts; and occasional hurricanes. As a result, the average annual production is only approximately 10 tons of sugarcane per acre, as compared with 30 tons per acre in nearby Puerto Rico and Cuba and much higher yields in Hawaii. The Virgin Islands are also at a disadvantage in sugar production because ocean freight rates to New York are substantially higher than in effect in Puerto Rico, which is the same distance from New York.

As a result of the foregoing, the large sugar estates which formed the economic backbone of the island began to disappear, and the acreage in cane declined from over 16,000 in 1900–1903 to 4,500 in 1933. As the acreage devoted to sugarcane declined, that devoted to cattle grazing increased until approximately 80 percent was so utilized. Though reasonably successful, the cattle industry did little to solve the economic problem of the island, since only 3 percent of the island's labor was employed therein. The dominant and only remaining large company, the West Indian Sugar Factory, Ltd., operating the largest sugar mill on the island and 13,000 acres of land, experienced heavy

losses during the 10-year period 1921–30, despite the substantially higher prices prevailing during all but 2 years of the period than prevail today, and with labor rates approximately 60 percent less than those in effect today.

In 1930 a crisis was precipitated in the economic situation on the island of St. Croix when the West Indian Sugar Factory, Ltd., collapsed financially. The American Red Cross then came to St. Croix to feed the people. The Government's efforts to interest private industry in consolidating and rehabilitating the sugar, rum, and other industries from 1930 to 1934 resulted in several studies being made by representatives of private industry, but all made adverse recommendations in view of the bankruptcy history of earlier ventures. During 1932 and 1933 the Government, through the Red Cross, was forced to feed approximately 40 percent of the population of the island. President Hoover, while on a visit to the islands during this period (1931), termed them an "effective poorhouse."

INCORPORATION OF THE VIRGIN ISLANDS COMPANY

Early in 1934 the Federal Government, recognizing the rehabilitation of the islands' industrial outlets as the only alternative to charitable support of the islands' natives, set up Federal project 16 by the Public Works Administration, acting through the Department of the Interior. This project acquired approximately 5,000 acres of land, two sugar mills, a distillery, warehouses, a short railroad, 12 old slave villages, shops, and miscellaneous agricultural buildings, which were cleared and rehabilitated, and acquired tractors, trucks, work animals, and other equipment, all at a total cost reported to approximate $2,700,000. At the time Federal project 16 was established, the proposed operating agency was created. After meeting a refusal by the municipality of St. Croix, the Department of the Interior arranged with the Colonial Council for St. Thomas and St. John for the creation of a corporation with broad powers, named the "Virgin Islands Company." This was accomplished by an ordinance passed April 9, 1934.

PURPOSES OF THE VIRGIN ISLANDS COMPANY

The powers conferred on the company in carrying out its operations are broad. The objects and purposes of the corporation's activities are concisely stated in section 3 (a) of the ordinance, which reads as follows:

> To aid in effecting the economic rehabilitation of the Virgin Islands of the United States, and to promote the general welfare of the people * * * and to exercise all of the powers conferred upon it herein in order to so advance and accomplish such economic rehabilitation and promotion of the general welfare.

Further, section 4 of the same ordinance provides:

> * * * The total number of shares of stock which the corporation shall have authority to issue shall be three * * * amounting in the aggregate to the sum of $30. * * * No dividends, salaries, or profits of any type or description whatever shall ever be issued, paid, or made available to any of the incorporators or holders of the said stock or to anyone on their behalf, but all of the earnings, income, and profits which may be derived by the corporation from the operations of any of its powers hereunder, shall be expended in effecting the economic rehabilitation of the Virgin Islands of the United States and in promoting the general welfare of the inhabitants of the Virgin Islands of the United States.

Section 13 of the ordinance provides:

> In the event of the dissolution of the corporation, the then stockholders of the corporation shall cause all of its assets, other than money, to be sold * * *, and the proceeds of such sale or sales together with all other moneys remaining in possession of the corporation, after the payment of its debts and expenses, shall be expended under the order of the district court of the Virgin Islands on the motion of the Chairman of the Colonial Council for the Municipality of St. Thomas and St. John, in such manner as to promote the general welfare of the inhabitants of the Virgin Islands. * * *

ORGANIZATION AND MANAGEMENT

The three shares of stock were issued to the incorporators, Harold L. Ickes, Secretary of the Interior, Oscar L. Chapman, Assistant Secretary of the Interior, and Paul M. Pearson, Governor of the Virgin Islands. The shares of stock are held by the stockholders as a board of trustees under a trust agreement, executed May 2, 1934, for the benefit of the people of the Virgin Islands, to be transferred to their successors in office.

The board of trustees is self-perpetuating, since the trust agreement requires reexecution of the agreement by the board after each change in membership. Vacancies are filled by the remaining members. Upon the death or resignation of the three members of the board of trustees, a new board of three members shall be appointed by the person then holding the office of President of the United States, if he shall consent to act. One member of the board of trustees is required to be selected from among the persons holding the offices of Secretary of the Interior, Assistant Secretary of the Interior, and Governor of the Virgin Islands. In practice, all three members have been selected from among the holders of these offices. At June 30, 1945, the stockholders and members of the board of trustees were: Harold L. Ickes, Secretary of the Interior; Abe Fortas, Under Secretary of the Interior; Charles Harwood, Governor of the Virgin Islands.

As a result of the recent changes in the Department of the Interior, the stockholders and members of the Board of trustees are now as follows: J. A. Krug, Secretary of the Interior; Oscar L. Chapman, Under Secretary of the Interior; Charles Harwood, Governor of the Virgin Islands (subject to change upon accession of William Henry Hastie as Governor).

The governing body of the company consists of a board of directors of seven members, serving without compensation, elected by the board of trustees. Each director serves until the next annual meeting and until his successor is elected and qualified. By terms of the trust agreement, the board of trustees is required to select one director from among the persons holding the offices of Secretary of the Interior, Assistant Secretary of the Interior, and Governor of the Virgin Islands. In practice, all of these persons have been included, together with the President of the Company. The following were members of the board of directors at June 30, 1945: Harold L. Ickes, Secretary of the Interior; Abe Fortas, Under Secretary of the Interior; Benjamin W. Thoron, Director of the Division of Territories and Island Possessions; Michael W. Straus, Commissioner of Reclamation; Charles Harwood, Governor of the Virgin Islands; Gilbert L. Pace, President of the Virgin Islands Company; D. Victor Bornn, St. Thomas, V. I. (a private individual).

Since that date Messrs. Ickes, Fortas, and Thoron resigned. Mr. Edwin G. Arnold succeeded Mr. Thoron, July 13, 1945, and on April 17, 1946, Mr. J. A. Krug and Mr. Oscar L. Chapman succeeded Messrs. Ickes and Fortas.

The bylaws of the Company provide for the election by the board of directors of a President, a secretary, a treasurer (or a secretary-treasurer), and Vice Presidents and assistant secretaries and treasurers as considered necessary. At June 30, 1945, the officers and their annual salaries were:

President (since Aug. 21, 1943), Gilbert L. Pace	[1] $7,500
Secretary-treasurer, Benjamin W. Thoron [2]	None
Assistant secretary-treasurer, Norman R. Cissel	5,400

[1] Increased to $9,000 effective Aug. 1, 1945.
[2] Succeeded by Edwin G. Arnold July 13, 1945, who was in turn succeeded by Mason Barr, Apr. 17, 1946.

The office of Vice President has remained unfilled since the separation of Mr. Leslie F. Huntt in November 1944.

In general, the President of the Company is empowered by the bylaws to hire, prescribe the compensation and duties of, and terminate the employment of such other agents and employees as he deems necessary. No executive or employee receives annual compensation as large as the President receives. In general, the rules and regulations of the Civil Service Commission and the Classification Act of 1923, as amended, do not apply. The Civil Service Commission advised the Company that its employees are exempt from the Classification Act, but are subject to the terms of the Civil Service Retirement Act, except those excluded by Executive Order 9154 dated May 1, 1942. Based on this, the Company makes deductions for retirement from the salaries of permanently appointed per annum employees.

OPERATING AGREEMENT

An operating agreement dated November 26, 1934, was made between the United States of America, by the Secretary of the Interior, and the Virgin Islands Company—

for the purpose of temporarily operating and maintaining the property * * * which has been acquired in the execution of a public works project in the Virgin Islands. The purpose of this operating agreement is to improve the general welfare of the people of the Virgin Islands and decrease unemployment by utilizing these properties for agricultural and industrial purposes.

The operating agreement was subsequently amended to include additional properties. The original expiration date of November 26, 1939, has been extended successively to November 26, 1944, and November 26, 1949.

The operating agreement provides as follows:

1. The corporation will maintain, use, and operate and keep in good condition and repair, the factories, mills, distilleries, manufacturing plants, warehouses, fixtures, equipment, appurtenances, and every other thing which are or may become part of the premises. * * *

2. That all funds (of the company) * * * shall be deposited currently into the Treasury of the United States in a special fund to be requisitioned, from time to time and as needed by an accountable officer (adequately bonded for the protection of both the corporation and the Government) for disposition as hereinafter provided.

3. That so much of the funds of the corporation as shall represent the net profits of operations (of this property) * * * shall at the end of each fiscal year be transferred to the general fund of the Treasury of the United States unless

the Congress shall make such profits available for other purposes. * * * that of the net profits of the corporation as determined for the purpose of transfer to the general fund * * *, there may be reserved in addition to amounts necessary to meet valid and unadjusted operating and maintenance obligations, such amount as may be reasonably necessary for operation and maintenance of the properties pending receipt of revenues available for such use and to meet unforeseen operating contingencies, but the amount so reserved shall be transferred to the general fund when other revenues become available.

4. That the remainder of the funds of the corporation shall be available to cover proper costs of operation and maintenance of the properties.

5. That the accounts of receipts and expenditures of the corporation in connection with operations hereunder shall be maintained by the corporation in such manner as may be prescribed by the Comptroller General of the United States. * * *

The operating agreement is considered to be the equivalent of a lease of the properties, the rental consideration of which is the maintenance of the properties and the requirement to pay operating profits into the United States Treasury. Therefore, it should be noted that the corporation will derive no profits from the operations of the properties, and it appears that there will be no profits to the corporation to be disposed of under the provisions of section 4 of the charter.

