Hotel Developers (Lanka) PLC – 2018

1.1 Opinion

The audit of the financial statements of the Hotel Developers (Lanka) PLC (“Company”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 read in conjunction with provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Emphasis of Matter

Without qualifying my opinion, I draw attention to Note No. 12.3 to the financial statements which describe the fully depreciated assets at a cost of Rs.2,063,000,000 and continue to be in use by the Company. The Company has carried out detail assets verification and valuation of each and every asset with the assistance of a Chartered Valuer. The Company expects to adopt the re-valuation model effective from 01 January 2019 reflecting the market value of the assets.

1.2 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.2.1 Key Audit Matter

Key audit matter is the matter that, in professional judgment, was of most significance in the audit of financial statements of the current period. The matter was addressed in the context of the audit of the financial statements as a whole, and in forming our opinion thereon, and a separate opinion is not provided in this matter. Description of how the audit addressed the matter is provided in that context.

Key Audit Matter	How the matter was addressed in the audit
Transactions with Related Parties (Note No. 37) -- Company has secured a term loan facility of USD 30 Mn and overdraft facility of Rs.500 Mn to finance the refurbishment program of the Hotel from DFCC Bank, a related party of the Company. Related party transaction was considered to be significant to the audit as the risk is that if these transactions are not conducted at arm's length, and/ or the accounting treatment of the rights and obligations of these transactions are not correct, it could influence the results of the Company.	Audit procedures were included, among others the followings. --- - Obtained an understanding of the process for identifying related party transactions. - Verified that the transactions are approved in accordance with internal procedures including involvement of key personnel at the appropriate level. - Reviewed agreements, amendments to the agreements, board minutes and board discussions. - Evaluated the rights and obligations per the terms and conditions of the agreements. - Determined whether the directors have disclosed relationships and transactions in accordance with SLAuS 550. - Obtained written representation from management and where appropriate, those charged with governance.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

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Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Company.

1.4 Audit Scope

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.

- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company, and whether such systems, procedures, books, records and other documents are in effective operation.

- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company.

- Whether the Company has performed according to its powers, functions and duties; and

- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Accounts Receivable and Payable

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1.5.1 Receivables

Audit Issue	Management Comment	Recommendation
Provisions had not been made for impairment in respect of the debtors amounted to Rs. 4,059,961 which had been outstanding over 150 days.	Upon inquiry, hotel management confirmed that bad debts provided in the financial statements are partly covered the above-mentioned debtors too.	Impairment indicators should be carefully evaluated by the management and if indications are observed, provisions should be made.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs.126,461,000 and the corresponding profit in the preceding year amounted to Rs.172,976,000. Therefore, a deterioration amounting to Rs.299,437,000 of the financial result was observed. The reasons for the deterioration are decrease in room revenue and increase in finance cost and depreciation during the year under review.

In analyzing the financial results of the Company for last four years and the year under review, the value addition of the Company had fluctuated from 2014 to 2018. After considering salaries, taxes and depreciation charged for the years (before dividend) 2017 and 2018, the value addition was Rs.1,576,369,000 and Rs.1,386,169,000 respectively showing a decrease in 2018 by 0.12 per cent. Details are shown below.

	Value Rs. "000"				
	2018	**2017**	**2016**	**2015**	**2014**
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Profit after Tax (before dividend)	(127,507)	258,017	141,012	116,712	163,519
Salaries	652,507	467,875	413,941	386,060	354,850
Taxes					
Income / Tax	11,840	20,737	45,366	22,231	112,175
NBT	65,756	68,036	57,392	49,291	54,053
VAT	282,712	289,494	86,257	24,912	65,895
Depreciation	500,861	461,542	368,254	203,010	266,587
Value Addition of the Company	1,386,169	1,565,701	1,112,222	802,216	1,017,079
Percentage of increase / decrease with compared to proceeding year	(12%)	41%	39%	(21%)	3.58%

2.2 Trend Analysis of major Income and Expenditure items

The following income and expenditure items of the year under review have been compared with the preceding year with the percentage of increase or decrease.

