Hotel Developers (Lanka) PLC - 2015

The audit of the financial statements of the Hotel Developers (Lanka) PLC ("the Company") for the nine months period ended 31 December 2015 comprising the statement of financial position as at 31 December 2015 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the nine months period then ended, and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka. This report is issued in terms of Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the Board determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Board, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

2 Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2015, and its financial performance and cash flows for the nine months period then ended in accordance with Sri Lanka Accounting Standards.

Emphasis of Matter

I draw attention to Note No. 12.3 to the financial statements which describe the recognition of the fair value related to the fully depreciated assets and continue to be used by the company which will be replaced or refurbished under the renovation programme and which is expected to be completed by 2017. My opinion is not qualified in respect of this matter.

2.2 Comments on Financial Statements

2.2.1 Compliance with Sri Lanka Accounting Standards (LKAS)

The following observations are made.

(a) **LKAS – 16 : Property Plant and Equipment**

Cost and cumulative depreciation over disposed assets of Rs.6,755,643 had not been written off from the books of accounts during the period under review. Further, the fully depreciated property, plant and equipment at a cost of Rs.1,625,979,070 have been continuously used by the Company to generate cash inflows without reviewing its useful life.

(b) **LKAS -17 : Leases**

An operating lease agreement had been entered into between the Government of Sri Lanka and the Company in order to utilize the land for the construction of sports complex for five years. However, the building constructed on such land is being depreciated over forty years in contrary to the provisions in the Standard.

(c) **LKAS – 19: Retirement Benefit Obligation**

The plan liability of the Company as at 31 December 2015 was Rs.104,523,856 whereas, the plan assets had not been invested to mitigate the future obligation.

2.2.2 Accounts Receivables

The following observations are made.

(a) Although the hotels belonging to the Company had set up the credit limits for its customers, six instances were observed which exceeded such credit limits amounted to Rs 3.5 million.

(b) No provision for impairment had been made on the receivable balance of Rs.3 million recoverable from the Board of Cricket in Sri Lanka which remained outstanding for more than 150 days as at 31 December 2015.

2.3 Non-compliance with Laws, Rules, Regulations and Management Decisions

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
Section 171 (6) of the Companies Act No, 07 of 2007	Adoption or change of a balance sheet date shall have an effect upon receipt of a notice by the Registrar of Companies. However, without receiving such notice, the Company had changed its balance sheet date from 31 March to 31 December since the year under review.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Company for the nine months period ended 31 December 2015 had resulted in a pre-tax net profit of Rs. 91,713,000 as compared with the corresponding pre-tax net profit of Rs. 275,695,000 for the previous financial year, thus indicating a deterioration of Rs.183,982,000 in the financial results. Functioning in 40 per cent capacity of hotel operations due to undergoing refurbishment project was the main reason attributed for the deterioration in the financial results for the nine months period ended 31 December 2015.

In analyzing the financial results of the Company for last four years and the year under review (from 01 April to 31 March 2015), the value addition of the Company had increased in the years 2011/2012 and 2012/2013. However, it had decreased by 14 per cent in 2013/2014 and again it had increased in 2014/2015 by 03 per cent. After considering salaries, taxes and depreciation charged for the years (before dividend) 2014/2015 and 2015/2016, the value addition was Rs.1,275,259 and Rs. 1,121,948 respectively in such years showing a decrease in 2015/2016 by 12 per cent.

3.2 Analytical Financial Review

(a) **Significant Accounting Ratios**

Some important accounting Ratios of the Company for the nine months period ended 31 December 2015 as compared with the previous year are as follows.

Details	For the 09 months period ended 31.12.2015	For the year 2014/2015
Gross Profit Margin (%)	82.14	80.66
Profit Mark up (Gross profit on cost of sales) (%)	460.03	422.65
Net Profit Ratio (%)	5.83	11.57
Finance Cost on Turnover (number of)	0.04	1.58
Inventory Turnover (times)	7.3	11.01
Current Ratio	3.02:1	7.27:1
Acid Test Ratio	2.95:1	6.31:1
Revenue per Available Room (Rs.)	6,991	10,276
Average Room Rate (Rs.)	20,326	18,906

The gross profit margin and the profit markup of the Company for the nine months period ended 31 December 2015 with compared to the previous year had increased by 1.48 per cent and 37.38 per cent respectively. However net profit ratio had been decreased by 5.74 per cent during the year under review with compared to the preceding year.

(b) <u>Working Capital Management</u>

The following observations are made.

(i) The Company's working capital and solvency margin since the upcoming years 2011/2012 are as follows.

Details	2015/16 Rs.000	2014/15 Rs.000	2013/14 Rs.000	2012/13 Rs.000	2011/12 Rs.000
Current Assets	1,611,530	1,900,448	2,460,383	1,458,250	2,553,586
Current Liabilities	1,218,212	794,141	1,457,961	8,851,962	4,103,034
Working Capital	**393,318**	**1,106,307**	**1,002,422**	**(7,393,712)**	**(1,549,448)**
Net Assets	15,084,682	14,142,907	15,356,784	(668,611)	11,887,620
Stated Capital	20,466,456	20,466,457	18,116,157	452,261	452,261
Solvency Margin	**(5,381,774)**	**(6,323,550)**	**(2,759,373)**	**(1,120,872)**	**11,435,359**

In analyzing the position of current assets and current liabilities of the Company since the upcoming years 2011/2012, the working capital of the Company was in a satisfactory level showing a positive solvency margin continuously since 2013/2014. However, in analyzing net assets with stated capital for the same period, a negative solvency margin was observed since 2012/2013.

(ii) A favourable bank balance of Rs.3,872,956 had been held in a current account of a private bank without being earned any return since March 2015.

4. Accountability and Good Governance

4.1 Corporate Plan

A Corporate Plan had not been prepared by the Company for medium term to focus on a strategic view of the hotel.

4.2 Annual Action Plan

An Annual Action Plan had not been prepared by the Company for the year under review.

4.3 Budgetary Control

Significant variance ranging from 11 per cent to 33 per cent had been observed between the budgeted and the actual figures, thus, indicating that the budget had not been made use as an effective instrument of financial control.

5. Systems and Controls

Weaknesses in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Company. Special attention is needed in respect of the following areas of control.

Control Area	Observations
(a) Control over Fixed Assets	Not reviewing useful life of fully depreciated assets.
(b) Credit Control	Control over the credit limits set out.