CAPITAL SOURCES

No direct appropriations have ever been made by the Congress to the Company. It has financed its operations from operating revenues, from allocations made from relief appropriations, and by borrowings from Federal agencies or private banking institutions. At June 30, 1945, $209,302 was due on notes payable to the Rural Electrification Administration, secured only by the property and revenue of a rural electrification project operated by the Company. No amount was owed to privately owned lending agencies at June 30, 1945; however, subsequent to that date, $85,000 was borrowed from the Virgin Islands National Bank and $100,000 from the Bank of Ponce, P. R., the latter under a credit arrangement providing for borrowings up to $450,000 secured by inventories of rum and sugar.

Relief fund grants, aggregating $899,327 to June 30, 1945, and net income since June 30, 1943, aggregating $443,729, have constituted the main sources of working capital. Losses from operations to June 30, 1943 (there was income since that date), aggregated $320,319 according to unaudited records; this amount has been applied in this report as a reduction of the relief fund grants, leaving $579,008 as the unexpended balance of such funds at June 30, 1945.

II. Activities (Including Comments on Operations for the Fiscal Year Ended June 30, 1945)

The financial exhibits and schedules included in this report were prepared from the books of the Company, and reflect the results of operations for the fiscal year ended June 30, 1945, and the financial condition of the Company at the close of that fiscal year as recorded in the books and records. However, there are serious deficiencies in these records which are set forth in detail in this report. The most serious of these deficiencies concerns the inaccuracy and unreliability of inventories of growing sugarcane and operating supplies. Moreover, there were costs and expenses affecting the reported net income

which were not recorded on the books, and, accordingly, are not reflected in the accompanying exhibits. These costs and expenses were:

1. Depreciation or rent, or other charges in lieu thereof, on the properties acquired and rehabilitated or built by the Public Works Administration as Federal projects 16, 17, and 18. It is reported that approximately $3,000,000 was spent by these projects on the properties turned over to the Company under the operating agreement. The Company to date has not determined the items and costs of depreciable property included therein; and consequently it is impossible to make an estimate of a reasonable amount of annual depreciation. Because the property is not owned by the Company, there is no requirement that the Company provide depreciation thereon, but it should be recognized that the net income or loss to the Government is not fairly stated on this basis.
2. The cost of administrative functions and legal service performed by the Department of the Interior is not borne by the Company.
3. The cost of the supervision of the Electric Division provided by the Rural Electrification Administration is not borne by the Company.
4. Some of the materials acquired by the Federal projects have been used by the Company at no cost.

SUGAR AND RUM OPERATIONS

The primary industry sought to be developed by the Company, in order to carry out the purposes for which it was created and, indeed, the reason for its creation, was the growing of sugarcane, together with the milling of sugar and distillation of rum. The Company's organization was designed principally to revive the sugar industry, despite its record of financial failure, because (1) sugarcane is the highest income-producing crop, (2) it employs a large number of workers, (3) it has been the only agricultural crop to survive the periodic droughts, and (4) it was believed that St. Croix rum, widely distributed and accepted prior to prohibition, could be reintroduced and profitably marketed. Other agricultural products have been the subject of experimentation, but none has been found to promise satisfactory economic assistance to the population. It appears essential, therefore, that the sugarcane industry be continued until some other product has been found which will flourish on the island, have a ready export market, and employ a large number of workers.

By the end of 1936, approximately 2,200 acres had been cleared and planted in sugarcane and 500,000 gallons of rum had been produced by the Company. Sugar was first milled in 1937. Since that time the Company has increased its acreage of sugarcane to over 3,000 and has, with other Federal agencies, encouraged the growing of sugarcane by the plantation owners and on the subsistence homesteads. Over 500 independent growers cultivated sugarcane during the fiscal year ended June 30, 1945. However, despite the gradual increase in total acreage in sugarcane and the receipt of the sugar subsidies during recent years, the Company has never profitably milled sugar, and the profits from other operations, chiefly rum, have generally been insufficient to offset such losses. By June 30, 1943,

after earning negligible profits in 1937 and 1943, the Company had accumulated an operating deficit of $320,319. The tremendous increase in rum sales during the fiscal year ended June 30, 1944, as a result of increased liquor consumption and decreased availability of whisky, enabled the Company to realize a net income of over $400,000.

Sales, costs, and income or losses on sugar and rum for the fiscal year ended June 30, 1945, are summarized from exhibit 2 as follows:

	Sugar	Rum
Sales (quantities)	[1] 6,837.53	[2] 73,180.25
Net sales	$454,784.00	$180,353.00
Average per unit	66.51	2.46
Costs and expenses	556,043.00	72,807.00
Average per unit	81.32	.99
Operating income (or loss)	(101,259.00)	107,546.00
Average per unit	(14.81)	1.47
Subsidies received from Federal agencies	32,146.00	----------
Average per unit	4.70	----------
Net income (or loss) before income tax	(69,113.00)	107,546.00
Average per unit	(10.11)	1.47

[1] Tons.
[2] Proof gallons.

NOTE.—Parentheses denote red figures.

More details with respect to production costs are presented in schedules 2 and 3. The accuracy of the costs and income on sugar and rum operations is impaired, because the inventories of cane growing in the field at June 30, 1944 and 1945, are inaccurate; the overstatement of the inventory at June 30, 1945, is believed to be at least $35,000. (See report, p. 19.)

The most significant feature of the operations during the fiscal year ended June 30, 1945, was the decline in rum sales to only $180,000 (compared with more than $1,000,000 in the preceding year) as the result of a dispute between officials of the Department of the Interior and W. A. Taylor & Co., Inc., over ownership of the Government House Rum label. W. A. Taylor & Co., Inc. (a subsidiary of Hiram Walker & Sons, Inc.), was the sole distributor of the Company's rum in the United States, Alaska, and Hawaii from October 8, 1936, until March 30, 1945, under a contract which originally provided, in section 11:

> The brand and trade marks shall be the property of the Importer (Taylor) and may be registered by it in its name. If at the end of one year * * * the Importer does not renew this contract then the Importer agrees to transfer and assign the trade mark and any registration of it to the Shipper (the Company). If said contract is renewed for a period of two years and during the period this contract is in effect the Importer shall liquidate its business or discontinue the importation or sale of alcoholic liquor, then the Shipper shall have the option to purchase the trade mark * * *.

We were informed that the brand name "Government House Rum" was submitted by the Governor of the Virgin Islands in a contest conducted by the Department of the Interior for the selection of a name. However, it appears that the question of ownership by the Government of the brand name and trade-mark was not raised until the last year of the extended contract term when it was proposed to reserve ownership in the corporation in any extension of the contract. Mr. Boyd J. Brown, as President of the Virgin Islands Company, negotiated, in the Company's behalf, the original contract in 1936

and the 5-year extension signed March 30, 1940. After leaving the Virgin Islands Company January 31, 1941, Mr. Brown became vice president of W. A. Taylor & Co., Inc., and, in that capacity, participated in subsequent renewal negotiations. Taylor refused to relinquish its claim of ownership and, after July 4, 1944, when $156,149 worth of rum was bought from the Company, placed no more orders until March 1945, just before the contract expired, when 1,048 barrels of 140-proof rum were ordered (188,000 gallons). Because of the financial condition of the Virgin Islands Company (i. e., the low cash position and the heavy rum inventory), the President, Mr. Pace, was eager to make the sale, which amounted to over $500,000. The net profit on this sale, had it been consummated, would have been at least $325,000. However, despite the fact that Taylor guaranteed to retain and pay for all rum on hand in the event the contract was not renewed, Interior Department officials directed the Company to cease preparations to fill the order, stating that "we cannot afford to jeopardize a new agency contract by putting a large quantity in the hands of an adverse party" (when a new distributor contract was being negotiated). It was explained by officials of the Interior Department that Taylor could not sell this large quantity of rum within a reasonable period, and that Taylor would undoubtedly sell it under the Government House label; that would be unfair competition for a new distributor.

The negotiations for a new distributor were being conducted at this time with Munson G. Shaw Co. These negotiations were concluded by a contract dated June 30, 1945, under which the Shaw Co. was given the exclusive right to distribute Government House Rum in the United States, Alaska, and Hawaii; the Virgin Islands Company guaranteeing to pay all costs and expenses, if any, resulting from Shaw's use of the trade-mark, label, and name under the license. We are informed (April 1946) that Shaw recently has begun to make rum sales in various States. However, the State of New York prohibited sales by both Shaw and Taylor, but officials of the Department of the Interior believe that sales will be permitted in that State in the near future.

No estimate is available of the amount of the Company's contingent liability, if any, relative to this matter. Also unavailable is the amount of the loss suffered by the Company since March 30, 1945, when the Taylor contract expired, because of no rum sales.

Sugar sales increased from $247,000 in the fiscal year 1944 to $489,000 in the fiscal year 1945, but the net loss on sugar decreased only from $99,000 to $69,000. As shown by exhibit 2, the loss of $69,000 is after deduction of the net subsidies received of $32,000. According to the management of the Company, it is doubtful that the sugarcane industry will be self-supporting until (1) 80,000 tons of sugarcane are produced per year, and (2) the native labor can be induced to provide enough cane weekly during the cutting season to enable the Company to operate the Bethlehem mill at practical capacity. Despite the fact that the work is seasonal, generally from mid-January until June, the Company has not been successful in getting the workers to put in the six 9-hour days per week during the cutting season considered necessary to achieve economical operation.

OTHER OPERATIONS

The old slave villages acquired by Federal project 16 were, in general, unfit for human occupancy, and during the rehabilitation period approximately 200 structures were built. These dwellings, in 12 villages, together with small subsistence plots, plowed and ready for cultivation, are furnished free to the families of over 400 Company employees. The Company's records indicate, as shown in schedule 2, that the cost of maintaining and operating these villages for the fiscal year ended June 30, 1945, amounted to $12,627. These costs are charged to sugar production as being equivalent to additional compensation to laborers.

