Hotel Developers (Lanka) PLC – 2016

The audit of the financial statements of the Hotel Developers (Lanka) PLC ("the Company") for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year 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 the 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 Hotel Developers (Lanka) PLC as at 31 December 2016, and its financial performance and cash flows for the year 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 fully depreciated assets at a cost of Rs. 1,933,122,442 and continue to be in use by the company. The Company is currently under-going a major refurbishment programme and these assets are either being replaced or refurbished and will reflect new values on completion of the refurbishment programme which is expected to be completed by 2018. My opinion is not qualified in respect of this matter.

2.2 Report on Other Legal and Regulatory Requirements

As required by Section 163(2) of the Companies Act, No.07 of 2007, I state the followings:

a. The basis of opinion and scope and limitations of the audit are as stated above.

b. In my opinion :

- I have obtained all the information and explanations that required for the audit and as far as appears from my examination, proper accounting records have been kept by the Company.

- The financial statements of the Company comply with the requirements of Section 151 of the Companies Act, No. 07 of 2007.

2.3 Comments on Financial Statements

2.3.1 Sri Lanka Accounting Standards (LKAS)

The following non compliances were observed.

(a) LKAS 16: Property Plant and Equipment

Fully depreciated property, plant and equipment amounting to Rs.1,933,122,442 as at 31 December 2016 had been used to generate cash flows without reviewing its useful life. Further cost and cumulative depreciation over disposed assets amounting to Rs.4,238,000 had not been derecognized from the books of accounts during the period under review.

(b) LKAS 19: Retirement Benefit Obligation

Company had not disclosed the actuarial gain and loss arising from changes in demographic assumptions and financial assumptions separately although both those assumptions had been changed during the year under review.

(c) LKAS 37 – Provisions, Contingent Liabilities and Contingent Assets

According to the Municipal Council Ordinance (amended) amended by the Municipal Council (amendment) Act No. 42 of 1979 and No. 42 of 1985, the Sri Lanka Tourism Development Authority (SLTDA) has confirmed that the Hilton Hotel is liable to pay 0.5 per cent out of the total revenue of the previous year to the Colombo Municipal Council (CMC) as hotel trade license fee. A court case had been filed by the CMC against the hotel (including all the city hotels) for such non- compliance since 2007. A provision of the one per cent of the total revenue or Rs.50,000 whichever is less by the Company had been made and the balance of that account as at 31 December 2016 was amounted to Rs.6.5 Million. Although the final decision of the verdict cannot be predicted, the actual amount as a 0.5 per cent from the total revenue since 2007 would be around Rs.94 Million as at the end of the year which was Rs.87.5 Million higher than the provision made.

2.3.2 Accounting Policies

Although there were impairment indicators relevant to the debtors outstanding for more than 150 days, provisions had not been made in the accounts relevant to Sri Lanka Cricket and President House amounted to Rs.3,236,129.

3. Financial Review

3.1 Financial Result

According to the financial statements presented, the operations of the Company for the year under review had resulted in a pre-tax net profit of Rs.172,944,000 as compared with the corresponding pre-tax net profit of Rs.91,714,000 for the nine months period ended 31 December 2015, thus indicating an improvement of Rs.81,230,000 in the financial result. The reasons for the improvement in the financial results were the higher occupancy of rooms and full operation of banquet with compared to the preceding year.

In analyzing the financial results of the Company for the year 2012 to 2016, it was revealed that the value addition of the Company during such periods had fluctuated. After considering salaries, taxes and depreciation charged (before dividend) the value addition in year 2015 and 2016 was Rs.991,741,000 and Rs.1,337,829,000 respectively, thus showing an increase of 35 per cent in the year 2016.

3.2 Analytical Financial Review

(a) Significant Accounting Ratios

Some important accounting Ratios of the Company for the year 2015 and 2016 are as follows.

