

Hotel Developers (Lanka) Ltd - 2023

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the Hotel Developers (Lanka) Ltd (“Company”) for the year ended 31 December 2023 comprising the statement of financial position as at 31 December 2023 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 material accounting policy 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 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 2023, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

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.

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

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 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

| Reference to Laws, Rules Regulations etc. | Non-compliance | Management Comment | Recommendation |
|---|--|---|---|
| Section 6.7 of Operational Manual for State Owned Enterprises published by Public Enterprises Circular 01/2021 dated 16 November 2021 | Annual assets verification had not been done by the Company. | Only renovated floors assets verification was conducted in view of the requirement to separately identify the items to be disposed and retained and proceed to public auction and in order to determine the valuation for the auction process and accounting. Hence, finalizing of the comprehensive asset verification was deferred until such time the full renovation is complete. | Action should be taken in accordance with the Public Enterprises Circulars. |

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs.688,713,000 and the corresponding loss in the preceding year amounted to Rs.885,122,000. Therefore, an improvement amounting to Rs.196,409,000 of the financial result was observed. The increase in the revenue was the main reason for this improvement.

2.2 Trend Analysis of major Income and Expenditure items

| Financial Statement Line Item | 2023 | 2022 | 2021 | 2020 | 2019 | Improvement/ Deterioration 2019-2023 | |
|---|-----------|-----------|-----------|-----------|-----------|--|----------|
| | Rs.000 | Rs.000 | Rs.000 | Rs.000 | Rs.000 | Rs.000 | % |
| Revenue | 4,228,100 | 2,887,267 | 1,178,381 | 1,081,135 | 2,878,752 | 1,349,348 | 46.87 |
| Gross Profit | 1,782,482 | 1,061,770 | 255,686 | 270,043 | 1,475,059 | 307,423 | 20.84 |
| Administration and Sales & Marketing Expenses | 1,015,817 | 855,959 | 585,498 | 591,036 | 910,514 | 105,303 | 11.57 |
| Depreciation and Other Expenses | 983,698 | 673,824 | 554,539 | 550,046 | 797,207 | 186,491 | 23.39 |
| Net Finance Income | (580,509) | (371,340) | (123,255) | (31,696) | (39,370) | (541,139) | (1374.5) |
| Profit after Tax | (688,713) | (885,123) | (957,225) | (918,107) | (325,630) | (363,083) | (111.5) |

2.3 Ratio Analysis

| Ratios | | 2023 | 2022 |
|----------------------------|-----|--------|--------|
| Gross Profit ratio | (%) | 42 | 37 |
| Net Profit / (Loss) Ratio | (%) | (19) | (22) |
| Current Ratio | | 0.31 | 0.64 |
| Quick Ratio | | 0.23 | 0.28 |
| Return on Capital Employed | | (0.02) | (0.02) |
| Interest Coverage Ratio | | (0.31) | (0.62) |

3. Operational Review

3.1 Operational Inefficiencies

| Audit Issue | Management Comment | Recommendation |
|---|---|--|
| (a) The Company's current ratio and quick ratio are very low as 0.31 and 0.23 respectively and the Company is in the financially critical situation where its ability to settle its short-term liabilities is very poor as per lower of ratios marked less than one (01). Further, the Company's ability to settle its long term and short-term borrowings would not be strong as its interest coverage | The past 04 years were extremely challenging to the hospitality sector as the global travel restrictions negatively impacted industry performances. Further, the hotel was in partial operation with only 153 old rooms due to the renovation between 2021 to Aug 2023. Hence, current ratio has declined between 2020 and 2023 as a result of utilizing overdraft facility to finance working capital requirement owing to the limited operational performances. | Need to be put in place plans to overcome the financial management issues. |

ratio became negative with negative net profit margin. In addition to that, as the return on capital employed got negative value for past years, the Company had failed to satisfy its owners with sufficient return.

Further, the low current ratios were common to the other hotels in the hospitality industry.

The interest cover ratio based on the performance of 2022 and 2023 are anyway very low due to the restricted hotel operations with industry wide limitations and due to the refurbishment project. The negative ROCE during past 3 years was in evitable due to inherent limitations of the industry.

- (b) Although actual usage of the 52 perch land belong to the Urban Development Authority (UDA) in front of the hotel using for the car park since 2016 rest with the Company, and the rent amounting to Rs.40 million had been paid without signing a lease agreement.
- Noted. We have communicated to UDA the corrections highlighted by the Company lawyers on draft lease agreement. Now awaiting for the finalized lease agreement from UDA.
- Agreement should be entered into.

3.2 Delays in Projects or Capital Work

| Audit Issue | Management Comment | Recommendation |
|---|--|--|
| Even though refurbishment project plan was revised and achieved revised targets about five months delay was observed with compared to the initial plan. | The change was made without impacting the 11 floors considered for the original renovation plan and the contract award and without any impact on scope change. | Actions should be taken to minimize the delays and take every rooms to room sale inventory soon. |

3.3 Procurement Management

| Audit Issue | Management Comment | Recommendation |
|---|--|--|
| The Company had not performed in accordance with the paragraph 8.11.4 of Government procurement guidelines, though the contractor of the Supply of Area Rugs procurement informs his inability to carry out the contract after the contract is award. | A show cause letter was sent via e mail requesting explanation for noncompliance to bid conditions and change of supplier and explanation was provided which did not justify their retention as the price increase and the change of delivery days were requested by their supplier and the new supplier proposed had not provided any cost benefit to the company nor had gone through the sample approval process. However, the process of blacklisting was not considered nor any further bids were awarded to the said contractor. | Action should be taken in accordance with the National Procurement Guidelines. |