The plantation houses acquired were also rehabilitated, and the Company has followed the policy of renting them to its officers and supervisory personnel at nominal rentals. During the past 3 years, the gross rental income has varied from $3,000 to $3,800. Costs during the fiscal year 1945, as shown in schedule 4, approximated $9,600. The excess of costs over rentals ($6,198) is shown as a loss rather than additional operating expense. It is stated that the character and location of these houses does not justify rental charges equal to costs of operation and maintenance.

The Company also has in its custody a 75-acre poultry farm developed by Federal project 16. This includes 20 poultry-fenced acres, 3 dwellings, 13 chicken houses, miscellaneous buildings, water supply system, and other equipment. The Company operated the farm for several years, supplying St. Thomas and St. Croix with poultry and eggs. However, difficulties were reportedly encountered in procuring feed and other supplies, and since April 1, 1941, the farm has been leased to a private operator who, by the terms of the lease, was to pay only the taxes on the property during the fiscal year ended June 30, 1943, and thereafter $22.50 per month plus 1 percent of gross annual revenue and an amount equivalent to the taxes assessed on the properties. During the last 3 years revenue therefrom totaled $517; costs during the fiscal year 1945 exceeded $1,500. (See schedule 4.)

For a period of years the Company has made occasional sales of crushed stone to the local government for road construction and to the Army for use at Benedict Field. The stone was obtained from a quarry and crusher first leased by the Company July 1, 1937, and operated intermittently since. On October 1, 1938, the lease was amended to provide for an annual rental of $250. Although sales have been insignificant, the rock-crushing plant was acquired March 1, 1944, at a cost of $4,582.37.

An abattoir was erected by the Public Works Administration in the year 1941 under the auspices of the Department of the Interior at a reported cost of $110,000. The abattoir was included in the operating agreement as of July 1, 1942, but it has never been operated directly by the Company. The Work Projects Administration conducted a "demonstration project" commencing in December 1941, and, as of January 1, 1943, the property was leased to the St. Croix Livestock Association, the association to pay for the use of the property 1 percent of gross annual receipts, commencing with the calendar year 1944, payable on the thirty-first day of January of the following year, and to assume the liability for the amounts due in lieu of taxes from

July 1, 1942. To date the Government, through the Company, has realized approximately $1,100 from this property, which was completed in 1941. The cost of the property is not reflected on the books of the Company, and, accordingly, no provisions are being made for depreciation. An adequate provision for depreciation for 1 year would reasonably approximate several times the revenue to date from this property (the Company engineer's estimate of the annual requirement for depreciation is $6,728).

Although one of the stated purposes of constructing the abattoir was to provide meat for local consumption, the residents of St. Croix have limited direct access to beef slaughtered in the island's own abattoir because of the lack of refrigeration facilities for local use.

The yacht *Flight*, an 80-foot over-all, 18-foot beam schooner, was acquired by the Company from Mr. S. L. Lambert of St. Louis, Mo., on January 15, 1942. Though its value has been variously estimated at from $10,000 to $20,000, it was acquired for $1. No valuation for the vessel was reflected on the books of the Company, and, of course, no provisions for depreciation have been charged against her operations.

By bare-boat charter dated October 31, 1944, the operation of the *Flight* was placed under the control of the Virgin Islands Cooperative, Inc., retroactively to December 1, 1942, to be carried out in conjunction with the operation of the St. Thomas market by that organization, which is discussed hereafter.

Data supplied us by the Virgin Islands Cooperative, Inc., indicates that during the period that organization operated the *Flight*, December 1, 1942, to December 31, 1944, a profit of approximately $3,800 was realized by the lessee. The Virgin Islands Company operated the vessel from January 1, 1945, to June 30, 1945, and, as shown in schedule 4, recorded a profit of $564 for the period.

The *Flight* has been used for general freight and passenger traffic among the Virgin Islands and between the Virgin Islands and Puerto Rico, the chief item of cargo being fuel oil in drums for the Virgin Islands Company. In this connection we were informed by the manager in charge (Mr. D. Victor Bornn) that the vessel has become so oil soaked as to be beyond restoration and incapable of withstanding the oil traffic for any prolonged period in the future. It appears that fuel-oil requirements could be more economically satisfied through bulk deliveries by the suppliers direct to the Company, and we understand that consideration is being given to the acquisition of storage and handling facilities. If such facilities are obtained and oil is purchased in bulk under term contracts instead of in drums through many small individual purchase orders, it is believed that some savings can be effected.

The market and cold-storage plant on the island of St. Thomas was operated for the Company's own account only for the period from January 1, 1945, to March 31, 1945, at a loss of $5,778, as shown by the books. (See schedule 4.) During this period the operations were managed by Mr. D. Victor Bornn. Effective April 1, 1945, this plant was leased to the municipality of St. Thomas and St. John for 1 year under an agreement which provides that 50 percent of the net profits shall be paid to the Company as compensation for the lease. Officials of the Company believe the market is operating at a

loss. However, the municipality is reported to have requested an extension of the lease to March 31, 1947. The market was constructed by the Public Works Administration (project 18) in 1941 and 1942 at a cost reported to approximate $188,000. It has facilities for bulk, refrigerated storage, meat and vegetable handling and marketing, and individual refrigerated lockers. It is the opinion of the management that the market can be operated at a profit only if a large scale "supermarket" type of activity is carried on, preferably by individuals operating the facilities under lease. To date, however, this policy, which would involve competition with privately owned enterprises, has not been adopted. We inspected the market during the course of the audit and noted that the facilities are not being fully utilized and that unsanitary conditions existed in halls and storage areas.

Previous to January 1, 1945, the market was leased to the Virgin Islands Cooperative, Inc., of which Mr. D. Victor Bornn is secretary. This lease was not reduced to writing until October 31, 1944, although it is understood that it was in process of negotiation for a considerable period before that date. On that date an agreement between the Company and the cooperative was signed, vesting in the cooperative the management of the market, retroactively, from July 1, 1942, to December 31, 1944. As mentioned in the foregoing, the operation of the schooner *Flight* by the cooperative was included in the terms of the agreement. As compensation for the lease, the cooperative agreed to pay to the Company 50 percent of the net profits obtained from the operation of the market and *Flight*. The Company agreed to reimburse the cooperative, up to a maximum of $12,000, for any deficit resulting from the operation. Although this agreement, as does that relative to the operation of the abattoir by the St. Croix Livestock Association, provides that the Company may have access to all books and records of the operators, no effort has ever been made by the Company in either case to examine the records in order to determine the amounts due the Company as compensation or, in the case of the cooperative, the amount owing by the Company because of the deficit incurred in the operation of the market and *Flight*. To June 30, 1945, the Company had paid $7,500 to the cooperative to apply on the deficit. (See exhibit 2.) Information furnished to us by Mr. Bornn indicates that the remaining liability of the Company relative to the operation of the market and *Flight* by the cooperative will not exceed $500. The loss on these operations of over $15,000 to December 31, 1944, was reported by the manager to have been sustained largely on the market operations in the calendar year 1944 after the War Department constructed its own storage facilities and withdrew its patronage of the market.

It may be noted that the Company reports it had certain other operations in prior years including the growing of fruits and vegetables on a commercial scale prior to the fiscal year 1943. It is also reported that the Company acted as agent for the Federal Works Agency in the operation of the West Indian docks and utilities at St. Thomas prior to March 25, 1943, and the operation of three projects for the National Housing Agency. Mr. Bornn acted as manager of these projects.

RURAL ELECTRIC DIVISION

The Rural Electric Division of the Company was formed in January 1941. On January 9, 1941, a loan contract was entered into between the Company and the United States of America, acting through the Administrator of the Rural Electrification Administration, in order to—

* * * finance the construction and operation of an electric generating plant and electric transmission, distribution, and service lines or systems in rural areas.

Construction was begun May 1, 1941, and the system was energized November 22, 1941. A small internal-combustion generating plant and 52 miles of distribution lines were constructed at a cost of approximately $200,000; the cost was financed by funds borrowed from the Rural Electrification Administration on notes secured exclusively by a mortgage covering all assets, rights, and income of the system. The Rural Electric Division apparently supplied a very welcome service, and it is reported that nearly everyone residing in the service area—the rural district between Christiansted and Frederiksted—subscribed during the early months of its operation. However, despite the popularity, the potential of the Division has always been much too small for it to be considered economically feasible. There are fewer than 450 customers, including less than 30 Government and commercial accounts. Nearly 80 percent of the customers are homesteaders or laborers who are charged flat rates of 50 cents, 75 cents, or $1 per month, regardless of the amount of energy used, depending on whether one, two, or three droplights are used. The financial statements for the Division reflect minor operating profits for the fiscal years ended June 30, 1942, 1943, and 1944. The fiscal year ended June 30, 1945 (see exhibit 3), showed a net loss of approximately $12,000. However, if proper provisions for depreciation had been made (see p. 22), a loss would be reflected for each year, and the accumulated deficit of approximately $11,000 at June 30, 1945, would have been increased to approximately $25,000. Total gross revenue of the system decreased from $37,938 in the fiscal year 1944 to $22,779 in the fiscal year 1945 largely because of the loss of sales to the War Department. It is apparent that load-building activities and increased rates cannot place the system in a profitable position. As indicated in the foregoing, the number of potential customers is limited, as is the number of customers whose loads might be increased through the installation of additional appliances. The flat rates, if doubled, would add but a few hundred dollars per month to revenues. The only known solution to the problem, according to power experts and Company officials, is the conversion of the old direct-current systems presently supplying the towns of Christiansted and Frederiksted to 110-volt, alternating-current systems and operating them in conjunction with the Rural Electric Division. We were informed that some discussions relating to this possibility had been held over an extended period of time, but unless some definite action is taken by the Company it is likely that the present town franchises will be extended.

TAXES

Unlike many other Government corporations, the Virgin Islands Company makes payments in lieu of property taxes and Federal income taxes, in the same manner as a private corporation, as required

by its charter and by special act of Congress (Public Law 616, 74th Cong., approved May 26, 1936). These payments are made to the municipality of St. Croix in accordance with the provision of the organic act of the Virgin Islands relative to taxes assessed on corporations domiciled therein (Public Law 749, 74th Cong.).

Prior to the fiscal year 1944, the Company experienced losses. Payments in lieu of income taxes determined by the corporation in its returns for the fiscal years 1944 and 1945 were as follows:

1944	$207,648
1945	[1] 13,883

[1] After audit adjustments, recomputed at $6,496.