Income/Expenditure Items	2018 Rs.	2017 Rs.	Increase/ (Decrease) %
Revenue	2,910,540,000	3,015,362,000	(3)
Room Revenue	1,219,736,000	1,317,248,000	(7)
Finance Cost	40,994,000	9,905,000	314
Depreciation	500,861,000	461,542,000	9

The closures of ball room for few months, giving offers for customers and reduction in room rate from November onwards were the reasons for the decrease in revenue and room revenue during the year under review. Capitalization of borrowing cost had been stopped due to completion of the refurbishment of Phase 1 and therefore finance cost had been charged against the profit and loss account. This had caused to increase finance cost by 314 per cent in 2018. Once the refurbishment of Phase 1 was completed, new asset value had been created and therefore depreciation against such capitalized assets had been increased from Rs.461,542,000 to Rs.500,861,000.

2.3 Ratio Analysis

Some important accounting Ratios of the Company for the year under review as compared with the previous year are as follows.

	2018	2017
Gross profit margin (%)	79.62	81.73
Profit mark up (Gross profit on cost of sales) (%)	390.61	447.42
Net profit ratio (%)	4.34	6.09
Beverage Cost Percentage (%)	0.35	0.32
Finance cost on turnover (times)	0.014	0.003
Inventory turnover (times)	9.76	10.06
Food Inventory Turnover (times)	41.52	56.27
Current ratio	0.80:1	0.86: 1
Acid test ratio	0.73:1	0.80: 1
Average Room Rate (Rs.)	22,947	21,077

The gross profit margin of the Company for the period ended 31 December 2018 with compared to the preceding year had decreased by 2.11 per cent and the profit markup had decreased by 56.81 per cent. Further net profit ratio had been decreased by 1.75 per cent during the year under review with compared to the preceding year.

3. Operational Review

3.1 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
In analyzing the current assets and current liabilities of the Company, a negative working capital of Rs.193,901,000 was observed as at the end of the year under review when compared with the negative working capital of Rs.122,915,000 of the preceding year which shows negative working capital had been increased by 57 per cent in 2018. In analyzing net assets with stated capital for the same period, a negative solvency margin of Rs.6,545,639,000 and Rs.6,433,127,000 were observed in 2018 and 2017 respectively.	Noted	Working capital should be managed carefully.

3.2 Transactions of Contentious Nature

Audit Issue	Management Comment	Recommendation
The Company had signed agreement with Bank of Ceylon and Sampath Bank in 2014 for USD 27 Million loan to finance the refurbishment program. Then in January 2018, Company had subsequently moved to DFCC Bank for USD 30 Million loan with the consent of previous two banks. However, agreement fees, syndication fees and legal fees aggregating to Rs.17,659,767 relating to USD27 million loan had been debited to work- in – progress account during the year under review considering these costs also were a part of the same financing of refurbishment. Although management has confirmed to audit that Company expect to write off this cost in an event where Phase II	Agreement fees, syndication fees and legal fees paid for syndicate loan facility obtained from the BOC & Sampath Bank amounting to Rs.17.6 Mn was held under WIP to be capitalized once the 2nd Phase of the refurbishment is implemented which will be financed by the syndicate facility. Though the Rs.17.6 Mn is part of the previous loan facility obtained, the facility was subsequently replaced with a term loan facility from DFCC. The above cost was considered as part of the cost incurred to obtain the new facility which guaranteed an annual approximate saving of Rs. 80 Mn from	If Phase II is not commenced, these costs should be written off in a systematic way.

is not commenced using this loan, final decision of Cabinet Approval for Phase II had not been received till 30 May 2019.	the interest rate difference. However, the cost stated above will be written off in the event the 2nd phase is not implemented utilizing this term loan.

4. Accountability and Good Governance

4.1 Corporate Plan

Audit Issue	Management Comment	Recommendation
A corporate plan is a reflection of the commitment by the Board of Directors and senior management in the future prospects of the entity. However a corporate plan had not been prepared by the Company for a period of not less than three years.	A Corporate Plan is being prepared and yet to be finalized pending the completion of the Refurbishment program. Strategies are being formulated by Hilton Worldwide considering the emerging competition and will be incorporated into the Corporate Plan.	Corporate plan should be prepared as an effective management tool.