	2016	2015
Gross profit margin (%)	82.65	82.60
Profit mark up (Gross profit on cost of sales) (%)	476.51	474.60
Net profit ratio (%)	6.81	6.41
Beverage Cost Percentage (%)	0.16	0.16
Beverage Turnover Ratio (%)	0.94	1.25
Finance cost on turnover (times)	0.001	0.18
Inventory turnover (times)	10.38	10.44
Food Inventory Turnover (times)	31.38	30.79
Current ratio	1.18:1	2.37:1
Acid test ratio	1.12:1	1.17:1
Revenue per Available Room (Rs.)	10,966	9,840
Average Room Rate (Rs.)	28,968	25,995

When compared the gross profit margin and the profit markup of the Company for the year ended 31 December 2016, with the preceding year, it had increased by 0.05 per cent and 1.91 per cent respectively. Further, net profit ratio had been increased by 0.4 per cent for the same period.

(b) Working Capital Management

The Company's working capital and solvency margin for the past five years are as follows.

Value "000"

Details	2016 Rs.	2015 Rs.	2014 Rs.	2013 Rs.	2012 Rs.
Current Assets	1,016,007	1,667,899	1,688,655	2,155,725	2,223,136
<u>Less</u>					
Current Liabilities	862,057	504,279	261,437	959,745	495,045

Working Capital	**153,950**	**1,163,620**	**1,427,218**	**1,195,980**	**1,728,091**
Net Assets	13,772,897	13,636,951	13,620,032	13,437,306	10,897,528
<u>Less</u>					
Stated capital	20,466,456	20,466,456	20,466,456	18,116,157	452,261
Solvency margin	**(6,693,559)**	**(6,829,505)**	**(6,846,425)**	**(4,678,851)**	**10,445,267**

In analyzing the position of current assets and current liabilities of the Company for the past five years, the working capital of the Company shows a satisfactory level by showing a positive solvency margin throughout the five years period from 2012. However, in analyzing net assets with stated capital for the same period, it shows a negative solvency margin since 2013.

4. Operational Review

4.1 Contract Administration

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A refurbishment to the Hilton Hotel, Colombo in conformity with the brand standards of Hilton World Wide had been carried out since 2014 with an initial engineer estimate of Rs.1,563 Million. Following observations are made in this regard.

(a) A request had been made by the Company from the Ministry of Finance and Planning on 21 February 2012 and 28 March 2012 to deviate from the Government Procurement Guidelines and to function the Board of Directors of the Company as the Procurement Committee for the entire refurbishment program including selection and employment of consultants considering the urgency of completing the refurbishment programme. Accordingly, Ministry of Finance and Planning had given approval on 29 March 2012 for the Chairman and the Board of Directors of the Company to select a project consultant ensuring optimum efficiency in contractual and financial management considering the nature and the urgency of the procurement concerned. Although the Department of Public Finance on 22 June 2015 and even numbered PED/ PMD/ Hilton had subsequently advised the Company to prepare an entity specific procurement procedure in the selection of consultants and Contractors, without preparing of such, Company had selected Consultants and Contractors for the refurbishment Program.

(b) Although the initial engineer’s estimate for the works was amounted to Rs.1,563 Million for the Phase I of refurbishment program, the contract had been awarded to a selected bidder at a sum of Rs.1,869 Million or by Rs.306 Million higher than the initial estimate. However, an additional work valued at Rs.351 Million and variations valued at Rs.282 Million had also been approved further in order to complete the work. As at 31 December 2017, a sum of Rs.1,908 Million had been paid to the contractor apart from another bill was pending.

(c) Although the initial work completion date as per the agreement made with the contractor for Phase I A and 1B was on 22 May 2015, the actual date of the completion of Phase 1 A and 1B were on 15 July 2016 and on 17 August 2017 respectively with 26 months delay of the whole Phase from the initially agreed date.

(d) The service of several consultants for project and cost management had been obtained by the Company since 2012 and a sum of Rs. 737 Million had been paid as at 31 December 2017 for three project management companies out of which two companies acted as consultants had been terminated by the Company due to their failure in achieving expected outcome. Phase II including the refurbishment of rooms and room corridors under the program had yet to be commenced even after five years period of initial work commencement in 2012.

5. Accountability and Good Governance

5.1 Corporate plan

A corporate plan had not been prepared by the Company for the year under review.

6. Systems and Control

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.

Area	Observation
(a) Fixed Assets	Non-reviewing useful life of fully depreciated assets
(b) Contract Administration	Non-adhering to time management in the completion of contract