In determining its liability for these payments, the Company has claimed that its invested capital, for the purpose of its excess-profits credit, included the value of property owned by the United States Government. As a result, no payments in lieu of excess-profits taxes were made. If the actual invested capital had been used in the determination, the Company would have been liable for a substantial payment in lieu of excess-profits tax. It is estimated that the deficiency for the fiscal year 1944 would be upward of $80,000 after carrying back all possible subsequent unused excess-profits credits. On the other hand, we believe that it may be argued that the Company had no equivalent of taxable income in any year because the entire annual income is payable to the United States Government, under the operating agreement, in lieu of rent. It is suggested that these questions be resolved by the Company by requests for rulings from the Bureau of Internal Revenue.

It may be observed that the payment in the fiscal year 1945 in lieu of tax for the fiscal year 1944 constituted about 40 percent of the total revenues of the municipal government of St. Croix, exclusive of the appropriation obtained from Congress for that year to cover the deficit of approximately $100,000 in total revenues. (The total municipal budget was approximately $590,000, but it is understood that actual expenditures were approximately $50,000 less than that amount, which surplus will revert to the Federal Treasury.) It was noted that the total budgeted expenditures of the municipality of St. Croix for the fiscal year 1945 showed a sharp increase over those for the prior year, although the annual upward trend was progressive since 1940. (The total budget for 1940 was approximately $225,000.)

Because of the nonprofit character of the corporation in the long run, the violent annual fluctuations in its income or losses, and the temptation for extravagance in municipal affairs when large payments in lieu of taxes are received, rather than because of the fact that the Virgin Islands Company is a Government corporation, it is suggested for the consideration of the Congress that the corporation should be exempt from payments in lieu of income taxes.

GENERAL

Although the Selective Training and Service Act of 1940 was not applied to the Virgin Islands until the fiscal year 1944, the Company has experienced a great deal of difficulty throughout the war period in obtaining and retaining skilled employees. This was due, in large part, to the many opportunities for employment with other Federal Government agencies and departments functioning in the islands that

pay regular wage scales and even the overseas premiums. Although wages paid by the Company are subject to the retirement deductions, the rates paid are not comparable to those paid by other agencies, and the employees are not subject to civil service. One case cited by the Company was the payment by the Office of Price Administration of messenger salaries which exceeded salaries paid by the Company for first-class Diesel operators.

The Company gives permanent employment to 450 to 500 persons, but during the crop season lasting from 4 to 5 months, this number is approximately doubled. In addition, the Company provides a market for sugarcane produced by approximately 500 small growers.

EXCEPTIONS

It is believed that there were no transactions or programs carried on by the corporation during the year ended June 30, 1945, without authority of law. However, it should be pointed out that there is no specific Federal statutory authority for the creation of the Virgin Islands Company, but Congress has recognized its corporate existence in section 5 of the act of May 26, 1936 (49 Stat. 1372, 48 U. S. C. 1401–d), which provides that the Company shall pay annually into the treasury of the local municipality, in lieu of taxes, amounts equal to the taxes that would be payable by private owners and operators of the properties, including income taxes.

III. Comments on Financial Position

The financial position of the Conpany at June 30, 1945, is shown by the balance sheet presented in this report as exhibit 1. The accuracy of this statement is impaired because of overstated inventories. (See below.) The following summary compares the financial position of the General Operations Division of the Company at June 30, 1945, and June 30, 1944:

General Operations Division

	June 30, 1945	June 30, 1944	Increase (or decrease)
Current assets:			
Cash	$208,457	$172,298	$36,159
Receivables (net)	103,633	425,912	(322,279)
Inventories	696,941	703,279	(6,338)
Total current assets	1,009,031	1,301,489	(292,458)
Current liabilities:			
Notes payable, Commodity Credit Corporation		64,648	(64,648)
Accrued Federal income tax	6,496	207,648	(201,152)
Other	88,425	102,464	(14,039)
Total current liabilities	94,921	374,760	(279,839)
Net working capital	914,110	926,729	(12,619)
Prepaid expenses	5,540	9,044	(3,504)
Land, buildings, and equipment (net)	103,117	73,619	29,498
Total	1,022,767	1,009,392	13,375
Equity of U. S. Treasury, represented as follows:			
Capital stock	30	30	
Grants from Federal relief funds, less losses	579,008	579,008	
Earned surplus (as adjusted, exhibit 2)	443,729	430,354	13,375
Total capital and surplus	1,022,767	1,009,392	13,375

Note.—Parentheses denote red figures.

The balance sheet of the General Operations Division reflects the status of funds employed in sugar and rum operations under contract with the Department of the Interior, together with various other miscellaneous activities previously outlined. The balance sheet does not reflect the investment in properties operated under contract at their depreciated cost; the original cost of such properties, as reported to us by the Company, was as follows:

Federal project 16:	
4,710 acres of land, Bethlehem sugar mill, 12 villages, agricultural and engineering structures, water-supply system, railroad, tractors, trucks, work oxen, cattle, mules, equipment, supplies, and materials	$2,057,088
Central sugar mill, sugar warehouse, and office building	342,017
Distillery, rum warehouses, and bottling plant	297,299
Other sundry expenditures (net)	6,545
Total	2,702,949
Federal project 17, St. Croix abattoir	110,000
Federal project 18, St. Thomas meat market and cold-storage plant	188,000
Total	3,000,949

The investment in land, buildings, and equipment, shown in the balance sheet at $103,117, includes only additions to the above properties financed by the use of corporate funds (cost, $129,868), less depreciation provided thereon ($26,751). Because these properties will revert to the Department of the Interior upon expiration of the operating agreement, the Corporation's additions thereto are in the nature of leasehold improvements.

The working capital of the Corporation was obtained from emergency relief grants, a summary of which follows:

	Year	Amount
Granted by—		
Federal Emergency Relief Administration	1934	$200,000
Federal Surplus Relief Corporation	1934	150,000
Emergency Relief Appropriation Act of Apr. 8, 1935	1936	168,813
Farm Security Administration: Rural rehabilitation	1938	230,624
Work Projects Administration: From Emergency Relief Appropriation Act of 1937 as supplemented by act approved Mar. 3, 1938 (Public Res. 80)	1940	45,331
Federal Works Agency, Work Projects Administration	1941	32,181
Do	1942	52,378
Do	1943	20,000
Total		899,327

These funds have been commingled with all operating funds which have constituted a sort of revolving fund invested in cash, accounts receivable, inventories, and additions to properties. To the extent that losses have been sustained ($320,319 to date, representing losses to June 30, 1943), these funds have been reduced; the remainder at June 30, 1945, was, therefore, $579,008. Whatever portion of these funds is not dissipated by the future operating losses of the enterprise should be required to be returned eventually to the United States Treasury for the reason that they would represent that portion of the original grants not expended for the purposes for which the grants were made.

The earned surplus of the General Operations Division ($443,729) represents operating income accumulated for the 2 years ended June 30, 1945. In accordance with the operating agreement, this amount

ultimately will be payable into the United States Treasury, although temporarily it has been reserved by the corporation for contingencies pursuant to the operating agreement. The funds representing earned surplus are commingled with the relief fund balances and cannot be severed from the corporation for payment into the Treasury, unless other resources of working capital are obtained, without preventing the Company from operating. While these funds are not considered available to meet operating losses until the relief fund balances are first used, it is considered possible that these earned surplus funds may be dissipated eventually through operating losses. It cannot be anticipated that the present rum market will continue indefinitely.

The working capital of the General Operations Division amounted to $914,110 at June 30, 1945, on the basis of inventories recorded in the books. Although no bank loans or other notes payable were owed at June 30, 1945, to other Government agencies or private financial institutions, subsequent to that date $85,000 was borrowed from the Virgin Islands National Bank and $100,000 from the Bank of Ponce, P. R., the latter under a credit arrangement providing for borrowings up to $450,000 secured by inventories of rum and sugar. In the meantime, the fact that normal sales of rum were not being made necessitated additional working capital to finance operations.

In this connection it was noted during the course of the audit that undue amounts of time and expense were devoted by Company officials over a period of several months in arranging for sufficient capital to enable the Company to commence operations in harvesting the 1946 crop. Although the president of the Company had informed the Department of the Interior as early as October 1945 of the necessity of obtaining additional capital in order to operate during the 1946 crop season, a bank-loan agreement was not consummated until about 2 weeks after the crop season was scheduled to begin. It was noted also that at times Treasury accounts have been overdrawn when necessary to prevent the cessation of operations.

Considering all of the foregoing aspects of the Company's working capital difficulties, it appears that permanent provision should be made for obtaining recurring working capital requirements of the Company including replacing working capital reductions resulting from operating losses.

Data with respect to the Company's major current assets at June 30, 1945, follow.

Receivables

Accounts receivable are summarized as follows:

Subsidy payments due from—	
Commodity Credit Corporation	$44,478
Agricultural Adjustment Agency	33,700
Commodity Credit Corporation (other than above)	8,347
Public Works Administration (net)	6,545
Other U. S. Government agencies	4,733
Total due from Government agencies	97,803
Other	18,430
Total accounts receivable	116,233
Less reserve for losses	12,600
Accounts receivable (net)	103,633

Other accounts receivable ($18,430) represent, in the main, items that originated more than 1 year prior to June 30, 1945; they are considered of doubtful collectibility, for which reason a reserve for loss of $12,600 was created. We were informed that most of these old accounts accumulated during former administrations and that the lax credit policies then in effect are slowly being corrected.

Inventories

The following tabulation summarizes commodities, supplies, and materials at June 30, 1945:

	Proof gallons	Cost per books
Commodities held for sale:		
Cane juice rum:		
1935 crop	960.00	$529.28
1936 crop	1,048.08	645.32
1941 crop	32,992.80	27,579.15
1942 crop	29,311.10	26,131.95
1943 crop	57,978.00	38,890.26
White label rum:		
1943 crop	365.91	235.05
1944 crop	172,323.50	119,631.45
Gold label rum, 1944 crop	80,919.37	55,020.17
Heavy bodied rum:		
1944 crop	67,705.42	43,407.53
1945 crop	80,911.52	67,459.32
Special rum, 1944–45 crop	9,480.10	6,082.24
Guavaberry rum, 1945 crop	320.00	208.77
Total rum in process	534,315.80	385,820.49
Cased rum	823.02	1,540.05
Total commodities held for sale	535,138.82	387,360.54
Raw materials and work in process:		
Sugarcane growing		128,028.95
Molasses	175,931.00	34,811.46
Undistributed maintenance department and overhead charges		6,030.78
Total raw materials and work in process		168,871.19
Operating supplies		140,709.37
Total commodities, supplies, and materials		696,941.10

The inventories as stated in the balance sheet do not represent physical inventories.

Rum in process is valued at cost of production plus insurance and warehousing. Although a Government inspector is present when rum is placed in or removed from the warehouses, certificates of receipts and deliveries are not received direct from the inspectors. Quantities are reflected in the accounts as shown by perpetual inventory records; at June 30, 1945, these records showed 534,315.8 gallons on hand at a cost of $385,820 (average 72.21 cents per proof gallon). The market value was reported to be approximately $1.50 per proof gallon. Carrying charges approximate 6 cents per proof gallon per year.

Sugarcane growing in the fields (book value, $128,029) is said by the Company to be stated at the estimated value of the ensuing year's crop less the estimated cost of cultivation and harvesting yet to be incurred. However, no data were available in substantiation of this estimate. Subsequent to the completion of the audit field work, these estimates were partially rechecked by the Company's representatives, and they report that the estimates were substantially overstated (approximate overstatement, $35,000).

Although the cost of molasses has been estimated at from 2 to 4 cents per gallon, the Company has for several years used the market price, as established by the Agricultural Adjustment Agency, for the valuation of the molasses inventory. At June 30, 1945, this price was 19.787 cents per gallon.

Perpetual inventory records are maintained for operating supplies, which are valued on the basis of average cost. No physical inventory of these supplies has been taken for approximately 5 years. The Company is now taking a physical inventory, and differences revealed will be adjusted in the fiscal year 1946. We believe this inventory may be substantially overstated.

It is the Company's policy to value sugar at the market price, which has been consistently below cost, in its balance sheets. No sugar was on hand at June 30, 1945.

CONTINGENT LIABILITIES

The Company had contingent liabilities at June 30, 1945, for additional payments in lieu of income taxes and for any losses and expenses in connection with trade-mark litigation that may arise.

As indicated on page 15, there may be a possible additional liability of upward of $80,000 in the payments to the municipality of St. Croix in lieu of excess-profits taxes for the year ended June 30, 1944. No provision for this liability has been made in the Company's financial statements. On the other hand, if the Company were successful in a possible contention that it has no equivalent of taxable income (because of its entire income is payable to the United States Government in lieu of rent for properties leased), it would be entitled to refund of all payments in lieu of income taxes (approximately $215,000).

The controversy relative to the trade-mark and name, "Government House Rum," with the Company's former distributors, W. A. Taylor & Co., Inc., has been related on page 10. It is stated by the Company's counsel in the Department of the Interior that there is no liability to Taylor for the reasons that (*a*) Taylor's right to the use of the trade-mark and trade name expired with the termination of the distribution contract, and (*b*) in any case, Taylor could not allege damages since the Alcohol Tax Unit has prevented them from using the name.

There is also the possibility of contingent losses as a result of inadequate insurance coverage.

No insurance is carried on property operated by the Company but owned by the United States Government, costing approximately $3,000,000, nor the Rural Electric Division property.

It was noted that the entire inventory of rum was covered by fire insurance, but the windstorm insurance provided coverage for only 400,000 proof gallons (approximately 535,000 gallons were in the inventory). Fire and windstorm insurance are carried on rum at a valuation of $2.75 per proof gallon although the cost is less than 73 cents per proof gallon.

The Government's practice of self-insurance has been assumed by the Company to prohibit the carrying of adequate insurance coverage on its own properties or any insurance whatever on those operated under the agreement with the Secretary of the Interior. However, it appears that the Company has an insurable interest in all these

facilities and, considering the Company's position, we believe that the management should consider extending the insurance coverage, particularly for the distribution system of the Rural Electric Division, which is subject to the periodic hurricanes of the area. In this connection, two decisions of the Comptroller General, B–41682 of May 31, 1944, and B–25040 (21 C. G. 928 of April 15, 1942), both to the Virgin Islands Company, clearly appear to authorize the Company to obtain adequate insurance protection.

The following summary compares the financial position of the Rural Electric Division at June 30, 1945 and 1944:

Rural Electric Division

	June 30, 1945	June 30, 1944	Increase (or decrease)
Current assets	$22,570	$37,335	($14,765)
Current liabilities	4,622	6,811	(2,189)
Net working capital	17,948	30,524	(12,576)
Prepaid expenses	1,383	223	1,160
Land, buildings, and equipment (net)	186,240	186,328	(88)
Total	205,571	217,075	(11,504)
Equity of Rural Electrification Administration, represented as follows:			
Notes payable	209,302	206,013	3,289
Deferred interest payable	7,236	7,825	(589)
Surplus (or deficit)	(10,967)	3,237	(14,204)
Total, as above	205,571	217,075	(11,504)

NOTE.—Parentheses denote red figures.

As shown in the foregoing summary, the assets and operations of the Rural Electric Division have been financed entirely by funds advanced by the Rural Electrification Administration. The advances were made on notes secured by a mortgage on all property owned or hereafter acquired by the Electric Division and the revenue derived therefrom. No recourse may be had by Rural Electrification Administration against other assets and revenues of the corporation in case of default. Of the $275,000 made available by the Rural Electrification Administration, $1,428 was never advanced. The principal amount was further reduced to $209,302 by the application of the proceeds from the sale of electric equipment to the United States Army and Navy, as required by the terms of the mortgage. The mortgage calls for repayment of the principal amount in monthly installments by January 10, 1966, with interest at 2.46 percent per annum. The principal and interest payments were deferred, and subsequently the interest rate was reduced to 2 percent per annum. At present the Company is making only the interest payments.

Although the Virgin Islands Company is not required to devote any of its "own" (General Operations Division) funds to the operation of the Electric Division nor to the payment of principal and interest on the notes, in the event the notes and accrued interest are paid in full, the Virgin Islands Company will receive full title to the property of the Electric Division. As indicated in section II, unless the operations of the Electric Division are expanded to include the towns of Christiansted and Frederiksted, it is apparent that the notes will not be paid. The mortgage provides that the Company will charge for

energy and services furnished by the Electric Division such rates as in the judgment of the Administrator of Rural Electrification Administration will be sufficient to pay all operating expenses, principal of and interest on the notes, and to provide a reasonable reserve for working capital. By terms of the agreement, such rates are applied to energy and services supplied to the General Operations Division, and no elimination is made in the financial statements by the Company for such interdivision sales and purchases.

The land, buildings, and equipment in the foregoing summary are stated at cost ($197,493) less reserve for depreciation ($11,253).

Depreciation was provided at the rates used in prior years. The Company has provided for depreciation on production and distribution plant at rates of 2 and 3 percent per annum, respectively, less related maintenance charges. These rates were prescribed by the Rural Electrification Administration until January 1, 1944, as was also the erroneous practice of deducting maintenance charges from the provisions for depreciation. Effective January 1, 1944, this practice was ordered stopped and rates of 3 and 3.48 percent were prescribed for use in the computation of the provision for depreciation of production plant and distribution plant, respectively. The Virgin Islands Company was unaware of the change effective January 1, 1944, and has made no attempt to correct the obviously inadequate provisions for depreciation. We informed the Rural Electrification Administration of this situation, and the Administration is proceeding to adjust the depreciation reserve accounts. Had the prescribed rates been in effect, the provision for the fiscal year ended June 30, 1945, would have been increased approximately $3,250. The accumulated reserves at June 30, 1945, were approximately $13,500 below the amounts that would have been reflected therein had the prescribed rates been used since the inception of the Rural Electric Division.

In our opinion, the average useful-life years assumed by the Rural Electrification Administration for internal-combustion engine production plant, 33⅓ years, is excessive, and the depreciation rate derived therefrom, 3 percent per year, is inadequate.

IV. Scope of Audit

We have examined the balance sheet of the Virgin Islands Company as of June 30, 1945, and the statements of income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the Company, and, without making a detailed audit of the transactions, have examined or tested accounting records of the Company and other supporting evidence, by methods and to the extent we deemed appropriate, except that we were unable because of lack of records to examine satisfactorily the inventory of sugarcane growing in the field. It was found also that the inventory of operating supplies required a complete physical check which could not be made by the Company's representatives within a reasonable time. In our opinion, our examination was made in accordance with generally accepted auditing standards, and it included all procedures which we considered necessary except with respect to the examination of inventories, which could not be examined satisfactorily.

BALANCE SHEET

Cash on deposit in the United States Treasury and in a local bank at June 30, 1945, as shown by the records, was reconciled with balances confirmed by the depositaries. These accounts were as follows:

	General Operating Division	Rural Electric Division	Total
In U. S. Treasury:			
Treasury special deposit account No. 17-328	$187,876.26		$187,876.26
Disbursing officers' accounts:			
No. 19-682	9,685.41	$7,478.56	17,163.97
No. 14-80x0108	10,895.33		10,895.33
Total	208,457.00	7,478.56	215,935.56
In local bank		2,368.81	2,368.81
Combined	208,457.00	9,847.37	218,304.37

The total of the individual balances in the detailed accounts-receivable ledgers for the General Operations Division was found to be in agreement with the balance of the control account. However, the total of the individual balances in the detailed accounts-receivable ledger of the Rural Electric Division was found to exceed the control-account balance by $428.85. We were informed that the accounts of this Division had not been balanced since 1943, at which time it was effected by a representative of the Rural Electrification Administration. At our request, the accounts were balanced at December 31, 1945, and the difference as of that date, $574.64, caused primarily by errors in the handling of penalty charges will be adjusted during the current year.

The amounts due from Commodity Credit Corporation and Agricultural Adjustment Agency as support and benefit payments, $44,477.91 and $33,700, respectively, were confirmed by direct correspondence with those agencies. Mr. G. L. Pace, President of the Virgin Islands Company, is also manager of Public Works Administration, project 16, and in that capacity he certified the net amount due the Virgin Islands Company. Seventy-two percent of the total amount of accounts receivable was confirmed.

We reviewed the accounts receivable with officials of the Company, and, based on information so obtained, it appears that the reserve for losses, as adjusted, was sufficient to cover such losses in collection as could be estimated at the time of our examination. (See p. 19 for comments on character of accounts.)

We reviewed the Company's policies and procedures and made test checks of the inventories as of June 30, 1945, insofar as possible. We did not verify quantities. It was impossible to make any verification whatever of the carrying value of sugarcane growing in the fields in the absence of any records thereof; it is believed that this inventory is overstated. (See report, p. 19.)

Our test checks of the inventory of operating supplies revealed that balances shown by the controlling accounts of both divisions differed from the totals of the perpetual-inventory records and indicated that substantial differences exist between the amounts shown by the perpetual-inventory records and materials actually on hand. The records indicated also that a considerable number of charges for

repairs are included in the inventory accounts and that in many instances materials are withdrawn from stores without proper authorization. An example of the latter type of error was the inclusion in inventory of cane carts and tanks, valued in excess of $11,000, issued and in use though no requisition was prepared and no entry made.

In this connection it was learned that no physical inventory had been taken for approximately 5 years. The Company is now engaged in taking a physical inventory, and differences revealed will be adjusted during the current fiscal year.

The amount of prepaid insurance, $4,515, is, in our opinion, properly applicable to future operations. However, the balance included in prepaid expenses, $1,025 for the General Operations Division and $1,383 for the Rural Electric Division, consists of a water bill for 1944, lump-sum settlements for annual leaves, boat repairs, and minor items which are either applicable to operations prior to June 30, 1945, or are too small to warrant deferment.

We reviewed the additions to the property accounts for the year ended June 30, 1945. In our opinion, these additions, with minor exceptions, represent proper capital charges.

No property retirements have been reflected on the books of the General Operations Division during the life of the Company (approximately 11 years). However, insofar as we could ascertain within the scope of our examination, no substantial physical retirements of property have been made by the General Operations Division of the Company to June 30, 1945.

Insofar as we could ascertain within the scope of our examination, and as represented to us by the management, all physical retirements of property made during the fiscal year have been reflected in the books of account as of June 30, 1945, except the water-cooling tower replaced during the year. It was reported that the amount involved approximated $4,000 (the related reserve amounted to $1,475.58 at June 30, 1945). An adjustment to record this retirement will be required in the fiscal year 1946.

No detailed property records are kept as a basis for accounting for the individual units of property held for the Department of the Interior under the operating agreement, including additions made by the corporation, nor of the Rural Electric Division properties.

Insofar as we could ascertain within the scope of our examinations, all direct liabilities are reflected in the financial statements and the management have represented that, in their opinion, all such liabilities were disclosed to us. The scope of our examination did not include a circularization of the Company's creditors.

The accounts payable control account balance exceeded the total of actual accounts payable at June 30, 1945, by more than $29,000. This situation existed as a result of poor record control and bookkeeping, particularly prior to June 30, 1944. The difference as of the latter date ($27,998) was adjusted by a credit to earned surplus. The balance of the overstatement will be adjusted during the current fiscal year.

The principal amounts of notes payable to the Rural Electrification Administration and the amount of interest accrued thereon to June 30, 1945, current and deferred, were verified by a confirmation received direct from Rural Electrification Administration.

Capital stock, $30, has not changed since the inception of the Company.

We examined correspondence and other documents pertaining to the grants from Federal relief funds, $899,327.

The surplus account was reviewed from the inception of the Company.

INCOME STATEMENT

We did not make a detailed audit of income and expense accounts.

Invoices covering the sale of all sugar sold were examined, and the total amount thereof reconciled with amounts charged and credited to accounts receivable and sales, respectively. Brokers, "account sales" statements (settlements) covering all sugar exported were examined, quantities and amounts were reconciled with quantities and amounts per invoices, and selling expenses were traced to the accounts. In reconciling sales quantities to inventory and production records, it was noted that sugar unaccounted for exceeded 150,000 pounds. The book value (over $5,000) was charged to selling expense. (See schedule 1.)

Invoices covering all sales of bulk rum and cases of four-fifths quarts of Government House rum during the fiscal year 1945 were examined, and total amounts were traced to sales and accounts receivable control accounts. Sales quantities of rum were reconciled with production and inventory records.

Prices at which the foregoing sales were made were checked to contracts or, in the cases of local sales, to established price lists.

Cost statements and cost records were reviewed as to the character of cost, their relation to production of sugar and rum, and the flow through the several processes. One complete pay roll was examined for rates of pay, time, approval, and account distribution. We made a substantial test examination of cash disbursement vouchers in order to determine that they were properly approved and supported and that they were distributed to the proper accounts. Selling, general and administrative, payments in lieu of taxes, interest, and depreciation expenses were reviewed and the charges test checked.

Revenues and costs of miscellaneous activities were also reviewed.

V. Other Comments

While the accounts and records of the Virgin Islands Company are fairly well designed to meet the Company's requirements, they have not been satisfactorily maintained. This has been due both to poor supervision and to lack of competent personnel. The system of internal control is not as strong as would be desirable, but generally is as good as is practicable under the circumstances.

We have made certain recommendations on financial and accounting matters to the management of the corporation. These recommendations are summarized in the appendix to this report.

Opinion of Financial Statements

As hereinbefore noted, we have been unable to satisfactorily verify inventories at June 30, 1945, of sugarcane growing in fields and of operating supplies, and it is believed there are serious overstatements

thereof which cannot be rectified in the accounts until physical inventories are taken. (See report, p. 19). Depreciation provisions for the electric property are inadequate. These inaccuracies mean that the net income for the fiscal year 1945 and the surplus at the end of that year are seriously overstated. There is also a possibility of an additional assessment of approximately $80,000 for payments in lieu of income taxes or a recovery of all payments in lieu of income taxes of approximately $215,000, depending upon rulings of the Bureau of Internal Revenue.

Because of these exceptions (there are no other material exceptions), it is impossible to state that the accompanying balance sheet and related income and surplus statements present fairly the position of the Virgin Islands Company at June 30, 1945, and the results of its operations for the fiscal year in conformity with generally accepted accounting principles.

T. Coleman Andrews,
Director.

FINANCIAL STATEMENTS AND SCHEDULES

EXHIBIT 1.—*The Virgin Islands Company—Balance sheet, June 30, 1945*

[Subject to comments in the accompanying report]

ASSETS

	General Operations Division	Rural Electric Division	Combined
Current assets:			
Cash:			
In U. S. Treasury	$208,457	$7,478	$215,935
In local bank		2,369	2,369
Total cash	208,457	9,847	218,304
Accounts receivable:			
Due from other Government agencies	97,803	1,075	98,878
Other	18,430	1,522	19,952
Total accounts receivable	116,233	2,597	118,830
Less reserve for losses	12,600	1,558	14,158
Accounts receivable (net)	103,633	1,039	104,672
Commodities, supplies, and materials, mainly at cost, which was not in excess of market (see report, p. 19):			
Rum, mainly in process of aging	387,361		387,361
Raw materials and work in process	168,871		168,871
Operating supplies	140,709	11,684	152,393
Total commodities, supplies, and materials	696,941	11,684	708,625
Total current assets	1,009,031	22,570	1,031,601
Prepaid expenses	5,540	1,383	6,923
Land, buildings, and equipment, at cost (see note):			
Land	539	2,479	3,018
Buildings	15,047	14,861	29,908
Machinery and equipment	114,282	180,153	294,435
Total	129,868	197,493	327,361
Less: Reserves for depreciation	26,751	11,253	38,004
Land, buildings, and equipment (net)	103,117	186,240	289,357
Total assets	1,117,688	210,193	1,327,881

LIABILITIES

Current liabilities:			
Accounts payable, other than Government agencies	$29,643	$94	$29,737
Accrued liabilities:			
Real-estate taxes	17,521	1,125	18,646
Federal income tax	6,496		6,496
Wages, etc	41,261	3,403	44,664
Total current liabilities	94,921	4,622	99,543
Contingent liabilities (see report, p. 20):			
Possible losses and expenses in event of trade-mark litigation, undetermined			
Additional assessment for Federal income taxes			
Equity of U. S. Treasury (see note) represented by—			
Capital stock issued and outstanding, 3 shares	30		30
Grants from Federal relief funds, less losses to June 30, 1943	579,008		579,008
Earned surplus since June 30, 1943, reserved by corporate management for contingencies (exhibit 2)	443,729		443,729
Total equity of U. S. Treasury	1,022,767		1,022,767

EXHIBIT 1.—*The Virgin Islands Company—Balance sheet, June 30, 1945*—Con.

LIABILITIES—Continued

	General Operations Division	Rural Electric Division	Combined
Equity of Rural Electrification Administration, secured exclusively by mortgage on electric properties and revenues therefrom, represented by—			
Notes payable in monthly installments to Jan. 10, 1966, with interest at 2 percent	----------	$209,302	$209,302
Deferred interest payable	----------	7,236	7,236
Total	----------	216,538	216,538
Less: Operating deficit (exhibit 3)	----------	10,967	10,967
Net equity, REA	----------	205,571	205,571
Total equity of U. S. Government	$1,022,767	205,571	1,228,338
Total liabilities	1,117,688	210,193	1,327,881

NOTE.—The properties of the General Operations Division are administered under an operating agreement with the U. S. Department of the Interior as extended to Nov. 26, 1949. This balance sheet does not reflect the original investment of the Department of the Interior in land, buildings, and equipment administered under the operating agreement. That investment, reported to amount to approximately $3,000,000, was financed by PWA grants. Under the operating agreement the annual net income is payable into the U. S. Treasury, unless temporarily reserved for contingencies. The working capital and the investment in land, buildings, and equipment shown in this statement, to the extent they are in excess of earned surplus, were financed by direct relief grants from Federal Emergency Relief Administration, Farm Security Administration, and other relief agencies. All operating losses are considered to be chargeable to such relief funds. Upon the termination of the operating agreement, physical properties acquired by PWA grants, as added to or altered by the Company, will be returned to the Department for disposition. Other assets, representing unexpended balances of relief grants, will be required to be accounted for to the U. S. Treasury upon termination of the enterprise.

EXHIBIT 2.—*The Virgin Islands Company, General Operations Division—Income and earned surplus statements for the year ended June 30, 1945*

[Subject to comments in the accompanying report]

INCOME STATEMENT

	Total	Sugar	Rum	Other (schedule 4)
Sales:				
Quantities	----------	[1] 6,837.53	[2] 73,180.25	----------
Dollars	$703,840	$489,038	$181,497	$33,305
Less: Freight, lighterage out, etc	35,398	34,254	1,144	----------
Net sales	668,442	454,784	180,353	33,305
Costs and expenses: [3]				
Cost of goods produced and sold (schedule 1)	601,186	504,607	57,546	39,033
Maintenance and repairs of idle sugar mill	24,708	24,708	----------	----------
Contribution toward loss of the Virgin Islands Cooperative, Inc	7,500	----------	----------	7,500
Selling expenses (schedule 3)	14,585	5,255	9,330	----------
General and administrative expense (schedule 3)	28,485	21,473	5,931	1,081
Total costs and expenses	676,464	556,043	72,807	47,614
Operating income (or loss)	(8,022)	(101,259)	107,546	(14,309)
Add: Subsidies received from—				
Agricultural Adjustment Agency on raw sugar produced	33,700	33,700	----------	----------
Commodity Credit Corporation on sugar sold that Corporation	44,478	44,478	----------	----------
Total	78,178	78,178	----------	----------
Less: Amounts paid or payable to growers or in increased wages	46,032	46,032	----------	----------
Net subsidies received	32,146	32,146	----------	----------
Net income (or loss) before taxes on income	24,124	(69,113)	107,546	(14,309)
Provision for taxes on income	6,496	----------	6,496	----------
Net income (or loss)	17,628	(69,113)	101,050	(14,309)

[1] Tons.
[2] Proof gallons.
[3] Costs and expenses in the above statement include a provision in the amount of $7,513 for depreciation on additions to buildings and equipment. No charge is included in costs for depreciation or rental, or other charges in lieu thereof, on property operated by the Company but owned by the U. S. Government having a reported cost of approximately $3,000,000.

Parentheses denote red figures.

Costs are believed to be understated and net income overstated because of an overstatement of inventories at June 30, 1945. (See report, p. 19.)

EXHIBIT 2.—*The Virgin Islands Company, General Operations Division—Income and earned surplus statements for the year ended June 30, 1945*—Continued

EARNED SURPLUS STATEMENT

Balance June 30, 1944, per books		$93,529
Add:		
Back operating losses incurred from the inception of the Company to June 30, 1943, now considered to be chargeable to grants from Federal relief funds		320,319
Adjustment of accounts payable at June 30, 1944		27,998
Total		441,846
Less: Provision for loss on doubtful accounts		11,492
Balance June 30, 1944, as adjusted		430,354
Add: Net income, as above	$17,628	
Less: Miscellaneous adjustments (net)	4,253	
		13,375
Balance June 30, 1945, reserved by corporate management for contingencies (see note to exhibit 1)		443,729

EXHIBIT 3.—*The Virgin Islands Company, Rural Electric Division—Income and earned surplus (deficit) statements for the year ended June 30, 1945*

[Subject to comments in the accompanying report]

INCOME STATEMENT

Electric operating revenue		$22,779
Operating expenses and taxes:		
Production	$16,964	
Distribution	3,149	
Maintenance	1,793	
Depreciation (understated, see report, p. 19)	3,114	
Taxes, municipal	750	
Administrative and general expenses	3,930	
Provision for bad debts	603	
Total operating expenses and taxes		30,303
Net loss from operations		7,524
Other income (net)		332
Net loss before interest charges		7,192
Interest on notes payable		4,651
Net loss		11,843

EARNED SURPLUS (DEFICIT) STATEMENT

Balance at beginning of period		3,236
Deduct:		
Net loss as above	$11,843	
Miscellaneous adjustment applicable to prior period	2,360	
		14,203
Balance at end of period (deficit)		10,967

SCHEDULE 1.—*The Virgin Islands Company, General Operations Division—Statement of cost of goods produced and sold—sugar and rum—for the year ended June 30, 1945*

	Sugarcane growing	Sugar mill	Rum distillery	Combined costs
Materials used:				
Purchased sugarcane (14,357.425 tons, at $4.28) [1]	----	$61, 418	----	$61, 418
Sugarcane produced (30,676.98 tons, at $4.78)	----	146, 712	----	----
Cane juice and molasses produced and used	----	----	$64, 851	----
Other materials	----	28, 290	13, 420	41, 710
Total materials	----	236, 420	78, 271	103, 128
Direct labor	$126, 607	36, 251	7, 632	169, 890
Overhead expense (schedule 2)	69, 684	116, 569	97, 354	283, 607
Total costs of production	195, 691	389, 240	183, 257	556, 625
Add: Inventory at beginning of fiscal year	79, 785	220, 773	264, 880	565, 438
Total costs to account for	275, 476	610, 013	448, 137	1, 122, 063
Deduct:				
Inventory at end of fiscal year [2]	128, 029	34, 812	387, 361	550, 202
Sugarcane transferred to distillery at cost	146, 712	----	----	----
Cane juice and molasses transferred to distillery at market	----	64, 851	----	----
Cost of cane tops, alcohol, and molasses sold (shown under costs of other sales)	735	215	1, 728	2, 678
Cost of rum, molasses, etc., used as sales samples and in public relations [3]	----	10	1, 502	1, 512
Cost of sugar unaccounted for [3]	----	5, 518	----	5, 518
Total deductions	275, 476	105, 406	390, 591	559, 910
Total production cost of sugar and rum sold	----	504, 607	57, 546	562, 153
Quantity sold	----	[4] 6, 837. 53	[5] 73, 180. 25	----
Average cost per unit	----	$73. 80	$0. 7864	----

[1] Exclusive of 87.5 cents per ton paid to growers through Federal subsidy program.
[2] The inventory of sugarcane growing in the field at June 30, 1945, is believed to be overstated. As a result costs of sugarcane used and costs of sugar and rum sold are understated. (See report, p. 19.)
[3] These costs charged to administrative and general expenses.
[4] Tons.
[5] Gallons.

SCHEDULE 2.—*The Virgin Islands Company, General Operations Division—Overhead expense for the year ended June 30, 1945*

Sugarcane growing:		
Plantation manager and supervision		$15, 221
Tractor expenses		11, 970
Livestock (work animals)		10, 137
Maintenance department expenses allocated		7, 297
Timekeeping, storekeeping, and other indirect labor		4, 386
Rental on leased plantation		1, 667
General and administrative expense		1, 578
Taxes		1, 563
Transportation expense		1, 254
Miscellaneous		1, 984
Maintenance and operation of free housing for plantation employees:		
Water	$5, 408	
Maintenance department expenses allocated	3, 589	
Taxes	1, 486	
Labor	1, 451	
Miscellaneous	693	
		12, 627
Total, sugarcane growing		69, 684

SCHEDULE 2.—*The Virgin Islands Company, General Operations Division—Overhead expense for the year ended June 30, 1945*—Continued

Sugar mill:	
Supervisory salaries	$13,726
Warehousemen; time, store, and tool clerks; and laboratory attendants	5,037
General and administrative expense	10,118
Taxes	2,547
Insurance	1,041
Maintenance department expenses allocated	6,359
Transportation expense	24,143
Tractor expense	13,485
General labor ($20,514.20), material ($2,722.36), and overhead allocation relative to operation and maintenance of sugar mill and equipment	39,593
Miscellaneous	520
Total, sugar mill	116,569
Rum distillery:	
Supervisory salaries	11,384
Watchmen, time and store clerks, checkers, coopers, and laboratory attendants	8,406
General and administrative expense	10,774
Insurance	17,596
Taxes	1,369
Government warehouse inspector's fees	999
Maintenance department expenses allocated	12,105
Transportation expense	2,577
General labor ($11,625.68), material ($9,444.92), and overhead allocation relative to operation and maintenance of distillery plant and equipment	29,451
Miscellaneous	2,693
Total, distillery	97,354
Total overhead	283,607

SCHEDULE 3.—*The Virgin Islands Company, General Operations Division—Selling and general and administrative expense for the year ended June 30, 1945*

	SELLING EXPENSE
Sugar:	
Weighing	$2,032
Sales commission	1,179
Tonnage and portage	1,108
Sampling	802
Miscellaneous	134
Total	5,255
Rum: Customs duty and internal-revenue tax	9,330
Total selling expense	14,585

SCHEDULE 3.—*The Virgin Islands Company, General Operations Division—Selling and general and administrative expense for the year ended June 30, 1945*—Continued

GENERAL AND ADMINISTRATIVE EXPENSE	
Executive salaries	$18, 136
Office salaries	40, 792
Loss in shipping, handling, and leakage (primarily sugar unaccounted for)	5, 494
Office expense	3, 983
Executive travel and auto expense	3, 592
Employees' welfare and public relations (including 1,512.75 proof gallons of rum valued at $1,502.33)	1, 956
Employees' travel expense	1, 677
Maintenance of office buildings	1, 114
Postage	810
Telephone and telegraph	745
Bank service charge	445
Interest expense	388
Miscellaneous	360
Total	79, 492
Less: Amount distributed to manufacturing costs (approximately 70 percent, in accordance with the Company's usual practice)	51, 007
Total general and administrative expense	28, 485

SCHEDULE 4.—*The Virgin Islands Company, General Operations Division—Summary of "other" sales, costs, and profits for the year ended June 30, 1945*

	Sale	Costs	Operating profit (or loss)
Operations of St. Thomas market and cold-storage plant Jan. 1, 1945, to Mar. 31, 1945 (see report, p. 12):			
Sale of meat	$3, 488	$7, 351	($3, 863)
Sale of fish	1, 348	2, 311	(963)
Locker rental	582	1, 144	(562)
Cold-storage rental	664	491	173
Cutting, grinding, wharfage, and miscellaneous services	322	885	(563)
Total	6, 404	12, 182	(5, 778)
Operation of schooner *Flight* from Jan. 1, 1945—freight, passengers, and miscellaneous (see report, p. 12)	2, 680	2, 116	564
Rentals:			
Houses occupied by officers and supervisory personnel	3, 444	9, 642	(6, 198)
Tractors	2, 234	2, 616	(382)
Trucks, stores, scales, and other equipment	1, 981	840	1, 141
Poultry farm leased to outside operator	386	1, 508	(1, 122)
Abattoir leased to St. Croix Livestock Association	1, 146	78	1, 068
Sales:			
Shop work and material sold	7, 867	6, 127	1, 740
Livestock	2, 218	1, 461	757
Alcohol	1, 648	1, 728	(80)
Cane seed	770	735	35
Increment in livestock value	1, 999		1, 999
Miscellaneous	528		528
Total "other" sales and costs	33, 305	39, 033	(5, 728)

NOTE.—Parentheses denote red figures.

APPENDIX

Memorandum of Recommendations on Financial and Accounting Matters

The foregoing audit report contains numerous comments on financial and accounting matters that call for corrective action by the management of the Virgin Islands Company. These matters, together with more detailed comments on accounting and bookkeeping matters, are the subject of the following recommendations.

FINANCIAL MATTERS

1. The most important financial recommendations concern the permanent sound financing of the Company. This could be effectuated upon reincorporation under Federal law, pursuant to the Corporation Control Act. (See report, p. 1.)

2. The operating problems of the Rural Electric Division should be studied with a view toward placing the operation on a paying basis.

3. The Company's policy with respect to operations outside of the island of St. Croix should be considered by the directors. It may be considered desirable to eliminate all outside operations because of operating difficulties.

4. Arrangements should be made for permanent working capital requirements. (See report, p. 17.)

5. Consideration should be given to extending insurance protection on the Company's property. It is suggested also that all employees having access to cash or checks should be bonded in adequate amounts; it was noted that none of the employees in the pay-roll department or who distribute wages are bonded and that a number of individuals who are not bonded are authorized to make collections.

6. The cost of housing for executives of the Company is in excess of rental revenues. It is suggested that the question of the adequacy of rental rates should be considered by the Company's directors.

7. The Company's records show $52,167.69 due from and $45,622.37 due to Federal project 16. The records of this project should be brought up to date and the accounts settled.

8. Greater efforts should be made in effecting collections promptly for services furnished by the Company. The General Operating Division also should cooperate with the Rural Electric Division to make collections of slow accounts for electric services; this cooperation should also extend to notification of the Rural Electric Division of tenant moves and other matters required in billing flat-rate customers.

9. If fuel-oil requirements can be supplied more economically through bulk deliveries by the suppliers direct to the Company than by the use of the *Flight*, consideration should be given to the acquisition of storage and handling facilities. (See report, p. 12.)

FINANCIAL AND ACCOUNTING CONTROL

1. The assistant treasurer, as the chief accounting officer of the Company, should supervise and control the records of the Rural Electric Division. At the present time, for all practical purposes, the Electric Division operates as an independent enterprise, and the assistant treasurer merely signs checks and deposits cash receipts. Neither of the two persons in the Electric Division office (the superintendent and a clerk) has had any bookkeeping or accounting training and, although the accounting is relatively simple and a complete detailed system has been prescribed, a number of errors were noted in the records during the course of the audit.

2. Satisfactory records should be maintained of the inventory of sugarcane growing in the fields by individual fields in a manner that will substantiate such inventories as well as provide accurate data for purposes of income determination. It is believed that a cost basis of reflecting transactions and balances of such inventories would be more satisfactory and simpler than the use of an appraisal basis based on sugar prices.

3. The perpetual inventory of operating supplies should be subject to continuous physical checks throughout the year. Errors in such inventories should not be allowed to accumulate for as long as 5 years.

4. Unit property records should be established and used as a control over physical property held by the Company for the Department of the Interior as well as its own account. In this connection, a rule should be adopted regarding the minimum amount of property additions that should be capitalized and recorded in the detailed records. These records should be used also as a basis for recording retirements of property which are not now being recorded in the accounts.

5. Greater use of financial statements and the accounts should be made by the management for control purposes. Periodic internal financial reports are not issued, and it appears that little assistance is given to the management by the Accounting Department in such matters. The President informed us that such data as is provided is too late to be of value, and we learned that other members of the management group are largely uninformed of the information available in the Company's records. The department heads and other members of the management group should be informed of the cost and statistical data presently available, and each should be asked to review that which relates to his department and to submit recommendations outlining information he believes would be helpful, with recommendations as to the form or manner of presentation, frequency of such reports, etc. The annual business-type budgets required by the Corporation Control Act, if carefully prepared by departments, can be utilized as a valuable managerial control device, by comparing budget figures with the actual figures in monthly reports, developed as described in the foregoing, with explanations of the causes of the major variations. The realization that favorable or unfavorable performance will be revealed promptly should serve greatly to increase the interest of department heads and supervisors in the cost and performance reports, which should prove to be of considerable value to them in planning and controlling the phases of the business within their cognizance and to officials of the Company, both in the Virgin Islands and in Washington.

6. Purchasing should be controlled through a purchasing department or section. In general, the purchasing procedure has degenerated to the point where department heads and supervisors make all purchases and the officers nominally charged with the responsibility of controlling purchasing merely ratify after the act. In order to keep individual purchases below $100, instances were noted where dozens of requisitions, purchase orders, and vouchers were issued simultaneously, after the delivery of material in what were, in effect, single purchases. This, of course, greatly and unnecessarily increases the paper work. There should be no resort to circuity to avoid compliance with the Company's established practices on purchases without advertising.

Properly approved requisitions and purchase orders should be issued in advance of all but true emergency purchases. Proper safeguards should be instituted to prevent the purchase or accumulation of surplus material.

7. It is recognized that the size of the Company and the capabilities of the available personnel prevent the maintenance of completely effective procedures from the standpoint of internal control and necessitate considerable attention to details on the part of the chief accounting officer. We believe, however, that a greater segregation of the cashier's and bookkeeping functions can be obtained and that the areas of responsibility and supervision within and through the various sections, through the chief accountant or office supervisor to the chief accounting officer, can be more clearly demarcated and enforced, thereby improving internal control and aiding in the detection or prevention of errors during the formative stages, prior to recording rather than after the event. This should also enable the assistant treasurer, as the chief accounting officer, to devote more attention to the broader aspects of the accounting system.

8. Checks or currency should not be handled by individuals who have access to accounts receivable records.

9. Under an effective system of internal control, it is required that the same employees who prepare pay rolls or report time should not distribute the pay checks or envelopes. We noted that pay-roll clerks or field supervisors do this for the Company and witness payment to employees who cannot write. We recommend that other employees of the Accounting Department distribute pay checks and envelopes, at least periodically, on an unannounced schedule.

10. A fixed petty cash fund should be kept by the cashier, any disbursements made therefrom being supported by signed vouchers which are reimbursed periodically from the general funds after approval by an executive of the Company other than the custodian. At the present time it is necessary to borrow from employees for change, and minor small purchases cannot conveniently be made.

11. Representatives of the Company should audit the accounts of contractors operating the St. Thomas market, the *Flight*, and the abattoir on a profit-or-loss-sharing basis, to establish by such means revenues receivable under such agreements or the share of losses payable.

ACCOUNTING METHODS

1. The Rural Electric Division accounts should be kept on the basis of a fiscal year ended June 30 rather than December 31; a June

30 fiscal year is authorized by the loan agreement and is acceptable to REA officials.

2. Adequate depreciation should be provided on the Rural Electric property.

3. Greater care should be used in deferring expenses as charges to future operations. Not only should items treated as prepaid be justifiable on the grounds of future benefit, but only items of significant amount should be so treated.

4. Adjustments of prior years' income should be charged or credited to the current year's income rather than to surplus. The surplus account should generally reflect no entries except annual net income and distributions to the United States Treasury.

5. Greater care should be taken in record keeping. Subsidiary records and controls should be kept in balance.

6. More detailed suggestions with respect to bookkeeping follow:

(*a*) We believe the company can more readily meet the delivery dates of "stewardship" reports to be submitted to the General Accounting Office, the Bureau of the Budget, the Department of the Interior, the Rural Electrification Administration, etc., tax returns, and other documents, and that the preparation of such reports can be facilitated, if the accounting system, as it relates to these forms, is reviewed with the idea of eliminating, where possible, the necessity for reclassification or analysis of book figures, and utilizing additional controlling accounts, where feasible, to reflect required account group totals.

(*b*) The account classification of the existing system should be studied. Accounts determined to be unnecessary should be eliminated and additional controlling or other accounts deemed desirable should be established. This should materially simplify the general ledger and facilitate the preparation of trial balances and reports.

(*c*) The nature and origin of the entries made in each account should be ascertained and listed, and procedures adopted to insure fullest possible utilization of original records and the elimination of unnecessary forms or duplication of effort. Particular attention should be directed to adjusting entries made in the past and procedures adopted to insure, where possible, routine recognition in the accounts of transactions or events which in the past have resulted in great numbers of adjusting entries. Particularly noteworthy in this respect are the numerous adjustments resulting from poor control over materials and supplies and purchases.

(*d*) The number and regularity of entries in each account should be studied in order to eliminate unnecessary entries and to prevent duplications. Additional books of original entry may be indicated.

(*e*) The propriety of the entries should be studied as well as the bases used (for example, in distributing the amounts accumulated in clearing accounts or the allocation of general and administrative expense). As part of such review the adequacy of the original or supporting data and the check made thereof should be ascertained. The entries should be based on adequate, properly reviewed and approved original data, and the final approval of the entries should be centered in persons of proper authority and competency.

(*f*) A standard series of monthly entries should be devised for transactions found to recur monthly, such as stores issues, clearing account distribution entries, payments in lieu of taxes, depreciation,

amortization, accruals, etc. The use of forms prepared in advance for such entries, with captions for all items normally affected, and explanations and directions where possible, should serve to make the maintenance of the records more orderly and routine, and to assist in preventing errors of omission.

(*g*) The necessity of an adequate review of such original data as time sheets, job orders, equipment-use reports, purchase orders, and material requisitions, and for correct summarization of such data, should be stressed with individuals charged with such responsibilities. We found many instances where such assigned duties were either ignored or carried out in a haphazard manner.

T. COLEMAN ANDREWS, *Director.*

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